



**CALIFORNIA SPECIAL DISTRICTS ASSOCIATION**

**DATE:** October 2, 2007



**CALIFORNIA STATE ASSOCIATION OF COUNTIES**

**TO:** Gerald Parsky, Chairman  
Public Employee Post-Employment Benefits Commission

**FROM:** Thomas Vu, California Special Districts Association  
Steve Keil, California State Association of Counties  
Rod Dole, County Auditors Association of California  
Desi Rodrigues, Department of Personnel Administration  
Dwight Stenbakken, League of California Cities  
Paul A. Smith, Regional Council of Rural Counties  
Sheila Vickers, School Services of California  
Richard Stensrud, State Association of County Retirement Systems



**COUNTY AUDITORS ASSOCIATION OF CALIFORNIA**

**RE:** Recommendations to the Public Employee Post-Employment Benefits Commission Regarding Public Agency OPEB Obligations



**CALIFORNIA DEPARTMENT OF PERSONNEL ADMINISTRATION**

The above public agency associations and individual public agencies have met throughout 2007 in an effort to provide assistance to the Public Employee Post Employment Benefits Commission (PEBC). We have met in consultation with staff from: PEBC, Department of Finance, State Department of Personnel Administration, California Research Bureau, State Department of General Services and Public Employee Retirement System. In part, we have assisted the development of a format, and collection of data, for a statewide survey of Other Post Employment Benefit (OPEB) related information from public agencies, results from which are being compiled by your staff. In addition we have met to develop, by consensus, "best business practice" recommendations to your Commission pertaining to management of OPEB obligations. Individual signatories to this letter may have additional recommendations that may be separately presented to your Commission.



**LEAGUE OF CALIFORNIA CITIES**

We jointly recommend your Commission adopt the following "best business practice" recommendations (not presented in priority order) pertaining to management of OPEB obligations:



**REGIONAL COUNCIL OF RURAL COUNTIES**

1. Request the State Controller to recommend a simple and inexpensive procedure to regularly retrieve and report OPEB related data from California public agencies. Consideration should be given to the experience of agencies complying with the 2007 survey to the Public Employee Post Employment Benefits Commission.
2. Seek federal guidelines, or in their absence a letter (see attached draft letter requesting a letter) from the Federal Office of Management and Budget (OMB), which may involve legislation or regulatory change, to ensure the



**STATE ASSOCIATION OF COUNTY RETIREMENT**

federal government will pay its proportional share of payroll cost obligations for bonded debt service used to pre-fund OPEB trusts.

3. Seek clarification from the Internal Revenue Service in a Revenue Ruling or some other document that may be relied upon by public employers regarding technical issues that would facilitate OPEB trusts including: (i) establishment of IRC 115 trust accounts for individual employee OPEB accounts, (ii) establishment of IRC 115 “essential governmental function” trust accounts for prefunding multi employer trusts for OPEB liabilities, (iii) establishment of IRC 115 “integral part” trusts for prefunding single employer OPEB liabilities, and (iv) operation of “self insured” retiree health plans established by meet and confer between labor and management.
4. Recommend GASB Standards 43 and 45 be clarified to permit trust fund accounts for OPEB to also be revocable for the single purpose of pre-payment of OPEB debt service. This could be accomplished by GASB permission to use revocable trust funds to deposit bond proceeds used to pre-fund OPEB unfunded liability (Preference would be to deposit bond proceeds in a revocable trust fund. We would continue depositing the Annual Required Contributions (ARC) to an irrevocable trust fund), and consideration of different amortization periods based on plans for funding.
5. Seek clarification in state statute, the Internal Revenue Code, and GASB regulations that OPEB trust funds may be used for both benefit payments and for early retirement of debt used to establish the OPEB trust.
6. Develop informational materials, in simple language, regarding what are GASB 43 & 45 obligations, and what issues public agencies should consider when planning for compliance.
7. Develop informational materials regarding what types of indebtedness options are available to public agencies to pre-fund OPEB trust accounts, including legal requirements for each.
8. Develop informational materials regarding what types of federal and state arrangements are available for agencies to pre-fund for OPEB costs.
9. Develop informational materials regarding retiree health care and actuarial “best practices” approaches by employers and unions for management and control of OPEB costs.
10. Seek clarification in state law, and if necessary from Federal Bankruptcy law, that creditors cannot attach assets in OPEB trusts.

We greatly appreciate the work of your Commission and look forward to an opportunity to discuss these recommendations with your Commission. If you have any questions, you may reach Thomas Vu at 442-7887, Steve Keil at 327-7500 ext. 521, Rod Dole at (707) 565-3287, Desi Rodrigues at 324-9400, Dwight Stenbakken at 658-8213, Paul A. Smith at 447-4806, Sheila Vickers at 446-7517, and Richard Stensrud at 874-9119.

Attachments

September 13, 2007

### Internal Revenue Code (IRC) Clarification Request

The purpose of this letter is to obtain clarification of IRC laws affecting healthcare accounts and trusts. The information will be used to assist us with our recommendations to the Public Employee Post-Employment Benefits Commission regarding OPEB obligations. We are requesting a response to the following questions:

1. What are all the "qualified" options available to pre-fund retiree healthcare benefits? Please provide implementation, restrictions, and accounting treatments.
2. Is the Voluntary Employee Benefit Account (VEBA) trust exclusive to health benefit or can other benefits (e.g., dental, vision, life insurance) be pre-funded under this trust?
3. Does the nondiscrimination rule apply to Section 115 Governmental trust?
4. Does Section 115 Governmental trust qualify as GASB Nos. 43 or 45 assets?
5. How is the employee contribution treated under Section 115 Governmental trust?
6. Is IRS approval required to establish a Section 115 Governmental trust?

Clarification of these questions will be beneficial and greatly appreciated.

September 17, 2007

Ms. Carrie Hug, Chief  
Financial Standards and Grants  
Office of Federal Financial Management  
Office of Management and Budget  
725 17<sup>th</sup> Street, NW, Room 6025  
Washington D.C. 2053

Dear Ms. Hug:

The purpose of this letter is to request that local jurisdictions may claim debt service on bonds issued to fund the actuarially calculated unfunded Other Post Employment Benefits (OPEB) liability under Paragraph B.13.b. of Circular A-87 (1993 version) and currently stated within 2 CFR Part 225, Appendix B, item 8, d., e., & f., following the same conditions and criteria outlined in the OMB Policy Statement Letter issued on January 31, 1994 by Norwood J. Jackson Jr. For purposes of this letter, the term "bonds" is also defined to include "other obligations". For purposes of this letter, the terms "claimable" and "allowable" means such expenditures shall be deemed allowable costs for purposes of claiming federal financial participation for applicable program costs.

As concluded in Mr. Jackson's letter regarding pension obligation bonds (POB's), we believe that debt service on bonds issued to finance an unfunded OPEB liability is the surrogate for allowable payments on the unfunded OPEB liability included in the annual actuarially-calculated OPEB Annual Required Contribution and, therefore, should be allowable.

Following these criteria for POB's, since debt service on OPEB actuarially calculated unfunded liabilities is allowable by Federal agencies under the foregoing provisions of Circular A-87, debt service on bonds issued to fund the OPEB actuarially calculated unfunded liability should be allowable if the following criteria are met:

- Debt financing of the unfunded actuarial liability is not more costly to the Federal Government than the allowable costs for the actuarially calculated unfunded liability over the remaining unamortized life of the OPEB UAL, considering bond principal, debt service, issuance costs, and any other relevant factors, as determined at the time of financing. If this criterion is not met, debt service on debt issued to finance the UAL will be allowed only to

the extent of no further cost savings under the current provisions of Circular A-87.

- All net bond proceeds are deposited in trust, invested, and managed similarly to a pension system.
- The funding for bond principal and debt service is (a) included in each period's OPEB requirement (e.g. annual, biennial, or other), (b) computed in the same manner as the actuary's amortization of the UAL at the time of the conversion to debt financing, and (c) calculated using the weighted average debt service rate on the bonds for the period in place of the actuarially assumed debt service rate. The period's OPEB requirement consists of funding for bond principal and debt service applicable to the period and the OPEB contribution requirement computed by the actuary for the normal costs and any UAL not funded by the bonds. Alternatives to (b) and (c) may be used if they do not result in substantially different OPEB charges.

Our primary objective of this request is to effectively reduce the debt service costs on the actuarially calculated unfunded liability by issuing bonds at a lower debt service rate. We wish to have the option to deposit the bonds proceeds in an appropriate trust fund(s) managed and invested in an appropriate trust fund. This trust structure is similar to past practice for POB proceeds. We understand clearly the need to exercise considerable caution and analysis when contemplating the possibility of issuing OPEB bonds and establishing, managing, and investing associated trust funds.

Before California public agencies can move forward with pursuing the consideration of issuing bonds to fund the actuarially calculated OPEB unfunded liability, we are requesting your approval for the claiming of debt service for those bonds. We would appreciate your consideration and assistance with this important issue and look forward to your reply. Please feel free to contact me with any questions regarding this request.

Sincerely,