



STATE OF KANSAS

Office of the Attorney General

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Curt T. Schneider.
Attorney General

November 4, 1975

ATTORNEY GENERAL OPINION NO. 75- 413

Mr. John K. Corkhill
Kansas Public Employees Retirement System
400 First National Bank Tower
One Townsite Plaza
Topeka, Kansas 66603

Re: KPERs - Board of Trustees - Powers and Duties

Synopsis: The present methods used by the Board of Trustees to disclose the rate of return on investments and the manner of crediting interest to members' accounts from funds in the retirement benefit accumulation reserve are within the statutory provisions of the Kansas Public Employees Retirement Act.

* * *

Dear Mr. Corkhill:

You have asked this office to review the report of the Legislative Post Auditor regarding the examination of the Kansas Public Employees Retirement System for the Fiscal Year ending June 30, 1974.

Because of the qualified nature of the opinion regarding two items you have asked us to advise you regarding the authority of the Board of Trustees of the retirement system in the matters referred to therein and to examine the statutory provisions governing the Kansas Public Employees Retirement System to ascertain whether the items before mentioned constitute any violation of the laws of the State of Kansas.

The Legislative Post Auditor's report contains a qualified opinion because: (1) the auditor's questioning of a charge against the retirement benefit accumulation reserve and an

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ancillary question regarding the determination of a reasonable rate of interest to be allowed to members' accounts and (2) alleged lack of adequate disclosure of rates of return on the investment portfolio.

Turning first to the question of the disclosure of the rate of return on investments, we find that the Kansas Public Employees Retirement System contains two provisions relating to disclosure or reporting regarding investments. The first is found in K.S.A. 74-4907(2):

"The board shall keep a complete record of all of its proceedings which shall be open at all reasonable hours to inspection. A statement covering the operation of the system for the past fiscal year, including income and disbursements, and of the financial condition of the system at the end of such fiscal year, showing the valuation of its assets and investments and its liabilities, shall be delivered after the end of each fiscal year and prior to October 1 of the next fiscal year to the governor and made readily available to the members and participating employers."

The second is found in K.S.A. 74-4921(1):

"The board shall provide for an examination of the investment program annually. The examination shall include an evaluation of current investment policies and practices and of specific investments of the fund in relation to the objective set forth in subsection (3), the standard set forth in subsection (4) and other criteria as may be appropriate, and recommendations relating to the fund investment policies and practices and to specific investments of the fund as are considered necessary or desirable. The board shall include in its annual report to the governor as provided in K.S.A. 74-4907 a report or a summary thereof covering the investments of the fund."

These citations appear to be the only direction regarding

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the reports which are required to be made public by the retirement system regarding its assets and investments. The first, K.S.A. 74-4907(2) does not appear to require any information regarding the rate of return on investments but it would appear, in our opinion, that this statute can be satisfied by simply listing the value of the investments at the end of the fiscal year.

The second statutory provision, K.S.A. 74-4921(10) contains no specific standards regarding the report of investments and does not provide that the internal examination of the investment program be made public. The statute does provide that the board shall include in its annual report to the governor a report or summary of a report covering the investments of the fund. This clearly suggests that any one of a variety of formats may be selected by the board which would satisfy the requirements of the statute. In reviewing the past practices of the board it appears that since the inception of the system in 1962, at least three general formats have been utilized in reporting the investments of the system to the governor in the annual report.

Prior to fiscal year 1972, it appears that there was no attempt to provide information regarding the rate of return for the overall assets of the system. It is noted at this point that the system has always included in its annual report a detailed listing of investments and the rate of return of the investments. However, there was no percentage of return for the total investment program provided nor was there an attempt to provide a percent of return for various categories i.e. common stocks, bonds, etc. The report was reviewed annually by the state auditor under the provisions of K.S.A. 74-4907 and no criticism of this method of reporting investments is found in a review of past records.

Commencing with fiscal year 1972, a new format of reporting investments was adopted by the board and used in fiscal years 1972, 1973 and 1974. This format included in the narrative of the annual report a statement regarding the rate of return for the investment portfolio. The rate of return was on the basis of indicated income which did not take into account actual income but merely listed the securities held by the system with the anticipated rate of return, making no allowance for any external factors such as losses due to sales, commissions or fees by brokers, managers, etc. This format resulted in the retirement system receiving a certificate of conformance from the Municipal Finance Officers Association for fiscal year 1972, and was inspected by the state auditor for fiscal year 1972 without any criticism and by the legislative post auditor in fiscal year 1973 with no criticism. This format

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remained unchanged for fiscal year 1974 and was the subject of Mr. Brown's qualification of his opinion.

We would also note that in January of 1975, the retirement system changed its format, reporting investment income for the annual report, and the Fourteenth Annual Report covering fiscal year 1975 is on the basis of actual receipts or net income. This means that in addition to investment income sales losses, fees, commissions, etc. are considered in determining the actual net income to the retirement system. Since this change which was initiated before Mr. Brown's audit commenced and is now in effect accomplishes the desired result of the audit report this point now appears to be moot. However, it is the opinion of this office that the Kansas Public Employees Retirement System in its method of disclosure of investment income satisfies any statutory requirements regarding reports required of the system and our opinion applies to all previous annual reports of the retirement system.

The second portion of the Legislative Post Auditor's report which resulted in his qualified opinion was two-fold. First is the question of whether the rate of interest to be credited to member's accounts in fiscal year 1974 was properly determined by the board of trustees.

There is general agreement between all parties that the actual or net earnings from investments after taking into account sale losses, commissions and fees was approximately 1.9% for fiscal year 1974. The board at its April 1974 meeting, on the advice of its actuary, determined that a rate of 4½% should be credited to individual members' accounts.

At first glance the difference in the two rates appears quite large and it would seem that some examination of the trustees' actions to determine its reasonableness would be in order. This is particularly true if the operation of the Kansas Public Employees Retirement System is viewed as a series of one-year segments, each one separate and independent of the other without regard for any long-term policy.

In reviewing the actions of the board since the start of the retirement system in 1962, it is apparent that the interest rate credited to individual members' accounts has never been the same as the actual net earnings of the investments of the system. A review of the records and correspondence of the board reveals that this is not mere chance but is the result of a policy adopted by the board on the advice of the actuary after

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careful consideration. It was determined that to relate the interest credited to members' accounts to actual earnings would cause wide fluctuations from year to year because of investment policies, market conditions and many other factors.

Since the retirement system is a system funded over a long period of time on an actuarial reserve basis the need for stability was felt to be of great importance. The board has consistently credited interest to members' accounts at the same rate as the interest assumption used in calculating the employer rates of contribution and all other calculations made by the actuary regarding the retirement system.

This resulted in the amount credited to the members' accounts being less than actual net earnings for the first ten (10) years of interest crediting under the retirement system. The excess earnings were treated as an "actuarial gain" and were used to reduce the employers' rate of contribution in subsequent years. For actuarial calculations they were considered part of the retirement benefit accumulation reserve.

In examining the record of the retirement system as a whole and the policies of the board regarding the adoption of the assumed rate of interest as the rate to be credited to individual members' accounts it is our opinion that the board of trustees in establishing a rate of interest to be credited to the individual members' accounts at 4½% for fiscal year 1974 was a lawful exercise of the authority granted to the board under the provisions of the Kansas Public Employees Retirement Act.

Having established that 4½% was a reasonable and lawful rate to be credited to the members' accounts for fiscal year 1974, we now turn to the question of whether the crediting of 4½% interest to the members' accounts could be properly made using funds from the undistributed income reserve (nonstatutory) and the retirement benefit accumulation reserve (statutory).

It is the position of the Legislative Post Auditor that unless specific statutory authority is found the actions of the board are prohibited, and infers that the action of the board was contrary to the law. We find no cases regarding K.S.A. 74-4922(b) and our office has issued no opinions regarding this matter. You have informed us that the retirement system has not received a formal legal opinion from any other counsel and you have further informed us that the Legislative Post Auditor's auditing team knew of no formal legal opinion on this point.

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It should be noted that the Kansas Public Employees Retirement System is a unique entity under Kansas law. K.S.A. 74-4903 provides:

"System established; power and duties. There is hereby created the 'Kansas public employees retirement system' which shall be a body corporate and an instrumentality of the state of Kansas. The system shall be vested with powers and duties specified in this act and such other powers as may be necessary or proper to enable it, its officers, employees and agents to carry out fully and effectively the purposes and intent of this act."

In view of the broad grant of expressed and implied powers to the retirement system it has consistently been the position of this office in numerous past opinions in other matters that unless an action is clearly prohibited, the retirement system may exercise broad discretion so long as the action is designed to carry out the express provisions of the retirement act.

It is our opinion that the actions of the board of trustees was, while not specifically authorized, not prohibited and therefore was within their discretion. The reasonableness of the crediting of interest at the assumed rate used for valuation purposes is clear in light of the established, long term philosophy of the board. The benefit of previous actuarial gains had inured to the benefit of the employers.

To argue that the only charges against the retirement benefit accumulation reserve are those which may be made upon the retirement of a member for an amount equal to the excess over the present value of retirement benefits over accumulated contributions is without merit. This would suggest that retired members would not receive the increases in benefits provided by the legislature unless the legislature specifically authorized additional charges against the retirement benefit accumulation reserve. As our court has stated, merely because money is not allocated for benefits rightfully due an individual the state cannot refuse to pay benefits, see *Smyth vs. Adjutant General*, 214 Kan. 715, 522 P2d 372.


Throughout the matter the board conducted itself in a manner designed to provide full knowledge of its actions to the general public. In their June, 1974 board meeting, the proposal to credit interest to members' accounts from funds in the retirement benefit accumulation reserve was presented to the board.

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The board's meeting was open to the public and the memorandum was made a part of the minutes of the board.

A qualified opinion from an auditor carries serious implications. Since the Kansas Public Employees Retirement System consists of approximately 100,000 active public employees in the state of Kansas and approximately 20,000 retired Kansas public employees, and the employer's support is derived from tax dollars, the management of the system is of great concern to all citizens of this state. A report which implies violations of the law and receives the public distribution which a report of this nature is entitled places the individual members of the board of trustees and the officers and employees of the system in the position of appearing to be in violation of the provisions of the retirement act which they are charged to implement. Since the critical issue of the report involved a statutory interpretation, it is unfortunate that a legal opinion was not sought by the Legislative Post Auditor or that he did not give the retirement system clear notice of the seriousness he attached to the fact that no legal opinion had been obtained from this office.

Very truly yours,


CURT T. SCHNEIDER
Attorney General

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