

Presentation by Girard Miller* CFA

In determining the proper role of Market Value data presentations in public retirement plan reports (both pensions and OPEB), it is important to consider the respective roles of the three primary professions whose work influences whether these plans succeed in achieving their objectives: actuaries, accountants and investors. I will not dwell today on the work of professional investors, even though my primary professional credential is a CFA, although I will provide one investment insight worthy of your consideration. Instead, I will focus primarily on the interaction of actuarial information and financial reporting information as they are used in the public pension community.

The Academy provides professional guidance and standards for actuaries who calculate the present values of plan liabilities, and the periodic contributions necessary for retirement plans to achieve their objectives, including full funding. The accounting and financial reporting community, whose principal standard-setting body is the Governmental Accounting Standards Board (GASB), relies heavily on the professional work of actuaries. GASB historically has not attempted to overlay an accounting solution on an actuarial problem. In the absence of compelling reasons to the contrary, GASB historically has relied heavily on the *best professional estimates* of actuaries for information displayed on the face of pension fund financial reports. This is consistent with other methods of valuation used in financial reporting. On matters that relate to predominantly accounting principles, however, such as intergenerational equity, the GASB retains “primary jurisdiction” over such matters as the maximum amortization period.

In light of this natural division of labor between the standards-setting boards, the users of governmental financial statements have a keen interest in the *comparability* of financial information contained in actuarial reports which are subsequently used in financial statements. Comparability is one of six fundamental characteristics of financial reporting, and has been a cornerstone of GASB pronouncements since the inception of the board.

It is this nexus – the comparability of actuarial information in public retirement plan reports – and how it should best be addressed by the Academy and the GASB, which I seek to discuss with you today.

Traditional actuarial practices and current governmental accounting standards have served the public pension community well, as the advocates of the *status quo* will readily inform you. The governmental environment truly is different because the entities are essentially perpetuities with broad powers to raise sufficient funds to meet their obligations over time. I have nothing to add to their arguments, but concur that the use of Market Value calculations on the face of governmental financial statements will not improve the operations nor the investments of pension funds. Using market values for assets in the ARC calculation will introduce greater volatility in contributions than is necessary or appropriate, and using “risk-free” market values for liabilities will not enhance the funding of public plans.

By retaining the traditional practice of using reasonably probable investment returns as the basis for discounting future obligations to calculate the AAL, UAAL and ARC, actuaries and accountants faithfully support the primary purpose of a public pension plan -- which is to establish a funding plan that has the best possible chance of equitably balancing the interests of today's taxpayers and tomorrow's retirees. Many (if not most) professionals in the CFA community would agree with me that using risk-free rates of return to value public plans (which enjoy a long-term horizon and capacity to prudently assume equity risks) will almost assuredly over-burden today's taxpayers. Such an MVL regime would perversely shift the entire *normal* market risk premium to the benefit of future generations at the expense of their forebears.

Notwithstanding these objections to use of MV as the primary financial reporting paradigm, however, I will now turn to an overlooked issue in this ongoing debate -- which is the lack of comparability between public pension plans. By allowing each unit to choose its own discount rate and amortization periods, both professional boards have failed to provide a means by which financial analysts, interested taxpayers and elected officials responsible for decision-making can compare a given plan with others. For example, if trustees of a seriously underfunded plan elect to "shoot for the moon" and adopt a speciously aggressive investment policy in an effort to inflate their expected returns and thus suppress the present value of their liabilities, there is no yardstick available now to permit analysts, decision-makers, the media and citizens to evaluate the extent of possible abuse.

For this reason, I encourage the Academy to consider requiring the inclusion of two appendices in actuarial reports presented to public sector boards. One of these could be MV-based, which unquestionably provides a common yardstick by which all plans could be compared. Realizing that such information represents a minority point of view about the nature of the world, and a controversial estimate of real-world liabilities, however, it must be balanced by the presentation of an alternative data set which more realistically reflects the objectives and purposes of public pension plans in general. Thus, the second required appendix should present a parallel set of actuarial estimates using as the discount rate the average rate used by plans of similar size (which the National Association of State Retirement Administrators or some other designated body could readily provide.)

Information from these appendices could be incorporated readily in the notes to financial statements of both the pension plan and the plan sponsor. Establishing an actuarial standard requiring such appendices would thus open the door for the GASB to standardize the *disclosure* of such information in the *notes* to financial statements (rather than the display of such information on the face of the financials).

Before embarking on such a change, both boards would be well advised to confer with users of these reports to verify that such information would actually benefit analysis and decision-making. Furthermore, it will be essential for the Academy, GASB and the affected professional associations to prepare succinct, plain-language guides to using and interpreting such supplemental disclosures.

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