

Findings and Recommendations

Three Retirement Systems Actuarially Unsound

Based on the July 1, 2004, actuarial valuations, the Public Employees' Retirement System – Defined Benefit Retirement Plan (PERS – DBRP), Sheriffs' Retirement System (SRS), and Game Wardens' and Peace Officers' Retirement System (GWPORS) are not actuarially sound, contrary to the Montana Constitution and state law.

Article VIII, Section 15, of the Montana Constitution requires public retirement systems be funded on an actuarially sound basis. State law defines a defined benefit retirement system as actuarially sound when its contributions are sufficient to pay the full actuarial cost of the plan over a period of up to 30 years.

The PERB obtains an actuarial valuation of each of its eight defined benefit retirement plans biennially. The most recent actuarial valuation was as of July 1, 2004. The PERB actuary determined the employer contribution rate would have to be increased as follows, starting July 1, 2005, to maintain an amortization of the UAAL over the 30-year period starting July 1, 2004:

PERS – DBRP	1.19%; from 6.9% to 8.09%;
SRS	2.15%; from 9.535% to 11.685%; and
GWPORS	.23%; from 9.00% to 9.23%.

The UAAL for each system has grown at an increasing rate, as shown in Table 1.

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Table 1
Unfunded Actuarial Accrued Liability*

<u>Valuation Date</u>	<u>PERS-DBRP</u>	<u>SRS</u>	<u>GWPORS</u>
7/1/2000 ^a	(\$569,940,000)	(\$38,502,000)	(\$9,044,000)
7/1/2000 ^b	(251,540,000)	(26,002,000)	(5,544,000)
7/1/2002 ^b	983,000	(16,965,000)	379,000
7/1/2004 ^b	466,798,000	7,586,000	5,100,000

* The negative amounts indicate the systems did not have an unfunded actuarial accrued liability.

^a Does not include the effects of legislation passed in the 2001 Legislative session.

^b Includes the effects of legislation passed in the 2001 Legislative session.

Source: Compiled by the Legislative Audit Division from actuarial reports.

In the July 1, 2004, valuation, the PERB actuary determined the UAAL for these three systems does not amortize without an increase in contributions. In the July 1, 2002, valuation, the PERB actuary determined the amortization period was .1 year for PERS-DBRP and approximately 30 years for each SRS and GWPORS. The actuary attributed the growth in the unfunded liability of the systems primarily to actuarial investment returns below the actuarial investment return assumption of eight percent for all three systems.

The PERB Funding and Benefits Policy states, "Whenever, through the use of long-term cash flow projections, the amortization period of a system's unfunded liabilities is projected to exceed 30 years for two consecutive valuations and the Board cannot reasonably anticipate that the amortization period would decline without an increase in funding sources, it is the obligation of PERB to recommend to the legislature that funding be increased."

Findings and Recommendations

Because the July 1, 2004, actuarial valuation projected an amortization period of the unfunded liabilities that exceeds 30 years for the PERS-DBRP, SRS, and GWPORS, the PERB should seek legislation for funding changes, as required by board policy. PERB plans to submit legislation to the 2005 legislature changing contribution rates to make the retirement systems actuarially sound.

Recommendation #1

We recommend the PERB seek legislation for funding changes to ensure the PERS-DBRP, SRS, and GWPORS are funded on an actuarially sound basis, as required by PERB policy and the Montana Constitution.

Public Employees' Retirement System- Defined Contribution Retirement Plan (PERS- DCRP)

The PERS-DCRP became effective on July 1, 2002. PERB has had to interpret and implement over 20 new statutes to ensure the PERS-DCRP was operated in accordance with state law. The following report sections identify areas where PERB can enhance compliance with state law concerning the implementation and operation of the PERS-DCRP.

Diversion of Pension Trust Fund Assets Through An Inter-Entity Loan

The PERB diverted funds from the PERS-DBRP Trust by borrowing funds from the PERS-DBRP Education Fund.

Article VIII, Section 15, of the Montana Constitution states, "Public retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses."

On August 15, 2003, an installment on the PERS-DCRP startup INTERCAP loan came due. The PERS-DCRP Administrative Fund did not have enough cash flow at that time to make the payment, so the fund obtained an inter-entity loan of \$114,000 from the PERS-DBRP Education Fund to make the INTERCAP loan payment. The

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Public Employees' Retirement Board

A Component Unit of the State of Montana

Notes to the Required Supplementary Information

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of latest actuarial valuation follows:

	PERS-DBRP¹	MPORS	GWPORS¹
Valuation date	June 30, 2002	June 30, 2002	June 30, 2002
Amortization method	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open
Remaining amortization period in years:	<i>Unfunded liability</i>		
Unfunded Credit ²			30

Actuarial assumptions:

Investment rate of return compounded annually	8%	8%	8%
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Projected salary increases

Merit	0% - 6%	0% - 7.3%	0% - 7.3%
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Benefit Adjustments

Non-GABA	N/A	50% newly confirmed officer	N/A
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¹ The ongoing funding of the PERS-DBRP, GWPORS and SRS is being watched closely. The anticipated unfunded liability of the PERS-DBRP will likely be amortized in 30 years; the GWPORS and SRS are funded at the rates necessary to pay benefits but appear insufficient to pay off unfunded liability.

² Assets are larger than the past service liability – creating an unfunded credit; the credit is amortized over future costs.

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SRS ¹	JRS	HPORS	FURS	VFCA
June 30, 2002	June 30, 2002	June 30, 2002	June 30, 2002	June 30, 2002
Entry Age	Entry Age	Entry Age	Entry Age	Entry Age
Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of revenue, open
30	30			21
Year smoothed market	Year smoothed market	Year smoothed market	Year smoothed market	Year smoothed market
8%	8%	8%	8%	8%
0% - 7.3%	None	0% - 7.3%	0% - 7.3%	N/A
3% after 1 yr	3% after 1 yr	3% after 1 yr	3% after 1 yr	N/A
N/A	Annual increase to salary of active member in like position	2% per yr service for newly confirmed officer	50% newly confirmed officer	N/A

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Notes to the Required Supplementary Information

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of latest actuarial valuation follows:

	PERS-DBRP	JRS	HPORS
Valuation date	June 30, 2004	June 30, 2004	June 30, 2004
Actuarial cost method	Entry Age	Entry Age	Entry Age
Amortization method	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open
Remaining amortization period in years:			
Unfunded Liability	does not amortize		19.1
Unfunded Credit ²		30	
Asset valuation method	4 Year smoothed market	4 Year smoothed market	4 Year smoothed market

Actuarial assumptions:

Investment rate of return compounded annually	8%	8%	8%
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Projected salary increases

General Wage Growth	1.25%	1.25%	1.25%
Merit	0% - 6%	None	0% - 7.3%

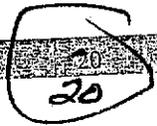
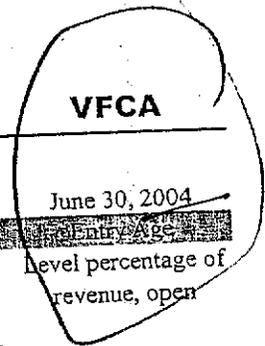
Benefit Adjustments

GABA	3% after 1 yr	3% after 1 yr	3% after 1 yr
Non-GABA	N/A	Annual increase to salary of active member in like position	2% per yr service for newly confirmed officer

¹ The unfunded actuarial liability will not amortize over the next 30 years. Based on actuarial assumptions as of June 30, 2004, additional funding is required at a rate of 1.19% for PERS, 2.15% for SRS and 0.23% for GWORS. The PERB will be requesting to increase the employer contribution rates during the next Legislative Session.

² Assets are larger than the past service liability - creating an unfunded credit; the credit is amortized over future costs.

SRS	GWPORS	MPORS	FURS	VFCA
June 30, 2004				
Entry Age				
Level percentage of payroll, open	Level percentage of revenue, open			
does not amortize	does not amortize	24%	18%	20
4-year smoothed market				
8%	8%	8%	8%	8%
0% - 7.3%	0% - 7.3%	0% - 7.3%	0% - 7.3%	N/A
3% after 1 yr	0% after 1 yr	3% after 1 yr	3% after 1 yr	N/A
N/A	N/A	50% newly confirmed officer	50% newly confirmed officer	N/A



going down