Message from the Board of Directors

Pension reform essential to getting Kentucky's financial house in order

As a leader in Kentucky's financial services sector, KyCPA is constantly monitoring factors that positively or negatively affect our economy, our members and their clients. One of the biggest challenges facing the commonwealth's future is the ongoing debate in Frankfort regarding pension reform. It is a complicated issue that if not properly and quickly addressed, could cause harm to Kentucky's economy – now and for years to come.

Given the gravity of this pressing issue, KyCPA's board of directors has offered its support to Gov. Matt Bevin and state legislators who are committed to finding a solution to a complex financial problem.

When difficult fiscal choices must be made, it is important for our leaders to focus on the facts in order to bring long-term solutions to the table. This is simply about two things: math and reality.

First – the math. A recent report conducted by PFM, a non-partisan consulting group, concluded that the public pension systems face an unfunded liability between $33 and $84 billion. Using investment assumptions for private pension plans in similar shape, the liability could be $64 billion. Kentucky's total annual budget is approximately $10.5 billion. If we do nothing, our next state budget will have to devote an additional $700 million per year to pensions, on top of the $1.5 billion this year.

Under the current defined benefit structure, most public employees can retire after 27 years of service, use sick leave and overtime to enhance pension payments, collect a public pension and paycheck concurrently, and receive a significant health insurance subsidy for life. Many private sector industries abandoned these models years ago because supporting them was often economically detrimental to the survival of companies.

That being stated, KyCPA agrees that no public employee or retiree should be blamed for accepting the benefits that were offered to them when they were hired, and they should be commended for dedicating their careers to public service and playing by the rules.

But here's the reality. Under those rules, due to the perfect storm of unforeseen demographic changes, meager investment returns and underfunding, the result has produced an upside-down pension system. Simply put, more money is owed to current and future retirees than is in the systems. If significant reforms are not undertaken, there will not be enough money to pay benefits later.

Like most complicated problems, there are multiple ways to solve this one – but all of them carry their own unique economic and political challenges. Increasing taxes alone can create an unfriendly business environment, deterring future investment or possibly prompting industry leaders to relocate their businesses elsewhere. Cutting spending, including to vital services - like education, Medicaid and public safety - would be equally devastating, and bankrupting the system would only shortchange retirees. Doubling down on the current system would only further downgrade Kentucky's bond rating, raise borrowing costs and increase future tax liabilities, failing both taxpayers and public employees.

Gov. Bevin and legislative leaders released a plan in late October with the goal of reducing the state's liabilities while honoring the commitment to our public servants. While the plan included a number of proposed changes, two key elements could put the commonwealth on a reasonable path to solve its massive math problem:

- Level dollar amortization – Working much like a 30-year home mortgage, this rigid approach to paying down liabilities, rather than relying on percent of payroll estimates, ensures that the actuarially determined contribution (ADC) is paid currently and not deferred. The systems should continue to use the investment assumptions that were adopted earlier this year to minimize future risk to the state. It also makes sense to phase in additional payments that will be incurred by outside agencies and local governments.
- Benefit structure – Defined contribution plans, which are the predominant source of retirement for private sector employees, provide a predictable funding model that can improve both the long-term fiscal health of the pension plans and fairness for Kentucky taxpayers. Importantly, the level of retirement benefits should compare favorably to those in the private sector. The state should also develop a benchmarking exercise to ensure that total compensation (salary and benefits) for state employees is competitive with the private sector so it can attract and retain a talented workforce.

Of course, these changes must also be coupled with efforts to reduce any remaining discretionary expenditures and selectively improve revenues. KyCPA supports tax reform that increases fairness and simplicity, protects taxpayer rights and makes Kentucky a more competitive place to do business. Taken together, these changes should result in additional revenue to the commonwealth.

CPAs are often called on to work with companies facing financial turmoil, and, unfortunately, we are occasionally the bearer of bad news. Sometimes, the truth hurts. While no plan is perfect, Kentuckians should rally around common-sense pension reform proposals that keep the promises owed to retirees, pay down the unfunded liability, improve the state's bond rating and reduce taxpayer risk.

This is why KyCPA stands ready to work with the governor and legislature to support measures that do just that. The time to act is now. Our profession, state, clients, employers and future generations depend on it.

(From left to right) Incoming AICPA Vice Chairman Bill Reeb, incoming KyCPA President Becky Phillips, KyCPA CEO Darlene Zibart and AICPA President and CEO Barry Melancon at the AICPA 2017 Fall Council.