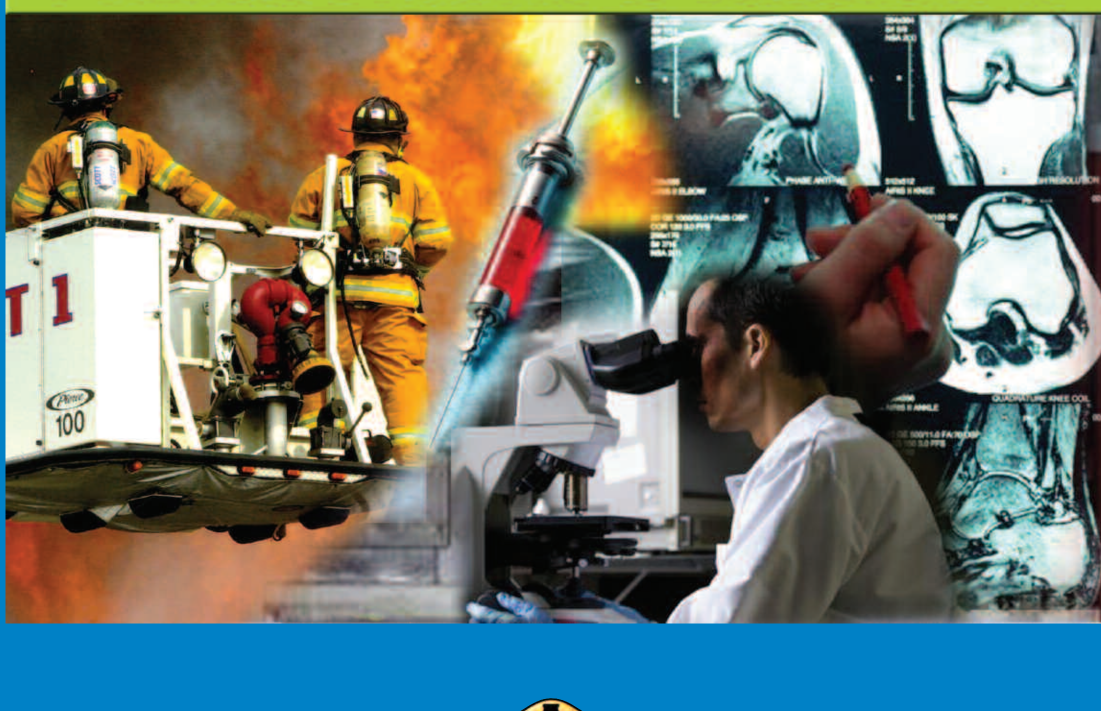
THE GREAT GASB

Potential Solutions to Statement 45



The Great GASB

Potential Solutions to Statement 45

GASB 45, a new accounting rule under the Governmental Accounting Standards Board, says that public employers can no longer report their other post-employment benefits (OPEB) on a pay-as-you-go basis but instead must account for and report the annual cost of these benefits for current and future retirees. While public employers do not have to actually pre-fund OPEB benefits, the new rule may push many jurisdictions to consider cost-cutting measures that could affect the financial health and well-being of IAFF members.

IAFF General President Harold Schaitberger warns, "It's likely that public sector employers will look to reduce retirement health care benefits to adjust their budgets under this new standard. Our members need to be prepared to assist their locals in fighting this massive challenge."

IAFF locals are urged to resist their employers' efforts to use GASB 45 as an opportunity to change or cut retiree health care benefits. There are many options to consider when complying with GASB 45, but cutting benefits should not be one of them. Each employer and local must work together to find a solution to GASB 45.

Some options to consider in complying with GASB 45 and alternatives to prevent cutting OPEB benefits:

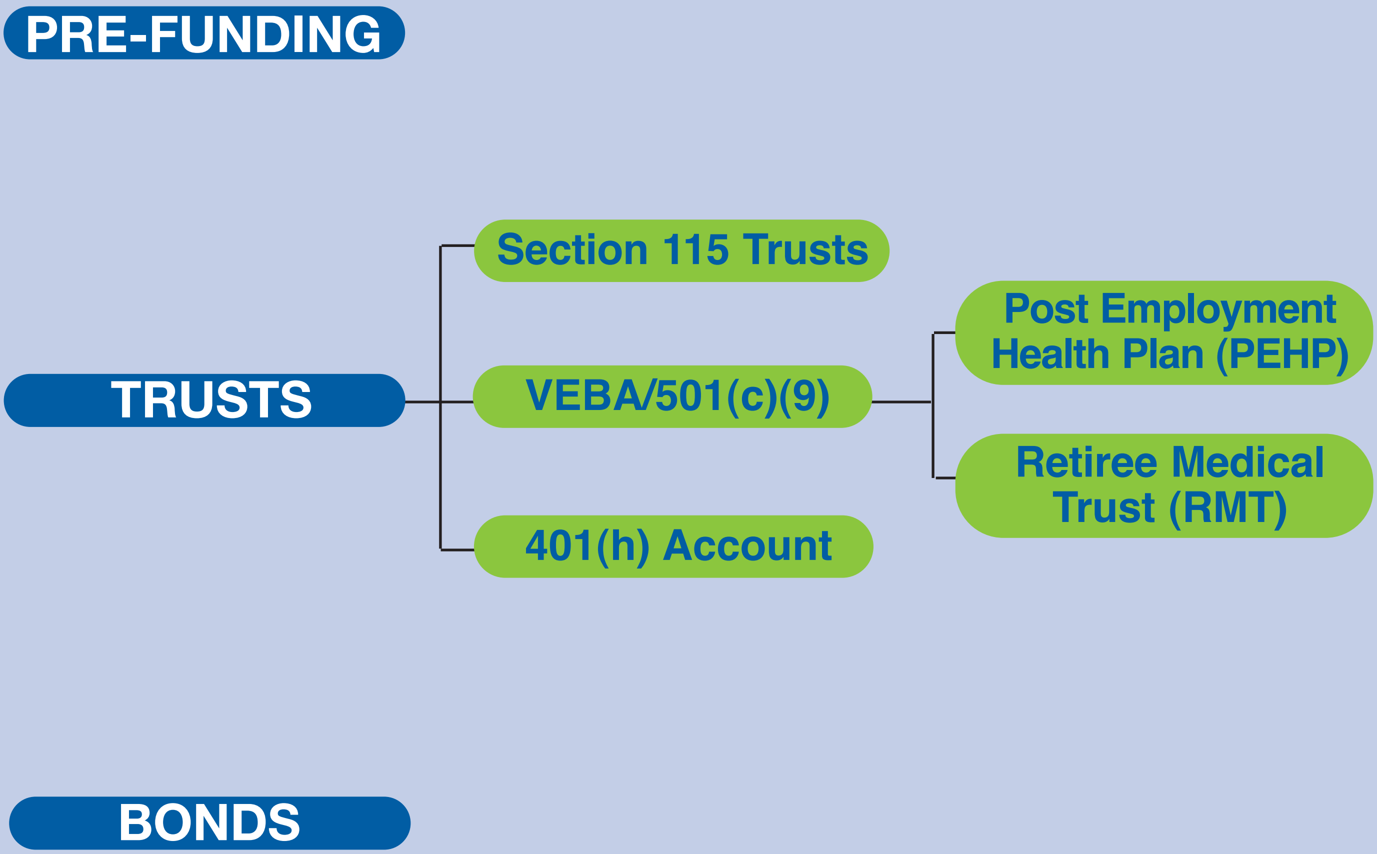
- Pre-fund retiree benefits.
- Use bonds to ease the funding burden and prevent benefit cuts.
- Use trusts to assist in paying for health insurance premiums, drugs, co-pays and deductibles for retirees. The costs of these items generally rise exponentially for retirees and are expensive for all individuals and increase as individual's age.

Effective Dates for GASB 45

Total Annual Revenues of the Sole or Largest Participating Employer in the Plan In the First Fiscal Year Ending After June 15, 1999	OPEB Statement will be Effective for that Employer for Periods Beginning After	OPEB Statement will be Effective for the Plan for Periods Beginning After
Phase 1: Government —$100 million or more	December 15, 2006	December 15, 2005
Phase 2: Government —$10 million or more, but less than $100 million	December 15, 2007	December 15, 2006
Phase 3: Government —Less than $10 million		December 15, 2007

Because of the dates above, many IAFF affiliates have not yet dealt with GASB 45. You may only find a few examples throughout this document.

GASB 45: Potential Solutions



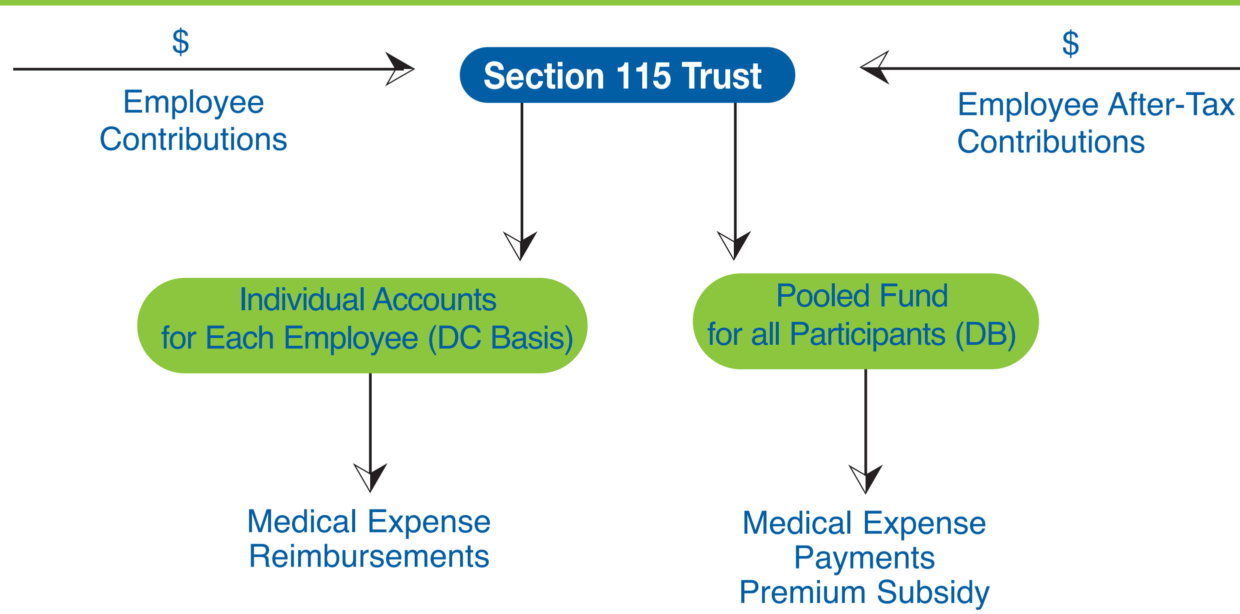
Pre-Funding

Summary	Advantages	Disadvantages	How to get started
Although GASB 45 does not require employers to pre-fund OPEB costs, to ease increased liabilities employers may consider pre-funding as a potential solution. Pre-funding means that employers would set aside the money to fund OPEB benefits they will owe in the future. Other pre-funding options include partial pre-funding and pre-funding for new employees only.	Costs are more predictable. Pre-funding contributes to higher bond ratings. Investment earnings on assets can help offset the cost of benefits. Benefits are more secure if assets have already been set aside to pay for them. The press and public can be used to urge employers to pre-fund and avoid a large liability.	Additional and larger initial payments would be necessary to cover the unfunded liability. The employer (municipality or city government) may have to adjust revenue and the tax rate, which could have political implications. Employers may attempt to alter or cut OPEB benefits, wages or services.	Set aside a trust used only to pay for benefits if the assets go toward lowering the balance sheet's OPEB liability. Create a separate account or earmark funds for pre-funding option. Establish a VEBA Trust to pre-fund OPEB costs.

Section 115 Trusts

Summary	Advantages	Disadvantages	How to get started
A Section 115 Trust provides a tax-exempt base for funding retiree health benefits.	Establishing a 115 Trust is generally less expensive than a VEBA Trust because there are fewer IRS interpretations required (depending on the plan). The 115 Trust is established by a governmental unit, including a municipality, to set aside funds for paying employee benefits. The accumulation of funds is excluded from federal income taxes. Meets GASB 45 requirements for pre-funding OPEB.	Because the Trusts can be based on individual accounts, the balances are often depleted before a retiree's death. Individual employees have limited control over their accounts since Section 115 Trusts are established and maintained by the employer. The variable amount option may lead to uncertainty as to how much money is available monthly for reimbursement, putting the emphasis on budgeting.	The employer or municipality must establish the Trust. Section 115 Trusts are government sponsored and controlled. They can be structured to provide very different benefits: -Fixed contribution and fixed amount available for medical expenses per month for life. -Fixed contribution and variable amount available for medical expenses per month for life (set annually). -Actuarially determined contribution and fixed (or non-fixed) amount available for medical expenses for life.

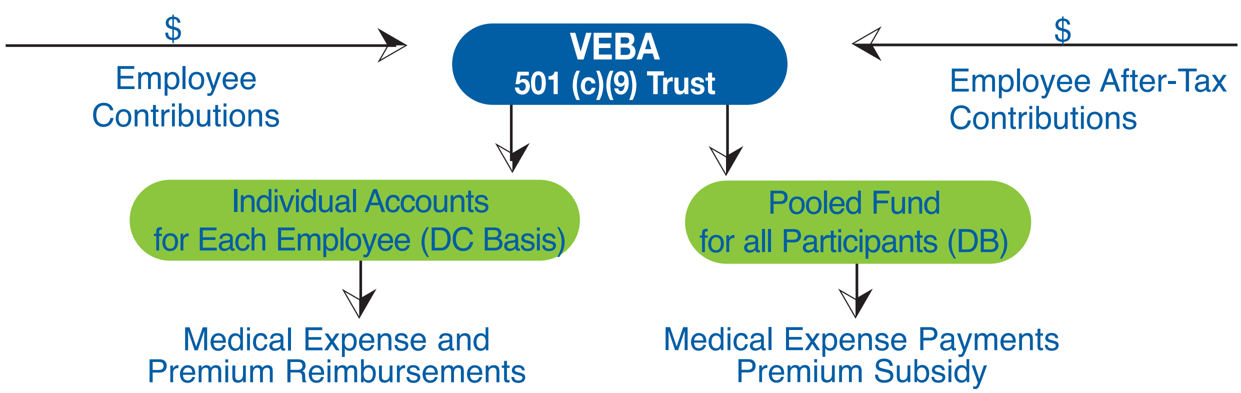
Section 115 Trusts



Voluntary Employee Beneficiaries Association (VEBA)

Summary	Advantages	Disadvantages	Affiliate examples	How to get started
A VEBA Trust is a tax-exempt trust primarily used to fund eligible medical expenses. It is created by an employee organization, an employer, or both, and is considered a 501(c)(9). Employees and employers may fund VEBA accounts through payroll deductions, as well as through proceeds from cashing in accrued leave. Trust earnings accumulate and compound and may be used to reimburse life, sick, accident or other health-related expenses. VEBA Trust pays for health insurance premiums for retirees, including COBRA, dental vision, long-term care premiums or out of pocket expenses for any qualified dependant. Unused funds may be carried over from year to year, and in the event of the death of the plan participant, dependents can continue to use the funds	for reimbursement.	VEBA Trusts are funds that are invested and accumulate tax-free. Upon termination, employees and their dependents are eligible for tax-free medical expense reimbursements up to their account balances. The employer does not pay payroll taxes on plan contributions, including sick, vacation and personal days or early retirement incentives. Should an employee terminate his/her employment, the employee can continue to draw down the VEBA account. VEBA Trusts provide consistency in benefits and costs over time. VEBA Trusts meet GASB 45 requirements for prefunding OPEB.	Unless written into the VEBA structure as allowable, employees may not rollover their individual account into another VEBA plan. An individual VEBA Trust account could be depleted before the retiree's death. VEBA Trusts include administrative costs. Individual participation is not an option; the IRS requires employees to decide in groups.	Salt Lake City, UT Local 1696 set up a PEHP plan for each of its employee groups. Metro Dade, FL Local 1403 Other examples: http://www.vebaonline.com/home/home.htm

Voluntary Employee Beneficiaries Association (VEBA)



Post Employment Health Plan (PEHP)

Summary	Advantages	Disadvantages	Affiliate examples	How to get started
A Post Employment Health Plan (PEHP) is a health reimbursement plan.It is a type of Voluntary Employees Beneficiaries Association (VEBA). A VEBA is a tax-exempt trust primarily used to fund eligible medical expenses. A VEBA Trust is set up by an employee organization and is considered a 501(c)(9). The PEHP is approved by the IRS and provides employees with tax-free reimbursements of medical expenses upon separation of service or retirement. The PEHP is similar to a defined contribution plan where funds are self directed. Employers have the option of funding the PEHP program solely with accrued employee sick and/or vacation leave, and may also elect to make an annual ongoing contribution for each eligible employee. The PEHP can pay for health insurance premiums, COBRA, long-term care premiums, dental/vision premiums and others. PEHP meets GASB 45 requirements for pre-funding OPEB.	Employers may elect to fund the plan solely with employees' unused sick leave and/or unused vacation leave. They may also fund the plan with an annual ongoing contribution for each employee. Paying accumulated compensated absences to employees in the form of a PEHP benefit instead of cash can help an employer reduce its recognized unfunded payroll tax liability. When employers invest reserves to fund the PEHP, they lower their payroll tax burden and at the same time provide employees with a post-employment health care benefit. The amounts contributed to the plan by the employer, investment earnings on the contributions, and the amounts distributed to them for the reimbursement of qualified medical expenses are free from federal income and FICA taxes. Employers have no tax reporting requirements associated with the program. The PEHP is pre-established. The start-up paperwork is available and has been IRS approved.	Third party administration costs. All bargaining unit employees must participate. In a non-collective bargaining environment, all employees must participate. (The employer may choose to establish different plans for different departments. For example, police, fire and public works.)	Salt Lake City, UT Local 1696 set up a PEHP plan for each of its employee groups. Metro Dade, FL Local 1403. Denver, CO Local 858. Burbank, CA Local 778. Lincoln NE Local 644.	Research potential funding sources. Discuss this option with members and the local's executive board. The IAFF-FC and Nationwide Retirement Solutions offer the PEHP to IAFF locals. Visit http://www.iaff-fc.com/services-PEHP.aspx for more information. Request information from IAFF-FC at the following email: info@iaff-fc.com then make the request for this benefit to the employer. The first step for the employer is to determine how the PEHP program will be funded. Once the funding is determined and the plan is adopted by the employer, the employer sends the periodic contributions on behalf of the employees to the program.

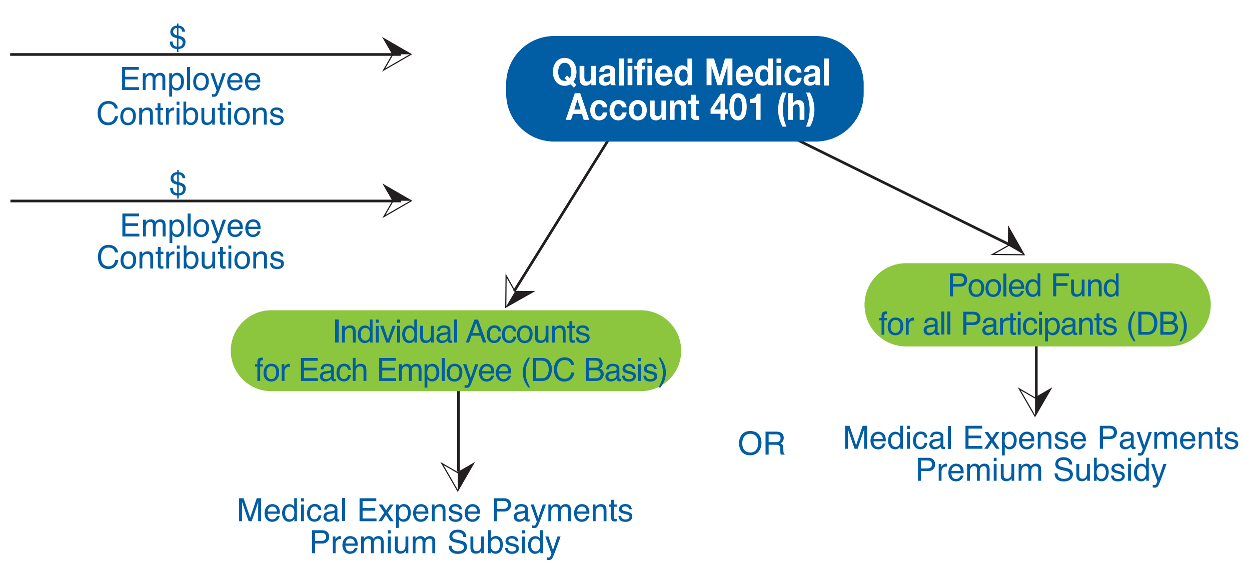
Retiree Medical Trust (RMT)

Summary	Advantages	Disadvantages	Affiliate examples	How to get started
A Retiree Medical Trust (RMT) is a hybrid health plan with features similar to defined benefit and defined contribution plans in that employers and/or employees make fixed contributions during the active employment of participating employees. These contributions can be pooled and held in a trust, a legally separate entity from the employees and the employer. Alternatively, the RMT can fund individual accounts. The contributions to the trust accrue earnings on a non-taxable basis. Upon retirement, RMTs can provide regular variable (non-vested) benefit payments to retirees for health care expenses similar to defined benefit pension plans. These payments may be used for out-of-pocket expenses, as well as health care premiums. Employers are exempt from payroll taxes on RMT contributions if the entire bargaining unit or group participates. Employee contributions are tax-exempt if they are mandatory. The trust is controlled by a board of trustees, made up of employees and/or employer representatives who design the plan, select professionals for investment of the funds and decide on distribution options.	Flexible and designed to meet the needs of the employees. RMTs cover medical premiums and expenses. RMTs include survivor benefits. RMTs are not limited by Internal Revenue Code 415 pension plan rules. A government may implement an RMT that does not create GASB liabilities if it consults with plan accountants and attorneys to carefully define contribution to the plan. Employers are not required to pay payroll taxes on RMT contributions. RMTs are tax-free for retirees because the benefit payments are used to reimburse medical costs.	Start-up costs are expensive and include consultations with actuaries, attorneys and accountants. RMTs favor groups over individuals—contributions are tax exempt only if the entire bargaining unit participates. Third party administration is required. Buy-in of the membership is required. Actuarial reviews are necessary. RMTs do not have a set plan or package; each one is different.	The Washington State Council of Fire Fighters established an RMT whereby participating employers or employees make monthly contributions with a projected plan to disburse a monthly amount for life after retirement. Clark County, NV, Local 1908 is establishing an RMT for retirees, funded by active employees. The city contributes each month to offset costs. The benefit is that the city is removed from liability for OPEB costs because it's controlled off the city's books.	RMTs can be established by employers, employee organizations, or both. Financing is achieved through pre-tax employer contributions that range from 1%-11% of salary. Employee contributions to RMTs could include transfer of an employee's accrued sick and vacation leave. The local should work with an attorney and an actuary to make decisions on enrollment, contributions and the logistics of an RMT. Elect a board to oversee the trust and develop a portfolio. After this process has been completed, the trust must be ratified by the members. Learn more from NCPERS about RMTs: www.ncpers.org

401 (h) Account

Summary	Advantages	Disadvantages
A 401(h) is a trust established under Internal Revenue Code that permits the maintenance of a separate account within the employer's Defined Benefit Pension Plan, and which is used to pay the employee's life insurance and medical expense costs. Contributions to this account are tax deductible, and the investment's earnings accumulate on a tax deferred basis. For the pension or annuity plan to meet the requirements of section 401(h), medical benefits must be (1) subordinate to pension benefits and (2) maintained in a separate account. In addition to tax-free accumulation, the medical benefits provided through a 401(h) account are also tax-free to retirees. 401(h) trusts must have a separate account for funding, actuarial and record-keeping purposes.	Contributions to a 401(h) will accumulate tax-free. 401(h) plans satisfy GASB requirements. 401(h) plans offer a solution that permits a qualified pension plan to provide tax-free medical benefits. 401(h) plans can include employee contributions, as well as employer contributions. The employer can fund the 401(h) on a pre-retirement basis. 401(h) plans allow account balances to carry over from year to year. Accounts are not maintained on an annual "use it or lose it" basis. 401(h) plans are administered under an existing board of trustees (i.e., the pension plan board), so no new administrative structure is needed. Excess pension plan assets may be used as a funding source.	401(h) accounts are outside the control of the employee organization. IRS imposes limits on funding 401(h) accounts. Contributions to the plan count against contribution limits to the pension plan. Distributions may only be made for qualified medical expenses. 401(h) accounts must have a formal legal structure. Money cannot be transferred between pension reserves and 401(h) reserves (except if you qualify for and follow Code Section 420). Benefit obligations are subordinate to the pension plan obligations. Tax qualification issues related to the 401(h) accounts may jeopardize qualification of the entire pension plan.

401 (h) Account



Bonds

Summary	Advantages	Disadvantages	Affiliate examples	How to get started
IAFF affiliates may consider the incorporation of OPEB bonds as an alternative means of funding health care benefits. To pay for a liability, an employer might sell a bond to an investor. In order to invest the proceeds in a way that results in an investment rate of return that outweighs the interest generated by the bonds. The OPEB bonds issued to date have been taxable, thus affording investment flexibility of proceeds. Therefore, the bond proceeds *and* the amount taxed go to the employer. An OPEB bond may have a minimal effect on total government debt and on the government's debt rating.	Liability of OPEB is paid. The employer assumes the risk.	Debt is now owed to the OPEB bond. Increasing health care expenditures make an OPEB bond risky. If the growth in health care expenditures exceeds the rate of return on the bonds, the employer will have to find another means of funding the difference. There is projected data for determining an estimate, but no fixed figures for future health care expenditures.	The city of Gainesville, Florida (Local 2157) issued a taxable OPEB bond as part of funding for its retiree health care plan.	Offer bonds as an alternative to cutting benefits. The employer must handle selling a bond.

GASB 45 Resources

- **IAFF GASB 45 Resource Home**
  www.iaff.org/gasb45
- **IAFF Web Forum on GASB 45**
  www.iaff.org/gasb
- **IAFF Online Jobaid: GASB 45**
  www.iaff.org/ET/jobaids
- **IAFF's GASB 45 Online Resource List**
  www.iaff.org/tech/LICB/BENgasb45.html
- **Governmental Accounting Standards Board**
  www.gasb.org
- **Find more Education and Training Programs** at www.iaff.org/et

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