Legislation Creates New Options for Funding Retiree Health Obligations

By Joel Sutter and Tom Berge

Legislation approved in 2008 has created significant new opportunities for local governments in Minnesota to fund the costs of retiree health insurance and related benefits. At the same time, new accounting standards for these benefits – referred to as "other post-employment benefits" or OPEB – are being phased in for all governmental units.

OPEB and the New Accounting Standards

For years, many local governments have provided limited benefits to retired employees. These benefits usually include health insurance but may also include life, dental, vision, or disability insurance. Until now, most local governments financed these benefits on a "pay-as-you-go basis," simply recording an expense when the premiums and payments came due.

In 2004, the Government Accounting Standards Board (GASB) released Statements No. 43 and 45, which will require that governmental entities recognize liabilities and costs for OPEB in their annual financial statements. The standards are based on the principle that these benefits are "compensation" earned during employment, and that the expense should be measured and recognized in the period in which the benefits are earned.

Implementation of GASB 45 is phased in over a three-year period. Entities with more than $100 million in revenue must implement the standards for the fiscal year ending December 31, 2007, or June 30, 2008. Smaller entities will need to implement GASB 45 over the next two years.

The first step in implementation of the new standards will be completion of an actuarial study to document accrued liabilities and costs for OPEB. The study must be updated every two or three years, depending on the number of employees

The GASB standards allow entities to mitigate the impact of OPEB obligations on their financial statements by setting funds aside in an irrevocable trust. However, in 2005 the Minnesota Attorney General opined that local government entities did not have authority to establish such trusts. And while entities in some other states have issued bonds to fund OPEB trusts, this also was not permitted under Minnesota law.

The 2008 Legislation

The 2008 allows government entities to:

- Establish trusts (either revocable or irrevocable) to fund OPEB costs and liabilities;
- Invest trust funds in stocks and other investments not allowed for other governmental funds; and,
- Issue bonds, without voter approval, to fund their OPEB liabilities and levy additional taxes for bond payments.

While this law gives local governments much greater options in funding their OPEB liabilities, it will also require them to consider some difficult decisions about funding options. One option is to do nothing different other than implementing the new GASB standards. *Neither GASB nor the new State law requires local governments to reserve funds, establish trusts, change their investment strategies, or issue bonds.*

Selecting between a revocable and irrevocable trust will have an impact on how your financial statements are presented. It also will affect the availability of the funds for other purposes.

The new law also specifies who may be a trust administrator and an investment advisor. The trust administrator may be the Public Employees Retirement Association (PERA), a bank or banking association with trust powers, or an insurance company or agency meeting specific qualifications. If PERA is the trust administrator, the funds will be invested through the State Board of Investments, using one of several options they will make available for this purpose. For other trust administrators, the law requires an investment advisor meeting specific qualifications.

Issuing bonds has the potential to reduce pressure on local governments' operating funds. This is particularly true for school districts, which have limited ability to increase their tax levies to fund OPEB costs. Bond proceeds provide a new revenue source to fund a trust; future OPEB costs could then be paid from the trust, rather than from operating funds. However, issuing bonds would increase property taxes and may have other political and financial consequences.

Developing a Plan

Before making any decisions on OPEB funding (e.g., establishing a trust, investing bonds, changing investment strategies), Ehlers recommends that each entity develop a comprehensive financial plan for its OPEB costs and liabilities. The plan should address at least the following issues:

- Determination of the current actuarial liability and the annual required contribution;
- Whether to establish a trust;
- Whether the trust should be revocable or irrevocable;
- What portion of the liability should be funded through a trust;
- How funds in the trust should be invested;
- Selection of a trustee and an investment advisor, if appropriate;
- Whether the liabilities and costs should be funded by issuance of bonds, contributions from existing funds, or some combination of both;
- Bond terms and structures;
- Tax impact of issuing bonds;
- Political and other consequences of issuing bonds;
- The impact on the General Fund; and,
- How future OPEB costs will be funded.

Financial advisors from Ehlers are available to discuss your options and help you develop an OPEB funding plan. Developing an effective plan will require a collaborative effort with your staff, Ehlers, your actuary, your auditor, and in some cases, your legal counsel, trust administrator, and investment advisor. For more information, contact Ehlers.