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Total rate of return (time-weighted) is a useful technique that is widely accepted for comparing investment results. It combines current yield plus changes in current market values for determining a portfolio's investment rate of return.

Total rate of return (time-weighted) for PERS, TRS, and PFC is shown below:

TIME-WEIGHTED TOTAL RATES OF RETURN(%)
AS OF JUNE 30, 1988 and DECEMBER 31, 1988 (a)
(unaudited)

	PERS	TRS	PFC
Year ending 6/30/88	3.79	3.76	5.3
Two years	7.46	7.85	6.5
Three years	13.80	13.37	11.8
Four years	15.02	14.62	(1)
Five years	(2)	(2)	13.1
Year ending 12/31/88	11.65	11.93	8.5
Two years	6.48	6.44	5.9
Three years	10.72	10.20	9.3
Four years	13.72	13.31	(1)
Five years	(2)	(2)	12.9

(a) source: PERS/TRS information obtained from Department of Revenue, Treasury Division internally calculated time-weighted rates of return. PFC information obtained from externally evaluated SEI Large Plan Report. Percentages presented are annualized time-weighted rates of return.

(1) four-year data not available for PFC from SEI external reports.

(2) five-year data not available for PERS/TRS for years ending June 30 and December 31, 1988.

As can be seen, the PERS/TRS Funds time-weighted rate of return generally exceeds that of the PFC. This is probably a reflection of the additional risk the retirement funds assume versus the more conservative approach taken by the PFC in its investments and asset allocation.

Another performance measurement would be reviewing the return of segments of the PERS/TRS and PFC portfolios; for example, reviewing PERS/TRS and PFC domestic equity investments to the S&P 500 or the fixed income investments to the Shearson Lehman Bond Index (SL-BONDS). Such an analysis would show:

PERS/TRS/PFC EQUITY AND FIXED INCOME TIME-WEIGHTED RETURNS
COMPARED TO SPECIFIC MARKET INDICES
ANNUALLY-COMPOUNDED RATES OF RETURN
FOR YEARS ENDING DECEMBER 31, 1988 (a)
(unaudited)

DOMESTIC EQUITIES

	1 year	2 years	3 years	4 years	5 years
PERS	18.21	9.75	12.98	17.38	(1)
TRS	18.21	10.04	12.95	17.27	(1)
PFC	15.50	11.10	13.50	(2)	15.00
S&P 500	16.80	10.90	13.40	17.80	15.30

FIXED INCOME

	1 year	2 years	3 years	4 years	5 years
PERS	8.73	5.14	9.37	12.33	(1)
TRS	9.10	5.01	8.58	11.71	(1)
PFC	7.20	4.30	8.10	(2)	12.10
SL-BONDS	7.60	4.90	8.40	11.50	12.20

(a) source: Dept. of Revenue, Division of Treasury internally calculated time-weighted rates of return; PFC externally evaluated SEI Large Plan Report; and, independent sources of market indices.

(1) five-year data not available for PERS/TRS.

(2) four-year data not available for PFC on SEI external reports.

The above analysis shows that for the most part PERS/TRS and PFC achieved a competitive return on its domestic equity investments compared to the S&P 500 index. PERS/TRS fixed income investments outperformed the Shearson Lehman Bond Index in each of the four years compared above. PFC also achieved a competitive return on its fixed income holdings when compared to the bond index.

Another informative comparison is reviewing the annual (each year standing on its own, unlike the cumulative returns used in the previous comparisons) rate of return and how that return fits into the universe of funds used for comparative purposes.

PERS/TRS/PFC
ANNUAL RATES OF RETURN AT MARKET VALUES
AND PERCENT RANKING IN COMPARATIVE UNIVERSE (a)

	1984		1985		1986		1987		1988	
	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
Equities										
PERS	-15.1	100	28.8	63	37.5	38	17.7	96	-5.4	23
TRS	-15.1	100	28.8	63	37.5	38	18.5	90	-5.2	22
PFC	- 9.6	28	30.6	46	37.2	59	24.8	27	-6.4	55
Fixed Income										
PERS	1.1	55	27.9	65	22.9	3	5.0	59	7.6	51
TRS	0.8	57	28.2	61	23.4	1	4.3	79	8.8	3
PFC	4.4	56	27.2	12	20.5	25	4.3	91	7.0	71

(a) source: PERS/TRS data from SEI report for quarter ending 6/30/88. PFC data from SEI large plan report for period ending 6/30/88.

The rates of return above are based on the market value of the equity and fixed income portfolios and includes unrealized gains. PERS/TRS rankings are based on a comparison with a universe of approximately 30 large state retirement funds. PFC rankings are based on a universe comparison of 63 funds. The "rank" describes (using percentages) how the fund performed in relation to the other funds of the universe. For example, a rank of 100 indicates the fund had the lowest performance and 99% of the universe performed better. Conversely, a rank of 1 indicates the fund performed the best and 99% of the universe achieved lower returns. A rank of 55 indicates the fund performed near the median (50%), and that 45% of the universe performed worse while 54% achieved better returns.

OTHER RATE OF RETURN DATA

While not truly comparable, investment fund returns can be reviewed against other fixed income returns.

PERS/TRS/PFC ANNUAL REALIZED (NOMINAL) RATES OF RETURN COMPARED TO OTHER FIXED RATE RETURNS (a)
(unaudited)

	Realized Rate of Return(%)			Fixed Rates of Return(%)		
YEAR	PERS	TRS	PFC	SBS(1)	DCP(1)	CD(1)
1980	9.54	10.41	11.29	10.40	n/a	12.91
1981	10.73	11.02	16.00	10.75	n/a	15.91
1982	8.52	6.98	15.10	12.35	n/a	12.04
1983	11.09	11.32	12.76	12.55	n/a	8.96
1984	10.66	9.47	10.89	12.00	n/a	10.17
1985	9.96	9.84	11.61	11.80	n/a	7.97
1986	13.16	13.12	14.36	11.87	9.30	6.62
1987	13.98	13.94	13.37	11.54	9.08	6.74
1988	8.20	8.20	9.01	11.00	9.93	7.58

(a) source: Division of Legislative Finance; Department of Administration, Division of Retirement and Benefits.

(1) SBS - State Supplemental Benefit System
DCP - State Deferred Compensation Plan
CD - Certificates of Deposit

n/a - not available

The comparisons above are not an accurate measurement of determining how PERS/TRS or PFC is performing in comparison to other funds or instruments. While it does demonstrate differing returns by different investing funds or instruments, it does not indicate nor provide a basis for comparing how similarly designed funds invested in similar securities are performing. Each of these funds or instruments, with the exception of PERS/TRS, have different objectives and goals and, therefore, have varying investment strategies and policies.

Also, the schedule above presents a different picture than the prior example. Here, annual realized (nominal) rates of return are presented. Realized rates of return do not include changes in market value and, therefore, are not usually used for comparing performance. In this schedule, PFC outperforms PERS/TRS in all but one annual period presented. This compares to the previous time weighted presentation that shows PERS/TRS outperforming PFC in all but one period presented. This exemplifies how, depending on a desired outcome, rate of returns can be used to make a point. Since PERS/TRS are pensions funds, their return

analyses should be based on a long-term view, not just how the funds performed in any one annual period.

Another review of returns can be made between the retirement funds and other market indices. Like the above, the returns are not truly comparable. These market indices reflect returns for certain investments, whereas the PERS/TRS and PFC Funds results reflect a total return on a balanced portfolio of many types of investments. For example, the Standard and Poor's 500 (S&P 500) index reflects returns on equities only; the 91 day Treasury Bill index (T-BILL) reflects short-term fixed income investments; and, the Shearson Lehman bond index (SL-BONDS) reflects returns on bond investments.

PERS/TRS/PFC TIME-WEIGHTED TOTAL RATES OF RETURN
COMPARED TO MARKET INDICES ANNUALLY-COMPOUNDED
RATES OF RETURN(%)
AS OF DECEMBER 31, 1988 (a)
(unaudited)

	1 Year	2 Years	3 Years	4 Years	5 Years
PERS	11.6	6.5	10.7	13.7	(1)
TRS	11.9	6.4	10.2	13.3	(1)
PFC	8.5	5.9	9.3	(2)	12.9
S&P 500	16.8	10.9	13.4	17.8	15.3
T-BILL	6.7	6.0	6.0	6.5	7.1
SL-BONDS	7.6	4.9	8.4	11.5	12.2

(a) source: Department of Revenue, Division of Treasury, and independent sources of market indices. PFC data from 12/31/88 Large Plan Report.

(1) five-year data not available for PERS/TRS.

(2) four-year data not available for PFC on SEI external reports.

The misleading nature of drawing conclusions solely from this analysis must be emphasized. For example, for the three years ending December 31, 1988 the S&P 500 had achieved an annualized return of 13.4%; contrasted to PERS, TRS, and PFC returns of 10.7%, 10.2%, and 9.3% respectively. The S&P 500 is an index that measures only equities traded on the exchanges. The PERS/TRS and PFC portfolios not only contain stocks but also bonds, other fixed income securities, and real estate. Additionally, PERS/TRS holds investments in foreign equities, whereas the S&P 500 reflects only domestic equity.

PERS/TRS and PFC may have achieved a return on its equity portfolio competitive to that of the S&P 500. However, fluctuations in bond, other fixed income, and real estate

investments may have affected the overall total portfolio rate of return. Therein lies the danger of relying solely on a comparison of fund performance to any one market index.

COST OF MANAGING AND INVESTING PERS/TRS AND PFC FUNDS

It has been alleged that the cost of administering the PERS/TRS Funds are "out of control" compared to the PFC. In reviewing the cost of administering the retirement funds versus the Permanent Fund the facts must again be kept in perspective and require closer scrutiny before drawing conclusions, similar to the closer analysis needed when comparing PERS/TRS and PFC rates of return.

The Department of Revenue, Treasury Division is responsible for, among other functions, the investment and management of the State of Alaska general investment fund; AHFC pledged fund; international airports construction fund; international airports revenue fund; state mortgage insurance fund; public employees' retirement trust fund; teachers' retirement trust fund; judicial retirement trust fund; military retirement trust fund; public school trust fund; and the University of Alaska trust fund. Also, the division is responsible for state cash management, debt management, and investment accounting.

By far the largest cost centers in the management of the PERS/TRS Funds are personal services (salaries) and contractual fees.

It has been alleged that it takes between 25-to-27 positions to manage the PERS/TRS Funds as compared to the PFC requiring 16 positions to manage their portfolio.

The 25-to-27 positions referred to above represents the total staffing of the Treasury Division. These positions do many tasks, as discussed above. Not all of those positions have duties related to the PERS/TRS Funds. We examined the job descriptions of employees in the Treasury Division and verified those descriptions with some employees through personal interviews. We also identified salary and benefits costs for each of the Treasury Division employees and for the division in total.

We have calculated that Treasury utilizes a full-time equivalent (FTE) staffing of 11.3 positions to manage, invest, and account for the PERS/TRS Funds in fiscal year 1988 at a cost of $655,273. These positions are responsible for executive management, asset accounting, portfolio management, real estate investments, and cash management as it relates to the PERS/TRS Funds. This compares to the fiscal year 1988 PFC staffing of 16 positions at a cost of $863,000.

Contractual fees comprise the largest cost of managing the PERS/TRS and PFC Funds. These costs consist of payments made for the services of professional money managers, external performance analysis, external auditors, consultants, and custody and safekeeping fees.

PERS/TRS fiscal year 1988 contractual payments amounted to $4,841,564 compared to PFC expenditures of $3,428,000. PERS/TRS incurs expenses that the PFC does not. PERS/TRS, being two separate funds, has increased costs for services such as investment processing, external auditors, and the external performance analysis. The retirement funds also incur additional costs due to PERS/TRS higher asset allocation to equities which, under an active investment strategy, necessitates additional trade costs and because PERS/TRS invests in foreign equities which require higher fees than does a domestic equity. PFC does not invest in the foreign markets, has a smaller asset allocation to domestic equity, and utilizes an index equity portfolio resulting in reduced management fees. As the PFC moves into the foreign markets and reevaluates asset allocation, one would expect to see an increase in their management fees.

The industry evaluates management and funds costs on a "basis point" system. A "basis point" reflects the cost to manage $1,000. We performed a "basis point" cost evaluation of the PERS/TRS and PFC Funds, as follows:

	PERS/TRS	PFC
Personal Services	1.90	.88
Travel	.05	.15
Contractual	14.02	3.48
Other (capital outlay, communications, rent, depreciation)	.08	.67
Total "Basis Point" cost per $1,000	16.05	5.18

As can be seen, the cost of PERS/TRS contractual is approximately four times that of the PFC. This reflects the additional costs PERS/TRS incurs due to its higher allocation to domestic equities, investment in foreign equities, the increased costs for identical services since these are two separate funds, and the economies of scale inherent in a large fund such as the PFC.

We do not feel a simple analysis with an allegation that PERS/TRS costs three times more to manage than the PFC is justified. A closer review shows valid reasons why PERS/TRS Funds are more expensive to manage than the PFC fund.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

A Board of Trustees concept or structure should be established that has broad powers and can exercise an active role in the management and investment oversight of the PERS and TRS Funds.

At present, the PERS and TRS boards (nor any other body) have minimal, if any, investment and management oversight responsibility over the nearly $3.5 billion of retirement fund assets invested and managed by Treasury. What little investment oversight authority the boards may have had was eliminated by amending legislation in 1987/1988.

Currently the PERS and TRS boards are mostly administrative in nature, handling the administrative aspects of the retirement systems. The boards have no authority to direct or establish investment policy or guidance nor do they have the ability to effectively object to a direction the funds may be heading and enforce an alternative.

We believe the State and other governmental employers, fund beneficiaries, and active participants would be better served by a restructuring of the current PERS and TRS boards and the process of reporting to those boards.

We conducted a survey of all states' public employees' and teachers' retirement systems and discovered that Alaska PERS and TRS Funds investment management oversight is severely lacking when compared to other larger, older, more experienced funds.

An overwhelming number of respondents to our survey have an investment oversight function that rests with an independent body apart from the investment activity itself. This oversight authority is vested in authoritative retirement boards, boards of trustees (ranging from 3 to 4 and up to 16 members), investment committees and councils (usually a subcommittee of a board of trustees), or a statewide investment commission or board. We believe a similar structure is warranted for the PERS and TRS Funds.

The PERS and TRS statutes should be rewritten to allow, and the boards should be restructured to accept, a new, stronger investment management oversight responsibility. We recommend that:

1. The current PERS and TRS boards be consolidated into one overall board of trustees. The board of trustees should be structured so that individuals with the necessary and appropriate expertise are appointed, as well as PERS and TRS beneficiaries and active participants. Additionally, Treasury officials and, barring

constitutional prohibitions, members of the legislature should be active participants on the board.

2. Subcommittees of the board of trustees could be established to handle the respective administrative duties of the PERS and TRS Funds.

3. The board of trustees should be vested with the authority to employ outside investment advisors to review investment policies and make recommendations; to establish investment policies; to engage the independent certified public accountants for the funds' audits and have results reported directly to the board; to contract with external performance evaluators who would report directly to the board; and to review Treasury investment and asset allocation decisions.

A Board of Trustees with overlapping and staggering appointments will also provide continuity from one administration to another. Retirement funds such as the PERS and TRS are perpetual in nature. They are considered to exist forever. As such, a continuity in management is required, one that can provide the historical perspective of past actions and effects. The nature of the political environment is quite opposite. Administrations come and go, as do the political appointees that make the decisions that affect the retirement funds. Presently, the commissioner of Revenue, an appointed position, is the fiduciary of the retirement funds. A political appointment of two or four years pales in comparison to the longevity of the retirement funds. A "changing of the guard" every two-to-four years does not provide the needed continuity in fund administration. An independent board of trustees, with oversight authority, would provide the needed oversight and continuity over these funds.

It has been argued that since the PERS and TRS Funds are designated as trusts and the commissioner of Revenue is designated fiduciary of the funds, that the boards cannot and will not accept the fiduciary responsibility of managing the funds.

In our discussions with PERS and TRS board chairpersons we learned that the boards do want to assume more investment oversight responsibility over the funds but at present do not have the statutory ability to do so.

It has also been stated that the boards would not accept the liability associated with acting as a fund fiduciary. According to the Division of Risk Management of the Department of Administration, the PERS and TRS boards are currently covered by the Directors and Officials liability protection policy. This coverage, in the amount of $100 million (with a $5 million self-insured clause), covers any board or

commission that is created by law and that the policy coverage would extend to any actions taken by the boards or commissions that are within its official duties. At present, the commissioner of Revenue, as fiduciary, is similarly covered by this policy. Additionally, the director of Risk Management stated that if the funds incur a loss due to a breach of fiduciary duty, the Directors and Officers liability insurance policy may make funds whole, depending on the circumstances, if the payments are a legal liability. Based on the above, it is our opinion that the insurance coverage presently available to the commissioner of Revenue is likewise available to the current PERS and TRS boards and would be available to a duly created board of trustees acting in the capacity of fund fiduciary.

Therefore, we recommend that the administration and the legislature establish a board of trustees concept or structure to provide investment oversight on the Treasury investment operations, particularly the PERS and TRS Funds. Some members of the board of trustees should have the necessary professional skills. Other members should represent fund beneficiaries, active fund members, the Treasury, and, barring constitutional prohibitions, the legislature. The board of trustees should have the authority to contract for audits, external performance evaluations, and professional advice. Additionally, the board of trustees should review on an ongoing basis Treasury's implementation of investment policy and asset allocations.

Recommendation ~~No.~~ 2

The entire portfolio of the PERS and TRS Funds should be subjected to an external performance review. Also, the external performance reports should be presented directly to the boards and should be in a complete, understandable, and acceptable format according to industry patterns and customs.

Presently, the ~~PERS~~ and TRS performance evaluation analyses conducted by an independent evaluation service ~~do not~~ review the entire retirement funds portfolios; are not in the usual and customary format; do not contain the usual and customary presentations; and do not compare the PERS and TRS Funds with an acceptably large enough universe of other funds.

We found it difficult to glean information on the PERS and TRS Funds operating results from the performance evaluation reports prepared by the external fund performance contractors. To assist us in understanding those performance reports, we contracted with the individual who had analyzed PERS and TRS Fund performance in the past.

Our contractor had similar difficulty in understanding the performance reports as presented. We subsequently discovered that the difficulty in understanding the reports and

determining fund performance lied not with the reader, but with the unconventional format that the PERS and TRS Funds results were presented.

According to representatives of SEI (Treasury's performance reporting contractor) the State's chief investment officer had instructed SEI to prepare the performance reports according to his own design. This format per our contractor causes confusion and difficulty in analyzing fund results. It is interesting that even SEI, the firm who prepared the reports according to Treasury's custom design, finds them difficult to understand. If people knowledgeable in this area find the performance reports difficult to read and analyze, we wonder how members of the PERS and TRS boards and interested beneficiaries and active participants can determine how their funds are performing.

Another area that our contractor found unique was the abbreviated form of the performance reports. The reports do not include a number of standard comparisons, analyses, and graphic presentations. These presentations assist in understanding the fund performance and how they compare to other funds. For example, the performance reports have no presentations of asset growth summaries; total plan rates of return; cumulative rates of return for market cycles (falling markets and rising markets); reward versus risk analysis; equity and bond purchases and sales turnover analysis; equity portfolio profiles (showing capitalization of investees, dividend yields, price/earning ratios, return on net worth, earnings growth rates, market/book ratios); diversification and rate of return by industry sectors; and other graphic and numerical presentations. It is argued that this type of information is of little value in establishing investment policy and asset allocation. However, all these analyses combined assist in formulating an informed judgement as to how the retirement funds are performing by interested parties other than those responsible for investment policy and asset allocation. These analyses, and many others, are used by the Permanent Fund Corporation Board of Trustees to review the performance of the Permanent Fund. These types of analyses are not report cards on a fund, but rather a presentation of how one particular fund is performing compared to other funds competing for a return on investment.

Other areas of the PERS and TRS performance reports identified as lacking are that a total plan analysis is not performed on the entire portfolio and that the universe of funds used for performance comparison is too limited.

The major benefit of an external performance evaluation is the identification of how one particular fund is performing and how it compares to other funds (known as the "fund universe"). To have a thorough evaluation/comparison, the

entire portfolio must be externally evaluated. Presently, the PERS and TRS portfolio does not have an externally generated total plan rate of return analysis because the funds' real estate investments and foreign investments are not taken into consideration. Most respondents to our survey indicate their entire portfolios are externally evaluated. Most of those funds also have investments in equities, fixed income, some foreign investments, real estate, mortgages, leveraged buyouts, and venture capital.

The PERS and TRS Funds are compared to a fund universe consisting of only 28 other funds. This contrasts to the Permanent Fund's evaluation which compares itself to a balanced fund population (where the funds have at least 5% invested in equities and 5% in bonds) of 910 funds and a Large Plan Report of 63 funds. We believe the PERS and TRS Funds comparison is too restrictive and should be enlarged. Comparing fund performance to a larger fund universe would provide a better indication of how the PERS and TRS Retirement Funds are performing compared to other funds.

We recommend that the entire PERS and TRS Funds be externally evaluated thereby generating a total plan rate of return; that the evaluations be performed and reported in the standard informative formats with all appropriate graphic and numerical presentations; that these reports should be presented directly to the boards; and that the PERS and TRS Funds be compared against an acceptable fund universe.

The boards and/or Treasury should provide as much information as possible to the beneficiaries, active members, executive and Legislative branches, and the public that is clear and direct. By doing so, it would enhance public accountability.

Recommendation No. 3

The Department of Revenue, Treasury Division (Treasury) should follow generally accepted accounting principles in its accounting of investments for the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) Funds.

Treasury does not account for PERS and TRS foreign equity investments in accordance with industry generally accepted accounting principles.

The term "generally accepted accounting principles" (GAAP) as used in reporting results of operations on the financial statements refers to a body of theory and practice developed by the accounting profession in association with industry and other organizations that may be impacted by the adoption of standards which include not only accounting principles and practices but also the methods of applying them. GAAP

is a technical accounting term encompassing a common set of accounting concepts, standards, and procedures necessary in order to render financial statements comparable between enterprises and between accounting periods. Without adherence to GAAP, users of financial statements would have no uniform standard for judging the presentation of financial position, results of operations, and changes in financial position in those financial statements.

A user of financial statements expects those statements to present fairly, clearly, and completely the economic facts of the existence and operation of an enterprise on a consistent and comparable basis. A departure from GAAP results in financial statements that may not meet the user's criteria and will generally result in a qualified auditor's opinion disclosing the departure and what effect that departure has on the financial statements. Treasury realizes the importance of an unqualified audit opinion. Treasury, in Appendix J of its General Investment Policies, requires an applicant for commercial real estate loans to submit audited financial statements that contain unqualified audit opinions. The presentation of PERS and TRS financial statements by Treasury are departures from GAAP.

Treasury does not properly account for and report investment transactions occurring in the PERS and TRS foreign investment portfolio. Treasury did properly account for and report on its foreign portfolio activities through fiscal year 1987; however, in fiscal year 1988, a departure from GAAP was made, with which we do not agree is appropriate or justifiable.

An important element of a financial statement, and a framework of modern accounting, is the presentation of the historical cost of assets, including investments.

Treasury forwards funds to its London-based foreign managers. These managers then invest in foreign equities. The amount of the funds transferred to the foreign managers is recorded as the cost of the PERS and TRS investment in foreign equities. When the foreign equities are subsequently sold by the foreign managers, the amount received from the sale, which may include a gain on the sale, is usually reinvested in foreign equities. Contrary to GAAP, the reinvestment of proceeds from the sale of the equities are not recorded in the accounting records and the cost basis of the foreign portfolio is not adjusted to properly reflect the new cost basis of the retirement funds' investments. This accounting treatment was implemented over the initial written objections of the state comptroller. The sale, gain, and reinvestment of funds should be accrued and recorded in the accounting records at the date of the transaction in accordance with generally accepted accounting principles.

This irregular accounting treatment causes a material understatement of the cost basis that PERS and TRS has invested in foreign equity holdings. The understated cost as presented in the PERS and TRS financial statements is misleading to the average reader who is not aware of the non-GAAP accounting treatment accorded these transactions by Treasury.

In their June 30, 1988 balance sheet, Treasury shows the cost and market value of PERS and TRS foreign portfolio as follows:

	Cost	Market Value
PERS	$77,847,000	$138,421,000
TRS	51,756,000	91,246,000

At first glance, a reader of the financial statements would think that PERS and TRS had generated a $60,574,000 and $39,490,000 (respectively) market gain.

However, had GAAP been applied to the accounting of the foreign portfolio, cost and market value would have been presented as follows:

	Cost	Market Value
PERS	$134,626,000	$138,421,000
TRS	88,711,000	91,246,000

Under GAAP, foreign portfolio market gains for the PERS and TRS Funds would have been $3,795,000 and $2,535,000, respectively. As reflected in the financial statements, PERS and TRS market gains are overstated by approximately 1,500 percent.

The Treasury Division, chief investment officer has stated that this accounting treatment is necessary because of "investment accounting principles," "fiduciary law," and "the IRS code." None of those references, even if they do address this issue, override GAAP and Alaska state law in these circumstances.

Alaska Statute 37.05.150 states, in part, "The accounting system must be in accordance with accepted principles of governmental (fund) accounting . . . ." Generally accepted governmental accounting principles are embodied in the Governmental Accounting, Auditing, and Financial Reporting publication prepared by the Government Finance Officers Association. In this handbook of governmental accounting, the jurisdiction of the Governmental Accounting Standards Board (GASB) is defined as "The GASB will establish standards for activities and transactions of state and local governmental entities . . . ." The handbook further defines

the hierarchy of GAAP for financial statements issued by state and local governmental units. This hierarchy is:

1. Pronouncements of the GASB are to be followed for accounting and reporting by state and local governmental units.

2. In the absence of a GASB pronouncement regarding accounting treatment, pronouncements of the Financial Accounting Standards Board (FASB) are to be followed.

3. Pronouncements of bodies composed of expert accountants that follow a due process procedure. This category includes audit and accounting guides and statements of position issued by the American Institute of Certified Public Accountants.

4. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry or the knowledgeable application of pronouncements to specific circumstances.

Since GASB is silent regarding the treatment of foreign investments, pronouncements of the FASB must be followed. In this case, generally accepted accounting principles established by the FASB, and its predecessor the Accounting Principles Board, should be followed by the Treasury Division.

We recommend that Treasury account for and report on the PERS and TRS Funds, including its foreign portfolio activity, in accordance with generally accepted accounting principles.

STEVE COWPER, GOVERNOR

DEPARTMENT OF REVENUE

TREASURY DIVISION

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August 22, 1989

Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit
P. O. Box W
Juneau, Alaska 99811-3300

Dear Mr. Welker:

I have reviewed the Division of Legislative Audit's preliminary report entitled "A Special Report on the Department of Revenue Treasury Division Public Employees' and Teachers' Retirement Funds".

At your request, I offer the following comments:

1. With regard to the discussion of realized returns on page eleven, I would like to point out:

   a. The Financial Analysts Federation has endorsed the enclosed "Performance Presentation Standards". These standards are the first and only such standards in the industry for guidance on how to calculate and report investment performance. Section V.B. specifies that the use of total return, including income and capital appreciation, is mandatory in the presentation of investment performance data. Realized rates-of-return, as pointed out in your report, do not include unrealized capital appreciation.

   b. Realized returns are relevant for a fund which has net cash flow requirements during the period being measured; in the case of retirement funds, a net cash flow from investments is not estimated by the funds' actuary to be required generally before FY 2005. See the enclosed "PERS and TRS Financial Projections", February 21, 1989, Mercer Meidinger Hansen. Sensitivity analyses in the projections indicate there may be some chance that a small portion of TRS investment earnings (no more than one-tenth) will be needed as cash to cover benefit payments after FY 1991;

   c. The timing of actual realization of unrealized gains is at a fund manager's discretion and may be affected by a fund's cash flow requirements. Thus, realized returns may reflect not only investment policy, as shaped by cash flow requirements, and a portion of investment returns, but also asset liquidation decisions prompted by cash flow needs.

2. On page 12, as your report points out, there are difficulties in comparing total fund returns to market indices for individual classes of investments. The most appropriate comparison would be to an average of the relevant indices weighted by the asset allocations of a fund. This would be similar to the approach prescribed by the Financial Analysts Federation in section V.I.6.a. of their "Performance Presentation Standards" (enclosed) for comparing results of balanced accounts managed by investment advisors.

3. I am in basic agreement with Recommendation No. 1. There are obviously many issues to be considered in trying to develop the best possible structure for governance of PERS and TRS investment management. The Department of Revenue would be happy to work with Legislative members or bodies in developing legislation to reform the structure.

   To address these same concerns, the Department has developed a proposal to create an independent trust company. The proposed structure would provide for the investment management of other State retirement and endowment trust funds, as well as PERS and TRS. It also would greatly improve State cash management procedures by allowing direct access to certain Federal Reserve System services, rather than through an intermediary custodian bank.

   The Department's proposal has been endorsed by resolutions of the PERS and TRS boards and has been reviewed by the State's fiduciary counsel, Willkie, Farr & Gallagher.

   There is one issue addressed in your report to which I should respond. The discussion of liability for fiduciary acts on page 17 does not take account of AS 37.10.071(d) and (e) which make fiduciaries personally liable and extends state indemnification of their liability only insofar as their actions are prudent, even though insurance would cover all fiduciary acts whether prudent or not. These statutory provisions were adopted to assure the most careful adherence by fiduciaries to the dictates of prudence. I do not concur with the suggestion that board members be allowed to avail themselves of the State's insurance coverage of liability for fiduciary acts when those acts fail to meet the statutory standard of professional prudence contained in AS 37.10.071(c).

4. I am in agreement with portions of Recommendation No. 2. My specific comments are:

   a. I agree that performance reports should cover the total fund and include cumulative rates-of-return, a reward versus risk analysis, and relevant graphics. The Department has awarded a new contract for outside performance measurement services that includes such information. The first reports under the new contract will be available following the end of the first quarter of fiscal year 1990.

b. I do not feel that other detailed analyses, mostly of individual manager portfolios, recommended in your report are useful either in establishing investment policy and asset allocations or evaluating manager or fund performance. Performance measurement data needs to be confined to comparative information that focuses on the bottom line -- rates-of-return -- and the critical policy variables -- asset allocation, bond maturity, and bond quality -- that contribute to it. The worst thing to do, if trying to ensure accountability, is to inundate fiduciaries with so much data that they can't see the forest for the trees or have time to adequately review the more critical information.

c. If there are particular problems with the format of the report, the audit should identify them and I would be happy to consider changes. As part of the new performance measurement contract the Department will obtain any specific suggestions the contractor has for revising the format. However, the Department will not relieve the contractor of the obligation of supplying the reports in the format specified by the Department if revisions to the format decrease the report's intelligibility or appear to be for the convenience of the contractor. There is no industry standard for most of the presentations in these reports, the only possible exception being certain basic information set out in Tables I and II of the enclosed "Performance Presentation Standards" which no firm has yet adopted. Various performance measurement firms have various formats. Each has its own "standard" format and is reluctant to provide custom reports as required by the Department due to the extra time and expense involved.

d. I agree that comparing performance to a larger universe is desirable, provided that, as your report stresses in several other places, the comparisons are meaningful. Under the circumstances it is not clear that the contractor can provide any larger universe that would be meaningful. The contractor, SEI Corporation, had the largest universes specified by the Department of the two firms responding to the RFP for these services. As part of the new contract, the Department will obtain the advice of the contractor on whether the universes can be meaningfully expanded.

The PERS and TRS funds are compared to two universes consisting of pension funds over $500 million -- one State pension funds, the other corporate. These universes were established to provide more meaningful comparisons than a universe including many small pension plans. Small plans for the most part operate under more restrictive constraints, have less diversification into the various asset classes represented in PERS and TRS, and are less likely to have professional management. As pointed out on page 5 of your report, similarity in objectives, constraints, opportunities, and resources are critical to achieving valid comparisons.

Not unexpectedly, larger plans generally seem to have superior investment returns as indicated by the enclosed "EXHIBIT 7" prepared by SEI. The segregation of corporate and state plans is useful because their significant difference in asset allocations to equities, which results in significantly higher returns for corporate plans, focuses attention on this critical policy variable.

5. The Department will comply with Recommendation 3, beginning with its audited financial statements for fiscal year 1989. However, I would like to make three comments:

   a. The statements on page 19 and 20 that Treasury does not account for foreign equity investments properly or in accordance with generally accepted accounting principles are overly broad. Treasury does account for foreign equity investments in accordance with generally accepted accounting principles, with the exception of its treatment of historical cost and the point of realization of foreign gains or losses. Treasury's statement of market value and total investment income for foreign equities is in accordance with generally accepted accounting principles. As stated by Ernst & Whinney in their annual audit of Treasury investments, the "differences would have no effect on total investment income".

   b. The departure from GAAP and its effects are fully disclosed in Treasury's financial statements. Your report should acknowledge this. The statement on page 20 that "A departure from GAAP...will generally result in a qualified auditor's opinion disclosing the departure and what effect that departure has on the financial statements." may leave the reader with the impression that Treasury did not make this disclosure.

   c. The departure from GAAP was based on consideration of a number of issues. These issues were fully discussed by Treasury staff and its independent auditors. The decision was personally reviewed by me. The issues are summarized in the enclosed memo of November 1, 1988. The report's failure to address the issues contained in the memo, which was provided to Legislative Audit, and its failure to acknowledge the Department's review of the issue may leave the reader with the impression that the departure was made arbitrarily or capriciously. In fact, the issues involved are very "close" as to what is the best accounting treatment. This is reflected in the fact that FASB-52, which is the accounting principle at issue here, was highly controversial and was adopted by the Financial Accounting Standards Board only by a 4-3 vote.

Sincerely yours,

Hugh Malone
Commissioner

HM/MBB/ph

encls.

PERFORMANCE PRESENTATION STANDARDS

Presented by the Committee for
Performance Presentation Standards

Claude Rosenberg, Jr., Chairman
R.H. Jeffrey
Robert Kirby
Dean LeBaron
John J.F. Sherrerd

Endorsed by the
Financial Analysts Federation

January 12, 1989

I. The FAF has endorsed the following standards for investment management performance presentation. Up to now, this all-important subject has been given insufficient attention; as a result, investment advisers (despite registration with the SEC) have been left to follow their own standards, which have been varied, uneven, and, in some instances, outright irresponsible and dishonest. If the investing public is to be treated fairly, and if the investment management industry is to represent the highest ethical and moral standards, a fair and understandable policy should be followed. The standards recommended earlier have been endorsed by the FAF Board of Directors after consideration of comments from its membership (which includes investment advisers, brokers, consultants, academicians and other interested parties).

II. The overall philosophy underlying these standards is the need for full disclosure of investment performance data to clients and client prospects. Certain statistics and presentation data have been delineated as requirements; but the main theme is that investment managers may present any reasonable statistics provided that their derivation, and particularly any exclusions therefrom, are highlighted and made abundantly clear.

III. Parties affected by these standards.

These standards are directed to "investment managers," which obviously includes all registered investment advisers, but the standards also apply to other organizations and individuals, such as:

A. Stock brokers acting as "portfolio managers" for clients, particularly those who charge separate (from normal commissions) fees for their management services.

B. Mutual funds, where certain regulatory presentation practices can be deceptive (but which exist under different jurisdictions).

C. Consultants, where it is recommended that similar standards be set by a separate FAF Committee.

IV. While clients and client prospects are encouraged to make extensive qualitative judgments of investment managers, these FAF guidelines concentrate on the quantitative—on a complete, accurate and fair presentation of investment performance data.

V. Performance Calculation.

A. Time-weighted performance calculation is the mandatory methodology, since it represents the only practical method for comparing manager results over time.

B. Total return, including income and capital appreciation, is also mandatory.

V. Performance Calculation (Continued)

C. To allow for the most efficient judgment of manager efficiency and client investment returns, results should be presented before fees so long as the manager's fee schedule is included with performance presentation.

D. Managers and new clients should agree in advance on the starting date for performance calculation.

1. This starting date should be part of the Management Agreement and calculations should conform to such agreed-to date.

2. Since the precise starting date for managed funds is not always definite (due to legal problems, delay of receipt of funds, etc.), it is recommended that a specified period (i.e., 30 days after funds have become available for investment) be set as inception for performance calculation. Again, the time period will vary from manager to manager, dependent on manager style or client preference; but agreement in advance between manager and new client eliminates potential confusion and sets a consistent standard.

E. Computational Standards.

1. Portfolios should be valued at least quarterly. Monthly valuation (and linking) is the preferred frequency where practical.

2. A time-weighted return formula which minimizes the effect of contributions and withdrawals must be utilized. Daily accounting for contributions and withdrawals is the preferred method.

3. When a contribution (or withdrawal) is significant (e.g., over 10%) in relation to the latest calculation of market value, a portfolio is best revalued on the date of the contribution (or withdrawal) in order to reduce possible distortion.

4. Investment income should be included on a full accrual basis (as opposed to cash basis).

F. Performance results for any one asset class (such as equities) should include cash equivalents and any other securities (e.g., convertible securities in an equity portfolio) held by the manager in place of that asset.

V. Performance Calculation, Paragraph F. (Continued)

1. If managers present performance results for any particular asset class excluding cash or other securities used by the manager in place of the asset class, performance with cash and the other securities should likewise be presented along with a statement that results so presented conform to FAF standards.

G. Compound annualized performance returns should be presented for all periods covered in presentation.

H. Exclusions from account performance calculations and presentation should be clearly stated.

1. Complete information on inclusions and exclusions of data should be presented, as per attached Tables I and II.

a. Managers should provide the percentages of their inclusions and exclusions to prospects. Thus, if the presented data constitutes 85% of the asset class (e.g., equities) managed, with 15% excluded, this should be so stated. If the presented data constitutes 50% of a particular type of investing within that asset class (e.g., small-to-medium capitalization equities), this should also be stated.

b. Examples of such exclusions might include:

Special category investments, such as assets not carrying full discretionary power within a manager's business in which other accounts are normally discretionary.

Client assets not being charged a fee, within a manager's business which is normally fee-based. As indicated throughout Section VIII., the performance of all fee-based accounts should be accounted for in manager measurement and presentation.

I. Balanced accounts.

1. Balanced accounts, with both equity and fixed income assets, should be separated into two distinct equity and fixed income categories. Each such category should be assigned its own cash balances so that the performance of each

V. Performance Calculation, Paragraph I. Number 1. (Continued)

investment class will include returns specifically reflecting the use of cash equivalents and other substitutions. While managers may be able to supply sufficient risk and volatility information on each investment class to allow clients to make a reasonable judgment of results as if cash had been included, the information content from the separation of balanced portfolios into distinct asset "pots" (each with its own cash equivalent or substitute holdings) is too valuable to leave to manager choice.

2. Assuming that the balanced account manager's assignment from the client is to periodically change the asset mix, managers altering the ratios between equities and fixed income should make bookkeeping transfers of cash from one category to the other. Accounting for such transfers should, of course, be based on the specific cash transfer dates.

3. Performance results from balanced accounts should, therefore, include the following:

a. Equities, including cash or substitute securities designated for potential investment in equities.

b. Fixed income, including cash or substitute securities designated for potential investment in fixed income.

c. Total account.

4. 3.a. and 3.b. results should be compared against their respective, comparable indexes, as if they were separate equity and fixed income accounts.

5. While separating the parts of a balanced account as recommended provides valuable insights into the capabilities of managers in each distinct asset class, the most significant performance criterion is still the combined, total account results.

6. Results for the total account are best compared against equity and fixed income proportions that reflect client objectives/guidelines; these proportions should be agreed to in advance by client and manager.

a. Comparative performance should then be calculated by apportioning the returns from each of the indexes chosen to represent each asset class to the agreed-to

V. Performance Calculation, Paragraph I. Number 6. (Continued)

percentage bogey for that asset class. Assume, therefore, that client and manager have agreed to a balanced account risk posture of 60% equities and 40% fixed income. The comparative indexes used for equities (assume the S&P 500) should be weighted at 60%, while the appropriate fixed-income indexes (assume the Shearson/Lehman Corporate/ Govt. Index) should be weighted at 40%, producing a number against which the total account performance return should be compared.

J. In addition to actual results, performance for accounts utilizing leverage should be calculated and presented as if they had been made for all-cash (no leverage).

VI. Indexes used for performance comparisons.

A. Managers should explain in advance any indexes used for performance comparisons to clients and prospects. These indexes should parallel the risk or investment styles the client account is expected to track.

B. Comparisons with specific measures (e.g., real returns adjusted for inflation, riskless returns from T-Bills, etc.) may be used so long as FAF standards on other factors, as presented herein, are followed.

VII. Treatment of convertible securities.

A. Convertible securities should normally be included in equity performance, unless manager and client agree in advance to their inclusion in fixed income. If convertibles are subsequently shifted from equity segments to fixed income, or vice versa, clients should be notified at the time of such shifting.

VIII. Formation and presentation of composite performance results by managers.

A. All managers should construct and present accurate composites of investment performance. Rules for such composites include:

1. Managers should compile and present such results for as long a period of time as accurate accounting can be accomplished, no less than 10 years if possible and up to 20 if practical.

2. Management organizations in business for less than 20 years should include results from the very first full calendar year since their inception.

VIII. Formation and presentation of composite performance results by managers, Paragraph A. (Continued)

3. Each and every year of such results should be presented to prospective clients, unless specific requests are for different periods.

4. Results presented to client prospects should be shown both for individual years and cumulative periods, as indicated in attached Table I.

5. All client accounts should be included for whatever period such accounts were under management; portions of periods under management (i.e., managers choosing inclusion of portions) is prohibited.

6. Clients' accounts no longer under management should be included in composite(s). So-called "survivor" performance results are to be avoided.

7. Changes in a manager firm's organization should not lead to an altering of composite results. Results achieved by an organization are the organization's reponsibility; changes in personnel do not constitute a justifiable reason to alter composite performance results.

8. Managers are encouraged to construct separate composites where valid reasons exist for doing so. A differentiation between taxable versus nontaxable accounts; fully discretionary versus not-fully-discretionary; and other categories which entail varied investment styles, controls, or risks constitute valid reasons for separate composites. As indicated in Paragraph 9.d. below, however, managers should list all of their composites, with performance figures and other pertinent information on each, whenever performance results are presented. Any and all exclusions from any presentation of performance results should be clearly stated.

9. Composite performance calculation and presentation should be weighted by account sizes. A median of unweighted results may also be presented, but this should be accompanied by results weighted by account size, along with the statement that the latter is the recommended procedure as set by the FAF.

VIII. Formation and presentation of composite performance results by managers, Paragraph A, Number 9. (Continued)

Managers should also clearly delineate the following:

a. The number of client relationships included in each (and all) composite(s);

b. The total size of the composite for the beginning (January 1) and end of each year;

c. The weighted average size of accounts constituting the composite.

d. As indicated above, information on all excluded assets from any composite presentation should be presented.

10. Fixed income and equity portions of balanced accounts should be included in their respective equity and fixed income composites, provided they conform to Section V., Paragraph I. above on balanced account calculations.

11. Balanced account composites should include only those accounts where the manager has discretion over changes from one asset to another. If the client has set balanced limits from which the manager should not deviate, the segregated assets (with their respective cash positions) should be included only with their like asset composite. (Example: Client gives Manager $6 million for bond management and $4 million for stock management, with no changes in mix to be made by Manager. The $6 million should be added to the Manager's bond composite and $4 million added to Manager's stock composite—nothing to be included in Manager's balanced account composite.)

12. Since performance results will be reported to clients along with either actual or average fee information (See Section V., Paragraph C.), composite figures should likewise contain sufficient information to enable clients and prospects to compute performance on both a pre- and post-fee basis.

13. Managers should indicate typical indexes against which any and all composites are normally judged by respective clients. Thus, a manager's equity composite which includes accounts with both large and small capitalization equities of comparable weighted size

VIII. Formation and presentation of composite performance results by managers, Paragraph A. Number 13. (Continued)

to the S&P 500 should be compared against the S&P 500, while a small-to-medium capitalization stock composite should be compared against NASDAQ, Russell 3000, etc. An account with, for example, 50% of its total in small-to-medium capitalization stocks and 50% in large capitalization stocks should be compared against similar-weighted separate indexes, rather than against either one of the two.

14. Composites should follow the same treatment of returns with and without cash as indicated in Section V., Paragraph F.

15. Presentation of risk measurements such as Alpha, Beta and Standard deviation for individual account returns within any composite is encouraged.

16. Other pertinent information for use in performance analysis should be added to composite presentations. For example, managers are encouraged to include (for each period) average market capitalization of stocks held, average quality and duration of bond holdings, etc.

B. Table II provides a sample recommended format for composite performance presentation to client prospects and consultants. Table II should accompany the specific performance results as presented in Table I.

IX. Verification of composites.

A. Audited composite and other performance figures are encouraged. At the very least, managers presenting performance data should make a positive written statement that full disclosure of assets included and excluded has been made and that calculations conform to FAF standards. Any deviations from these FAF standards should be specifically stated.

B. The principles of these FAF performance presentation standards should apply to all individuals and organizations serving investment management functions. Consultants are likewise encouraged to adopt similar standards and principles in reporting performance data.

X. Table III is a checklist for managers and clients—to assure proper conformance to the standards presented above.

TABLE I

XYZ Capital Management: Actual and Annualized Equity Performance Versus S&P 500

Category of Accounts: Tax-Exempt Client Portfolios

Annualized Percentage Returns for N Years Through Year X

ear	Standard Deviation[9]	Actual Return (%)	2 Yrs.	3 Yrs.	4 Yrs.	5 Yrs.	6 Yrs.	7 Yrs.	8 Yrs.	9 Yrs.	10 Yrs.	11 Yrs.	12 Yrs.	13 Yrs.	14 Yrs.	15 Yrs.	16 Yrs.	17 Yrs.
'87	1.2%	10.72	14.30	19.80	15.51	16.07	17.47	14.28	17.58	18.19	17.39	15.06	15.08	15.44	12.75	10.78	13.25	12.25
		5.24	11.75	18.05	15.00	16.47	17.30	13.82	16.00	16.29	15.28	13.03	13.90	15.55	11.88	9.88	10.42	10.65
'86	3.0%	17.99	24.62	17.15	17.44	18.87	14.89	18.59	19.16	18.15	15.51	15.48	15.84	12.91	10.79	11.84	12.35	
		18.67	25.04	18.45	19.46	19.87	15.33	17.62	17.75	16.45	13.84	14.73	16.45	12.41	10.21	10.78	11.00	
'85	1.9%	31.61	16.73	17.26	19.09	14.28	18.70	19.32	18.17	15.23	15.24	15.64	12.50	10.25	11.41	11.99		
		31.75	18.34	19.72	20.18	14.66	17.45	17.61	16.18	13.32	14.34	16.25	11.90	9.59	10.24	10.50		
'84	3.0%	3.54	10.68	15.18	10.31	16.27	17.40	16.36	13.34	13.55	14.17	10.91	8.64	9.99	10.70			
		6.29	14.13	16.55	10.75	14.78	15.42	14.11	11.21	12.55	14.31	10.25	7.92	8.73	9.12			
'83	2.8%	18.32	21.49	12.67	19.69	20.38	18.66	14.80	14.86	15.40	11.67	9.11	10.55	11.27				
		22.55	22.05	12.28	17.01	17.34	15.48	11.92	13.36	15.79	10.66	8.07	8.94	9.34				
'82	6.8%	24.75	9.94	20.15	20.90	18.72	14.24	14.27	15.04	10.95	8.23	9.87	10.70					
		21.54	7.47	15.21	16.07	14.11	10.25	12.10	14.98	9.41	6.72	7.78	8.31					
'81	3.5%	- 3.10	17.92	19.65	17.26	12.24	12.74	13.72	9.34	6.54	8.48	9.51						
		- 4.97	12.18	14.29	12.32	8.12	10.61	14.06	7.98	5.19	6.49	7.18						
'80	4.4%	43.50	32.96	24.95	16.44	16.20	16.80	11.24	7.81	9.85	10.86							
		32.42	25.35	18.75	11.66	14.02	17.60	9.96	6.53	7.85	8.48							
'79	3.1%	23.19	16.60	8.61	10.23	12.08	6.63	3.49	6.24	7.72								
		18.65	12.46	5.29	9.83	14.83	6.61	3.27	5.12	6.10								
'78	2.4%	10.37	1.98	6.22	9.47	3.59	0.53	4.02	5.93									
		6.59	- 0.53	7.04	13.90	4.36	0.91	3.31	4.63									
'77	2.4%	- 5.77	4.21	9.17	1.96	-1.33	2.99	5.31										
		- 7.17	7.26	16.44	3.80	-0.19	2.78	4.35										
'76	2.5%	15.24	17.51	-4.67	- 0.19	4.84	7.29											
		23.94	30.42	7.74	1.64	4.89	6.40											
75	2.9%	19.82	- 0.24	- 4.85	2.39	5.76												
		37.23	0.46	- 4.87	0.60	3.21												
74	3.0%	-16.94	-15.21	-2.83	2.51													
		-26.46	-20.80	- 9.28	- 3.89													
73	2.7%	-13.45	5.10	9.96														
		-14.69	0.75	5.08														
72	3.2%	27.62	23.94															
		19.00	16.62															
71	3.1%	20.37																
		14.30																

XYZ CAPITAL MANAGEMENT COMPOSITE OF ALL CLIENTS (BOLD)

S&P 500 INDEX

Characteristic Line[10]

Beta = .89

Annual Alpha = +2.6%

R^2 = 90.3%

This performance presentation of XYZ Capital Management conforms to the standards set by the Financial Analysts Federation (standards dated ,19).
In addition to the information presented herein, such standards include:

1) Returns from all cash reserves and equivalents and/or bonds used by the manager in place of equities are included in performance calculations.
2) Figures include accounts under our management from their respective inception dates, including those clients no longer with the firm.
3) No selective periods of performance have been utilized. Results from all accounts have been continuous from their inception to the present or to the cessation of the client relationship with the firm.
4) The composite calculation has been appropriately weighted for the size of each account.
5) Results are presented before management and related custodial fees. XYZ Capital fee schedule is attached.
6) Convertible securities have been included in these equity results.
7) No alterations of composites as presented here have occurred due to changes in personnel or other reasons at any time.
8) The[illegible]s have been audited as of 3/3/88 (statement attached).
9) Ap[illegible]ately two-thirds of all portfolios had returns equal to the composite "actual return" +/- one standard dev[illegible]
10) The [illegible]cteristic Line is a regression of manager composite performance versus S&P 500 over the full performa[illegible]iod (17 years).

TABLE II

XYZ Capital Management Equity Account Summary
Category: Tax-Exempt Client Portfolios

Year	Composite Assets ($000) Beg. Yr.	Yr. End	% Equiv. Equity Assets [9]	% XYZ's Total Equities Managed	# of Clients	Average Account Size ($000)	Median Account Size ($000))
1987	5,506,550	5,881,173	100%	96%	65	80,580	40,813
1986	4,456,012	5,506,550	100	90	62	77,557	28,726
1985	3,463,639	4,464,521	100	92	57	65,655	38,975
1984	3,253,627	3,439,790	100	93	55	52,118	25,926
1983	2,486,902	3,253,627	100	91	56	48,562	20,608
1982	1,840,726	2,480,485	100	89	52	42,042	20,933
1981	1,749,541	1,840,726	100	90	51	31,737	19,262
1980	1,133,875	1,749,541	100	91	45	35,705	26,285
1979	850,993	1,133,875	100	92	42	23,622	12,882
1978	645,561	850,993	100	90	41	18,500	11,268
1977	677,257	645,561	100	85	42	14,345	7,510
1976	540,736	677,257	100	87	44	13,822	7,588
1975	343,959	540,736	100	88	43	11,265	6,058
1974	317,764	343,959	100	90	40	8,000	4,801
1973	179,007	317,764	100	98	33	8,362	6,795
1972	78,626	179,007	100	98	21	7,459	1,997
1971	28,205	78,626	100	98	14	4,914	927

This composite presentation of XYZ Capital Management conforms to the standards set by the Financial Analysts Federation (standards dated ,19).
In addition to the information presented herein, such standards include:

1) All cash reserves and equivalents and/or bonds used by the manager in place of equities are included in composite presentations.
2) Figures include accounts under our management from their respective inception dates, including those clients no longer with the firm.
3) No selective periods for presentation have been utilized. Data from all accounts have been continuous from their inception to the present or to the cessation of the client relationship with the firm.
4) The composite calculation has been appropriately weighted for the size of each account.
5) Results are presented before management and related custodial fees. The average fee charged for each period appears in the presentation.
6) Convertible securities have been included in these equity composites.
7) No alterations of composites as presented here have occurred due to changes in personnel or other reasons at any time.
8) The data have been audited as of 3/3/88 (statement attached)

Table III

FAF Investment Manager Performance Presentation Standards Checklist

Following is a checklist for investment managers, their clients and prospects, and for consultants—to assure proper conformance to the Financial Analyst Federation "Performance Presentation Standards of January 12, 1989."

I. Performance calculations.

☐ *A. Performance results have been calculated on a time-weighted basis.*

☐ *B. Returns combine income and current market valuations (thus, presenting so-called total returns).*

☐ *C. Manager fee levels have been disclosed along with performance records so that after-fee results can be measured.*

☐ *D. Performance results of broad security classes such as equities or fixed income have been calculated with cash or substitute securities included. If cash has been excluded in the calculations, returns with cash have also been presented, along with the statement that FAF standards consider performance with cash as most representative of managerial results and most representative for comparisons with other managers.*

☐ *E. All exclusions from performance calculations and presentation by manager have been disclosed.*

☐ *F. The method of linking interim performance results (daily, monthly, quarterly) has been explained. (FAF standard is for monthly linking.)*

☐ *G. Balanced account performance.*

☐ *1. Manager has assigned cash and substitute securities to the specific asset category to which it belongs, thereby allowing a clear division of the performance record for each asset managed.*

☐ *2. If cash and substitute securities are not assigned to a separate asset, comparisons should not be made against other managers' performance figures for assets where cash returns have been included.*

☐ *3. Manager has supplied information on risk, volatility and/or other measures which allow for reasonable performance evaluation.*

☐ *H. Convertible securities have been consistently assigned to either equities or fixed income, and have not been shifted without notice being given to clients concurrent or prior to such shift.*

☐ *J. Managers have provided the indexes against which their submitted performance records have normally been compared.*

☐ *K. If managers' assets have been leveraged, and performance returns calculated on this basis, results on an all-cash (unleveraged) basis have been provided.*

II. Investment manager composites of performance results.

☐ *A. Manager has submitted a composite of all accounts managed for each period submitted; the composite includes results from any and all accounts no longer clients of the firm.*

☐ *B. If a manager has separate composites, all have been submitted. A prospect should be able to account for the performance of all of the manager's assets managed.*

☐ *C. Composites are not "survivors only" compilations; they include results of all accounts ever managed, including those of clients no longer with the firm.*

☐ *D. All performance results contained in the composite include cash and substitutable securities, as per I.D. above.*

☐ *E. All individual years and cumulative performance results for all periods have been supplied. The composite covers every year of the past 10 years, along with longer term results if the manager has been in business this long.*

☐ *F. Compound annualized returns have also been provided for all periods.*

☐ *G. A clear statement from manager indicates that no selectivity of account results for partial periods exists.*

☐ *H. Composite or other data have not been altered for reasons of personnel changes or any other reasons.*

☐ *I. Composite results are:*

☐ *1. Weighted for the dollars under management (the FAF standard).*

☐ *2. Presented on a median (unweighted) basis (recommended only as additional information, not as the primary disclosure).*

☐ *J. Data includes:*

☐ *1. Number of client relationships in the composite.*

☐ *2. Assets under management for each period.*

☐ *3. Average and median size of accounts in the composite have been presented.*

☐ *4. Assets included in the composite presented are shown as a percentage of the manager's total accounts which share very comparable investment guidelines and risks; and as a percentage of the manager's total funds under management. All clients and related performance data for this asset type can be accounted for.*

☐ *K. Fee information is clear, so that pre- and post-fee results can be determined.*

☐ *L. Composites include typical indexes against which manager has been judged.*

☐ *M. Alpha, Beta, Standard Deviation of Returns and other measures of risk, quality, variability, etc. within the composite for each year have been indicated.*

☐ *N. Other information provided:*

_____

_____

III. Verification of performance data.

☐ *A. Results have been audited by reputable auditors.*

☐ *B. Results are not audited, but include statements that calculations and presentation of individual accounts and composites conform to FAF performance presentation standards.*

☐ *C. Neither of A. or B. above.*

PERS AND TRS FINANCIAL PROJECTIONS

FEBRUARY 21, 1989

WILLIAM M.
MERCER MEIDINGER HANSEN
INCORPORATED

PERS AND TRS FINANCIAL PROJECTIONS

FEBRUARY 21, 1989

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WILLIAM M.
MERCER MEIDINGER HANSEN
INCORPORATED

February 21, 1989

Mr. James R. Wilson
Statement Investment Officer
State of Alaska
Department of Revenue
Treasury Division
P.O. Box SB
Juneau, AK 99811

Re: PERS and TRS Financial Projections

Dear Jim:

Enclosed you will find our actuarial projections of financial results for both PERS and TRS for the next 15 years. As always, care should be exercised in using these long-term financial projections.

For both PERS and TRS, we provide projections based upon four different sets of actuarial assumptions. The first table for each retirement system is based upon the current actuarial assumption which assumes an investment return rate of 9% per year and salary increases of 6.5% for the first five years of employment and 5.5% for later years of employment. Then, for each retirement system, we provide three additional projections. The first one assumes a 1% higher investment return with no change in the salary increase assumption; the second one assumes no change in the investment assumption but a 1% lower rate of salary increase assumption; the last one, which provides the most optimistic scenario, bases its projections upon a 1% higher rate of investment return with the 1% lower salary increase assumption.

For both PERS and TRS, there were actuarial losses during FY88. These losses led to lower funding ratios and increases in employer contribution rates. There were three major deviations from actuarial assumptions during the year. Of greatest importance was the substantial increase in the monthly premiums for retiree medical insurance. The monthly rate is currently $250 per month per benefit recipient. After a few years of declining retiree medical insurance premiums, the rates have once again shot skyward.

There were actuarial losses from less-than-anticipated investment return rates during the year. Even with the three-year smoothing approach used on valuation assets, the dramatic drop in equity values on October 19, 1987 still had an affect on the total investment performance for the year. Based upon valuation assets, both PERS and TRS had investment performance rates during the year which were about 3% less than our 9% interest assumption.

A Marsh & McLennan Company
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Partially dampening the affects of these two actuarial losses were the less-than-anticipated salary increases during the year. Both PERS and TRS experienced actuarial gains in this area.

The projections this year, when compared with last year's projections, all show slightly lower funding ratios and slightly higher employer contributions at all durations. More than anything else, this reflects the impact of the higher cost of post-retirement medical insurance. Also, this year's projections include additional employer contributions for the Retirement Incentive Program.

Summary

Despite actuarial gains from less-than-anticipated salary increases during FY88, actuarial losses from a dramatic rise in retiree medical insurance premiums, as well as less-than-anticipated investment performance, led to a decrease in funding ratios for both PERS and TRS. Nevertheless, both plans are still extremely well funded and are projected to remain so in the ensuring years.

Sincerely,

Bob

Robert F. Richardson, ASA, EA, MAAA
Principal

RFR:js

State of Alaska TRS
Financial Projections ('000 omitted)

Investment Return 9.00% (nominal) Salary Increases 6.04% (6.5/5.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Total Assets	Accrued Liability	Surpluss (Deficit)	----------Flow Amounts During Following 12 Months---------- Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	1,331,905	1,348,677	(16,772)	413,558	59,004	37,085	96,089	78,902	17,987	136,075	1,475,967
1989	1,475,967	1,482,362	(6,395)	438,535	59,519	39,723	99,242	83,548	15,694	139,521	1,631,182
1990	1,631,182	1,628,457	2,725	465,022	57,897	38,667	96,564	80,385	8,179	153,781	1,793,142
1991	1,793,142	1,784,918	8,224	493,110	57,715	37,723	95,438	93,429	2,009	168,735	1,963,887
1992	1,963,887	1,952,792	11,094	522,893	60,979	39,897	100,876	98,692	2,183	184,802	2,150,872
1993	2,150,872	2,136,494	14,378	554,476	64,418	42,196	106,614	104,192	2,421	202,398	2,355,692
1994	2,355,692	2,337,571	18,121	587,967	68,040	44,627	112,667	109,945	2,722	221,675	2,580,089
1995	2,580,089	2,557,711	22,378	623,480	71,855	47,197	119,052	114,812	4,240	242,848	2,827,177
1996	2,827,177	2,799,971	27,206	661,138	75,870	49,916	125,786	125,013	773	265,931	3,093,880
1997	3,093,880	3,061,206	32,675	701,071	80,095	52,791	132,886	129,756	3,130	291,120	3,388,130
1998	3,388,130	3,349,291	38,839	743,415	84,542	55,830	140,372	138,434	1,938	318,741	3,708,810
1999	3,708,810	3,663,024	45,786	788,318	89,218	59,124	148 342	146,321	2,021	348,904	4,059,735
2000	4,059,735	4,006,144	53,591	835,932	94,136	62.695	156,831	151,330	5,501	382,066	4,447,302
2001	4,447,302	4,384,959	62,343	886,422	99,307	66,482	165,789	155,844	9,944	418,716	4,875,962
2002	4,875,962	4,803,804	72,158	939,962	104,740	70,497	175,237	165,218	10,019	459,035	5,345,017
2003	5,345,017	5,261,848	83,169	996,736	110,445	74,755	185,200	172,835	12,366	503,255	5,860,638

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	----------As % of Salaries---------- Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	--As % of Assets-- Net Contribs	Investment Earnings
1988	98.8	14.27%	9.16%	23.43%	19.08%	1.28%	9.00%
1989	99.6	13.57%	9.06%	22.63%	19.05%	1.01%	9.00%
1990	100.2	12.45%	8.32%	20.77%	19.01%	0.48%	9.00%
1991	100.5	11.70%	7.65%	19.35%	18.95%	0.11%	9.00%
1992	100.6	11.66%	7.63%	19.29%	18.87%	0.11%	9.00%
1993	100.7	11.62%	7.61%	19.23%	18.79%	0.11%	9.00%
1994	100.8	11.57%	7.59%	19.16%	18.70%	0.11%	9.00%
1995	100.9	11.52%	7.57%	19.09%	18.41%	0.16%	9.00%
1996	101.0	11.48%	7.55%	19.03%	18.91%	0.03%	9.00%
1997	101.1	11.42%	7.53%	18.95%	18.51%	0.10%	9.00%
1998	101.2	11.37%	7.51%	18.88%	18.62%	0.05%	9.00%
1999	101.2	11.32%	7.50%	18.82%	18.56%	0.05%	9.00%
2000	101.3	11.26%	7.50%	18.76%	18.10%	0.13%	9.00%
2001	101.4	11.20%	7.50%	18.70%	17.58%	0.21%	9.00%
2002	101.5	11.14%	7.50%	18.64%	17.58%	0.20%	9.00%
2003	101.6	11.08%	7.50%	18.58%	17.34%	0.22%	9.00%

Table 2

State of Alaska TRS
Financial Projections ('000 omitted)

Investment Return 10.00% (nominal) Salary Increases 6.04% (6.5/5.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Total Assets	Accrued Liability	Surplus* (Deficit)	----------Flow Amounts During Following 12 Months---------- Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	1,331,905	1,348,677	(16,772)	413,556	59,004	37,885	96,889	78,902	17,987	140,749	1,490,641
1989	1,490,641	1,482,362	8,279	438,535	57,237	39,723	96,960	83,548	13,413	157,188	1,661,242
1990	1,661,242	1,628,457	32,785	465,022	55,090	38,667	93,757	88,385	5,372	174,699	1,841,313
1991	1,841,313	1,784,918	56,394	493,110	53,216	37,723	90,939	93,429	(2,490)	193,213	2,032,036
1992	2,032,036	1,952,792	79,244	522,893	54,614	39,897	94,511	98,692	(4,181)	213,155	2,241,009
1993	2,241,009	2,136,494	104,515	554,476	56,000	42,196	98,195	104,192	(5,997)	235,006	2,470,018
1994	2,470,018	2,337,571	132,448	587,967	57,363	44,627	101,989	109,945	(7,956)	258,954	2,721,016
1995	2,721,016	2,557,711	163,306	623,480	58,692	47,197	105,890	114,812	(8,922)	285,261	2,997,355
1996	2,997,355	2,799,771	197,384	661,138	59,976	49,916	109,892	125,013	(15,122)	313,966	3,296,199
1997	3,296,199	3,061,206	234,994	701,071	61,199	52,791	113,990	129,756	(15,766)	345,313	3,625,746
1998	3,625,746	3,349,291	276,455	743,415	62,349	55,830	118,180	138,434	(20,254)	379,691	3,985,182
1999	3,985,182	3,663,024	322,159	788,318	63,406	59,124	122,530	146,321	(23,791)	417,255	4,378,646
2000	4,378,646	4,006,144	372,501	835,932	64,351	62,695	127,046	151,330	(24,284)	458,544	4,812,905
2001	4,812,905	4,384,959	427,946	886,422	65,161	66,482	131,643	155,844	(24,202)	504,145	5,292,848
2002	5,292,848	4,803,804	489,044	939,962	65,804	70,497	136,302	165,218	(28,917)	554,303	5,818,235
2003	5,818,235	5,261,848	556,386	996,736	66,248	74,755	141,003	172,835	(31,831)	609,323	6,395,726

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	----------As % of Salaries---------- Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	--As % of Assets-- Net Contribs	Investment Earnings
1988	98.8	14.27%	9.16%	23.43%	19.08%	1.28%	10.00%
1989	100.6	13.05%	9.06%	22.11%	19.05%	0.85%	10.00%
1990	102.0	11.85%	8.32%	20.16%	19.01%	0.31%	10.00%
1991	103.2	10.79%	7.65%	18.44%	18.95%	-0.13%	10.00%
1992	104.1	10.44%	7.63%	18.07%	18.87%	-0.20%	10.00%
1993	104.9	10.10%	7.61%	17.71%	18.79%	-0.26%	10.00%
1994	105.7	9.76%	7.59%	17.35%	18.70%	-0.31%	10.00%
1995	106.4	9.41%	7.57%	16.98%	18.41%	-0.31%	10.00%
1996	107.0	9.07%	7.55%	16.62%	18.91%	-0.48%	10.00%
1997	107.7	8.73%	7.53%	16.26%	18.51%	-0.46%	10.00%
1998	108.3	8.39%	7.51%	15.90%	18.62%	-0.53%	10.00%
1999	108.8	8.04%	7.50%	15.54%	18.56%	-0.57%	10.00%
2000	109.3	7.70%	7.50%	15.20%	18.10%	-0.53%	10.00%
2001	109.8	7.35%	7.50%	14.85%	17.58%	-0.48%	10.00%
2002	110.2	7.00%	7.50%	14.50%	17.58%	-0.52%	10.00%
2003	110.6	6.65%	7.50%	14.15%	17.34%	-0.52%	10.00%

Table 3

State of Alaska TRS
Financial Projections ('000 omitted)

Investment Return 9.00% (nominal) Salary Increases 5.04% (5.5/4.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Total Assets	Accrued Liability	Surplus* (Deficit)	Flow Amounts During Following 12 Months Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	1,331,905	1,348,677	(16,772)	409,656	58,541	37,584	96,126	78,590	17,536	126,055	1,475,495
1989	1,475,495	1,476,121	(626)	430,303	57,181	39,090	96,272	82,889	13,383	139,373	1,628,251
1990	1,628,251	1,614,564	13,687	451,990	55,328	37,668	92,995	87,343	5,653	153,391	1,787,295
1991	1,787,295	1,761,762	25,532	474,770	53,923	36,320	90,243	91,961	(1,718)	168,018	1,953,594
1992	1,953,594	1,918,539	35,056	498,699	55,872	38,051	93,922	96,757	(2,834)	183,608	2,134,368
1993	2,134,368	2,089,059	45,309	523,833	57,895	39,864	97,759	101,741	(3,982)	200,558	2,330,944
1994	2,330,944	2,274,591	56,353	550,234	59,995	41,763	101,757	106,927	(5,169)	218,993	2,544,767
1995	2,544,767	2,476,514	68,252	577,966	62,172	43,752	105,924	111,171	(5,247)	239,099	2,778,619
1996	2,778,619	2,697,541	81,078	607,096	64,429	45,836	110,265	120,690	(10,425)	260,860	3,029,054
1997	3,029,054	2,934,142	94,912	637,693	66,766	48,018	114,784	124,686	(9,901)	284,437	3,303,589
1998	3,303,589	3,193,767	109,822	669,833	69,185	50,304	119,490	132,547	(13,057)	310,115	3,600,647
1999	3,600,647	3,474,741	125,906	703,592	71,687	52,769	124,456	139,543	(15,087)	337,962	3,923,522
2000	3,923,522	3,780,270	143,252	739,053	74,272	55,429	129,701	143,580	(13,879)	368,383	4,278,026
2001	4,278,026	4,116,064	161,962	776,302	76,943	58,223	135,165	147,035	(11,869)	401,814	4,667,971
2002	4,667,971	4,485,809	182,162	815,427	79,696	61,157	140,853	155,255	(14,402)	438,375	5,091,944
2003	5,091,944	4,887,949	203,995	856,525	82,531	64,239	146,771	161,618	(14,847)	478,229	5,555,326

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	As % of Salaries Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	As % of Assets Net Contribs	Investment Earnings
1988	98.8	14.29%	9.17%	23.46%	19.18%	1.25%	9.00%
1989	100.0	13.29%	9.08%	22.37%	19.26%	0.86%	9.00%
1990	100.8	12.24%	8.33%	20.57%	19.32%	0.33%	9.00%
1991	101.4	11.36%	7.65%	19.01%	19.37%	-0.09%	9.00%
1992	101.8	11.20%	7.63%	18.83%	19.40%	-0.14%	9.00%
1993	102.2	11.05%	7.61%	18.66%	19.42%	-0.18%	9.00%
1994	102.5	10.90%	7.59%	18.49%	19.43%	-0.21%	9.00%
1995	102.8	10.76%	7.57%	18.33%	19.23%	-0.20%	9.00%
1996	103.0	10.61%	7.55%	18.16%	19.88%	-0.36%	9.00%
1997	103.2	10.47%	7.53%	18.00%	19.55%	-0.31%	9.00%
1998	103.4	10.33%	7.51%	17.84%	19.79%	-0.38%	9.00%
1999	103.6	10.19%	7.50%	17.69%	19.83%	-0.40%	9.00%
2000	103.8	10.05%	7.50%	17.55%	19.43%	-0.34%	9.00%
2001	103.9	9.91%	7.50%	17.41%	18.94%	-0.27%	9.00%
2002	104.1	9.77%	7.50%	17.27%	19.04%	-0.30%	9.00%
2003	104.2	9.64%	7.50%	17.14%	18.87%	-0.28%	9.00%

Table 4

State of Alaska TRS
Financial Projections ('000 omitted)

Investment Return 10.00% (nominal) Salary Increases 5.04% (5.5/4.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Total Assets	Accrued Liability	Surplus* (Deficit)	Flow Amounts During Following 12 Months Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	1,331,905	1,348,677	(16,772)	409,656	58,541	37,584	96,126	78,590	17,536	140,727	1,490,167
1989	1,490,167	1,476,121	14,046	430,303	55,722	39,090	94,812	82,889	11,923	157,064	1,659,155
1990	1,659,155	1,614,564	44,590	451,990	52,441	37,668	90,109	87,343	2,766	174,350	1,836,270
1991	1,836,270	1,761,762	74,508	474,770	49,349	36,320	85,669	91,961	(6,293)	192,494	2,022,472
1992	2,022,472	1,918,539	103,933	498,699	47,439	38,051	87,489	96,757	(9,267)	211,896	2,225,101
1993	2,225,101	2,089,059	136,042	523,833	49,421	39,864	89,284	101,741	(12,456)	233,013	2,445,657
1994	2,445,657	2,274,591	171,066	550,234	49,281	41,763	91,044	106,927	(15,883)	256,000	2,685,773
1995	2,685,773	2,476,514	209,259	577,966	49,003	43,752	92,755	111,171	(18,417)	281,085	2,948,442
1996	2,948,442	2,697,541	250,901	607,096	48,568	45,836	94,404	120,690	(26,286)	308,272	3,230,428
1997	3,230,428	2,934,142	296,286	637,693	47,958	48,018	95,976	124,686	(28,709)	337,760	3,539,479
1998	3,539,479	3,193,767	345,711	669,833	47,154	50,304	97,458	132,547	(35,089)	369,891	3,874,281
1999	3,874,281	3,474,741	399,540	703,592	46,130	52,769	98,900	139,543	(40,643)	404,767	4,238,405
2000	4,238,405	3,780,270	458,135	739,053	44,861	55,429	100,292	143,580	(43,288)	442,868	4,637,985
2001	4,637,985	4,116,064	521,921	776,302	43,324	58,223	101,546	147,035	(45,488)	484,714	5,077,211
2002	5,077,211	4,485,809	591,402	815,427	41,475	61,157	102,632	155,255	(52,624)	530,476	5,555,063
2003	5,555,063	4,887,949	667,114	856,525	39,277	64,239	103,517	161,618	(58,101)	580,377	6,077,339

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	As % of Salaries: Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	As % of Assets: Net Contribs	Investment Earnings
1988	98.8	14.29%	9.17%	23.46%	19.18%	1.25%	10.00%
1989	101.0	12.95%	9.08%	22.03%	19.26%	0.76%	10.00%
1990	102.8	11.60%	8.33%	19.94%	19.32%	0.16%	10.00%
1991	104.2	10.39%	7.65%	18.04%	19.37%	-0.33%	10.00%
1992	105.4	9.91%	7.63%	17.54%	19.40%	-0.44%	10.00%
1993	106.5	9.43%	7.61%	17.04%	19.42%	-0.53%	10.00%
1994	107.5	8.96%	7.59%	16.55%	19.43%	-0.62%	10.00%
1995	108.4	8.48%	7.57%	16.05%	19.23%	-0.66%	10.00%
1996	109.3	8.00%	7.55%	15.55%	19.08%	-0.85%	10.00%
1997	110.1	7.52%	7.53%	15.05%	19.55%	-0.85%	10.00%
1998	110.8	7.04%	7.51%	14.55%	19.79%	-0.95%	10.00%
1999	111.5	6.56%	7.50%	14.06%	19.83%	-1.00%	10.00%
2000	112.1	6.07%	7.50%	13.57%	19.43%	-0.98%	10.00%
2001	112.7	5.58%	7.50%	13.08%	18.94%	-0.94%	10.00%
2002	113.2	5.09%	7.50%	12.59%	19.04%	-0.99%	10.00%
2003	113.6	4.59%	7.50%	12.09%	18.87%	-1.00%	10.00%

Table 5

State of Alaska PERS
Financial Projections ('000 omitted)

Investment Return 9.00% (nominal) Salary Increases 6.04% (6.5/5.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Assets	Accrued Liability	Surplus* (Deficit)	Flow Amounts During Following 12 Months: Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	2,088,428	2,246,583	(158,155)	945,136	128,539	64,553	193,092	97,859	95,233	200,702	2,384,364
1989	2,384,364	2,511,963	(127,599)	1,002,222	126,601	68,452	195,053	106,870	88,183	228,218	2,700,764
1990	2,700,764	2,801,804	(101,039)	1,062,756	123,924	72,586	196,510	116,504	80,006	257,607	3,038,378
1991	3,038,378	3,118,259	(79,881)	1,126,946	122,858	76,970	199,829	125,883	73,946	289,087	3,401,411
1992	3,401,411	3,464,631	(63,221)	1,195,014	125,211	81,619	206,831	135,955	70,875	323,092	3,795,378
1993	3,795,378	3,843,567	(48,189)	1,267,193	128,328	86,549	214,877	148,046	66,832	359,963	4,222,172
1994	4,222,172	4,256,607	(34,435)	1,343,731	132,148	91,777	223,925	160,809	63,116	399,936	4,685,224
1995	4,685,224	4,706,881	(21,658)	1,424,893	136,626	97,320	233,946	175,544	58,402	443,273	5,186,899
1996	5,186,899	5,196,490	(9,591)	1,510,956	141,724	103,198	244,922	191,787	53,135	490,219	5,730,253
1997	5,730,253	5,728,256	1,997	1,602,218	147,698	109,431	257,130	209,342	47,788	541,081	6,319,122
1998	6,319,122	6,305,512	13,610	1,698,992	155,546	116,041	271,587	228,844	42,743	596,237	6,958,102
1999	6,958,102	6,931,281	26,820	1,801,611	163,784	123,050	286,834	247,363	39,471	656,186	7,653,758
2000	7,653,758	7,611,981	41,776	1,910,428	172,431	130,482	302,913	269,379	33,534	721,345	8,408,636
2001	8,408,636	8,349,986	58,650	2,025,818	181,505	138,363	319,869	293,243	26,625	792,030	9,227,292
2002	9,227,292	9,149,673	77,619	2,148,178	191,027	146,721	337,748	318,446	19,302	868,695	10,115,290
2003	10,115,290	10,016,415	98,874	2,277,928	201,018	155,582	356,601	344,013	12,587	951,909	11,079,787

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	As % of Salaries: Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	As % of Assets: Net Contribs	Investment Earnings
1988	93.0	13.60%	6.83%	20.43%	10.35%	4.27%	9.00%
1989	94.9	12.63%	6.83%	19.46%	10.66%	3.48%	9.00%
1990	96.4	11.66%	6.83%	18.49%	10.96%	2.80%	9.00%
1991	97.4	10.90%	6.83%	17.73%	11.17%	2.30%	9.00%
1992	98.2	10.48%	6.83%	17.31%	11.38%	1.97%	9.00%
1993	98.7	10.13%	6.83%	16.96%	11.68%	1.67%	9.00%
1994	99.2	9.83%	6.83%	16.66%	11.97%	1.42%	9.00%
1995	99.5	9.59%	6.83%	16.42%	12.32%	1.19%	9.00%
1996	99.8	9.38%	6.83%	16.21%	12.69%	0.98%	9.00%
1997	100.0	9.22%	6.83%	16.05%	13.07%	0.79%	9.00%
1998	100.2	9.16%	6.83%	15.99%	13.47%	0.65%	9.00%
1999	100.4	9.09%	6.83%	15.92%	13.73%	0.54%	9.00%
2000	100.5	9.03%	6.83%	15.86%	14.10%	0.42%	9.00%
2001	100.7	8.96%	6.83%	15.79%	14.48%	0.30%	9.00%
2002	100.8	8.89%	6.83%	15.72%	14.82%	0.20%	9.00%

Table 6

State of Alaska PERS

Financial Projections ('000 omitted)

Investment Return 10.00% (nominal) Salary Increases 6.04% (6.5/5.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Assets	Accrued Liability	Surplus* (Deficit)	Flow Amounts During Following 12 Months Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	2,088,428	2,246,583	(158,155)	945,136	128,539	64,553	193,092	97,859	95,233	224,047	2,407,708
1989	2,407,708	2,511,963	(104,255)	1,002,222	121,095	68,452	189,547	106,870	82,677	256,943	2,747,328
1990	2,747,328	2,801,804	(54,475)	1,062,756	112,941	72,586	185,527	116,504	69,024	291,921	3,108,273
1991	3,108,273	3,118,259	(9,987)	1,126,946	106,373	76,970	183,343	125,883	57,460	329,242	3,494,974
1992	3,494,974	3,464,631	30,343	1,195,014	107,466	81,619	189,085	135,955	53,130	369,629	3,917,733
1993	3,917,733	3,843,567	74,166	1,267,193	110,035	86,549	196,584	148,046	48,539	413,789	4,380,060
1994	4,380,060	4,256,607	123,453	1,343,731	112,496	91,777	204,273	160,809	43,464	462,080	4,885,604
1995	4,885,604	4,706,881	178,722	1,424,893	114,826	97,320	212,146	175,544	36,602	514,818	5,437,024
1996	5,437,024	5,196,490	240,533	1,510,956	116,996	103,198	220,195	191,787	28,408	572,308	6,037,739
1997	6,037,739	5,728,256	309,483	1,602,218	118,980	109,431	228,411	209,342	19,070	634,916	6,691,725
1998	6,691,725	6,305,512	386,213	1,698,992	120,746	116,041	236,787	228,844	7,943	703,028	7,402,696
1999	7,402,696	6,931,281	471,415	1,801,611	122,260	123,050	245,310	247,363	(2,053)	777,180	8,177,824
2000	8,177,824	7,611,981	565,842	1,910,428	123,485	130,482	253,967	269,379	(15,412)	857,901	9,020,312
2001	9,020,312	8,349,986	670,326	2,025,818	124,377	138,363	262,740	293,243	(30,503)	945,608	9,935,417
2002	9,935,417	9,149,673	785,743	2,148,178	124,891	146,721	271,611	318,446	(46,834)	1,040,877	10,929,459
2003	10,929,459	10,016,415	913,044	2,277,928	124,977	155,582	280,560	344,013	(63,454)	1,144,421	12,010,426

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	As % of Salaries Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	As % of Assets Net Contribs	Investment Earnings
1988	93.0	13.60%	6.83%	20.43%	10.35%	4.25%	10.00%
1989	95.8	12.08%	6.83%	18.91%	10.66%	3.22%	10.00%
1990	98.1	10.63%	6.83%	17.46%	10.96%	2.36%	10.00%
1991	99.7	9.44%	6.83%	16.27%	11.17%	1.76%	10.00%
1992	100.9	8.99%	6.83%	15.82%	11.38%	1.44%	10.00%
1993	101.9	8.68%	6.83%	15.51%	11.68%	1.17%	10.00%
1994	102.9	8.37%	6.83%	15.20%	11.97%	0.94%	10.00%
1995	103.8	8.06%	6.83%	14.89%	12.32%	0.71%	10.00%
1996	104.6	7.74%	6.83%	14.57%	12.67%	0.50%	10.00%
1997	105.4	7.43%	6.83%	14.26%	13.07%	0.30%	10.00%
1998	106.1	7.11%	6.83%	13.94%	13.47%	0.11%	10.00%
1999	106.8	6.79%	6.83%	13.62%	13.73%	-0.03%	10.00%
2000	107.4	6.46%	6.83%	13.29%	14.10%	-0.18%	10.00%
2001	108.0	6.14%	6.83%	12.97%	14.48%	-0.32%	10.00%
2002	108.6	5.81%	6.83%	12.64%	14.82%	-0.45%	10.00%

Table 7

State of Alaska PERS
Financial Projections ('000 omitted)

Investment Return 9.00% (nominal) Salary Increases 5.04% (5.5/4.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Assets	Accrued Liability	Surplus* (Deficit)	Flow Amounts During Following 12 Months— Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	2,088,428	2,246,583	(158,155)	936,223	127,717	63,944	191,661	97,502	94,159	200,654	2,383,240
1989	2,383,240	2,497,668	(114,428)	983,408	121,758	67,167	188,925	106,061	82,864	227,873	2,693,977
1990	2,693,977	2,770,007	(76,030)	1,032,972	115,276	70,552	185,828	115,134	70,694	256,550	3,021,221
1991	3,021,221	3,065,357	(44,136)	1,085,034	110,559	74,108	184,666	123,829	60,837	286,884	3,368,942
1992	3,368,942	3,386,586	(17,645)	1,139,719	109,358	77,843	187,201	133,080	54,121	319,284	3,742,347
1993	3,742,347	3,735,867	6,480	1,197,161	109,893	81,766	191,659	144,194	47,465	354,104	4,143,915
1994	4,143,915	4,114,220	29,696	1,257,498	113,294	85,887	199,181	155,808	43,373	391,687	4,578,975
1995	4,578,975	4,524,205	54,770	1,320,876	116,802	90,216	207,017	169,199	37,818	432,354	5,049,148
1996	5,049,148	4,967,303	81,845	1,387,448	120,417	94,763	215,180	183,882	31,298	476,281	5,556,726
1997	5,556,726	5,445,658	111,069	1,457,376	124,142	99,539	223,681	199,637	24,044	523,692	6,104,462
1998	6,104,462	5,961,862	142,600	1,530,827	127,977	104,356	232,332	217,073	15,460	574,820	6,694,743
1999	6,694,743	6,518,135	176,608	1,607,981	131,922	109,825	241,747	233,228	8,519	630,024	7,333,285
2000	7,333,285	7,120,015	213,270	1,689,023	135,978	115,360	251,338	252,553	(1,214)	689,641	8,021,712
2001	8,021,712	7,768,923	252,789	1,774,150	140,144	121,174	261,319	273,361	(12,043)	753,900	8,763,570
2002	8,763,570	8,468,197	295,372	1,863,567	144,420	127,282	271,702	295,108	(23,406)	823,160	9,563,325
2003	9,563,325	9,222,083	341,242	1,957,491	148,806	133,697	282,502	316,776	(34,274)	897,888	10,426,939

* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	As % of Salaries— Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	As % of Assets— Net Contribs	Investment Earnings
1988	93.0	13.64%	6.83%	20.47%	10.41%	4.22%	9.00%
1989	95.4	12.38%	6.83%	19.21%	10.79%	3.27%	9.00%
1990	97.3	11.16%	6.83%	17.99%	11.15%	2.48%	9.00%
1991	98.6	10.19%	6.83%	17.02%	11.41%	1.91%	9.00%
1992	99.5	9.60%	6.83%	16.43%	11.68%	1.53%	9.00%
1993	100.2	9.18%	6.83%	16.01%	12.04%	1.21%	9.00%
1994	100.7	9.01%	6.83%	15.84%	12.39%	1.00%	9.00%
1995	101.2	8.84%	6.83%	15.67%	12.81%	0.79%	9.00%
1996	101.6	8.68%	6.83%	15.51%	13.25%	0.59%	9.00%
1997	102.0	8.52%	6.83%	15.35%	13.70%	0.41%	9.00%
1998	102.4	8.36%	6.83%	15.19%	14.18%	0.24%	9.00%
1999	102.7	8.20%	6.83%	15.03%	14.50%	0.12%	9.00%
2000	103.0	8.05%	6.83%	14.88%	14.95%	-0.02%	9.00%
2001	103.3	7.90%	6.83%	14.73%	15.41%	-0.14%	9.00%
2002	103.5	7.75%	6.83%	14.58%	15.84%	-0.26%	9.00%

Table 8
State of Alaska PERS
Financial Projections ('000 omitted)

Investment Return 10.00% (nominal) Salary Increases 5.04% (5.5/4.5 assumed)

As of June 30	--Valuation Amounts on July 1-- Assets	Accrued Liability	Surplus* (Deficit)	Flow Amounts During Following 12 Months Total Salaries	Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	Net Contribs	Investment Earnings	Ending Asset Valuation
1988	2,088,428	2,246,583	(158,155)	936,223	127,717	63,944	191,661	97,502	94,159	223,993	2,406,579
1989	2,406,579	2,497,668	(91,089)	983,408	116,253	67,167	183,420	106,061	77,359	256,559	2,740,497
1990	2,740,497	2,770,007	(29,509)	1,032,972	104,304	70,552	174,856	115,134	59,722	290,738	3,090,957
1991	3,090,957	3,065,357	25,601	1,085,034	97,758	74,108	171,865	123,829	48,036	326,952	3,465,946
1992	3,465,946	3,386,586	79,360	1,139,719	97,784	77,843	175,627	133,080	42,547	366,052	3,874,544
1993	3,874,544	3,735,867	138,678	1,197,161	97,546	81,766	179,312	144,194	35,118	408,583	4,318,246
1994	4,318,246	4,114,220	204,026	1,257,498	97,012	85,887	182,899	155,808	27,091	454,770	4,800,107
1995	4,800,107	4,524,205	275,902	1,320,876	96,149	90,216	186,364	169,199	17,165	504,869	5,322,142
1996	5,322,142	4,967,303	354,838	1,387,448	94,921	94,763	189,683	183,882	5,801	559,115	5,887,058
1997	5,887,058	5,445,658	441,400	1,457,376	93,290	99,539	192,829	199,637	(6,808)	617,801	6,498,050
1998	6,498,050	5,961,862	536,188	1,530,827	91,217	104,556	195,773	217,073	(21,300)	681,230	7,157,981
1999	7,157,981	6,518,135	639,846	1,607,981	88,657	109,825	198,482	233,228	(34,746)	749,851	7,873,085
2000	7,873,085	7,120,015	753,070	1,689,023	85,562	115,360	200,923	252,553	(51,630)	824,092	8,645,548
2001	8,645,548	7,768,923	876,625	1,774,150	81,880	121,174	203,055	273,361	(70,307)	904,267	9,479,508
2002	9,479,508	8,468,197	1,011,311	1,863,567	77,554	127,282	204,836	295,108	(90,272)	990,835	10,380,071
2003	10,380,071	9,222,083	1,157,988	1,957,491	72,524	133,697	206,221	316,776	(110,556)	1,084,380	11,353,895

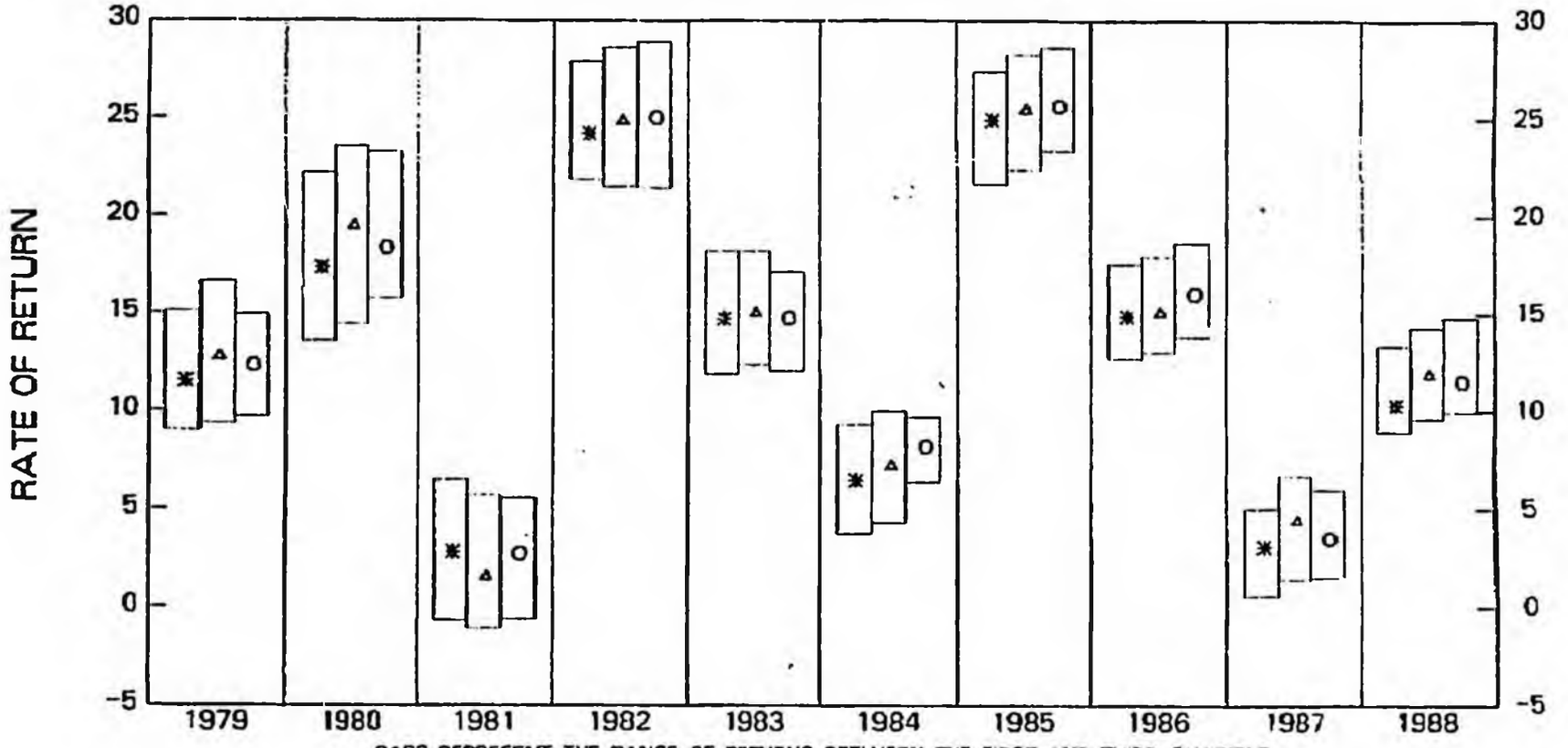
* Surpluses reduce employer contributions over 5 years
* Deficits increase employer contributions over 25 years

PERCENTAGE RATIO RELATIONSHIPS OF ABOVE DATA

As of June 30	Funding Ratio	As % of Salaries Employer Contribs	Employee Contribs	Total Contribs	Benefit Payments	As % of Assets-- Net Contribs	Investment Earnings
1988	93.0	13.64%	6.83%	20.47%	10.41%	4.20%	10.00%
1989	96.4	11.82%	6.83%	18.65%	10.79%	3.02%	10.00%
1990	98.9	10.10%	6.83%	16.93%	11.15%	2.05%	10.00%
1991	100.8	9.01%	6.83%	15.84%	11.41%	1.47%	10.00%
1992	102.3	8.58%	6.83%	15.41%	11.68%	1.16%	10.00%
1993	103.7	8.15%	6.83%	14.98%	12.04%	0.86%	10.00%
1994	105.0	7.71%	6.83%	14.54%	12.39%	0.60%	10.00%
1995	106.1	7.28%	6.83%	14.11%	12.81%	0.34%	10.00%
1996	107.1	6.84%	6.83%	13.67%	13.25%	0.10%	10.00%
1997	108.1	6.40%	6.83%	13.23%	13.70%	-0.11%	10.00%
1998	109.0	5.96%	6.83%	12.79%	14.18%	-0.31%	10.00%
1999	109.8	5.51%	6.83%	12.34%	14.50%	-0.46%	10.00%
2000	110.6	5.07%	6.83%	11.90%	14.95%	-0.63%	10.00%
2001	111.3	4.62%	6.83%	11.45%	15.41%	-0.78%	10.00%
2002	111.9	4.16%	6.83%	10.99%	15.84%	-0.91%	10.00%

TOTAL FUND: RATES OF RETURN BY ASSET SIZE

FOR PERIODS ENDING DECEMBER 31



BARS REPRESENT THE RANGE OF RETURNS BETWEEN THE FIRST AND THIRD QUARTILE

ANNUAL MEDIAN RETURNS

		1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
UNDER $10 MILLION	(*)	11.7	17.5	3.0	24.4	14.9	6.6	25.1	15.0	3.2	10.5
$10 TO $50 MILLION	(Δ)	12.9	19.6	1.7	25.0	15.1	7.3	25.6	15.2	4.6	12.0
OVER $50 MILLION	(o)	12.5	18.5	2.8	25.2	14.9	8.3	25.8	16.1	3.7	11.7

ANNUALIZED LINKED MEDIAN RETURNS

	1979-88	1980-88	1981-88	1982-88	1983-88	1984-88	1985-88	1986-88	1987-88	1988
UNDER $10 MILLION	12.9	13.1	12.5	14.0	12.3	11.8	13.2	9.4	6.8	10.5
$10 TO $50 MILLION	13.6	13.7	13.0	14.7	13.1	12.7	14.1	10.5	8.2	12.0
OVER $50 MILLION	13.7	13.8	13.3	14.8	13.2	12.9	14.0	10.4	7.6	11.7

EXHIBIT 7

MEMORANDUM

STATE OF ALASKA

DEPARTMENT OF REVENUE

TO: The Honorable Hugh Malone
Commissioner of Revenue

DATE: November 1, 1988

FROM: Milton B. Barker MB
Deputy Commissioner

SUBJECT: Foreign Equity Investment Accounting

End-of-period valuation reports in investment accounting are computed based on reported market values for marketable securities. If the investments and the domicile of the investor are in the same country (and, therefore, denominated in the same currency), then the books of account are probably kept in the country's currency. However, if the investments are located in another country and are denominated and traded in a foreign currency, then the market valuation at the end of a period is denominated in the foreign currency. In order to provide a valuation report in terms of the investor's domestic currency and books of account, the foreign denominated value is converted to domestic value by applying the momentary foreign exchange rate prevailing at the end of the period between the domestic currency and the foreign currency. This is an entirely appropriate methodology for valuation reports, but it is not appropriate for reporting foreign investment activity or for recording foreign investment transactions on the investor's domestic books of account.

If investments are made in different countries having different currencies, then purchases, sales, gains, losses, and income transactions should not be converted into U.S. dollar books of account. The value is not fixed in terms of U.S. dollars and will not become fixed until the foreign currency is sold and the proceeds are used to buy U.S. dollars which are repatriated. When the U.S. dollars are repatriated, that is when events should be recognized on the U.S. dollar books of account.

Over the last five years the retirement funds have been investing in foreign markets through our two contract managers, Citibank and Morgan Guaranty, both of London, England. The funds' domestic book values should reflect the amount of U.S. dollars we advanced to the managers for investment purposes and not foreign transactions which are arbitrarily valued at a presumably appropriate exchange rate somewhere near that point in time. By attempting to convert all foreign investment activity into recordable U.S. dollar equivalents, we are essentially marking up the funds' book values to market values (albeit on a lagging basis). Such actions destroy the historical nature of book value in keeping track of the net U.S. dollar amount which was invested in the securities, creates a book value which is inconsistent with the other book values on the domestic books of account, and misleads users of the data.

The foreign investing through managers is analogous to buying stock in a single foreign company or a mutual fund. The book value is the U.S. dollars used to acquire the stock. If the company or mutual fund buys or sells some

of its assets, it does not affect book value. If the company or mutual fund retains income for investment in the business or fund or uses it to buy other assets, it does not change book value. The only things which could change book value would be investing more U.S. dollars to buy more of the stock or selling some of the stock for foreign currency and then exchanging the foreign currency for U.S. dollars. The fact that the book value of the company's assets are increasing or decreasing does not change the book value of the retirement funds' investment. It does, however, change the market values.

Even dividend or interest income earned in foreign currencies should not be ascribed as U.S. dollar income. As long as the income remains in foreign currency investments, its amount in U.S. dollar terms is not fixed and varies with each transitory change in the exchange rates. If the income is remitted in U.S. dollars, then its amount is fixed and then we can recognize it as U.S. dollar income on accounting reports.

Attached is Chapter 16 of the Miller Comprehensive GAAP Guide 1988 which discusses FASB-52, the statement of the Financial Accounting Standards Board that establishes generally accepted accounting principles for foreign operations and exchange. FASB-52 requires recognition in U.S. dollars of the book value of the income, gains, and losses realized in foreign currencies but not converted into U.S. dollars.

There are several aspects of FASB-52 that suggest this is a less than satisfactory treatment of the accounting problem.

1. For one thing, FASB-52 was highly controversial and was adopted by only a 4-3 vote.

2. Significantly, any foreign currency exchange gain or loss that results from translating (but not converting) income, gains, and losses realized in foreign currencies into U.S. dollars is not recorded as income on the U.S. dollar books of account, but is instead to be posted directly to a separate component of shareholder equity and realized as income only on partial or complete liquidation of the foreign investment. This seems rather arbitrary since not only the gain or loss component but also the original book value of the investment is just as much at risk to fluctuations in foreign exchange rates.

3. Along these lines, it is interesting to note that on page 22 Miller suggests that if it is not possible to compute meaningful exchange rates (in his examples, owing to foreign strife or exchange restrictions), "it is best to include earnings of a foreign operation only to the extent that cash has been received in unrestricted funds." Similarly, on page 24 Miller states "disclosure of exchange rate changes. . .that occur subsequent to the balance sheet date should be disclosed, if the effects are material." Given that the retirement funds investments are of a

long-term nature, the exchange rate as of the balance sheet date is not meaningful. Partial or complete liquidations of these foreign investments are highly infrequent.

Perhaps the basic problem is that FASB-52 is oriented toward business activities in foreign countries that generate liabilities in foreign currencies. (The second model which FASB-52 addresses (page 4), a business which conducts operations in U.S. dollars, is certainly not relevant.) The retirement systems are a misfit in that they operate in foreign currencies yet all their liabilities are in U.S. dollars. Indeed, this would be true of any foreign investment, as opposed to business, activity. The examples and language of FASB-52 do not explicitly address investment activities.

MBB/gb

Attachments

ANNUAL RATES OF RETURN (a)
ON EXTERNALLY MANAGED EQUITIES
OF ALASKA RETIREMENT FUNDS

MANAGER AND INCEPTION DATE		03-31-89 to 06-30-89	06-30-88 to 06-30-89	Inception to 06-30-89
R.E. Equity Managers:		MANAGER R of R	MANAGER R of R	MANAGER R of R
Aetna	(09-30-80)	N/A	4.77% (b)	6.19% (b
Hancock	(09-30-80)	N/A	-0.42 (b)	3.24 (b
Equitable	(12-31-80)	8.67	8.00	8.39
Sentinel	(03-05-84)	N/A	6.54 (b)	7.02 (b
JMB	(04-12-84)	3.49	11.57	8.92
Morgan	(06-01-84)	10.50	9.27	12.08
Karsten	(12-26-84)	N/A	4.82 (b)	6.74 (b
Group Average			7.64%	7.54%
Domestic Equity Managers:				
Alger	(06-14-84)	47.58%	10.12%	10.81%
Invesco	(06-14-84)	33.64	1.90	13.88
Lehman	(06-14-84)	32.09	18.99	17.27
IDS	(01-12-89)	37.24	28.21	28.21
Loomis, Sayles	(01-12-89)	31.37	31.31	31.31
Miller Anderson	(01-12-89)	26.20	27.74	27.74
United Capital	(01-12-89)	27.35	22.13	22.13
Active Group Average*		32.51%	17.69%	15.06%
State Street	(07-13-88)	29.21	17.40	17.40
Treasury	(11-02-87)	11.22	8.56	7.98
Domestic Group Average		32.24%	17.59%	15.15%
International Equity Managers:				
Citicorp	(11-01-83)	-18.59	7.77	24.83
Morgan Guaranty	(11-01-83)	-7.71	10.74	25.56
Group Average		-13.27%	9.26%	25.20%
ALL EQUITY MANAGER AVERAGE			14.55%	15.08%

* - Not net of fees of approximately .31%.
a - Pure internal rate of return weighted by amount and date of deposits.
b - Used 03-31-89 value because 06-30-89 was not available.

Portfolio Management, Treasury Division
August 16, 1989

ANNUAL RATES OF RETURN (a)
ON INTERNALLY MANAGED FIXED INCOME INVESTMENTS
AND ON THE TOTAL FUNDS OF ALASKA RETIREMENT FUNDS
Fiscal Years 1985 through June 30, 1989

	Fiscal Year 1989 Rates of Return at		Fiscal Year 1988 Rates of Return at		Fiscal Year 1987 Rates of Return at		Fiscal Year 1986 Rates of Return at		Fiscal Year 1985 Rates of Return at		Fiscal Year 1985 Through June 30, 1989 Rates of Return at	
	Cost (c)	Market	Cost (c)	Market	Cost (c)	Market	Cost (c)	Market	Cost (c)	Market	Cost (c)	Market
R. E. Mortgages	9.08%	11.81%	10.63%	8.60%	13.38%	4.05%	11.74%	17.96%	13.05%	26.61%	12.07%	16.45%
Bonds and Reserves (b)	9.08	15.04	9.48	7.67	10.43	4.87	11.61	23.24	9.75	29.65	10.14	15.18
Total Fixed Income	9.62%	14.72%	9.63%	7.79%	10.98%	4.71%	11.64%	21.67%	10.83%	28.62%	10.55%	15.44%
Total Equities	14.55%	14.55%	-5.12%	-5.12%	20.39%	20.39%	37.80%	37.80%	21.54%	21.54%	15.08%	15.08%
TOTAL FUND	11.58%	14.65%	2.73%	1.93%	14.94%	10.90%	19.74%	26.59%	13.27%	26.84%	12.14%	15.31%

a - Internal rates of return under simplifying assumption of mid-month flows for fixed income investments.
b - Net of gains, losses, and amortizations.
c - Cost returns for fixed income investments; but market returns on equities. The returns for total fund approximate actuary's calculation of returns.

Portfolio Management, Treasury Division
August 18, 1989

HB

581

File

HOUSE COMMITTEE REPORT

(11)
Date Referred: April 9, 1990 FURTHER REFERRALS:

Date of Committee Action: 4/28/90

The FINANCE Committee considered: HB 581

HOUSE BILL NO. 581 UNIVERSAL HEALTH CARE TASK FORCE

"An Act creating a universal health care task force; and providing for an effective date."

RECOMMENDATIONS:
[✓] be replaced with CS HB 581 (FIN) [ ] the same title [✓] a new title
[ ] have attached amendment(s)
[ ] do pass
[ ] do not pass
[✓] no recommendation
[ ] individual recommendations
[ ] additional referral to the _____ Committee

ADOPTS: _____ letter of intent

ATTACHES NEW FISCAL NOTE(s): (Dept)
[✓] fiscal impact DHSS
[ ] zero fiscal note
[ ] zero with analysis

APPROVES PREVIOUS: (Date/Dept)
[ ] fiscal note(s)
[ ] zero fiscal note(s)
[ ] zero fn/analysis

SIGNING DO PASS:

Brown
Koponen
Ulmer

SIGNING: (Check approp. column)

	Do Not Pass	No Rec	Amend
Hoffman		+	
Larson		4/30 rec. 2	
Barnes		X	
Shultz	X		
Phillips		✓	
Rieger		✓	
Wallis		✓	

Larson
CO Chairman's Signature
Hoffman

STATE OF ALASKA
1990 LEGISLATIVE SESSION

BILL VERSION: CS HB 581 (FIN)
PUBLISH DATE: _____

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: "An Act creating a universal health care task force & providing for an effective date."
Sponsor: by the HESS Committee
Requestor: by the House Finance Committee

Agency Affected: DHSS
BRU: Administrative Services
Components: Planning and Development

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 91	FY 92	FY 93	FY 94	FY 95	FY 96
PERSONAL SERVICES	73.3	105.9				
TRAVEL	17.5	26.5				
CONTRACTUAL	87.8	7.1				
SUPPLIES	0.9	0.5				
EQUIPMENT	-0-	-0-				
LAND & STRUCTURES	-0-	-0-				
GRANTS, CLAIMS	-0-	-0-				
MISCELLANEOUS	-0-	-0-				
TOTAL OPERATING	179.5	140.0	-0-	-0-	-0-	-0-
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	179.5	140.0				
FEDERAL FUNDS						
OTHER						
TOTAL	179.5	140.0	0	0	0	0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY	3	3				

ANALYSIS: (Attach a separate page if necessary)

See attached assumptions and calculation analysis.
No fiscal impact in FY 1990.

Prepared by: House Finance Committee
Phone: 465-3727
Division: Co-Chairman Ron Larson
Date: _____

Approved by Commissioner: Co-Chairman Lyman Hoffman
Date: _____
Agency: _____

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

CSHB 581 (FIN)
FISCAL NOTE CALCULATIONS AND ASSUMPTIONS April 27, 1990

PERSONNEL		FY 91	FY 92
RAIII 20 months	= $ 84,740	$ 33,896	$ 50,844
RA II 16 months	= 54,912	24,024	30,888
CTIII 18 months	= 39,564	15,386	24,178
Total personnel	$179,216	$ 73,306	$105,910

TRAVEL	FY 91	FY 92
Task Force travel:		
8 meetings, 5 members, 3 days per diem	$ 10,500	17,500
Evenings will be public meeting & discussion		
Next day is education/work session		
Avg. fare $400; per diem $90; misc. $30		
Total per meeting, per member $550		
Staff travel for research and meetings:	7,000	9,000
Total travel	$17,500	$26,500

CONTRACTUAL	FY 91	FY 92
Printing		-0-
3 X $5,000 for expert testimony & task force education	14,000	-0-
Advertizing (display ads)	3,500	6,500
Telephone long distance calls	350	650
Office Space	-0-	-0-
Employer survey (phone)	20,000	
Characteristics survey (phone, interview and observation)	50,000	
Total contractual	$87,850	$ 7,150

SUPPLIES	FY 91	FY 92
Paper goods, office supplies	$ 600	450
Reference books	300	
Total supplies	$ 900	$ 450

EQUIPMENT	FY 91	FY 92
Personal Computer	-0-	-0-

TOTAL FOR PROJECT	$179,556	$140,010

Assumptions:

1. Written work of the task force in providing program description and supportive documentation will be provided by legislative research agency, including any report printing.

2. Teleconferencing of public meetings will be provided at no cost through the legislative network or other comparable arrangement.

3. Reimbursement for services of those appointed by the Governor will be limited to travel and per diem.

4. Advisory committee members will provide funding for travel and other costs for their participation from their respective budgets.

5. Office space to be provided within existing legislative offices or by other donated arrangement.

6. Computer used for staff research work will be donated.

Original sponsor(s): HESS Committee

IN THE HOUSE BY THE FINANCE COMMITTEE

CS FOR HOUSE BILL NO. 581 (Finance)

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act creating the Universal Health Care Task Force; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. FINDINGS. The legislature finds that

(1) over 50,000 residents of the state cannot afford to pay their medical bills, are not covered by a group health insurance plan, do not qualify for public assistance programs, and cannot afford to pay individual health insurance premiums; a vast majority of the uninsured are either employed or are dependents of employed state residents;

(2) many state residents with high risk, preexisting health conditions are unable to obtain health insurance and must deplete their personal resources in order to obtain care;

(3) many state residents do not receive certain kinds of critical care due to exclusions in their health insurance policies;

(4) the health insurance coverage for many state residents does not cover costly illnesses or injuries causing catastrophic financial consequences to them and their families;

(5) due to the lack of health insurance coverage, many state residents do not obtain necessary preventive care, and this leads to dramatically higher remedial care and an additional incidence of disease and illness in the state;

(6) the cost of providing health care to those who are unable to pay is shifted to those who are taxpayers or participants in a health insurance plan;

(7) it would enhance the ability of Alaska businesses to remain competitive if they had better access to affordable health care coverage for their employees;

(8) the Governor's Interim Commission on Health Care recommended that "a state working group should explore and develop health insurance plans for medically uninsured Alaskans";

(9) every state resident should be guaranteed a basic level of health care regardless of income and should not become financially destitute before obtaining health care; access to health care should be universal, including those state residents with preexisting health conditions;

(10) the issues of medical indigency and universal health care are complicated, complex issues requiring review by an authoritative group for a certain period of time.

* Sec. 2. PURPOSE. The purpose of the Universal Health Care Task Force created by this Act, is to

(1) design a cost-efficient program that allows access to health care, through insurance or other means, to all state residents, and that provides a basic level of health care services;

(2) define the best strategy for implementing a universal health care program, including consideration of the redistribution of existing funds spent on health care in the state in order to provide for a more rational and equitable health care system.

* Sec. 3. UNIVERSAL HEALTH CARE TASK FORCE. (a) The Universal Health Care Task Force is created in the Department of Health and Social Services. The task force is composed of five individuals appointed by the governor with a significant and demonstrated expertise or interest in health care. As a nonvoting technical advisory committee to assist the task force, the governor shall also assign one representative each from the Department of Health and Social Services, the division of insurance, the division of

retirement and benefits, and the Office of the Governor, and the presiding officer of each house of the legislature shall assign a member from that house.

(b) The members of the task force are entitled to receive per diem and travel expenses authorized for boards and commissions under AS 39.20.-180.

(c) The task force shall select a chair and a vice-chair from among the members of the task force.

* Sec. 4. DUTIES OF THE TASK FORCE. The task force shall

(1) solicit advice and information from health care consumer groups, the insurance industry, health care providers including the State Medical Association, the Alaska Psychiatric Association, the Alaska Psychological Association, the Alaska Mental Health Board, the State Health Association, the Alaska Pharmaceutical Association, the Alaska Public Health Association, the Alaska Dental Association, the Alaska Academy of Physicians Assistants, the Alaska Nurses Association, the United States Department of Veterans Affairs, the United States Department of Defense, the Civilian Health and Medical Program of the Uniformed Services, public employee unions, representatives of the medically indigent, emergency services personnel, large and small businesses, the Medical Care Advisory Committee, the Alaska Native Health Service, actuaries, public relations experts, the public, and the technical advisory committee created in sec. 3 of this Act;

(2) analyze all the relevant information necessary to recommend a program of universal health coverage, including 1990 census data and the study done in 1954 for the United States Department of the Interior by Thomas Parran, titled "Alaska Health: A Survey Report";

(3) update the information in the "Alaska Comprehensive Health Care Financing Study" done by the Battelle Human Affairs Research Center in

1982;

(4) make an accurate estimate of the number of people who are unable to receive necessary health care services in the state, which patients are generating unpaid medical bills, which state residents are uninsured or lack adequate insurance, which health care providers are providing uncompensated care, who is paying for the cost of uncompensated care, and the total cost of uncompensated care in the state;

(5) identify those health care services necessary to achieve an acceptable minimum level of health care for all state residents and to examine those health care services that provide the most care for the most people at the least cost, including prevention services; the Oregon Basic Health Services Act shall be examined by the task force;

(6) recommend ways to coordinate services between nonprofit health care providers, profit making health care providers, the state division of public health, the United States Department of Veterans Affairs, the United States Department of Defense, and the Alaska Native Health Service in order to achieve a more efficient and effective health care delivery system;

(7) consider possible delivery systems for a universal health care program, including using a single, comprehensive statewide system or changing existing health care services to yield an integrated system of health care coverage; options that shall be considered include

(A) expanding the use of private health insurance to provide coverage to the uninsured and underinsured;

(B) continuing or reinstating government programs, including the Medicaid medically needy option or the catastrophic illness program, if private insurance is not the best way to provide coverage;

(C) sponsoring the pooling of small employers into a single organized health care purchasing group;

(D) mandating coverage in the workplace for employers with a certain threshold number of employees;

(E) mandating a minimum basic level of health services to be included in a health insurance plan, with a special emphasis on important preventive services and children's health services;

(F) requiring that health care programs include residents who are unable to obtain insurance due to a high risk or a preexisting medical condition;

(G) requiring that health care programs include coverage for costly medical services that have a catastrophic financial impact on patients and their families, including making the state the payor of last resort before a family becomes destitute;

(H) requiring that the University of Alaska provide health coverage for all students;

(I) combining the workers' compensation system with a universal health care program;

(J) establishing or lengthening the time for continuation or conversion of health insurance coverage after a state resident leaves employment;

(K) using the unemployment insurance program to also cover health care services for the unemployed;

(L) examining the ability of the state to self-insure under a universal health care program;

(M) making charity care a requirement as part of the licensing or certificate of need process;

(N) having special programs designed to ensure that children have adequate health coverage, such as the child health care programs established in Minnesota;

(8) consider a means of financing a universal health care

program including the following:

(A) the use of a payroll tax for full or partial financing of a small employer insurance pool;

(B) a Medicaid waiver requesting a block grant from the federal government to subsidize a universal state program;

(C) using the permanent fund dividend program to finance coverage for some residents;

(D) using reasonable deductibles and co-payments to discourage frivolous use of health programs;

(E) using the unemployment tax to cover the costs of insurance for the unemployed or uninsured;

(F) a Medicaid buy-in for the medically uninsured;

(G) streamlining coverage so that families are not covered under two separate insurance programs;

(9) pursue financial support from other sources, including private foundations like the Robert Wood Johnson Foundation, for the work of the task force and for implementation of a universal health care program;

(10) coordinate with the community health planning efforts described in Senate Bill 326 of the Sixteenth Alaska State Legislature;

(11) solicit actuarial data and other technical information and assistance from the health care insurer providing coverage to the state;

(12) utilize information provided by the Health Care Cost Containment Task Force established by the Sixteenth Alaska State Legislature.

* Sec. 5. REPORT. The task force shall, by March 1, 1992, provide a preliminary report, and by June 30, 1992, provide a final report to the legislature and the governor that recommends a program for providing universal health care, including recommendations for implementing the program in phases in an expeditious, yet orderly manner.

* Sec. 6. This Act is repealed June 30, 1992.

* Sec. 7. This Act takes effect February 1, 1991.

Attachment 1
4/18/90
HB581

Amendment #1 By Rieger

To: CSHB581 (HESS)

Page 2, Lines 17-19 Delete all material after "residents," and replace with "and that provides a basic level of health care services.

Page 2, Line 22, after "provide for a" insert "more"

Page 2, Lines 23-24. Delete all material after "system" and ".

Technical

Page 3, Line 3, after "benefits," insert "a member selected by"

Page 3, Line 3, after "representatives," insert "a member selected by"

Page 3, Line 8, delete "governor" and replace with "task force"

+ Page 4, Line 29 through Page 5, Line 3: Delete all material and re-letter accordingly

+ Page 6, Lines 10-14: Delete all material and re-letter accordingly

Page 4, Lines 26-28: Delete all material and re-letter accordingly

Am# 2

Presiding ~~member~~ officer of ~~the~~ each house of the legislature shall assign a member from that house.

page 2, line 28: after "care." insert "The governor shall consider, to the greatest extent possible, making appointments that represent a broad cross section of Alaskans interested in health care."

HEALTH CARE COALITION
OF
ALASKA

March 16, 1990

REC'D MAR 19 1990

Jim

Honorable Johnny Ellis
Chairman
Health, Education and Social Services Committee
Alaska State Legislature
P.O. Box V (MS3100)
Juneau, Alaska 99811

Dear Representative Ellis:

On behalf of the health care industry in this state, I commend you and your colleagues for recognizing and responding to the need for a universal health care task force. I believe this to be the most significant piece of health legislation this session.

The entire issue of cost and access is impacted by the medically indigent, native health delivery system, veterans care, CHAMPUS, Medicare, Medicaid, military delivery system, the public and the private sector. There are no easy answers to our current dilemma, but unless we pull ALL the players into the game, we will never find a solution.

I have two requests that I sincerely ask you to consider. The first request is to consider adding health industry members to the task force. Apart from providing the educational expertise, I believe they would be objective and honest in their assessments. But most importantly, it would be helpful for them to participate in any final resolutions. Secondly, I have enclosed an overview of what many believe is the problem facing society today. I realize how busy you are, but I strongly urge you to read this document. Hopefully it summarizes the need, and possibly the direction you might consider for the Task Force.

Again, thank you for recognizing the urgent need for this kind of a group. You might suggest to Senator Kelly that his cost containment group might be best served through this task force.

Sincerely,

Ray Schalow
Chairman

ALASKA ACADEMY OF PHYSICIANS ASSISTANTS • ALASKA PHARMACEUTICAL ASSOCIATION • ALASKA PUBLIC HEALTH ASSOCIATION
ALASKA STATE MEDICAL ASSOCIATION • HEALTH ASSOCIATION OF ALASKA • ALASKA NATIVE HEALTH BOARD • ALASKA NURSES ASSOCIATION • ALASKA DENTAL SOCIETY

working together . . . caring together

4107 Laurel Street Anchorage, AK 99508 (907) 562-2662 Fax 561-2063

Alaska State Medical Association

4107 Laurel Street Anchorage, Alaska 99508 (907) 562-2662 (Fax) 561-2063

Dr. John Kitzhaber, an Oregon physician and current president of the Oregon State Senate offers a clear and cogent presentation on the issue of uncompensated care in America. I have taken the liberty of paraphrasing his comments and urge you to read them thoroughly. It speaks to an issue that we in the health industry are just now beginning to understand, and it points out the need for greater dialogue between provider and legislator in order to address a critical social problem.

Let me begin by stating to you that unequivocally the most serious threat facing the health industry today is uncompensated care. If left unresolved, it will erode the health of our society and in turn will lead to an erosion of the clinical autonomy of physicians and other providers. It will also undermine some of the very principles on which our health care system has been built and will lead to increased regulation of the practice of medicine and probably to a government controlled health care delivery system.

To understand the threat and challenge it poses, we must first consider the evolution of our American health care system. Our health care system was founded on the principle of universal access, the idea that all Americans, regardless of their income, should have access to the health care system and to all the services it has to offer. We were able to deliver on this social objective because of our fee-for-service reimbursement system and the ability to cost shift. So when the poor came for treatment, the service was rendered and the cost was merely shifted to someone who could pay through an incremental increase in their bill or in their insurance premium.

This policy was no accident, but was the result of conscious decisions in both the public and private sector. In the public sector, we enacted Medicare and Medicaid in 1986 extending coverage to the poor and the elderly. At the same time, we had a rapid expansion of private policies funded primarily through employment. This rapid growth of third-party insurance coverage led to the belief that health care for the poor in this country was free, when in fact it being subsidized primarily by the government and by the business community. We created what we felt to be an ideal health care system. It was a system with no financial restraints, where individuals had access to as much health care as they wanted or needed. Physicians could practice pure medicine, viewing their patients primarily from their health needs without concerning themselves over income. But this system also led to, and encouraged utilization. It led to the deeply held social belief in this country that health care is a right. That resulted, understandably, in a dramatic increase in

expenditures. The amount we spent on health care grew from $75 billion in 1980 to nearly $500 billion in 1988 and it still continues to grow. An more telling, is the growth of health care expenditure as a percent of the Gross National Product. We spent 7.4 cents on the dollar in 1970 and we spend about 12 cents today. If this rate continues, by the turn of the century we will be spending 20 percent of the Gross National Product on health care, and by about 2020, we will be spending 40 cents out of every dollar on health care.

This, of course, will not happen. It makes a great deal of sense in terms of a social policy, but makes little sense in terms of an economic policy. No single set of expenditures can grow at a rate faster than the growth of the Gross National Product.

The prosperity we have enjoyed in the lst 20 years has allowed us to absorb these rapid increases and has masked the underlying fallacy of the way we finance health care in this country. A number of factors occurred that have brought our ideal health care system into collision with economic realities. New medical technologies were being developed and being used because there was no financial restraint on the system, and at a tremendous cost. Secondly, the population was aging. There has been a significant increase in the elderly as a percent of the population, and they use more health care services. They have a larger incidence of chronic diseases, both of which increase the financial strain on the system. These factors brought the people who had been traditionally subsidizing the cost of health care for the poor, the business community and the government, to a position where they had to reevaluate their willingness to continue to do that. The economic stagnation that we experienced at the beginning of this decade could no longer absorb the rapid increases in the cost of health care. Our annual productivity growth was 3% a year in the sixties and seventies, but fell to half a percent a year by 1979, and was actually negative in the early eighties.

Our federal budget deficit increased from about $73 to $211 billion in five years. We liquidated all our foreign assets and became the largest debtor nation in the world. The government in the first part of this decade recognized that they could no longer continue an open-ended subsidy of the cost of care for the poor without raising taxes, increasing the deficit or making deep cuts in other domestic programs. At the same time, this country entered the world market. We began recognizing that we were not competing just among ourselves like the auto industry once did, but were competing with mainland China, West Germany, Japan, etc. They realized that cutting costs, particularly labor-related costs, had to be done in order to remain competitive with cheap labor industries abroad. They couldn't pass the cost of health care on to their consumers and still remain competitive; particularly when American business has to carry the cost of health care on the books as necessary expense and are competing with countries that do not carry health care as a cost, because they have nationalized health care programs.

The business community now became interested in cost containment in order to remain competitive. The government became interested in cost containment to balance the budget. The object of business and government was simply to reduce the exposure to the cost shift, and to reduce their funding and subsidy of the cost to care for the poor. The subsidy was not taken out of the system, it was merely shifted on to individuals and

providers. How did they do it?

In 1983, the federal government enacted the DR'G`s, which is a prospective reimbursement system that shifted economic risk on to providers. They began requiring first-day hospital deductible for Medicare, increases in the Part B monthly Medicare premium. This shifted costs on to the individuals. With Medicaid, the program for the poor, they cut their match rate and shifted that to the states. The first thing the states did was cut provider reimbursement rates, so that now we get 45 to 50 cents on the dollar for taking care of someone on welfare. That pushed costs and responsibility to the individuals. We have had 800,000 women and children squeezed off Medicaid in the last ten years. That program, which used to cover 65 percent of the poor, now covers less than 38 percent of the poor.

The private sector reacted exactly in the same way with an increased involvement in HMO's, PPO`s, and other prospective managed care plans that put the providers at risk. They increased co-payments and deductible for their employees then shifted costs on to individuals. The important thing to remember is that cost containment reflected absolutely no social policy beyond cutting costs for the government and the business community. There was recognition that the amount of health care that could be spent on the poor was limited. There was no consideration of the implications of those decisions on access to health care. They reduced the funding in the system, but didn't reduce what the public expected from the system.

Today we find ourselves in a situation of transition. We are still ostensibly committed to the principle of universal access; but now the system is driven by economic factors, not by the social factors that drove it in the Sixties and Seventies. Providers are now at economic risk, and we are losing our ability to cost shift.

Our ability to deliver on the concept of universal access has depended on cost shifting and the willingness of business and government to subsidize the cost of care for the poor. But what we are seeing today, while we are still supposedly committed to universal access, is a progressive shifting of the responsibility to pick up that cost. Remember that between 1965 and 1980 that subsidy was borne by government and business which spread it out over taxpayers in general. So society was paying for the social responsibility to have universal access in this country.

Because of the cost containment measures that have occurred, the subsidy has now been shifted to providers. Physicians have far less ability to absorb this shift and what formerly was subsidized care for the poor is now showing up as uncompensated care. As physicians reach a point where they can't absorb additional uncompensated care and still pay the bills, they push the costs on to individuals. So today, if you don't have insurance coverage or money, you are increasingly likely to lose access to the health car system - either because the provider won't take in any additional indigent patients, or you delay treatment because you are afraid you can't afford it.

This has changed how we finance health care in this country. Our health care system now has a bifurcated financing mechanism. On one side

is the public system, which is Medicare and Medicaid; and on the other side is the private system which is mostly employment based policies and some individual policies. There has always been a little gap in between where some people slip through the cracks. But as long as government and the business community were willing to subsidize the cost of care for the poor, that gap has been very narrow and has really contained only society's truly downtrodden.

Today as those two-third party payers are trying to escape from the subsidy, we've seen a reduction in government expenditures, co-payments and deductible in Medicare and increases for Medicaid eligibility, so people spill of the public side into that gap. As competition in the world market increases, we shift from a manufacturing to a service based economy with large numbers of low paid, non-unionized workers without health insurance coverage, and as premium rates continue to climb, people spill off the private side into that gap. Today that gap is no longer narrow, it has 37 to 40 million Americans in it. They are no longer just society's downtrodden. Seventy percent of those people are working full time or part time or are dependents of someone who is working. But it's those in that gap that are generating 75 percent of the uncompensated care. Why should we be concerned about this? Because there are some serious consequences in the shifting of responsibility to pay for the care of the poor, and there are some social and professional consequences that affect providers.

The first social consequence is an erosion in our commitment to universal access. Because there is a physician surplus in the country, and because care for the poor is no longer subsidized but is uncompensated, we have a very competitive, market-driven system in the provider community. Since market systems were not designed to foster social responsibility, it shouldn't be surprising that no one is competing for the poor. Public health clinics are closing and we are seeing patient dumping from hospital to hospital, physician to hospital and between physicians. There are treatment delays and a growing number of people in the gap.

That leads to the second consequence, which is a very real and measurable deterioration of health for a growing number of Americans. We have 40,000 neonatal deaths each year from the complications of low birth weight. Two-thirds of those mothers do not receive adequate prenatal care. Forty percent of the poor in America are children and only one-third of them are covered by Medicaid, the other two-thirds are in the gap and are losing access to basic preventive services. We are seeing an increase in pertussis and pediatric nutritional problems. There is case after case of people actually dying because of lack of access to the system. People are dying from strokes because they couldn't get in to get their blood pressure medication refilled. People are dying of heart failure and having MI's because of lack of routine checkups. People are dying of perforated ulcers because of treatment delays.

The third consequence is that we are mortgaging our own future. Remember, that 40 percent of the poor in this country are children, and two-thirds of them are in the gap. Also in that gap are tens of millions of young working Americans. These people constitute a large part of the shrinking workforce of tomorrow that we're expecting to fuel the economy and pay for

a growing retired population. How are we going to do that in the face of $170 billion owed to foreign governments and nearly a three trillion dollar national debt; a ten trillion dollars unfunded liability, the difference between what we expect them to make and what we are planning to take out of their paychecks to pay for Medicare, Social Security and federal pensions, most of which are automatically indexed and have no income eligibility requirements. What we're asking these people to do is be more productive than any other generation. We are asking them to do something that we have all refused to do, and that is recognize that increases in personal consumption have to be balanced with increases in productivity.

In the last ten years, American workers have averaged a $3200 increase per capita in personal consumption and only $950 of that has been paid for by increases in what each one produces. The remaining $2200 has been paid for by cuts in domestic spending and investment and by foreign debt. We are asking this group of people to be more productive than anyone in the history of this country, and probably take a reduction in their standard of living. Having asked them that, we are crippling them going in by denying them access to the basic health care services they need to be healthy, productive members of the workforce. You cannot have an increase in productivity unless your workforce is health and well educated. This is a very, very serious implication.

There are also some disturbing professional implications. The first is the growing problem of uncompensated care that is catching physicians and providers between what society expects from our health care system, and economic realities. When the government and the business community move to limit their subsidy of the cost of health care for the poor, they could do so without denying access to individuals, and they could do so without publicly or explicitly abandoning the idea of universal access, because they shifted that subsidy on to the providers. But when physicians move to limit their exposure to this for exactly the same reasons, they have to deny access to individuals. When a physician reaches a point where he or she cannot absorb any additional uncompensated care, they either have to reduce the number of indigent patients they see or reduce the services they provide to those patients. In either case, that means rationing. Increasingly, physicians in this country are being forced to become the rationing instruments for a society that refuses to recognize that rationing is occurring. That puts physicians in direct conflict not only their professional ethics, but with social expectations for the health care system. It casts them in a very unfavorable light as many people still view physicians as they were in the halcyon days of the 1960's or 1970's, when the economy was booming and incomes were rising. Most physicians do not understand the relationship between cost shifting and subsidizing care for the poor, and they don't understand the implications of taking cost shifting away from providers. The thought that a wealthy profession would be denying access to the poor is unacceptable to them. It puts them in a very vulnerable position politically. As the problems of the poor intensify, state legislatures are going to begin to react and they are going to say: If physicians are not going to take care of the poor voluntarily, we are going to force you to do that. There are a lot of ways that are designed to force physicians to assume the responsibility for taking care of the poor, but they ignore the fact that society, while paying lip serve to universal access, has

made a decision to limit the amount of money that they're going to spend on it. When someone convinces corporate America that a government sponsored health care program will put them in a better position in terms of competition in the world market; then we will be looking at a nationalized health care program. But in the short run, we are looking at increased regulation, reduction, and erosion in physician clinical autonomy.

What can we do about this problem? To solve this crisis in uncompensated care, we have got to start by accepting three very hard realities. The first reality is that resources are limited and that's a difficult reality. But it should be obvious to anybody who looks at the need in this country and looks at the available dollars. As we said, we have a national debt approaching three trillion dollars that must be reduced. We have a huge defense budget that has been traditionally hard to pare down, and we spend $450 billion a year on Medicare, Social Security and other federal pensions. At the same time, we are cutting aid to education, we are also cutting investments in road, sewers, and infrastructure; and civilian research and development. All of those things we need to increase the productivity in this country.

No one wants their personal health care expenditures cut, but at the same time, we want to reduce government spending. We want good road and schools, safe streets, criminals behind bars, a comfortable retirement, police protection, fire protection, clean air, clean water; and we want to do all that, of course, with lower taxes and higher wages.

Obviously that doesn't work. There is a finite amount of money that this country can invest in health care versus the other things we also have to invest in. Once we come to grips with the fact that there is a finite health care budget in America, then we have to decide who is going to get the service and how much service each person is going to get.

That brings us to the second reality. The rich are always going to have access to more health care than the poor. That's all right if what the poor get is adequate and if they're all getting it. After all, one of the hallmarks of a capitalistic system is that goods and services are distributed on the basis of income, not necessarily on need or merit. We readily accept that in most instances. We don't expect public housing to look like the Ritz and we don't expect food stamps to be redeemed in very expensive restaurants. But because of our system, our concept of universal access, we take for granted that the poor should have access to all the health care services that are available to the rich.

This is the only part of our system that operates on this open-ended economic principle. What we've done is reject a multi-tiered system based on income. But actually we already have that kind of a system in place. The rich have always been able to fly to other states and other countries for diagnostic and therapeutic modalities not available near home. They have had consultations and elective surgeries that the poor have not had access to. We would all agree that everyone should have a right to prenatal care. You may argue whether or not the public should pay for a face lift electively for everybody on welfare, but it becomes much more difficult when you are trying to balance a transplant versus prenatal care.

What we need is a better definition of adequate health care to address that question. If we know resources are limited, if we know people with high incomes can buy more health care than people of lower incomes, and if we know that society can't buy everything for everyone who might benefit from it, we must consciously and responsibly decide what level of health care everybody should get, that means the definition of adequate health care.

That brings us to the last reality, the inevitability of rationing. This is very difficult for physicians and providers to come to terms with. But when you define adequate health care, you also define what's more than adequate. That lads to the basis for explicit rationing of health care. I suggest that rationing already exists in our system. We ration by income and transportation barriers. But more importantly, we ration through a lack of any policy to guide how we spend our health care dollars. We ration inadvertently by legislative decision. If we have a limited amount of money in the health care budget and you spend it on one thing, it`s not available to be spent on something else.

Consider how we are doing this today. We spend almost $2000 per capita on health care in America. That is more than any other country in the world and yet our wellness as measured by morbidity and mortality statistics is not significantly higher than in England, which spends half as much, or even Singapore which spends a fourth as much. Why is that? Because we have no policy to guide how we spend our health care dollars. We are spending huge sums on some and none on others. We spend more per capita than any country in the world, yet 37 million Americans have no coverage and many of them are losing access to the system. We spend three billion dollars a year on neonatal intensive care while we're denying prenatal care to hundreds of thousands. We spend $50 billion a year on people in the last six months of their lives, while we are closing pediatric clinics. That's like having someone in charge of a truck fleet for your corporation who adopts a policy that he won't change the oil in the trucks until the blocks melt. You certainly wouldn't hire that guy to work for you. But that's exactly how we spend health care dollars in this country. We don't spend it on prenatal care, we spend it on neonatal intensive care. We don't treat hypertension, we treat people who have stroked out. We are rationing by default. It's guided by no social policy and it's not equitable. We are wasting millions of dollars and thousands of lives. The reason we are rationing implicitly as opposed to explicitly is because we don`t want to come to grips with our own limits.

To solve this problem of uncompensated care with of the ominous implications for society and for physicians, we have to recognize that our health care system is indeed in flux and that we have to build a new system that is based on the three realities that we've just discussed: limited resources, acceptance of the fact that the rich will always be able to buy more health care than the poor, and that we`re going to have to ration. We have to recommit ourselves to universal access, but not universal access for everyone to everything. Universal access for everyone to an adequate level of health care. This will put our system back on a sound economic foundation, and means we are going to have a three tiered system of delivery in this country. We already have a non-defined sort of implicit multi-tiered system. But this would mean a

government sponsored tier for the poor. It would mean a tier that the business community funds for those who are working, and a traditional fee-for-service tier for those who wish to buy additional health care services. It`s at that bottom tier that we have to come to grips with rationing.

The government has a responsibility to pay for the poor, not for the elderly. The government should pay for the poor regardless of age and there is no reason Lee Iacocca needs Medicare. We should put an income eligibility requirement on it.

It`s the bottom tier that we have to come to grips with rationing. It's this tier that we have to set the socially acceptable minimum level of health care for this country, and how do we get there? I suspect there are three elements to resolving this. We must have a clear social policy and we need to define adequate health. Then we need a universal insurance system to insure that people get access to that care. The social policy we had in the Sixties, Seventies, and Eighties, was universal access. One of the reasons we are in trouble today is because we were able to cover everybody for almost everything. But unless you define what it is you`re covering people for, you still have an open-ended system that we can't afford. Politically it's far more difficult to deal with the question of adequate health care than to design and politically adopt a position to deal with the universal insurance coverage question.

We must have a clear social policy because we need a framework to guide how we spend those health care dollars in a way that is efficient and equitable. We must make an attempt to recognize our limits and adopt such a policy. Should we discontinue funding for heart, bone marrow and liver transplants for people on welfare or should we take that money and extend it out to buy preventive and prenatal services for a far larger group of people who have been in the gap? The question is not whether transplants have merit. The question is not whether, in the short run, we could find some additional money to buy a few more transplants for people on public assistance. The issue is, does it make more sense and is it a better use of public dollars if we we're going to spend more on health care to buy high tech services for a group of people who already had access to virtually everything in the private sector; or should we extend services to a larger number of people who currently do not have access to any health care whatsoever. Should universal access to adequate health care be the first priority for spending additional dollars?

Once we get a definition of adequate health care and array our health care services on a priority basis, we are changing, in a very fundamental way, the nature of the rationing debate. The rationing debate traditionally has an individual focus. It goes like this: You have one heart and three potential recipients. Do you give that heart to the 17-year-old unwed mother of three on welfare or do you give it to a 40-year-old corporate executive? This raises the kind of imponderable ethical and moral question that society, almost by definition, can't resolve on an individual basis. But when you develop a definition of adequate, and array your health care services in a priority order, you shift that debate from the individual focus to a social focus. You are no longer debating which service should be given or denied to which individual, you are debating which priority funding should be given to

each service, given the reality of limited resources. Society has made the decision to limit the amount of money it's spending on health care. Society needs to make the decisions on how to spend that money. That takes physicians out of the squeeze and they can now continue to be patient advocates. They can continue to do everything they can possibly do for their patients within the context of the resources that society has made available.

How do we get to this definition of adequate? There are really three steps. The first and probably the most difficult is building a consensus. A group of dedicated providers and health experts should break down every dollar spent on health care. A list should be made of the number of people getting the service and the cost; the number of people not getting the service and the economic as well as health implications of not giving them that service; and the cost to extend the service to cover everybody in giving them that service; and then the cost to extend the service to cover everybody in the unmet need population. Arrange this list in a tentative priority order and begin presenting it at town hall meetings where citizens are actually getting involved in working through the trade-offs and choices that are necessary to set up a priority list of health care choices. Bring this information together and generate a final list that will be submitted to the legislature. Once the health care resources are arrayed in that kind of a list, you have to integrate it with the budget process. You must, then, require that the funding go to the first item on your priority list for everyone in the population for whom the state has responsibility. You go down and fund the second, third, etc., until you run out of money.

What that does is, put accountability in the system. If our state legislature decided to cut $20 million out of our health care budget, it would not be an abstract accounting exercise. It would mean the deletion of very specific services for very specific individuals off the bottom of the priority list and then the debate becomes far more focused. If you want to come in and refund the transplant program, it's very clear that you either have to knock something else off your priority list - you have to make a choice, a clinical choice and a political choice between those two health services, or you have to rob another program, or raise more money.

The final point with this type of system is that, if it's done on the basis of sound clinical grounds, you can actually save money in the system. A study done in California suggested that the cost of treating a low birth weight infant was $28,000 up to six figures. The study suggested that if you provided that care to all the indigent women who needed it, you could save $22 million a year in your health care system. That's money that can be used to add services on your priority list. It could be used to raise provider reimbursement levels to a reasonable point where people are not trying to avoid dealing with that population.

What is the role of physicians in resolving this problem? The most significant role they plan is to come to grips with their own limits. They have got to recognize that health care resources in America are in fact limited. How can we expect the public to accept the limits or expect state legislatures to recognize the limits if physicians are not willing to recognize them themselves. We are inviting all of the ominous

consequences that uncompensated care is bringing our way. We have to do that as a first item and express that publicly, physicians must discuss it with each other and with their patients.

Secondly, professional organizations need to adopt a policy, a statement on how to expend limited health care dollars. Something that says the first priority is to extend the basic level of health care coverage, and then we can fight about the budget. But to do that, we have to get involved in the definition of "adequate". Physicians are really the only group in this country that have the qualifications to provide sound clinical input to the state legislature. We need to say, yes, we are going to have to ration health care in this country. It's inappropriate and unethical for physicians to do it, society needs to do it. If the legislature is going to ration health care, then offer a list of clinically wise priorities. This makes sense in terms of marginal costs and marginal benefits. We have to provide that input and then support the legislative decisions that make responsible resource allocation decisions. We have to do that publicly, in our community and at the legislative level.

Uncompensated care requires a partnership solution between public policy makers at the state legislative level and leadership in the medical community. If left unresolved, the problem of uncompensated care is going to result in an erosion in our social commitment to universal access, a deterioration of health for a growing number of Americans with very serious social and economic consequences. It is going to put physicians in conflict with their professional ethics and with what society expects from the health care system. This will lead to regulation, an erosion of clinical autonomy, and very likely a nationally controlled health care delivery system. We cannot accept this outcome as in the final analysis, physicians are patient advocates.

I hope this will assist your understanding concerning the health care industries dilemma and crystallize societies dilemma as well.

Sincerely,

Ray Schalow
Executive Director

AB581

MEDICAL INDIGENCY ProjectNotes

National Conference of State Legislatures Vol. 1, No. 2 February 1990

HEALTH CARE FOR THOSE WHO CANNOT ALWAYS AFFORD CARE

The headlines of the nation's newspapers and periodicals mark the absence of a national health care assurance policy: "US Must Cure Health Care Ills;" "State Health Care Funding Criticized;" "Can You Afford to Get Sick?: The Battle Over Health Benefits;" "US Rations Health Care;"and "Deciding What Medical Care the Poor Can Have: Lists Are Drawn Up." State and federal efforts to better the health care system are fragmented and often work at cross purposes. The lack of agreement on a solution begs the unanswered question: who is responsible?

Health care expenditures have escalated astronomically in the last 25 years. Health care costs consumed 5.9 percent of the Gross National Product (GNP) in 1965. The U.S. Department of Commerce has reported that the nation's health care tab was $600 billion in 1989, or 11.5 percent of the GNP. Those billions, up 10 percent from 1988 total health care expenditures, translate into approximately $2,400 per person. 1990 health spending is expected to reach $661 billion. At the same time, the number of uninsured has grown substantially.

Medical indigency and health insurance are top priority issues for the 1990 legislative sessions. Health insurance issues are explicitly tied to medical indigency policy. Improving access to health care is of concern to medical indigency policymakers as millions of uninsured people report financial barriers to receiving needed care. Mandating health insurance benefits, establishing financial incentives for employer-paid coverage, and creating state-sponsored insurance plans are a few of the key issues facing state lawmakers today.

INSURANCE STATUS

Recent efforts to help solve the problems of medical indigency and uncompensated care focus on the "insurance status" of the population. Lack of insurance leads to an abundance of problems for individuals and health care providers alike. If they can't afford to pay cash or the insurance deductible, the 37 million Americans without health insurance must rely on the goodwill of hospitals, doctors, and other providers. Lack of health insurance or insufficient insurance coverage is not an exclusive problem of the unemployed, the elderly, or persons living in rural areas.

- A decade ago, approximately 25 million Americans under age 65 did not have health insurance. Today, 37 million Americans, approximately 16 percent of the nation's population, have no health insurance coverage at all, more people than the combined populations of New York, New Jersey, and Illinois.
- Of the uninsured and increasingly underinsured Americans, the majority have ties to the workplace. Twenty-three million "working poor" have jobs or are dependents of workers.
- Almost one third of uninsured employees work for employers who do not offer insurance. More than one-third of uninsured workers do not participate in their employer's health insurance plan even if they are eligible. Approximately one-third of uninsured workers do not qualify for their employer's health plans.[1]
- Underinsured people are those who cannot pay for their share of insurance deductibles or copayments or for medical care not covered by their insurance policies. Fifty million Americans are covered only part of the year, and millions more are covered by inadequate plans for catastrophic illness or accident. Nearly every health care consumer has the potential of facing medical expenses for which he or she cannot pay because insurance policies generally have a cap on expenditures.
- The uninsurable or "high risk" population consists of an estimated one to two million people with high health risks, such as heart disease, diabetes, or acquired immunodeficiency syndrome (AIDS). Many are refused health insurance coverage and others cannot afford to purchase an individual policy, which usually is offered for a much higher premium.
- Researchers believe that the uninsurable population is growing and attribute the increase to the following factors: insurers are adopting more restrictive health insurance standards due to an increasingly competitive insurance market; not as many employers are providing health insurance benefits because of escalating costs; and advances in technology enable insurers to identify people who have potentially costly illnesses.
- Others presumably can pay for their care but do not. For example, some people who have insurance do not pay their deductible or copayment amount. It is unclear how many insured people have difficulty paying these costs.

- o Seventeen percent, representing 9.5 million women of child-bearing age (15 to 44), have no private or public health insurance.[2] Researchers have concluded that 9 percent of women who have private insurance have policies that provide inadequate coverage for maternity care.[3]
- o Between the ages of 15 and 44, women's need for health services is substantially higher than men's because of reproductive health needs, including perinatal care and contraception. Furthermore, the reproductive years are the time period when women's health most affects society as a whole, by determining the health of the next generation.
- o Burdens of inadequate and incomplete insurance coverage weigh heavily on minority women. A disproportionate burden of illness falls on ethnic minorities, especially African-American women, giving rise to a greater need for health care.

Among the factors contributing to the growth in the uninsured population are the following: a smaller percentage of poor people are covered by Medicaid, because states have limited eligibility over the years to help control costs; most new jobs in the past 10 years are in the service sector, where employees are less likely to be covered by health insurance; and work-based dependent coverage appears to be declining. For this reason many state initiatives focus on expanding work-based insurance coverage, either by giving employers incentives or by requiring them to make insurance available.

[1] Irene Fraser, *Promoting Health Insurance in the Workplace: State and Local Initiatives to Increase Private Coverage* (Chicago: American Hospital Association, 1988).
[2] Kay Johnson, Director, Health Division, Children's Defense Fund, quoted in Hunger Action Forum, Vol. 2, No. 8, August 1989.
[3] Paula Braveman, MD, et al., *"Women Without Health Insurance: Links Between Access, Poverty, Ethnicity, and Health," The Western Journal of Medicine,* 1988 December: 149: 708-11.

FINANCING INSURANCE COVERAGE

"A main reason why so many people lack health insurance ... is that state government regulations are increasing the costs of insurance and pricing millions of people out of the market for insurance. [illegible]"

All 50 states have mandated benefit laws which typically require employers that offer group health plans to include specific benefits. During the past 20 years, states across the U.S. have imposed nearly 700 of these mandates. This approach has become increasingly more controversial when employers are mandated to provide insurance coverage. The National Center for Policy Analysis estimated that in 1986, between 14 percent and 25 percent, or 5.2 million to 9.3 million of the people without health insurance, had no insurance because state governments imposed special interest regulations that mandated expensive coverage.

States are struggling with the financial realities of health care mandates. States are not always in a financial position to respond to urgent health care needs. The vagaries of funding a multitude of state programs sometimes require states to mandate employer-based expansions of health care services. Financing programs at times is simply beyond the capabilities of current state budgets. However, employer-based mandates are not the only alternative available, a variety of state approaches are presented below:

- o One approach to insuring the employed uninsured population is to expand the number of employers who offer health benefits.
- o Another approach is to develop mechanisms that enable employees who cannot afford their share of the premium for work-based insurance, especially for dependents, to purchase insurance at affordable rates.
- o Unemployed uninsured people also may benefit from programs that enable more workers to purchase insurance, if they are allowed to participate.
- o The problems facing the underinsured may require insurance policies to provide coverage for more services, such as mental health benefits, mammography screenings, and maternity care.
- o Another approach is to exempt certain covered services from cost-sharing requirements.

In 1990 many states will consider these approaches as well as state risk pools for the one to two million Americans deemed uninsurable.

- o At least 15 states have insurance risk share pools to help provide access to insurance for high risk individuals who otherwise would have trouble obtaining coverage.
- o The costs to risk pool participants are usually 25 to 50 percent higher than premiums paid by persons with private insurance.
- o Even with the high contributions paid by covered people, risk pool programs must be subsidized to cover their costs.

State legislatures and the federal government are considering a variety of other financing mechanisms. Alternatives include using funds from general revenues, changing the estate and gift tax laws, increasing tobacco and alcohol taxes, creating tax incentives for expanding health coverage, enacting state risk pool arrangements, mandating benefits, and Medicaid expansions.

WHOSE RESPONSIBILITY?

STATE

State governments are faced with increasing health care costs for the medically indigent and are under pressure to find more adequate and equitable means to finance health care. The following state examples illustrate the innovative ways in which states address these issues:

COLORADO

The Colorado Health Care Access Act **(HB 1034)** was introduced by Representative Carol Taylor-Little and Senator Sally Hopper in January of this year. The legislation, patterned after the 1989 Oregon Basic Services package, proposes to address the access problem in two ways: first, by guaranteeing basic health coverage for everyone with incomes under the federal poverty line and committing not to reduce eligibility or provider payment due to budget constraints; and second, by giving small employers a tax incentive to provide health insurance for their employees, a strategy intended to help the working poor. The act would add as many as 170,000 Coloradans with incomes below the federal poverty line to the expanded Medicaid program, many of whom would be children. Up to 245,000 Colorado workers and their families in thousands of small firms also are expected to benefit.

Under the proposal, an independent, objective commission comprised of health care providers, consumers, and experts in health care financing, delivery, and ethics would develop a list of health care services in order of priority, according to the benefits and costs of each service. The proposal requires the commission to consult with the Joint Review Committee for the Medically Indigent, the Joint Budget Committee, and the House and Senate health committees.

Sponsors of the legislation hope to benefit business in three ways: by giving small employers access to low-cost health insurance through a state pool; by providing a tax credit to small employers who purchase insurance through the pool; and by giving all employers valuable information on the effectiveness and appropriateness of services prioritized by the commission, which employers can use in designing more cost-effective benefit packages, thus helping them to control costs.

GEORGIA

In 1989 Representative E.M. Childers, chair of the House Health and Ecology Committee, authored a resolution in the Georgia General Assembly creating the Access to Health Care Commission **(1989 Georgia Laws, p. 1749, HR 162)**. The commission is charged with studying factors that limit access to health care in Georgia and making recommendations concerning programs and policies to improve access in the state. The commission is composed of 30 members: six representing the state General Assembly (health, insurance, and appropriations committees); health providers (hospitals physicians, nurses, and health centers); health consumers; business; insurers; and state organizations.

A comprehensive solution to the problem of medical indigence is the goal. Georgia has one of the highest infant mortality rates in the United States. Eighteen percent of the population under age 65 is uninsured, including 55 percent of families with income between 50 and 100 percent of the federal poverty level. Of particular concern are the following rural health issues: 40 percent of the state's population are located in rural areas; 50 percent of the population aged 65 and above are located in rural areas; and problems exist with the financial instability of the state's rural hospitals.

INDIANA

Legislation enacted in 1989 **(1989 Indiana Acts, P.L. 327, SEA 385)** established a Commission on State Health Policy. The commission is intended to improve the effectiveness of programs financed by the state and the effectiveness and delivery of health care services in the state. A study and recommendations are to include research on access to health care, the cost of health care and its underlying factors, preventive health care, and the role of healthy lifestyles. The act also creates a State Health Policy Advisory Committee to provide information and assist the commission in the performance of its duties. The commission is to submit an interim report to the governor and the General Assembly before November 1, 1990, and a final report before November 1, 1991.

The Steering Committee on Health Care for the Medically Underserved, a coalition of health care providers, business, government, and consumer representatives, issued a report calling for state-supported demonstration projects to test private financing mechanisms for uninsured and underinsured residents. The projects are intended to help the state develop an overall policy for financing the delivery of health care services to the working poor. The committee recommended that the state expand its Medicaid program to cover more women, children, and infants who cannot afford health care. It also recommended that the state study ways to develop other public programs to increase health coverage for the indigent.

MISSOURI

In December 1989, Representative Gail L. Chatfield proposed sweeping legislation to create the Missouri Universal Health Assurance Plan **(HB 1127)**. The sponsor emphasized that the intent of the legislation is to provide increased health care coverage to citizens who are currently uninsured by restructuring the state's financing mechanisms so that individuals, businesses, and providers of health care may all benefit. The proposed legislation would cover a range of options, including: mandatory employer coverage, direct state subsidies of individual premiums, and expansions of Medicaid. The basic premise behind the bill is to establish a Canadian style comprehensive health program with three guiding principles: universal access, cost containment, and quality assurance.

The Canadian system mentioned above is perceived to have one of the best health care systems in the developed world. The model is best described as a single-payer public system providing affordable, universal coverage. Each province has its own system, although all provinces conform to basic rules of universality and accessibility.

The Missouri plan is intended to replace the patchwork of private and public insurance with a single state insurance program for which everyone is eligible and within which every resident will have access to a basic package of health care services. The proposed plan would consolidate all of the money presently being paid by private companies and individuals, as well as the state, federal, and local governments into a single fund. Finally, the plan contains quality assurance provisions for constant monitoring and improvement of the quality of care.

OTHER

Nearly 1.8 million residents of **North Carolina** either have no health insurance or inadequate coverage. A task force of the North Carolina Institute of Medicine has proposed creation of a comprehensive health-benefits plan that would represent the minimum level of insurance coverage to which all citizens would have access. The plan would include comprehensive coverage for primary care, particularly preventive services, but would provide for only 10 days of inpatient care in order for the coverage to remain affordable. The gross cost of the plan would be $1.4 billion, but institute officials contend that the net cost would be much lower -- about $700 million -- because of savings resulting from reductions in cost shifting and out-of-pocket expenditures by the medically indigent.

In **Washington** state, a bill introduced late in 1989 would create the Universal Health Access Program, based on the Canadian health care system. Nearly 700,000 people -- 15 percent of the population -- remain uninsured and unable to afford health services. Representative Dennis Braddock hopes that a universal health system will enable the state to combine and streamline the various health care programs currently operated by the state with a price tag of $3 billion a year.

FEDERAL

Federal proposals also have addressed the issue of how to better protect uninsured, underinsured, and uninsurable Americans.

The Pepper Commission, created by the now-repealed Medicare Catastrophic Coverage Act of 1988, is currently formulating recommendations on how to deal with the insurance crisis, curb costs, and widen access to care. Among the issues being discussed are the following: implementation of employer-paid health insurance for workers and dependents coupled with a new payroll tax to buy coverage for those lacking insurance; creation of a single government agency empowered to set rates for Medicaid and Medicare; and expansion of Medicaid. The "play or pay" option already has been embraced or proposed in some states, e.g., Massachusetts, Colorado, Oregon, and Washington. However, critics fear it would hurt small firms and trigger unemployment.

The Social Security Advisory Council, a private sector panel studying the system, has until July 1990 to draft a report, with a final report on the health care system due to the Department of Health and Human Services by January 1991. The Council, unlike the Pepper Commission, has no congressional mandate, and no major changes or restructuring are expected to be suggested.

Congress has passed several initiatives to expand Medicaid coverage. The current trend is to expand Medicaid whereby states are able to address the health care needs of pregnant women, infants, and children in low-income families. Forty-one states have raised Medicaid income eligibility to at least the full federal poverty level. Of these, nine have increased their eligibility levels to the maximum allowed -- 185 percent of federal poverty.

LABOR/BUSINESS

The U.S. Chamber of Commerce, the National Association of Manufacturers, and other business groups are pushing for government action. Business representatives maintain that they "have done all we can do" to manage health care costs. Employers realize that if they do not insure workers they pay dearly. They subsidize the cost of care provided to workers whose employers do not provide health care. The issue of health care costs is one of the most bitterly fought at the bargaining table, e.g, "Baby Bell" contract, Pittston Coal Company strike.

Unions have played a major role in developing employer-based health care coverage for working families. Until recently, such coverage provided access to care for most working Americans and their families. But the health insurance system has evolved during the past decade because of the shifting economy. Over the years, organized labor has fought to protect workers from increased health care costs. However, only 29 percent of employers today offer 100 percent reimbursement for health care, compared with 53 percent just five years ago. A growing number of workers are no longer provided family coverage or cannot afford high monthly premium contributions to insure spouses and children. Working families are now paying more for their health care, if they can afford to pay for it all.

In order to control skyrocketing costs, an AFL-CIO grassroots campaign seeks to develop a five-point national health care program that would: place a cap on all health care expenditures, assure all Americans access to basic health care services, invest in technology assessment, develop guides for physicians to consult in treating various conditions, and inform consumers about cost and quality of health care services by making materials available to all consumers. Federation President Lane Kirkland has stressed that the AFL-CIO's objectives are to launch a "combined federal-state program that will control health care inflation, require all businesses to do their fair share in providing health care protection to employees, provide coverage for the poor and unemployed, effectively monitor the quality of health care,

and eliminate unnecessary procedures."

"[illegible] employers seem willing to trade some reductions in deductibles and copayments for additional protection against catastrophic medical expenses. But the appeal of more traditional high-option benefits, such as first-dollar coverage for hospital stays, will lead many employees to choose the high-option plans, no matter how financial incentives are changed to favor low-option plans and HMOs." Pamela Farley Short and Amy K. Taylor, National Center for Health Services Research.

More Americans are paying more for their own health costs, according to the Employee Benefit Research Institute. Of 1,000 Americans surveyed, about 43 percent paid higher monthly premiums in the last two years; another 32 percent paid more for deductibles; and about 40 percent paid more co-payments and dependent-coverage costs. Critics argue that what we do not need are programs that are little more than "band-aids," stop-gap measures that moderate the inequities individuals now experience in the distribution and provision of medical care in our nation.

The question remains, where will responsibility lie? Policymakers at both the state and federal level continue to struggle with these issues. Is a national legislative solution the answer? Some argue that only a federal solution is equitable. On the other hand, federal proposals are often characterized as preemptive of state authority. States are wary of federal interventions that strip state flexibility and displace state plans to deal with the problem. Are individual state solutions the answer? States are in varying degrees of fiscal health. Many contend that piecemeal state solutions will further hamper efforts at "universality." The debate continues, and states retain the authority to address their own needs and develop service systems designed to best respond to their unique circumstances.

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ALTERNATIVE FUNDING SOURCES FOR CARE OF THE MEDICALLY INDIGENT

Medical indigency issues continue to dominate health care agendas across the nation. Legislators feel pressure from a variety of sources to address the problem, including health care advocates, business leaders, physicians, and hospitals, most notably public hospitals. The last few years have witnessed a shift in public policy approaches to meeting the needs of the medically indigent. The goal of presenting state information in ProjectNotes has been to inform state legislators of these approaches.

A variety of approaches have been proposed and implemented to help solve the problem and legislators are keenly aware that what works for one state may not be acceptable or feasible in another. Proven and promising strategies states have used to control health care costs while seeking alternative revenue sources to fund care for the medically indigent are highlighted in the April edition of ProjectNotes.

TECHNICAL ASSISTANCE UPDATE

The Medical Indigency Project has sponsored state technical assistance programs in **Alaska, Colorado, Kansas, Nevada, Oklahoma, South Carolina,** and **Wisconsin.** The April edition of ProjectNotes recaps these programs and tracks legislative activity surrounding the issue of medical indigency in the state since the program presentation.

1989 HEALTH CARE LEGISLATION REVIEW

The Health Services Program is currently compiling the seventh in a series of NCSL publications summarizing significant health care laws passed by the 50 states, commonwealths, and territories in 1989. The section on Medical Indigency will be previewed in the April edition of ProjectNotes.

MEDICAL INDIGENCY PROJECT

The National Conference of State Legislatures (NCSL) has a strong commitment to assisting state legislatures with a variety of medical indigency issues. NCSL is assembling a consortium of funders to address the problems of medical indigency. The Colorado Trust and American College of Emergency Physicians are the first to support the Medical Indigency Project. NCSL received a two-year grant from the Colorado Trust to assist state legislators in developing policies on health care for the medically indigent. The Colorado Trust is a private foundation established in 1985. Its primary mission is to promote and enhance the health and well-being of all people, particularly the citizens of Colorado. The American College of Emergency Physicians strives to provide a unifying direction of purpose in the field of emergency medicine. The college provides information regarding the practice of emergency medicine and encourages training of emergency physicians, with the aim of improving emergency room care.

The project conducts on-site technical assistance, publishes periodic reports, and maintains an information clearinghouse on innovative state programs of care for the medically indigent. The project also will produce three newsletters on issues concerning the medically indigent. ProjectNotes is the first in a series of reports on access to care, financing, and the quality of health care for the medically indigent.

TECHNICAL ASSISTANCE

Technical assistance services offer legislatures programs tailored specifically to their state's situation. Assistance in the past has included special workshops, assistance with drafting legislation, and special testimony.

A number of states have expressed an interest in technical assistance for 1989 - 1990 on a variety of topics related to the issue of medical indigency. Requests for technical assistance come from states with large medically indigent populations and states that have experienced a recent increase in this group. States chosen to receive technical assistance are determined according to state need, issue area, potential impact on the legislative process, and legislative interest. If your state legislature is interested in more information on technical assistance programs concerning issues affecting the medically indigent, please contact project staff.

PUBLICATIONS

The Medical Indigency Project has produced a variety of publications and other information resources on major medical indigency health policy issues. One copy of each publication is provided upon request at no cost to state legislators, legislative staff, and state legislative libraries. Please contact NCSL's Book Order Department at the number listed in the FYI section.

INFORMATION CLEARINGHOUSE

The Medical Indigency Project and other health projects have developed an extensive information clearinghouse on a variety of health topics. The information clearinghouse guarantees legislators and legislative staff a quick, reliable, and knowledgeable source of information when research reports and legislation are being formulated. NCSL's Health Services Program fields over 1,000 information requests a year from legislative offices, health departments, other health care professionals, and the media.

Requests cover a broad range of medical indigency topics, including: uncompensated care, Medicaid eligibility and expansion, funding sources, health insurance regulation, risk pools, mandated health benefits, and state programs for the medically indigent. The resources of the Medical Indigency Project information clearinghouse may be accessed by contacting project staff.

MEETINGS AND SEMINARS

NCSL's Annual Meeting and other seminars and conferences provide an opportunity to reach a large number of interested legislators. Health issues are always among the most important sessions at these meetings and draw large audiences. Information on upcoming workshops will be included in future editions of ProjectNotes.

National Conference of State Legislatures
1050 17th Street, Suite 2100
Denver, Colorado 80265

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A Technical Assistance Program
for the Alaska State Legislature

March 30 - 31, 1990

Health Care Financing Project
Medical Indigency Project

Health Services Program
Human Services Department

National Conference of State Legislatures
1050 17th St., Suite 2100
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CORRECTION

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5/4/90
Binkley
hand out

Alaska Permanent Fund Corporation
P.O. Box 4-1000 Juneau, Alaska 99802-4100
(907) 465-2047

April 25, 1990

The Honorable
Senator Johne Binkley
Co-Chairman, Senate Finance Committee
P. O. Box V
Juneau, AK 99811

Dear Senator Binkley:

You have posed several questions regarding HB 580 which consolidates the investments of several funds under a single corporation known as the Alaska State Investment Corporation. Your questions and my answers follow:

Q: **Proponents of HB 580 indicate that the Alaska State Investment Corporation will be organized and operated similar to the Permanent Fund? Will the two organizations be exactly the same? If not, what are some of the major differences?**

A: The two organizations are not parallel in that there are several major differences as follows:

State Investment would be exempt from the Open Meetings Act.
The Permanent Fund is not.

State Investment would be exempt from the Administrative Procedures Act.
The Permanent Fund is not.

State Investment would be exempt from the State Procurement Act.
The Permanent Fund is not.

Two seats of State Investment's board are appointed by other board members.
All seats on the Permanent Fund's board are appointed by the Governor. There is no "inbreeding".

State Investment staff accountability is not well defined. The board appoints an executive director responsible only for "board executive and administrative functions". (Not investment functions.) That board also appoints an assistant executive director called an "investment director" but assigns him no investment functions. Apparently the executive director cannot remove this assistant. This duality is confusing and will tend to both undermine the executive director and create tension within the organization.

The Permanent Fund has simple, straight lines of authority and accountability. The board appoints an Executive Director who hires his own staff. The Executive Director is accountable to the board for the performance of all functions.

Q: Proponents of HB 580 state that the Permanent Fund should not be responsible for the investment of other funds. Are there any technical reasons which would prohibit the Permanent Fund from assumption of additional investment duties?

A: No. Indeed, the management style employed by the Permanent Fund would probably result in less total cost, provide greater staff depth and restore credibility.

It is interesting to note that HB 580 provides that State Investment can assume fiduciary, administrative or management responsibility for the Alaska Permanent Fund but apparently the reverse is not acceptable.

Q: Should the State's General Fund be managed by an investment company? Could State Investment take over the General Fund under provisions of HB 580?

A: In my opinion the State's General Fund should remain in the Treasury within the Department of Revenue under the direct control of the Governor as a "line" organization. The General Fund has a short-term cash management orientation whereas the other funds have long-term goals and investment regimens. HB 580 would permit the transfer of the General Fund to State Investment on the sole authority of the Commissioner of Revenue.

It would appear that this is the ultimate intent of the framers of HB 580 since there are provisions which permit State Investment to enter into an agreement with the Federal Reserve. Use of the Federal Reserve would be beneficial in the low cost clearance of warrants for the General Fund but would not be a major assist for the trust and endowment accounts. Since a state may enter into only one agreement with the Fed, the placement of the agreement within State Investment will "pull" the General Fund into that organization.

Q: You have set up three State financial organizations; AIDEA, the Bond Bank and the Permanent Fund. How do you feel about HB 580?

A: Uneasy. Financial organizations need authoritarian structure and anti-corruption control. New organizations need to develop credibility. HB 580 is wide open in that it divorces State Investment from too many disciplines. As executive director of the Permanent Fund I would love to have the operational flexibility the many exemptions provide, but I have never requested them because of potential abuse, appearance of abuse, and resultant loss of confidence and credibility.

Q: Legislation on these matters has been somewhat "fast-tracked" because of the SBS problem. Is it essential that we act quickly?

A: Quick action should not result in establishing the wrong organizational structure and guidelines. SBS matters could be handled in the short-run by Administrative or Executive Order. In the long-run, SBS must be managed by investment professionals. The establishment of a totally new financial organization such as State Investment will take some time. The simple renaming of Treasury will not do the trick. It would seem logical that an effective date of January 1, 1991 for all aspects of the legislation would enable the new governor to appoint her/his board members. This legislation should not be used as a vehicle to foster "midnight appointments", finding a resting spot for specific individuals, or starting the building of a critical organization by a group of people who may not be in a leadership role in seven months.

Finally, attached are audited total operating and investing expenses for the past three years per your request.