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March 14, 2007

<u>MEMORANDUM</u>

TO: Local Government Officials

FROM: Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

SUBJECT: Implementation of Governmental Accounting Standards Board Statement No. 45

<u>Background</u>

Many state and local governments provide *other postemployment benefits* (OPEB) to their retirees. OPEB refers to postemployment benefits other than pension benefits and includes healthcare benefits (medical insurance) and other options such as life insurance. The promise to provide these benefits to employees can create a significant liability that the providing government must pay in the future. Most governments have been accounting for OPEB on a "pay-as-you-go" basis which means that the cost of these benefits have been reported as the benefits are paid out to eligible recipients.

In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement 45, titled *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Statement 45 establishes standards for accounting and financial reporting for state and local governmental employers that offer OPEB and requires accrual-basis measurement and recognition of OPEB expenses and liabilities that will result in recognition of expenses over periods that approximate employees' years of active service.

Governments that provide healthcare benefits to both active and retired employees are subject to the provisions of Statement 45. An example is when a local government allows employees to remain in their healthcare plan after retirement and the retiree pays a portion or even 100 percent of the cost of the benefit. **If your local government does not currently or never has offered OPEB, then GASB Statement 45 does not apply to you and you do not need to take any action towards implementing the statement.**

Effective Date

The requirements of the statement are effective in three phases. Governments that were phase 1 governments for the purpose of implementation of Statement 34 should apply the requirements of the statement in financial statements for periods beginning after December 15, 2006; for phase 2 governments the effective date is for periods beginning after December 15, 2007; and for phase 3 governments, the effective date is for periods beginning after December 15, 2008.

Actuarial Valuations

A major issue that needs to be addressed in implementing Statement 45 is actuarial valuations. Actuarial valuations are required by GASB Statement 45 regardless of whether a governmental entity establishes a plan to advance fund its OPEB obligations by accumulating assets or continues to fund OPEB on a pay-as-you-go basis. Actuarial valuations are necessary to comply with the accounting and financial reporting requirements of Statement 45 which includes determining the annual required contribution (ARC). The ARC includes the normal cost for the year and an amount to amortize the total unfunded actuarial accrued liability over a period of up to 30 years.

The actuarial valuation is required at least every two years for all OPEB plans that have a total membership of 200 or more and at least every three years for plans that have fewer than 200 members. A simplified alternative measurement method of obtaining actuarial valuations is available for OPEB plans that have fewer than 100 members.

Any local government subject to the requirements of GASB Statement 45 that does not obtain the mandated actuarial valuation will most likely receive an adverse opinion from its auditor on its financial statements. This is because the accounting and reporting requirements of the standards cannot be met without an actuarial valuation.

Funding Issues

The new OPEB standard does not mandate the funding of OPEB benefits (in other words, to set aside assets in advance to pay benefits in the future).

If you do not advance fund actuarially determined required contributions of OPEB benefits, a liability will be reported on the local government’s accrual-based financial statements. For those who stay with the pay-as-you-go approach, the OPEB liability could eventually cause a deficit balance in Net Assets, which could affect bond credit ratings and the cost of borrowing.

Therefore, local governments that offer OPEB are encouraged to establish a trust fund or an arrangement with a separate plan administrator for accumulating assets to pay future OPEB.

Chapter 771 of the Public Acts of 2006 authorizes and sets conditions for political subdivisions of the state of Tennessee to establish an investment trust for the purpose of prefunding OPEB. A copy of Chapter 771 of the Public Acts of 2006 is attached.

What Do Local Governments Need to Do Next?

Local governments should review existing OPEB arrangements and retain an actuary to value OPEB liabilities and provide reporting requirements. They should also consult with their financial advisors, accountants and auditors about compliance with GASB Statement 45.

For a plain language summary of GASB Statement 45, go to the following address on the GASB's website, www.gasb.org/project_pages/opeb_summary.pdf. The Government Finance Officers Association has prepared a publication entitled *The Elected Officials Guide to OPEB*. Contact the Government Finance Officers Association for information about this publication at 312-977-9700.

Local governments subject to the provisions of GASB Statement 45 should start working towards the implementation of the statement as soon as possible. Any questions about the contents of this memorandum should be directed to the Division of Municipal Audit.

Enclosures: Chapter 771 of the Public Acts of 2006

CHAPTER NO. 771

SENATE BILL NO. 3530

By Henry

Substituted for: House Bill No. 3449

By Sargent

AN ACT to amend Tennessee Code Annotated, Title 8, Chapter 50, relative to the creation of investment trusts for certain post-employment benefits offered by governmental entities.

WHEREAS, the Governmental Accounting Standards Board issued Statements 43 and 45, which set forth standards on accounting and reporting for post-employment benefits (other than pensions) by governmental entities; and

WHEREAS, these new standards will require political subdivisions of the State of Tennessee to account for such post-employment benefits on an actuarial basis during an employee's career rather than on a pay-as-you-go basis during retirement; and

WHEREAS, it is beneficial to the state to assist Tennessee political subdivisions that offer other post-employment benefits by authorizing such subdivisions to create an investment trust whereby the political subdivisions may begin financing those benefits in advance; now, therefore,

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 8, Chapter 50, is amended by adding a new part thereto as follows:

8-50-1201. Short title. This part shall be known and may be cited as the "Other Post Employment Benefit Investment Trust Act of 2006".

8-50-1202. Definitions. As used in this part, unless the context otherwise requires:

(1) "State Funding Board" or "Funding Board" means the board created pursuant to § 9-9-101;

(2) "Other post-employment benefits" or "post-employment benefits" means non-pension benefits paid on behalf of former employees or the former employees' beneficiaries after separation from service. Such benefits may include, but shall not be limited to, medical, prescription drugs, dental, vision, hearing, Medicare Part B or Part D premiums, life insurance, long-term care, and long-term disability;

(3) "Political subdivision" means any Tennessee local governmental entity including, but not limited to, any municipality, metropolitan government, county, utility district, school district, public building authority, and development district created and existing pursuant to the laws of Tennessee, or any instrumentality of

government created by any one (1) or more of the named local governmental entities or by an act of the general assembly.

8-50-1203. Establishment of Trust. (a) A political subdivision as defined in § 8-50-1202 (3) may by resolution legally adopted and approved by its chief governing body establish an investment trust for the purpose of pre-funding other post-employment benefits accrued by employees of the political subdivision, to be paid as they come due in accordance with the arrangements between the employers, the plan members and their beneficiaries. This authorization shall be subject to the following conditions:

(1) The chief governing body must establish a written plan of the post- employment benefits provided;

(2) The investment committee of the political subdivision must adopt, in writing, an investment policy authorizing how assets in the trust may be invested;

(3) The trust must conform to all applicable laws, rules and regulations of the Internal Revenue Service, if any; and

(4) The trust document, the written plan of benefits, and the investment policy as well as any other information or documentation as determined by the funding board must be submitted to the state funding board for approval.

8-50-1204. Trust Conditions. (a) The assets of any trust created under this part shall be irrevocable, and shall be preserved, invested and expended solely pursuant to and for the purposes of this part and shall not be loaned or otherwise transferred or used for any other purpose. The assets of the trust shall be expended solely to:

(1) Make payments for other post-employment benefits pursuant to and in accordance with terms of the political subdivision's respective post -employment benefit plan; and

(2) Pay the cost of administering the trust.

(b) Any investment trust so created shall have the powers, privileges and immunities of a corporation and all of its business shall be transacted, all of its funds invested, and all of its cash and securities and other property held in trust for the purpose for which received.

(c) Notwithstanding any law to the contrary, all assets, income and distributions of the investment trust shall be protected against the claims of creditors of the political subdivisions, plan administrators, and plan participants, and shall not be subject to execution, attachment, garnishment, the operation of bankruptcy, the insolvency laws or other process whatsoever, nor shall any assignment thereof be enforceable in any court.

8-50-1205. Powers and duties. In addition to the powers granted by any other provisions of this part, the chief governing body of a political subdivision that establishes an investment trust hereunder shall have the powers necessary or convenient to carry out the purposes and provisions of this part and the purposes and objectives of the investment trust including, but not limited to, the following express powers:

(1) Invest any funds of the trust in any instrument, obligation, security, or property that constitutes legal investments as provided in the investment policy adopted pursuant to § 8-50-1203(a)(2);

(2) Contract for the provision of all or any part of the services necessary for the management and operation of the investment trust;

(3) Contract with financial consultants, auditors, and other consultants as necessary to carry out its responsibilities under this part;

(4) Contract with an actuary or actuaries in determining the level of funding necessary by that political subdivision to fund the other post-employment benefits offered by the subdivision;

(5) Prepare annual financial reports, including financial statements, following the close of each fiscal year relative to the activities of the trust. Such statements and reports shall contain such information as shall be prescribed by the board and be prepared in accordance with the governmental accounting standards board; and

(6) Upon the request of the State Funding Board, file the annual report and financial statements with the chair of the funding board. The report and statements shall be filed with the chair of the board within ninety (90) calendar days from the date of the request, unless the chair extends such time in writing.

8-50-1206. Audit. The annual report, including financial statements, all books, accounts and financial records of any trust created hereunder shall be subject to audit by the comptroller of the treasury. Any political subdivision maintaining a trust under this part may, with the prior approval of the comptroller of the treasury, engage licensed independent public accountants to perform the audits. The audit contract between the political subdivision and the independent public accountant shall be on contract forms prescribed by the comptroller of the treasury. The political subdivision is responsible for reimbursement of the costs of audits prepared by the comptroller of the treasury and the payment of fees for audits prepared by licensed independent public accountants.

8-50-1207. Scope of Part. Nothing in this part shall be construed to define or otherwise grant any rights or privileges to other post-employment benefits. Such rights and privileges, if any, shall be governed by the terms of the political subdivisions' respective post- employment benefit plans.

SECTION 2. This act shall take effect upon becoming a law, the public welfare requiring it.

PASSED: May 11, 2006

JOHN S. WILDER
SPEAKER OF THE SENATE

JIMMY NAIFEH, *SPEAKER*
HOUSE OF REPRESENTATIVES

APPROVED this 26th day of May 2006

PHIL BREDESEN, GOVERNOR