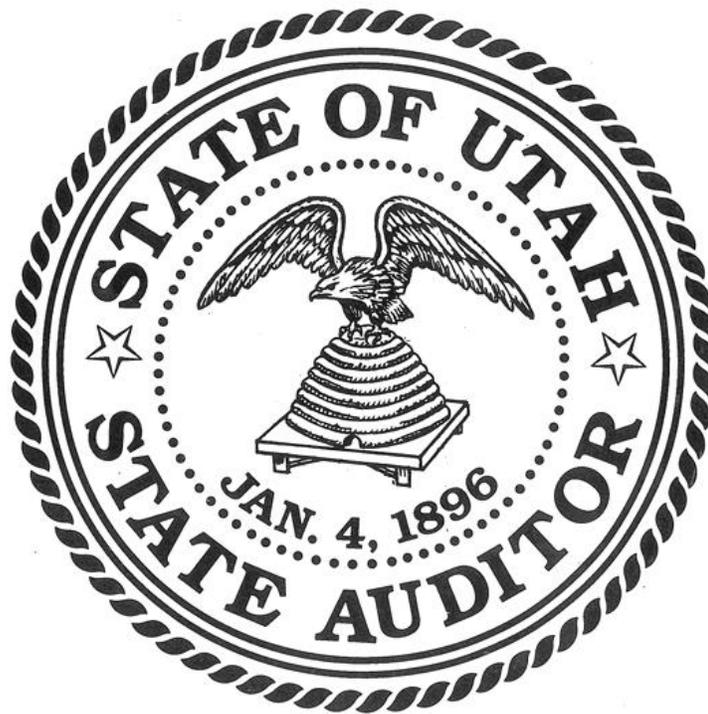


**Analysis Report No. AR 16-03**

# **The Cost of Yesterday's Pension Promises to Public Education**

**December 13, 2016**



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## **The Cost of Yesterday's Pension Promises to Public Education**

### **Background**

Pensions are one approach employers have used to compensate their workforces. Total compensation encompasses all of the wages, health insurance premiums, retirement benefits, leave, taxes and other items of value that an employer provides to or on behalf of employees. Historically, governments often provided their workforce lower relative wages in exchange for the promise of pension payments in the future. Too often, pensions were funded on a “pay-as-you-go” basis, with politicians and policymakers being rewarded by employees willing to work for promises of additional post-retirement compensation, but future taxpayers being burdened by the delayed cost of paying for those promises.

A government entity's present-day funding of an underfunded pension system results in money being diverted away from current activities to pay for past promises. This report analyzes the impact this diversion of funding—to “prop up” the “old” pension system—has on public education.

### **Analysis**

Pension systems are regularly evaluated to determine whether they are actuarially sound — to weigh how likely the system is to meet an obligation to pay retirees in the future. These studies show that Utah's past contributions and investment earnings were insufficient to pay vested retirement benefits. The unfunded liability (UAAL) is the gap between the pension's liabilities and the value of existing assets. The Utah Retirement Systems (URS) computes the amount needed to pay for the unfunded liability spread (amortized) over 25 years<sup>1</sup>.

The chosen mechanism to fund the UAAL consists of increasing the employers' required pension contribution rates. In 2008, the required contribution rate for the noncontributory system<sup>2</sup> for state and school employees (Tier 1) was 12.72%. By 2015, this required contribution rate had escalated to 22.19%. This significant increase reflects the inadequacy of past funding efforts, whether through employer contributions or investment returns. Since this rate is applied against an employer's applicable wages, the increased rate places a greater burden on government budgets and ultimately upon the taxpayers who fund that governmental entity, with no increase in worker productivity. Currently, the rate required to cover the unfunded

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<sup>1</sup> Beginning in 2009.

<sup>2</sup> Currently designated the Tier 1 Public Employees Noncontributory System for State and School Employees

liability is 9.94% of applicable wages. In other words, almost half of the current required contribution rate is going to pay for those past promises which weren't fully funded.

Whether or not an employee participates in the Tier 1 pension, the required UAAL rate is applied against all applicable wages when paid into the pension system. In other words, even if an employee is enrolled in the Tier 2 Defined Contribution retirement plan (i.e. the 401(k) plan), his/her employer would still pay 9.94% of the employee's wages to URS to help fund the Tier 1 pension system in which the employee is not enrolled.

Figure 1 shows that nearly \$204 million was set aside in 2015 to pay for the unfunded liability. This is money that could have been used to fund current educational activities but is instead being diverted to fund past pension promises. This diversion represents 3.7% of Utah's \$5.5 billion total public education expenditure in fiscal year 2015.

**Figure 1 – 2015 Public Education Payments To Pay Unfunded Liabilities**

<b>School District</b>	<b>UAAL†</b>	<b>School District</b>	<b>UAAL†</b>
Alpine	\$22,710,707	Nebo	\$10,577,869
Beaver	595,142	North Sanpete	919,778
Box Elder	3,853,441	North Summit	469,587
Cache	5,422,692	Ogden	4,998,621
Canyons	12,692,345	Park City	2,927,176
Carbon	1,317,699	Piute	199,422
Daggett	141,958	Provo	5,297,124
Davis	22,947,551	Rich	295,617
Duchesne	1,808,327	Salt Lake	11,995,810
Emery	1,176,530	San Juan	1,719,709
Garfield	445,967	Sevier	1,775,213
Grand	760,476	South Sanpete	1,296,532
Granite	24,998,671	South Summit	632,383
Iron	3,015,865	Tintic	152,609
Jordan	16,762,602	Tooele	4,705,973
Juab	779,146	Uintah	2,766,507
Kane	588,327	Wasatch	2,559,894
Logan	2,088,972	Washington	9,753,958
Millard	1,463,602	Wayne	253,875
Morgan	749,807	Weber County	11,497,587
Murray	2,277,983	<b>Charter Schools</b>	<b>2,543,783</b>
		<b>Grand Total</b>	<b>\$203,936,837</b>

† Unfunded Actuarial Accrued Liability

Source: Utah Retirement System

**Figure 2 –2015 Public Education Expenditures**

<b>Category</b>	<b>Total Expenditure</b>	<b>%</b>
Employee Wages	\$2,411,677,857	44%
Employee Benefits	1,108,277,307	20%
Purchased Services	602,790,742	11%
Supplies	473,766,125	9%
Property	334,499,050	6%
Other	579,914,387	10%
<b>Total Expenditures</b>	<b>\$5,510,925,468</b>	<b>100%</b>

Source: Utah State Board of Education

## Summary

The trade-off Utah faces for yesterday's pension promises is a decreased amount of today's funding being available to meet today's educational expenses. If yesterday's taxpayers had fully funded the pension, and today's taxpayers were not required to pay for the unfunded liability, that money could have instead been allocated to the following purposes:

- Reduce education expenses by 3.7%,
- Increase the Weighted Pupil Unit (WPU) by almost 7.5%,
- Increase teacher pay by 14%,
- Raise public education employee wages by approximately 8.5%,
- Double the number of teacher aides and paraprofessionals inside classrooms, or
- Operate an additional 40 elementary schools or several hundred new classrooms.

Making promises about the future is risky, especially with pensions where there is a significant incentive to make promises today for which others must pay tomorrow. As a result, past pension promises now divert significant portions of today's budgets for work that was performed years if not decades ago. Utah's policymakers should continue to take steps to ensure today's expenses are paid today and not pushed onto taxpayers in the future.