

State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
AUDIT COMMITTEE MEETING

Westmark Fairbanks Hotel
813 Noble Street
Fairbanks, Alaska

September 23, 2015

ATTENDANCE

Committee Present: Martin Pihl, *chair*
Kristen Erchinger
Gayle Harbo

Committee Absent: None

Department of Revenue Staff Present:

Jerry Burnett (deputy commissioner)
Pamela Leary (Treasury Division director)
Gary Bader (chief investment officer)
Bob Mitchell (deputy chief investment officer)
Scott Jones (state comptroller)
Judy Hall (board liaison)

Department of Administration Staff Present:

Commissioner Sheldon Fisher (ARMB trustee)
John Boucher (deputy commissioner)
Kevin Worley (chief finance officer, Retirement & Benefits Division)

Others Present:

Mike Hayhurst (KPMG)
Melissa Beedle (KPMG)
David Slishinsky (Buck Consultants)
Dave Kershner (Buck Consultants)
Todd Kanaster (Buck Consultants)
ARMB trustee Sam Trivette
ARMB trustee Sandi Ryan
ARMB trustee Tom Brice
Stuart Goering (board legal counsel, Department of Law)
Joy Wilkinson (Office of Management & Budget)

CALL TO ORDER

CHAIR PIHL called the meeting to order at 9:11 a.m.

ROLL CALL

All three committee members were present.

PUBLIC MEETING NOTICE

MS. HALL confirmed that public meeting notice requirements had been met.

APPROVAL OF AGENDA

MS. HARBO moved to approve the agenda and MS. ERCHINGER seconded. The agenda was approved without objection.

APPROVAL OF MINUTES – June 17, 2015

MS. HARBO moved to approve the minutes of the June 17, 2015 meeting. MS. ERCHINGER seconded. The minutes were approved unanimously.

PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS AND APPEARANCES

There were no public appearances, and MS. HALL reported that she had received no communications to the Audit Committee.

REPORTS

A. Presentation: FY15 ARMB Audited Financial Statements

[A copy of KPMG's presentation of the Treasury Division audit results for the period ended June 30, 2015 is on file at the ARMB office.]

MIKE HAYHURST, lead engagement audit partner at KPMG, started with the audit status, saying there were no significant changes to the audit plan. KPMG continues to refine its auditing of alternative investments using the services of Nick Katsanos, the firm's valuation and investment bank specialist, but that was not a change in the audit plan. In the last week they have obtained the market value adjustments resulting from the time lag between the valuation date and the fiscal year-end, so those are completed. Once again, there will be an unadjusted audit difference relative to those items because they are above KPMG's listing scope, but they are not material to the Treasury Division financial statements. Still pending is finalizing the documentation. The financials have been through KPMG's concurring partner review: there are a couple of follow-up comments related to some information and edits on the financials that will be worked through after this meeting. They expect to issue the reports this week.

MR. HAYHURST stated that there were no corrected misstatements identified. The uncorrected misstatement was the difference in alternative investment valuations between year-end and lag period used to record investments. They did not identify any significant deficiencies or material weaknesses in internal controls during the audit. They look at the internal controls around the purchases and sales of investments, the valuation of the investments, and many of the procedures that Treasury does around the alternative investments. Treasury has fairly robust internal controls

for when they reach out and work with the investment managers, to validate for themselves that the information they are getting is a good representation of what is going on throughout the year.

MR. HAYHURST reviewed the list of other significant items that KPMG is required to communicate (slide 4). Collectively, there were no matters to report. He said KPMG expected to issue unmodified opinions saying that they believe the Treasury Division financials are presented in accordance with GAPP related to the invested assets under the investment authority of the commissioner of the Revenue Department, as well as the report on invested assets for the State of Alaska retirement and benefit plans.

He briefly drew attention to the list of people making up the core audit team (slide 6). Also provided was a breakout of the fiscal year end valuation of investments and a comparison to the prior fiscal year. He said KPMG's testing process was fairly similar this year on the marketable securities, testing on a sample basis and using the national pricing desk to test the pricing. They also do a sample of purchases and sales and confirm investments with the custodians. On the alternative investments, KPMG gains an understanding of the process and controls for the whole population of those investments. They actually do a risk assessment on the alternative investments and identify them by groups according to risk categories. This year all the investments in the absolute return fund, which is a fund-of-one where the ARMB is the sole investor, were selected for testing. Similar to last year, KPMG also looked at back-testing and benchmarking relative to the roll-forward period from the audited financial statement date, which is typically December 31, to the State's balance sheet date of June 30.

Regarding upcoming accounting standards, MR. HAYHURST said the fair value measurement and application standard establishes a hierarchy of inputs similar to what the State has for commercial entities right now. He did not think the Treasury Division would see a significant change to its financials, which are already at fair value. The methodologies are not necessarily going to change significantly.

MR. HAYHURST noted that responsibilities in the audit were included in the Appendix.

CHAIR PIHL remarked that the committee recognized the auditors' comment about Treasury Division staff's preparation for and cooperation during the audit, which was as usual and what was expected.

B. Update: DRB Audits

Division of Retirement & Benefits CFO KEVIN WORLEY reported there are eight concurrent audits in progress right now. They are ahead of schedule from last year when GASB 67 requirements delayed the audit process. Staff anticipates having the draft financial statements available for the Audit Committee on October 8. A teleconference committee meeting is scheduled for October 15. He stated that the audits are moving along very well and he was pleased with the current status. The audits require working with Treasury Division staff quite a bit, and DRB has been getting information from them very quickly.

MS. ERCHINGER requested a briefing on engagement with the employers regarding census audit information.

MR. WORLEY stated that last year, as part of GASB 67 and 68, the independent auditor started census audits of employers. KPMG has shared the list of employers that they are looking at on yearly, five-year and ten-year cycles. This year has gone a lot smoother, and there has been quicker turnaround from employers as they understand the information that the auditors need to fulfill the audit requirements. There is one outstanding employer at this time, and the division has been in contact with them.

CHAIR PIHL mentioned that KPMG at the last meeting had indicated they would report on the employer census data. He asked KPMG to give that report now.

MR. HAYHURST stated that KPMG's census testing does not necessarily test contributions coming in at the level that DRB keeps records. The census testing they look at is date of hire, date of birth, date of retire (if applicable), and any change in marital status.

MELISSA BEEDLE of KPMG added that they also look at the contribution for specific employees and recalculate it to make sure the right amount is being reported to the state. They have not encountered any issues with that.

MR. HAYHURST said the issues KPMG ran into were similar to last year, and they plan to talk to Buck Consultants to identify to what extent it will impact the reporting. The most significant item they run into is a change in marital status. The second most frequent item is date of hire (especially if an employee has moved from one employer in the state to another employer in the state).

CHAIR PIHL said he thought KPMG's employer audits would be broader and cover the employer reporting of payrolls and contributions. MR. HAYHURST replied that it was not what they do in the census data audit.

MS. ERCHINGER stated that she would like to talk about the internal employer audits in the future. She remains concerned about the small employer audit staff and the process by which the administration follows up with those employers to make sure that issues that are identified are corrected. Then, to the extent that employers are not responsive to the state in submitting contributions they are withholding from their employees, for example, what is the follow-up on that? As resources get constrained at employers, there are going to be bigger and bigger problems, not fewer problems. She thought it was important to get out in front of that potential wave of additional issues. She has said before that, to her, the cost of employer auditors more than pays for itself, because somebody will be paying the bill eventually for the contributions that are not being submitted to the state. It makes the most sense to get the right people to pay the bill. In order to get that to happen, there has to be timely audit information. If an employer is audited once every ten years, and an audit identifies problems that happened years ago, it will be more challenging to get those missing contributions.

MS. ERCHINGER commended the Department of Administration for KPMG being able to report that the auditor had not seen any errors in the calculation of contributions. That is because the

department created a report form that employers are required to use, which does the calculations. There may be some other ways of incorporating that kind of hard-coded data collection from the state side that the employers are using when they are reporting. An example to address inconsistencies in the hire dates would be on the form that employers submit every payroll. If there was a box to put new hires and their hire dates, the department can compare the hire date against paperwork from the employer and note any discrepancy immediately, instead of waiting for an audit years down the road to identify it.

MR. HAYHURST said he did not want to downplay the importance of employers that are not making their payments, but it is truly not material relative to the external financial statements and what they represent relative to dollars.

CHAIR PIHL remarked that Ms. Erchinger's comments were a good recap of what the committee has been trying to address for at least five years.

C. Update: GASB 68 – Allocation of Net Pension Liability

MR. WORLEY reported that a legal opinion has been developed and submitted to all the employers that participate in the PERS and TRS plans. Notification was also sent via email and letters to all the employers in the plans informing them of the decision that the State is recognizing its on-behalf contribution as a non-special funding situation. The State will record only its allocated share of the net pension liability, and employers could do the same. The Department of Administration sent out a draft schedule to all participating employers indicating the employer contribution made by the employer, as well as the amount of the non-employer contribution contributed by the State, to show an allocation of each piece by employer. Employers will see two lines: one based on their actual contributions, and the second based on the contributions that the State makes over 22% on PERS and 12.56% on TRS.

CHAIR PIHL drew attention to the net pension liability reconciliation schedules for 2013/2014 in the meeting packet (*on file at the ARMB office*). He mentioned there were minor variations between those numbers and what was in the actuarial valuation reports.

A discussion ensued among the chair, the gentlemen from Buck Consultants, and Mr. Hayhurst, about the calculation of the employer portion of the net pension liability and some rounding that occurs.

CHAIR PIHL noted that the schedules would be updated for fiscal year 2015. The state contribution for PERS would be \$1 billion instead of \$176 million, and for TRS the state contribution would be \$2 billion. That would change all the calculations rather dramatically. He added that two years down the line the \$1 billion would be \$79 million, and any employer's contribution would go up dramatically.

MR. HAYHURST said he understood what the chair was getting at, but KPMG has talked with Jeff and he did not think the \$1 billion and \$2 billion were going to flow through and be reflected in the percentages. He thought it would be set aside and the question asked what the impact of that is to the net pension liability allocation, and how that impacts the employers' portion of what that is, and how it impacts the non-employer portion as it looks at the schedule. The employers will have a positive

impact to that in their financials for FY15 because there will be a nonreciprocal transaction for which they are receiving the benefit of the additional amount the state made. He did not think it would be sticking the state in at \$1 billion and flow that percentage through. He thought it would be set aside and then look at the impact of that and what allocated percent that would be to the net pension liability and how that would flow through. There may be another column on the flow-through schedules because the actuarial percentage for the pension expense and other items would still be calculated. Then what is the nonreciprocal benefit that they receive relative to the additional contribution made.

CHAIR PIHL asked what would happen when the state would be \$79 million. MR. HAYHURST said he had not thought of four or five years out. CHAIR PIHL suggested that the auditor should take the actuary report and take the employer contributions for the 24-25 year period, and take the state assistance for the 24-25 year period, and smooth it. MR. HAYHURST replied that smoothing would not be the right method under GASB. He added there are essentially two methods that can be used under GASB: the actuarially determined method (which is a forward-looking method), and most states are not using that because it is fairly complex, and the historical contribution method (which is what the State has adopted). He said he got the chair's point, and that is another discussion to have about the \$3 billion appropriation to the pension systems, because it will reduce the non-employer portion pro rata in the future (because the employers will be capped). If the future contribution rates as a total are going down, that will reduce the non-employer portion much more significantly than the employer portion.

CHAIR PIHL said he was trying to suggest something to the State of Alaska on how it does the net pension liability calculations that apply to every PERS and TRS employer. If it were up to him, he would try to avoid having the number gyrate unnecessarily. Another acceptable way to calculate the employers' share is to take the portion of the 22% rate that is going to retire the unfunded liability and apply it to the projected payrolls for the 24-25 year period that the employers are going to pay it. If he were an employer, that is what he would do.

MS. ERCHINGER said her following comment was not blaming anyone around this current table because they were not there to inherit the final gyrations that went into making a decision about how this was going to roll out. But it was disappointing, and now problematic, that employers were not part of the conversation in terms of the actual methodology. This does not just affect the financial statements of the State; it affects the financial statements of every municipality in the State of Alaska. They were not given an opportunity to even weigh in on this or ask how else it might be calculated or what the ultimate impact would be on their financial statements. They are given numbers where they have a choice now of either including them in their financial statements one way or another or deciding to make their own numbers using some of the actuarially determined numbers as a basis for what they project in their statements going forward. This puts them all at risk for their own independent audit opinion. It boxes in every employer and is a bad example of working together on something that is really important. It is more important to some municipalities more than others, such as some that have tax caps or enterprise funds that set tariffs based on what they are booking in their financial statements. It has real world impacts on ratepayers and taxpayers at the local level that very likely were not anticipated at the state level when the decisions were made. So she was disappointed that there was not an opportunity for employers to weigh in before the deal was done because it created a lot of confusion and put employers at odds. Possibly this would have been the end result that

everyone would have come to, if everyone was at the table and understood all the reasons behind the decisions to go this route. At least there would have been buy-in and no need to force every employer in the state to have this conversation with their auditors for months before they make a decision on how to formulate it, and worse, pull in their elected officials to have this dialogue publicly. She said she appreciated all the work that was done to get to this point, but it could have been done much more cooperatively.

CHAIR PIHL said he understood that appeals had already been filed on the pension liability allocation. He asked if there was an allotted period for appeals before the allocation process becomes final.

Deputy commissioner JOHN BOUCHER responded that he had only seen a draft of the letter to employers, but apparently it was in the mail. He asked if the Chair thought the department ought to have promulgated a regulation. He believed there was a process of appeal to the Office of Administrative Hearings.

CHAIR PIHL pointed out that when the same formula is applied to TRS, with the history of state funding of education and what the constitution says with respect to funding of education, and when the state is trying to shift to the municipalities a huge amount related to state assistance for them to have to disclose, that is a huge departure from...[incomplete]. Even for PERS, there is a history for nine years of the State meeting its intended obligation with respect to state assistance.

Chief investment officer GARY BADER asked if the percentages in the schedule were the percentages of liabilities that the state and municipalities have to show on their books.

MR. HAYHURST replied that the allocation shows the amount of pension liability that the employer would pick up. It is up to the employer to make a decision if they are going to pick up one number relative to them or a combination of some of both numbers if they believe it is a special funding situation.

MR. BADER, having been told that the State would use the first two lines of the schedule to report its share of the unfunded pension liability on its books, asked if the State was showing the non-employer contribution as part of its liability.

MR. HAYHURST confirmed that, adding that the State's position is that the amount that the State is contributing on-behalf is not a special funding situation and, therefore, the employer would show the allocated net pension liability for the amount that it is making as well as the on-behalf amount that is being made on its behalf. Therefore, the State of Alaska, consistent with that position, would pick up the two numbers for the State of Alaska on the schedule as an individual employer liability. He explained that there are two lines on the schedule for each employer: the first line is specifically an allocation of the pension liability based upon what the employer itself contributes, and the second line is an allocation of the net pension liability that relates to the on-behalf payment that the state made related to that employer. If an employer determined that the on-behalf payment was not a special funding situation, it would have to add both the lines together to come up with what pension liability

to show on its books. If, working with its auditors, an employer determined that the on-behalf payment was a special funding situation, it would likely choose to only pick up the first number on the schedule.

MR. BADER said that explanation made it much clearer. He noted that Chair Pihl raised the issue that the on-behalf number will jump around each year, based upon the state's contribution, and he specifically mentioned the legislature's \$1 billion appropriation into PERS. That would change all the percentages on the schedule, depending on the year.

MR. HAYHURST said it could, although, regarding the \$1 billion to PERS and the \$2 billion to TRS, what KPMG is talking about is that that money cannot just be thrown into the mix and all of a sudden make everybody else's percentages go down to point-zero-zero-something and the State's percentage go up, and so the State picks up the total liability. That is not the intent, so the large appropriations would be set aside. What still has to be determined is whether to take the \$1 billion related to the PERS beginning net pension liability and run that through and see that the net pension liability went down by X amount, and that X amount reduction will be allocated based on the beginning percentages. Or would it go through the actuarial calculation of pension expense and other deferred inflows/outflows to say what the ending would be and what it is now because of this extra \$1 billion. That differential is the plug that really is going to then have an allocation, but he is not quite sure how that would allocate to the employer individually because the schedule gets complex with every employer getting two lines.

MR. HAYHURST acknowledged that the on-behalf number could potentially bounce around every year, depending on what the ARMB sets as the total contribution amount, and where that is in relation to the contribution cap. Historically, that percentage has not bounced around a huge amount. He added that Chair Pihl made a very good point about looking down stream five years. The reason the State is making this is that it will potentially reduce the additional amount the State ultimately is going to have to contribute. He did not know if it would dip below the cap or not, because it is an actuarial calculation that includes what the investment returns are and so forth.

CHAIR PIHL reiterated that, based on what the legislature did two years ago, and using percent of pay, in 2017 that number will drop from \$1 billion to \$79 million. That means the employers' liability will more than double.

MS. ERCHINGER said the fact that the legislature's appropriation of \$3 billion would not be included in the calculations to allocate the net pension liability would create an inconsistency between what the employers have reported as the state's on-behalf, as the State has reported to the employers, and what the employers have recorded in their financial statements already. It might work for the State, but she did not know how it was going to work for everybody else. Everybody should have been having this conversation, and it should not have been done in a back room with a bunch of lawyers. It will have far-reaching implications that those lawyers did not weigh, even while they were looking out for the self-interest of the State, which is great because it is everyone's interests. Hopefully, these considerations will be taken into account if those conversations occur in the future. Now the application will be inconsistent, with the \$3 billion being in one year and the next year it is out, and employers will see huge swings in their financial statements. It has real world implications for municipalities in their budgets and in the taxes they levy against their citizens. Those concerns should

be heard loud and clear before decisions are made in the future about how these numbers are going to be applied. In the end, the State is going to report on their financial statements what they need to report, and she had no problem with that. The question is if the municipalities are going to have good, consistent information, and are they going to be able to set budgets that do not do this every year.

CHAIR PIHL stated that year by year in this whole process the municipalities are required to book their share of the State's assistance contribution on their financial statements. The Department of Administration supplies the amount the State contributes on behalf for PERS and TRS. He said the reasonable answer would be to look long-term at the two numbers for each employer (on the net pension liability reconciliation schedule).

MR. HAYHURST said he was open to having the conversation again with DRB and the actuary about the calculation method, taking into account the employers not experiencing as much volatility in year-to-year net pension liability allocation.

CHAIR PIHL requested that Buck give the breakdown showing for both defined benefit and defined contribution payroll the percentage of the 22% rate that is going to apply to the unfunded liability for pension. He noted that two years down the road the State will be dealing with healthcare disclosure on top of it.

MR. WORLEY related that one item talked about in GASB 68 is that this is a separation of accounting versus funding. So, in terms of funding, employers are still going to pay the 12.56% (TRS) and the 22% (PERS). He said he was not sure how throwing in the accounting side of it and the impacts on municipalities affects property taxes and other things. The employers are still paying the same percentage contribution rate.

MS. ERCHINGER said it was a great point that this is really an accounting issue and does not necessarily affect funding. The problem is the letter from the Department of Law talks about the State not being liable for the funding, and that is a conversation than goes farther than anyone wanted to get into. She said she understood that the State had to come up with a methodology to justify how these numbers were developed, but it is too bad that it went beyond that. Whether the State is or is not liable, everyone has just been getting along with doing their best to try to figure out how to fund the pension plans.

COMMISSIONER FISHER said he thought this was the subject of a discussion at a prior Audit Committee and that this solution was actually discussed.

MS. ERCHINGER stated that it was discussed a couple of years back, and then the committee was told that the decision was made that this allocation was not going to happen, and the State had agreed with the recommendations of KPMG on the presentation. With the new administration, there was a change to go back to the former way of thinking, and that is what was reported. The committee heard at the February meeting that the elegant solution that had been discussed was not, in fact, what was ultimately going to be rolled out, but there were no specific details or what the numbers would look like.

MR. HAYHURST said he wanted to make clear that KPMG consistently felt that this would be a special funding situation, and he did not think that the State ever actually agreed with that. KPMG was trying to get an understanding of the components the State was looking at that made that, which kind of came together...[incomplete]. In certain respects, that was what was pushing the legal side of this, because the State needed to come up with the position, and GASB did not help with that. The elegant solution that KPMG talked about at the February committee meeting is slightly different than what came out. What he had been thinking is that KPMG would issue schedules that showed it as a special funding situation that KPMG would opine on. The reason they ultimately said they could not do that is the State really was not in agreement that it was a special funding situation. Then KPMG said they did not know how they could issue a schedule showing special funding with an opinion if the State, which is the most significant employer and also responsible for pulling the schedules together, says they think the schedules are wrong. KPMG continued to work to get information on the State's side, and he has been neutral as to whether it is special funding or not. KPMG tried to think of alternative presentations that were different than what he thought of as the elegant solution but provided the information in a neutral manner. It does not really help the employers because they now have to work with their auditors, and different employers will potentially have different answers across the state. It is something neutral that KPMG can issue an opinion on that at least provides information. The historical contribution method was selected, which was one of the allowed methods. He was open to talking about whether it makes sense, given the \$3 billion appropriation in FY15, to consider the actuarially determined method. It may change the numbers and shorten the timeframe for the employers to issue something.

MR. BOUCHER said he appreciated that KPMG clarified that if there was any indication to anyone at any time that the State viewed this as a special funding issue that it was a miscommunication.

MS. ERCHINGER said she was not saying that the State changed its position on special funding but that it changed its position on the presentation.

MR. BOUCHER said it was fair to say there was a misunderstanding of the views of the elegant solution that was proposed, which came to light after the February committee meeting. He agreed with Ms. Erchinger that this could have been rolled out much sooner. Part of the issue is that the State wanted to give information that was more or less real information to the employers, but it could not get to a final position with KPMG until months ago, after essentially the differing positions between KPMG and the State came to a point where KPMG had to see something substantive from the State. The administration would have preferred not to have dealt with this in this fashion. Because of the timeliness of the final resolution, the administration was in a box. He said that, from his perspective, the biggest reason that this accounting law now exists is that taxpayers all across the country were not aware of this liability. This is a first step toward transparency as to who this liability is potentially on. For both the State of Alaska and the employers it is good that this issue is now front and center and potentially affecting the people who ultimately might pay the liability. It will be a challenging time because when a large bill is presented nobody jumps up and says they will take it. In turn, this will lead governments to have to deal with questions like this. He hoped it is not viewed as the end of the conversation, but the administration had to start somewhere. Other things have been put on the table, such as the earlier discussion about the two methods for the calculation. He noted that the administration has not been entirely silent on this issue; for instance, the State informed the Alaska

GFOA a while ago. While the process was not totally transparent, the administration telegraphed where it was going, but there was no schedule where people could see how it would impact them. No doubt, this will cause difficult conversations between elected officials and their financial people. Ultimately, was that not what GASB 68 was all about?

MR. BOUCHER said the State of Alaska has a bigger issue of a big unfunded liability and is trying to figure out how jointly it will pay for it.

CHAIR PIHL said people may wonder why he is digging into this stuff. He is one of two public members of the Alaska Retirement Management Board, and he has always felt that that position is one to look at how the whole pensions and liabilities and unfunded liability are playing out across the state to all the employers.

MS. ERCHINGER stated that she is the only employer position on the ARMB. That constituency is pretty much the same as the State constituency – everyone has shared taxpayers and the same citizens. Whether the State pays the bill or the taxpayer pays the bill is really a question of whether the oil companies pay the bill or the taxpayer pays the bill. It is important to be able to say that, without her being shot at with arrows that she is not being a fiduciary. It is not a matter of finger pointing but a matter of making sure that everybody has a voice in the conversation because the impacts on the state budget, on local budgets, and on taxpayers and other revenue payers are different. She said she appreciated being able to have this dialogue, but the conversation should not be happening just in this room because other people, especially the taxpayers, want and need to be involved in order to feel like they are part of the process.

CHAIR PIHL requested that the Buck's breakdown of the rate structure be sent to all the employers so they will know what it is and be armed with the information on which basis they can calculate what they are going to pay until 2039 to meet their share of the liability under statutes.

MS. ERCHINGER noted that it was in the valuation reports, so maybe just highlighting those pages to make it easier for employers to find would suffice.

COMMISSIONER FISHER commented that it may have been true at some point in the past that the oil companies or the taxpayers would have to pay the unfunded liability, but he did not think that was going to be true in the future.

In terms of creating the net pension liability schedule, COMMISSIONER FISHER addressed Mr. Hayhurst with the question of whether there are only two options for the calculation – the one being used and the actuarially determined method.

MR. HAYHURST responded that he understood there was the actuarially determined method, which in GASB is the preferred method but more mathematically complex, and the historical contribution method. He said he would have to check if there are shades of the historical contribution method.

DAVID SLISHINSKY of Buck Consultants stated that one does not necessarily have to just take the last year's contribution. One can do averaging of, say, the last three years or the last five years under the historical contribution method.

MR. HAYHURST explained that KPMG has talked with states they work with around the country and also looked at the historical contributions and said if there is an unusual item within that historical contribution that is not representative of what would be done going forward they may need to make adjustments to that historical method to not get an odd situation. The \$1 billion and \$2 billion appropriations to PERS and TRS would be that unusual situation to be set aside. To him, the impact of that means an ongoing situation where either consider that in the historical contribution method and if there is the ability to do that, or if not, does it mean having to go to an actuarial method to figure out how to reflect that accurately so as to not have the gyrations in contribution rates. He said there may be some shades there, but there are two basic methods, with some potential ability to sway primarily the historical method.

MR. SLISHINSKY stated that within each general approach there may be some specific differences that could be utilized that would provide a different result but still, in the spirit of that method, be acceptable under GASB.

CHAIR PIHL submitted that there was a third method, which is to calculate according to existing statute what you are obligated to pay.

COMMISSIONER FISHER stated that to say you don't like how the schedules are drafted and presented is a very different issue than saying you don't even like that there is a schedule.

CHAIR PIHL stressed that he was not saying the latter: he was trying to help the administration avoid a problem of employer payment gyrations down the road.

COMMISSIONER FISHER said maybe this required further talking because he did not fully understand the Chair's proposal.

MS. ERCHINGER said the schedule's numbers were based on the numbers before the \$3 billion injection to PERS and TRS, but the numbers are also based on significantly higher state contributions than is happening currently. There are three consecutive years where the rates are up and down. The Chair is saying that if an employer said let's forget the first two of those and just go with what the statute says and what their employer contributions are and what the state's contributions are on their behalf, project those out until 2039, and add it up and get their unfunded liability to put on the books. From a layperson's standpoint, as well as from trying to get rid of the volatility over the next few years, that at least makes some sense.

COMMISSIONER FISHER asked if there was flexibility under the historical contribution method to do what the Chair was suggesting.

MR. HAYHURST replied that he did not believe so. KPMG talked this past year about how the cap plays into it, but to just throw out the historical contributions and go with the cap would mean having to go to the actuarially determined method of calculation.

COMMISSIONER FISHER said it would not be just throwing it out: it is recognizing it as the extraordinary occurrence that makes the historical calculation actually less representative.

MR. HAYHURST stated that, similar to the discussions around the elegant solution, he was open to taking this back and saying that although the cap does not make sense, but when push comes to shove with this discussion, is there some way to reflect it without having to go to the actuarial method and make it that mathematically complex. The discussions so far have been that that is not really represented within GASB. Alaska's situation is fairly unique, with the legislature's decision to put a lot of money into the retirement systems, at the same time period that the effective date for adoption of the GASB 67 and 68 requirements are coming to fruition.

COMMISSIONER FISHER asked Mr. Hayhurst to do that, and MR. HAYHURST indicated he would try to get it into the schedule this week or early next week. MR. HAYHURST added that Mr. Worley and Buck Consultants should be part of that conversation.

D. Future Audit Committee Topics

CHAIR PIHL queried fellow committee members about any additional topics they wanted on a future agenda, apart from the regular items on the meeting calendar.

MS. ERCHINGER suggested dusting off the conversation about employers that should be, but are not, contributing to the retirement system. Elected officials in most places turn over every two years, and local elections are coming up. She thought just informing the new elected officials would get new folks looking at the fact that their city is not contributing. At a time when everything is falling apart, everybody ought to be contributing, unless their city is considering literally closing its doors. She added that it is fraud to take PERS contributions from employees and spend it on anything other than sending that check to the State of Alaska. Everything possible should be done to make sure that that gets resolved.

CHAIR PIHL stated that the Department of Administration needs more legislative authority to go after the delinquent employer contributions.

MS. ERCHINGER pointed out there is an intercept provision. She understood that revenue sharing was not going to be around a lot longer, so the window of opportunity to intercept funds going to certain communities is shrinking. When an employer does not pass along the contributions to the state, those employees are not getting credited for their service and will be the ones harmed. She wanted to protect the pensions of those people who have had the money taken out of their paychecks and they are not even getting credited with the service.

MR. WORLEY explained there are situations where employers are in the plan but are not recognizing that PERS is one of their retirement plans, so they are not even deducting employee money, let alone reporting. Those employees are also not getting credit for service. Since 2006, the new employees

would be defined contribution plan members, and there is that situation as well. The Division of Retirement & Benefits has talked to a couple of employers that are very far behind and could not even catch up if they tried. The termination process itself would result in a significant cost to them, so either way the State is dealing with not getting much, if anything. He said he was willing to discuss ways to deal with the result of that difficult situation.

MR. WORLEY said that he had talked to the Alaska Department of Commerce about intercepting state revenues. One issue they are running into with that at the Department of Commerce, because of their involvement with fuel loans or other types of loans the department makes, is that DRB's standing for getting funds is several layers deep. So while the division has the authority, the probability of actually getting money would probably be nil.

MR. BOUCHER recalled that the division tried the intercept process for getting delinquent contributions from employers and was not supported. MR. WORLEY confirmed that.

MS. ERCHINGER commented that the state, in trying to solve the problem, is setting a precedent to do whatever the solution is for that one employer, which then creates expectations down the road and raises issues of fairness. She wondered if there was a different way by working with the Alaska Municipal League so it is part of the solution, rather than the State having to make an exception for an employer.

E. Further Meeting Schedule

A teleconference meeting is planned for October 15. The next regular meeting is Wednesday December 2, 2015 in Anchorage.

OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

There were no other matters.

PUBLIC/COMMITTEE MEMBER COMMENTS

MR. HAYHURST remarked that there is no executive session, nor does there necessarily have to be one. However, he wanted to express how much he appreciated the professionalism of the State working through the issue (net pension liability allocation). It has been a long process that started two years ago and came to a head this year. Ultimately, where KPMG was relative to special funding, and where the State was, was pretty opposed. KPMG pushed to get information from the State, which kind of drove the process. But through that whole process, there was no name-calling or raised voices. While both parties came to different answers, he very much appreciated the process and the professionalism that the State had through the whole thing.

ADJOURNMENT

The meeting adjourned at 10:53 a.m., on a motion made by Ms. Erchinger and seconded by Ms. Harbo.

Note: An outside contractor prepared the summary minutes from staff's recording of the meeting. For in-depth discussion and presentation details, please refer to the recording and staff reports and written presentation materials on file at the ARMB office.

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