QUESTAR III
OTHER-POST-EMPLOYMENT BENEFITS RECOMMENDATION

September 2014
Other Post-Employment Benefits (OPEB) are benefits (other than pensions) that Questar III provides to its retired employees. The cost of these benefits is shown as a liability on Questar III’s financial statements as required by Governmental Accounting Standards Board (GASB) Statement No. 45 (“GASB 45”). GASB is recognized by governments, the accounting industry, and the capital markets as the official source of Generally Accepted Accounting Principles (GAAP) for all state and local governments. The GASB standards are not federal laws or regulations and the organization does not have enforcement authority, however, compliance with the GASB standards is enforced through the Office of State Comptroller (OSC) regulations regarding GAAP.

As such, Questar III’s financial statements comply with GASB’s accounting standards. GASB 45 requires entities to recognize long-term liability for OPEB. The OPEB liability shown on Questar III financial statements reflects the financial impact of Questar III’s commitments to its retired and active employees who have served our component school districts.

In the event that Questar III was to no longer exist, the full obligation of the OPEB liability incurred by Questar III would become a liability of the BOCES’ component school districts. In an effort to plan for meeting these expenses in a financially sensible and responsible manner, and to protect the future capacity of our component school districts, Questar III determined it was necessary and appropriate to set aside funds over a period of years to enable the Agency to meet this long-term liability.

As a governmental service agency, Questar III followed the accrual basis of accounting. In accordance with this accounting method and GASB 45, Questar III treated both short-term and long-term OPEB liabilities as claims against Questar III’s financial resources by recognizing OPEB obligations as current year expenditures and liabilities. Over many years, agency programs, contracts, and grants were charged a cost associated with OPEB as a way of addressing this long-term liability.

This Report provides the history of Questar III’s treatment of OPEB funding; addresses issues raised in late 2012 by three component school districts; the creation of the OPEB Task Force by the BOCES; findings from the independent forensic audit of OPEB accruals; and recommendations by the District Superintendent to the Questar III Board regarding the Office of the State Comptroller’s mandated liquidation of OPEB accruals held by Questar III.

History of Questar III’s OPEB Accruals and Accrual Methodology:

Prior to 1999-2000, Questar III recognized the extensive costs associated with other post-employment benefits, particularly retiree health insurance. The agency was concerned that these escalating future costs were not being addressed in current budgets and were greater than the amount appropriated in
the agency administrative budget. Questar III determined that its obligations for retiree health insurance should be funded in a manner similar to the State’s fully funded pension plans, recognizing that long-term costs of OPEB could be reduced by millions of dollars if the liability was funded and proceeds were invested at market rates.

The following actions were taken:

- In fiscal year ending 2000, a liability for OPEB was first recorded in the General Fund.
- When GASB 45 was issued, this liability was shifted to the Trust & Agency Fund as the funds were held in trust on behalf of its retirees and employees.
- Upon implementation of GASB 45 in 2009, the funds were moved back to the General Fund and a Health Insurance Action Plan (see Appendix A) was developed.

This Plan was approved by the Questar III Board of Education on October 8, 2009. The plan reflected the recommendations of the State Comptroller, who, in a 2008 publication, stated, “governments should develop plans to address these (OPEB) costs, which can be managed through a combination of cost containment, cost sharing and funding set-asides.” The Plan includes action items such as: charging programs and grants for the cost of the benefit as it was earned; endorsing the NYS Comptroller’s legislative proposal to allow the creation of GASB 45 trusts by local governments; creating a GASB 45 trust under Section 115 of the Internal Revenue Code (IRC) in accordance with that legislation; and transferring OPEB accruals into that GASB 45 trust.

A letter dated February 4, 2010 was sent to all component-district board members and superintendents of schools explaining this plan and providing an explanation of Questar III’s accounting practices concerning OPEB. Similar notifications were provided in every subsequent year.

It is worth noting that the Office of the State Comptroller (OSC) released an audit of Questar III in 2009. The Questar III accrued liability fund existed during that audit and there were no findings concerning its existence. Additionally, the OSC has been and remains inconsistent in the application of its position concerning how local agencies should plan for these financial obligations. While some BOCES, including Questar III, have been told to liquidate such funds, other local governments have not.

**Objections by Component School Districts:**

Following years of acceptance of the BOCES OPEB practice by component school districts, at a business officials meeting held in December of 2012, Questar III component district business officials (initially East Greenbush and Averill Park, and later Lansingburgh) questioned for the first time, the BOCES accrual of funds for OPEB. This led to a detailed review of the OPEB accrual practice at Questar III BOCES. District Superintendent James N. Baldwin convened a meeting with component superintendents, business officials, and Questar III board members in January of 2013 at which the BOCES practice was discussed and it was announced the BOCES would form a Task Force that would review the matter. The Task Force

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1 This was confirmed several years later by a GASB 45 report, *Accounting and Reporting by Employers for Postemployment Benefits Other than Pensions.*

was asked to make recommendation as to what actions, if any, should be taken by the Questar III Board of Education to address the issues and provide for funding of the BOCES’ obligations to its retired and current employees regarding health insurance in retirement.

**Work of the OPEB Task Force**

All component districts were offered an opportunity to designate a member to the Task Force. East Greenbush expressly declined. The Task Force was comprised of superintendents and business officials from other component districts as well as several members of Questar III’s staff. The Task Force was chaired by Paul Puccio, Questar III Board member, Chair of the Questar III Audit Committee and member of the Schodack Central School District Board of Education.

Over the course of several meetings, Task Force members considered the following:

- the history of Questar III’s accounting practices and its budgeting and rate setting process;
- the generally accepted accounting principles purportedly subscribed to by the State;
- the experience of other BOCES in similar situations;
- relevant information from OSC and the State Education Department (SED).

The BOCES requested an opinion from OSC concerning the accounting method utilized by Questar III. In that request, Questar III asserted that based on GASB standards and guidance, it is a “service agency” since 90% of its revenues result from contracts for services or grants. GASB recognizes that a service agency may utilize the full accrual accounting method. Questar III’s position was affirmed by the GASB as indicated by Appendix B to this document.

During the course of its work, the Task Force fully vetted all options ranging from continuing current practices to liquidating the accrued funds. A variety of options to liquidate the fund were also explored. Additionally, the Task Force considered the need to fund current OPEB obligations in the Agency’s administrative budget, assuming the accrual was liquidated (see Appendix C).

On October 11, 2013, a full six months after the BOCES request, District Superintendent James N. Baldwin received a letter from the OSC stating that Questar III must discontinue its practice of accumulating funds and holding them for the OPEB liability (see Appendix D). OSC opined that any funds accumulated in excess of current OPEB expenditures were to be returned to school districts. Ignoring the position of GASB and disavowing its own advice to local governments, OSC asserted its authority under New York General Municipal Law to establish accounting standards for use by all governmental jurisdictions in New York State. Rejecting Questar III’s assertion that it should observe GASB rules for service agencies, OSC required that Questar III use modified accrual accounting practices.
Task Force Recommendations:

Given the OSC position that the accrual must be liquidated, the Task Force concluded that Questar III should exercise a high level of diligence to return funds in a fair and equitable way by engaging an independent auditor and legal review.

The Task Force also recognized that given the requirement that OPEB obligations be treated, under modified accrual accounting, as a current liability, the full amount of the pay-as-you-go OPEB obligation should be appropriated by the annual Administrative Budget of Questar III. The component districts would be asked to fully fund the obligation in the Administrative Budget of the BOCES for 2014-15 and each year thereafter. In order to return funds to the districts and minimize the impact of the increased Administrative Budget on them, the Task Force recommended the total amount of accrued funds identified for each district be used to mitigate the impact of the required increase in the Administrative Budget levy over time.

The Task Force further recommended that three options be made available for review by all of the component districts. These options would liquidate the accrual on a declining basis using a five, seven, or ten-year period of time. Each district would review the implications of these liquidation options, and submit comments and preferences to District Superintendent James N. Baldwin with the expectation that one option would be chosen for all districts.

Acceptance of the Task Force Report

The Questar III Board accepted the final OPEB Report of the Task Force dated February, 2014 by resolution at its April 15, 2014 regular meeting.

Results of independent Forensic Audit and Legal Review:

Based on the recommendation of the Task Force, Questar III issued an RFP for Forensic Accounting of the OPEB liability and an RFP for independent legal review. The bid for accounting was awarded to D’Arcangelo & Co, LLP to be performed by Patrick Powers, CPA and his team. Mr. Powers worked with Questar III’s business office to obtain necessary documentation to determine the source of contributions to the OPEB accrual. Once the forensic accounting was complete, Mr. Powers prepared options for returning districts’ contributions to the accruals in a five, seven, or ten-year period as recommended by the Task Force. The forensic audit also determined that a portion of the accrual (approximately $2.3 million) was attributable to the federal fund. As such, Questar III will contact grantor agencies to arrive at a disposition of these funds.

On July 24, 2014, the independent auditor and attorney presented findings to the superintendents and business officials of our component districts at a meeting called by the District Superintendent. The auditor reviewed the methodology that was used to allocate the funds. The independent attorney, Jeffrey Swiatek of Hodgson Russ LLP, commented on the methodology that was used by the auditor to account for the funds in the accrual. They shared, as requested, three scenarios, both overall and
district-specific, for liquidating the accrual on a declining basis over a five, seven, or ten-year period, commencing 2015/16. ³

Mr. Powers’ findings are illustrated in the following table, which details the OPEB liability, sources, and amounts to be returned to components and non-components.

**Questar III BOCES Return of OPEB Accrual; Summary and Return by Year**

<table>
<thead>
<tr>
<th>Description</th>
<th>Five Years</th>
<th>Seven Years</th>
<th>Ten Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Amount Accrued</td>
<td>$22,901,555.36</td>
<td>$22,901,555.36</td>
<td>$22,901,555.36</td>
</tr>
<tr>
<td>Less: Due to NY Federal School for Special Ed. Fund</td>
<td>(2,318,337.26)</td>
<td>(2,318,337.26)</td>
<td>(2,318,337.26)</td>
</tr>
<tr>
<td>Total Due to Components and Non-Components</td>
<td>20,583,218.10</td>
<td>20,583,218.10</td>
<td>20,583,218.10</td>
</tr>
<tr>
<td>Less: Due to Non-Components (Excluding Hoosick Falls)</td>
<td>(1,406,343.09)</td>
<td>(1,406,343.09)</td>
<td>(1,406,343.09)</td>
</tr>
<tr>
<td>Total Due to Components and Hoosick Falls</td>
<td>19,176,875.01</td>
<td>19,176,875.01</td>
<td>19,176,875.01</td>
</tr>
<tr>
<td>Less: Administration Budget Allocation (2013-2014)</td>
<td>(970,000.00)</td>
<td>(970,000.00)</td>
<td>(970,000.00)</td>
</tr>
<tr>
<td>Less: Administration Budget Allocation (2014-2015)</td>
<td>(1,245,936.00)</td>
<td>(1,245,936.00)</td>
<td>(1,245,936.00)</td>
</tr>
<tr>
<td>Less: Health Insurance Holdback</td>
<td>(2,675,000.00)</td>
<td>(2,675,000.00)</td>
<td>(2,675,000.00)</td>
</tr>
<tr>
<td>Return Due to Components and Hoosick Falls</td>
<td>$14,285,939.01</td>
<td>$14,285,939.01</td>
<td>$14,285,939.01</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year Ending June 30,</th>
<th>Five Years</th>
<th>%</th>
<th>Seven Years</th>
<th>%</th>
<th>Ten Years</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>$3,571,484.75</td>
<td>25</td>
<td>$3,142,906.58</td>
<td>22</td>
<td>$2,571,469.02</td>
<td>18</td>
</tr>
<tr>
<td>2017</td>
<td>3,428,625.36</td>
<td>24</td>
<td>2,571,469.02</td>
<td>18</td>
<td>2,142,890.85</td>
<td>15</td>
</tr>
<tr>
<td>2018</td>
<td>2,857,187.80</td>
<td>20</td>
<td>2,285,750.24</td>
<td>16</td>
<td>1,714,312.68</td>
<td>12</td>
</tr>
<tr>
<td>2019</td>
<td>2,285,750.24</td>
<td>16</td>
<td>2,000,031.46</td>
<td>14</td>
<td>1,428,593.90</td>
<td>10</td>
</tr>
<tr>
<td>2020</td>
<td>2,142,890.85</td>
<td>15</td>
<td>1,714,312.68</td>
<td>12</td>
<td>1,428,593.90</td>
<td>10</td>
</tr>
<tr>
<td>2021</td>
<td>1,428,593.90</td>
<td>10</td>
<td>1,142,875.12</td>
<td>8</td>
<td>1,142,875.12</td>
<td>8</td>
</tr>
<tr>
<td>2022</td>
<td>1,142,875.12</td>
<td>8</td>
<td>1,142,875.12</td>
<td>8</td>
<td>1,142,875.12</td>
<td>8</td>
</tr>
<tr>
<td>Totals</td>
<td>$14,285,939.01</td>
<td>100</td>
<td>$14,285,939.01</td>
<td>100</td>
<td>$14,285,939.01</td>
<td>100</td>
</tr>
</tbody>
</table>

³ Pending the outcome of the OPEB study, in 2013/14, Questar III adjusted rates so that they did not include OPEB expenses. OPEB expenses in 2013/14 were taken directly from the accrued liabilities. Pending the result of the forensic audit, each component district was credited with an amount, based upon RWADA for 2014/15.
At the conclusion of the meeting, each district was asked to submit, in writing, any questions or comments on the methodology and their preference as to the time period for liquidation (5, 7, or 10 years). District Superintendent James N. Baldwin discussed the intention to liquidate the funds based on the consensus of the group and indicated that prior to disbursement of funds or credits, Questar III would require releases from future liability concerning the OPEB matter from any board of education receiving a credit or refund (see Appendix F).

The following table indicates district preferences relating to the liquidation period.

<table>
<thead>
<tr>
<th>District Name</th>
<th>Five Years</th>
<th>Seven Years</th>
<th>Ten Years</th>
<th>Non-Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averill Park CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Berkshire UFSD</td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Berlin CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brittonkill CSD</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Cairo-Durham CSD</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Catskill CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chatham CSD</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Coxsackie-Athens CSD</td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>East Greenbush CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germantown CSD</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Greenville CSD</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Hoosic Valley CSD</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Hudson City SD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ichabod Crane CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lansingburgh CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Lebanon CSD</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>North Greenbush</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Rensselaer City SD</td>
<td></td>
<td></td>
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<td>✓</td>
</tr>
<tr>
<td>Schodack CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taconic Hills CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Troy City SD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wynantskill CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hoosick Falls CSD</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Totals**: 10 4 8 1

**Looming Consequences:**

It is estimated Questar III would have saved its component school district taxpayers approximately $45 million by earning portfolio level returns as illustrated in Appendix E of the June 30, 2013 GASB 45 Certified Actuarial Valuation comparing current discount rates to portfolio types of returns.

The taxpayers and students in our region will ultimately pay a heavy price for the liquidation of this fund as required by OSC. Going forward, current year OPEB expenses will be drawn from current budgets of
component school districts, further straining their capacity to provide educational programs for students.

In the absence of legislative action, the public policy of the State of New York, as interpreted by the State Comptroller, prohibits government entities from exercising fiscal prudence by forcing them to incur OPEB expenses and then defer payment for such obligations to the future. This is not wise public policy. It puts the health insurance (provided as a term and condition of employment) for tens of thousands of local and BOCES retirees at risk.

The Questar III management and Board attempted to avoid these consequences for taxpayers and students by accumulating resources that could be invested and used to pay these expenses. Had it not been for the letter from the OSC requiring Questar III to return the funds, precipitated by the actions of three component school districts, Questar III would have continued its fiscally responsible and prudent practice of accruing funds for this purpose and investing them as a way to save millions for taxpayers. Knowing the long-term consequences to our component school districts, their taxpayers and students, it is with great reluctance that we proceed with the liquidation as directed.

**Recommendations of the District Superintendent regarding OPEB:**

The District Superintendent makes the following recommendations, based upon the requirement of OSC that the funds be liquidated, the report of the BOCES-created OPEB Task Force, the report of the independent auditor, and the independent legal review:

**Recommendation 1**

Based on the data from the forensic audit and the preferences of component districts, the $14,285,939.01 due to components and Hoosick Falls will be liquidated over five years. Should any credit provided to a district exceed its share of the Questar III administrative levy in any year, the excess credit will be carried forward to the following year until exhausted.

**Recommendation 2**

Based on the data from the forensic audit, the $1,406,343.09 due to school districts that are not part of the Questar III region will be credited to program purchases over a five-year period. Districts due credits of less than $10,000, will be credited in one year. These credits will be subject to the same carry forward procedures in the event program purchases do not exceed the respective annual credit.

**Recommendation 3**

Questar III will retain accruals in the federal fund in the amount of $2,318,337.26. Questar III will seek guidance from the State Education Department concerning how to address these accruals.
Recommendation 4

Before any accruals are distributed, the recipient district board of education must authorize and sign a release from liability relating to OPEB. No credits or funds will be disbursed by Questar III without such execution and receipt of such release.

Recommendation 5

Consistent with modified accrual accounting standards, Questar III will retain a 12-month estimate of future OPEB costs from the accrual in its General Fund.

Recommendation 6

Submit the approved plan approved by the Questar III Board to the State Education Department for its approval prior to distribution of any funds.

Conclusion

These recommendations are responsive to district concerns about “smoothing” the impact of the necessary increase in the Questar III Administrative budget on school district budgets over time.

They attempt to manage the required liquidation in a manner that will not result in future aid offsets to school districts. Each district receiving a credit is strongly encouraged to consider the potential effect on aids received from the State because districts previously received aid on these funds. The decision concerning how aid will be addressed in the future lies with New York State, not Questar III BOCES.

We have consulted with the State Education Department through this process and have advised Department officials of these recommendations. This plan is subject to the approval of the State Education Department. A copy of the plan will also be filed with the Office of State Comptroller. Questar III will supply both with the necessary and supporting information.
Appendix A

QUESTAR III LONG TERM RETIREE HEALTH INSURANCE ACTION PLAN

Retiree Health Insurance Commentary for the June 30, 2009 Financial Statements

History: During World War II the Federal Government enacted a salary freeze. As a result many private and public sector employers began offering retiree health insurance benefits as a way to circumvent the salary freeze and attract good employs. Questar III also offers this benefit. Several years ago, the leadership of Questar III recognized the significant costs relating to retiree health insurance. Each year, as Questar III grew, the number of retirees increased. At the same time the annual retiree health insurance premiums increase at double-digit rates. This benefit was not sustainable on a long-term basis unless we were able to capture some of the dollars while providing the service to school districts and various grant projects. Over the years we accumulated approximately $16.1 million dollars to fund this benefit.

Fiscal Planning: Private-sector companies are required to record and disclose these long-term obligations for many years. This accounting requirement had a devastating effect on individual companies and in some cases whole industries. The Governmental Accounting Standards Board (GASB), the body that establishes Accounting rules for Governments, wanted the same regulations to apply to all governmental entities. Questar is a fiscally conservative organization, we understood that sooner or later we would have to address this liability and began including in our cost structure a portion of this long term obligation. Subsequently GASB issued statement number 45 that requires us to account for this benefit effective June 30, 2009.

Questar is Unique: Most BOCES limit the scope of their services to their component school districts. However, Questar III’s State Aid Planning service has been a state-wide service, making Questar unique among the BOCES. In addition, several regional and state-wide grant awards continued to expand the reach of Questar’s service area beyond our 22 component school districts. This also created the need to capture dollars while providing the services to ensure that the district that received the service also absorbs the actual long term cost.

Fairness to Component Schools: Because Questar III lacks the authority to levy taxes, and can only charge for services and administration if we did not capture dollars for the retiree health insurance liability as the services were provided we would place an undue burden on the taxpayers of the component school districts. Questar III’s leadership sought to protect their component districts from these staggering future costs by accruing a portion of the liability on an ongoing basis. By June 30, 2009, Questar III had accrued $16.1 million which is sufficient to offset the first year of the GASB 45 liability.
GASB 45 Calculation (assumptions and results):

Significant actuarial assumptions used to calculate the GASB 45 liability are as follows:

1. Discount Rate ................................................................................................................. 2.5%
2. Inflation Rate:
   o Year 1 ......................................................................................................................... 11%
   o Ultimate in Year 2012 ................................................................................................. 7%
   o Amortization period for initial obligation at date of implementation............30 years

Significant results from the GASB 45 valuation:

1. First year liability to be presented in the audited financial statements $ 16,026,817
2. Total liability as of June 30, 2009 $ 115,739,379

Long Term Retiree Health Insurance Action Plan: We understand that Retiree Health Insurance total liability amount is staggering. Questar III management proposes the following six steps to manage and limit this liability in the long run. If our plan is successful in improving the discount rate and reducing our health insurance inflation rates we will realize significant savings.

<table>
<thead>
<tr>
<th>Step</th>
<th>Action Item</th>
<th>Responsible</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Charge the programs and grants for the cost when employees earn the benefit.</td>
<td>Harry Hadjioannou</td>
</tr>
<tr>
<td>2.</td>
<td>Establish an employee wellness program and reengineer our health insurance</td>
<td>Harry Hadjioannou</td>
</tr>
<tr>
<td></td>
<td>plans to improve our health insurance inflation trend.</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Endorse the NYS Comptroller’s legislative proposal to allow the creation of</td>
<td>Jim Baldwin &amp;</td>
</tr>
<tr>
<td></td>
<td>certain GASB 45 trust for funding purposes.</td>
<td>Harry Hadjioannou</td>
</tr>
<tr>
<td>4.</td>
<td>Create a GASB 45 Trust under section 115 off the Internal Revenue Code (IRC)</td>
<td>Harry Hadjioannou</td>
</tr>
<tr>
<td>5.</td>
<td>Transfer whatever Questar III accumulated to cover this liability into the</td>
<td>Harry Hadjioannou</td>
</tr>
<tr>
<td></td>
<td>GASB 45 trust so we can improve our discount rate from 2.5% to 8%.</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Monitor our progress through financial modeling.</td>
<td>Ray Cerrone</td>
</tr>
</tbody>
</table>
TO: Questar III OPEB and Financial Practices Task Force
FROM: Meghan Heimroth
DATE: May 31, 2013
RE: Special Purpose Entity Status

Technical Inquiry Presented to GASB

Nature of Inquiry:

Primary Reference: Government-Wide Statements (selected from a drop-down menu)

Pronouncement: GASB Statement (selected from a drop-down menu)

Number: 34 (selected from a drop-down menu)

Paragraph Number(s): GASB 34 Preface & Summary

Secondary Reference: Government-Wide Statements (selected from a drop-down menu)

Pronouncement: GASB Statement (selected from a drop-down menu)

Number: 34 (selected from a drop-down menu)

Paragraph Number(s): 213, 214, 216, 217, 219, 222, 223, 225, 229

Briefly State Your Question:

Can a BOCES (Board of Cooperative Educational Services) be considered a special-purpose entity and as such use full accrual accounting, especially as it relates to the presentation of the Other Post-Employment Benefit liability?

Briefly State Your Preliminary Conclusion to the inquiry:

There are distinct differences in accounting treatment for a special-purpose government, such as a BOCES, from that of a governmental entity, such as a school district. Under the guidelines of GASB 34, it is apparent that as a BOCES, Questar III is a special-purpose government since it has been created by the New York State Legislature to fulfill special needs of New York State School Districts. As a special-purpose government,
Questar III is engaged only in business-type activities and as such, argument could be made that a BOCES should present its financial statements similar to that of enterprise funds, which report on the full accrual basis of accounting. Over 90% of Questar III revenues are from the sale of services. This is a significant difference between BOCES and school districts, which have taxing authority. It is so significant, in fact, that it warrants a different accounting treatment at the BOCES level.

Briefly state the views of others involved (for example: accountants, clients, auditors) or of other organizations. If not applicable, type “none.”

Under governmental, modified accrual accounting only current assets and liabilities are recorded on the fund financial statements. Long-term liabilities are presented on the government-wide financial statements. Hence, the argument has been made that to the extent that the OPEB liability is a long-term liability it should not be accounted for on the fund financial statements but rather, solely on the government-wide financial statements.

Include any other comments here

Questar III recognizes OPEB (Other Post-Employment Benefits) expenditures when a liability is incurred, regardless of when the cash is paid out. Because OPEB is essentially a claim against Questar III’s financial resources, it is recognized as an expenditure and a liability in the current year. Programs, contracts, and grants are charged for the cost associated with OPEB when the employees earn the benefits. Since fiscal year 1999-2000 a portion of the OPEB liability is recorded in the governmental fund types as it is the intention of the Board of Education and management to fund this liability as soon as New York State passes necessary legislation and/or the interest rate environment improves. The definition of a current liability is an “obligation due within one year of the balance sheet.” Questar III’s fiscal management team believes that the OPEB liability qualifies as a current liability as it is “due” immediately regardless of when it will be paid. This liability is considered current for two reasons. First, according to Questar III’s Health Insurance Action Plan it is the BOCES intention to fund the OPEB liability in accordance with GASB 45 as soon as legally possible. Second, Questar III is a special-purpose government that generates revenue from fees for service, and as such, is allowed, under GASB 34, to use full accrual basis of accounting.
Response from GASB Technical Team Member

Scott Reeser, CPA, Project Manager at GASB, responded and a teleconference discussion ensued regarding the inquiry that was presented (see above). The guidance from Scott is that because Questar III meets two of the three requirements of an Enterprise Fund, as described in paragraph 67 of GASB 34, it can be considered a special purpose entity. And in accordance with paragraph 138 of GASB 34, a special purpose entity should present its financial statements using the full accrual method of accounting.

GASB Statement #34; Paragraph 67

67. Enterprise funds may be used to report any activity for which a fee is charged to external users for goods or services. Activities are required to be reported as enterprise funds if any of the following criteria is met. Governments should apply each of these criteria in the context of the activity’s principal revenue sources.

a. The activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity. Debt that is secured by a pledge of net revenues from fees and charges and the full faith and credit of a related primary government or component unit—even if that government is not expected to make any payments—is not payable solely from fees and charges of the activity. (Some debt may be secured, in part, by a portion of its own proceeds but should be considered as payable “solely” from the revenues of the activity.)

b. Laws or regulations require that the activity’s costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues.

c. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).
GASB Statement #34; Paragraph 138

Reporting by Special-purpose Governments Engaged Only in Business-type Activities

138. Governments engaged only in business-type activities should present only the financial statements required by enterprise funds. (See paragraphs 91-105) For these governments, basic financial statements and RSI consist of:

a. MD&A (paragraphs 8–11, as appropriate)

b. Enterprise fund financial statements (paragraphs 91–105), consisting of:
   (1) Statement of net assets or balance sheet
   (2) Statement of revenues, expenses, and changes in fund net assets
   (3) Statement of cash flows

c. Notes to financial statements (paragraphs 113–123)

d. RSI other than MD&A, if applicable (paragraphs 132–133).

Conclusion

Questar III can be considered a special purpose entity. It should use the full accrual method of accounting as is required for Enterprise Funds. Questar III may have to modify the presentation of its financial statements in accordance with Enterprise Funds.
Retiree Health Insurance Cost and the Admin Budget

The requirement that health insurance for retirees be included in the administrative budget is found in Commissioner’s regulations -8 NYCRR 170.3(b). Below is an excerpt from the BOCES Administrative Handbook outlining the treatment of retiree health insurance costs:

**Accounting for Certain Assessments**

Costs of supplemental retirement benefits, health insurance for retirees, interest income and expenses, and most liability insurance are to be included in the administrative budget.

Supplemental retirement benefits and health insurance for retirees are expenditures for staff who provided service in the past years. These costs are viewed as an obligation that is more appropriately attributed to the agency rather than current service users.
Dr. James N. Baldwin
District Superintendent
Questar III BOCES
10 Empire State Boulevard
Castleton, New York 12033

October 11, 2013

As you know, the Governmental Accounting Standards Board (GASB) statement 45 requires states and many local governments to report liabilities for OPEB (primarily health care benefits) in a manner similar to how they report pension liabilities. GASB 45 does not require governments to fund these benefits. In fact, there is no State statute expressly authorizing local governments, school districts or BOCES to establish trusts to accumulate such funds.

In addition, the General Municipal Law authorizes the Office of the State Comptroller to prescribe a system of accounts for New York’s local governments, school districts and BOCES, among other entities. Our Office prescribes the modified accrual basis of accounting and current financial resources measurement focus for statutory reporting purposes for school districts and BOCES. Questar’s research and audited financial statements acknowledge this authority and accounting methodology when they state that it must report activities to the State Education Department and this Office using the modified accrual basis of accounting.

A key question presented to this Office was whether the Comptroller should allow BOCES to use alternate bases of accounting to accumulate resources to fund OPEB liabilities when existing State legislation does not provide authority for such an accumulation in an OPEB trust. To our knowledge, the State Education Department has not taken a formal position on this issue. We also note that generally accepted accounting principles (GAAP) do not appear to allow other types of local governments or schools in New York to makes similar accounting basis elections to accumulate resources to fund OPEB liabilities. We conducted substantial research and consulted with different agencies to arrive at a decision that considers all parties affected.
Due to the potential impact such an accounting change would have on component school districts and the fact that no other local governments and school districts may elect such an accounting change to fund OPEB liabilities, this Office will not authorize alternate bases of accounting for BOCES. Consequently, all BOCES should continue to report activities using the modified accrual basis of accounting.

We further note that GASB 45 has very little effect on governmental funds reported using the modified accrual basis of accounting. The amount recognized as an expenditure should equal the amount contributed to an OPEB plan, or the amount expected to be liquidated with expendable available financial resources. Since New York State has not authorized OPEB plans, Questar may only record a liability when its payment to OPEB providers for premiums is actually due and expected to be liquidated with current financial resources.

In presenting its research on the modified accrual basis of accounting, Questar stated that it considers the OPEB payments due and payable because it intends to pay these funds into an OPEB trust, if the Governor and State Legislature pass legislation to allow it. However, the intended use of the resources is irrelevant to when Questar may recognize a liability pursuant to GAAP. Regardless of whether Questar plans to accumulate resources in the General Fund or in an OPEB trust, it does not provide the means to record an accrual-based OPEB liability in governmental fund statements prepared using the modified accrual basis of accounting.

In summary, Questar should continue to report activities using the modified accrual basis of accounting. It also should base the costs charged to its component districts on expenditures recognized using the modified accrual basis of accounting. In addition, Questar should treat any portion of the cash accumulated for its OPEB liability in excess of the properly recognized amount of OPEB expenditures as surplus, and return it to the component school districts in accordance with applicable statutes.

If you have any questions, please feel free to contact Dan Duffy, Manager of the Professional Standards Unit, at (518) 474-5505.

Sincerely,

Andrew A. SanFilippo
Executive Deputy Comptroller

cc: Harry Hadjioannou, Assistant Superintendent for Business & Financial Services
    Charles Struberia, Assistant Commissioner, State Education Department
    Jeffrey Leonard, Chief Examiner, Glens Fall Regional Office
    Daniel F. Duffy, Principal Examiner, Professional Standards

1 GASB Statement 45, Paragraph 19
Appendix E

Appendix 6 - Comparing Results using 2.50% and 8.00% Discount Rates

Results Assuming a 2.50% Discount Rate (No Funding)

<table>
<thead>
<tr>
<th>Fiscal Year Ending</th>
<th>Annual OPEB Cost</th>
<th>Percentage of Cost Contributed</th>
<th>Net OPEB Obligation</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30, 2009</td>
<td>$17,682,858</td>
<td>1.5%</td>
<td>$16,046,115</td>
</tr>
<tr>
<td>June 30, 2010</td>
<td>$15,424,875</td>
<td>12.3%</td>
<td>$20,775,258</td>
</tr>
<tr>
<td>June 30, 2011</td>
<td>$15,027,702</td>
<td>13.8%</td>
<td>$24,729,281</td>
</tr>
<tr>
<td>June 30, 2012</td>
<td>$15,457,317</td>
<td>12.6%</td>
<td>$25,077,470</td>
</tr>
<tr>
<td>June 30, 2013</td>
<td>$15,074,286</td>
<td>12.7%</td>
<td>$25,083,957</td>
</tr>
</tbody>
</table>

Results Assuming an 8.00% Discount Rate (Funding)

<table>
<thead>
<tr>
<th>Fiscal Year Ending</th>
<th>Annual OPEB Cost</th>
<th>Percentage of Cost Contributed</th>
<th>Net OPEB Obligation</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 30, 2009</td>
<td>$9,528,972</td>
<td>57.97%</td>
<td>$14,554,129</td>
</tr>
<tr>
<td>June 30, 2010</td>
<td>$6,774,285</td>
<td>28.77%</td>
<td>$9,789,773</td>
</tr>
<tr>
<td>June 30, 2011</td>
<td>$6,523,599</td>
<td>33.46%</td>
<td>$7,141,306,548</td>
</tr>
<tr>
<td>June 30, 2012</td>
<td>$6,850,923</td>
<td>33.57%</td>
<td>$7,069,380,541</td>
</tr>
<tr>
<td>June 30, 2013</td>
<td>$6,852,222</td>
<td>41.14%</td>
<td>$6,281,501,504</td>
</tr>
</tbody>
</table>

Chart Comparing Annual OPEB Costs
(Funding at 8% vs. Non Funding at 2.5%)

- Funding 8%
- No Funding 2.5%
Appendix F

FUND SURPLUS RESOLUTION AGREEMENT AND RELEASE

This Fund Surplus Resolution Agreement And Release ("Agreement") is by and between the [NAME] School District ("District"), [ADDRESS], and the Board of Cooperative Educational Services Rensselaer – Columbia - Greene Counties ("Questar III", which shall be defined to include Questar III’s Board members, administrators, officers, employees, attorneys, agents, representatives, successors and assigns), 10 Empire State Boulevard, Castleton, NY 12033. The District and Questar III may be referred to collectively herein as the “Parties.”

WHEREAS, Questar III retained D’Arcangelo & Co, LLP ("D’Arcangelo") to conduct an independent audit of the funds that Questar III has accrued for purposes of satisfying future liabilities for post-retirement and other post-employment benefits ("OPEB"); and

WHEREAS, D’Arcangelo issued an Agreed-Upon Procedures Report on July 21, 2014 (the “Report”) which, among other things, confirmed the total balance of funds accrued by Questar III for OPEB purposes as of June 30, 2013 and, of that balance, amounts that could be returned to the component and non-component school districts who participated in the relevant programs conducted by Questar III (the “Accrual Amount”); and

WHEREAS, the Questar III Board has adopted a plan by which the OPEB Accrual Amount will be returned to such component and non-component school districts (the “Plan”), utilizing the basis for return set forth in the Report, and

WHEREAS, the Plan has received approval from the State Education Department; and

WHEREAS, the Parties hereto wish to memorialize the terms by which the District will participate in the Plan;

NOW, THEREFORE, THE PARTIES HEREBY AGREED AS FOLLOWS:

...
1. Questar III will return to the District a total of $________ (the “Payment Amount”), which by this Agreement shall be deemed to constitute the District’s full and complete entitlement to its share of the OPEB Accrual Amount. The Payment Amount shall be returned over a period not to exceed five years as follows:

[Insert Payment Schedule]

The Payment Amount as set forth above shall be returned in the form of a credit against the amount that the District otherwise is required to contribute to Questar III for component district administrative charges in each of the school years set forth in the Payment Schedule above. If the portion of the Payment Amount to be returned in any school year exceeds the amount that the District must otherwise remit to Questar III, the excess balance shall be added to the portion of the Payment Amount to be returned in the next subsequent school year pursuant to the above Payment Schedule. If any such excess balance remains after the final year of the Payment Schedule, the excess balance shall be credited against the District’s required contribution to Questar III in the next subsequent school year, and any additional school years as may be necessary to fully return the Payment Amount to the District. In no case shall Questar III be required to return any portion of the Payment Amount in the form of a cash payment to the District, or in any other manner except as set forth herein.

2. The District hereby accepts the return of the Payment Amount, as set forth herein, as full and complete satisfaction of any claim or entitlement the District would otherwise have, by law, contract, equity or otherwise, to return of any portion of the Accrual Amount.

3. In consideration for the return of the Payment Amount as set forth herein, the District hereby releases and discharges Questar III from any and all obligations, claims or liabilities, of any nature, that relate to the Accrual
Amount and/or Questar III’s OPEB accruals up to the date of execution of this Agreement, and the District hereby agrees that it will not commence, maintain or cooperate with any action, proceeding or claim in law or equity, of any nature or in any forum, against Questar III in relation to the Accrual Amount and/or Questar III’s OPEB accruals up to the date of execution of this Agreement, which shall include but not be limited to any action, proceeding or claim in law or equity, seeking to recover (a) any portion of the Accrual Amount beyond that which is set forth in this Agreement, or (b) any other payment or relief that relates in any way to the Accrual Amount and/or Questar III’s OPEB accruals up to the date of execution of this Agreement.

4. The District agrees that presentation of this Agreement shall serve as the District’s unqualified and irrevocable consent to discontinue with prejudice any action, proceeding or claim in law or equity, commenced or maintained by or on behalf of the District and/or its officers in violation of the terms of this Agreement.

5. The Parties affirm that this Agreement fully and completely sets forth the agreed upon resolution of any rights, entitlements or claims that the District may have in relation to the Accrual Amount, and that no other promises or agreements have been made or would be effective in relation to the Accrual Amount.

6. The District and Questar III hereby each respectively affirm that the execution of this Agreement has been authorized by action of its Board of Education.

FOR QUESTAR III:  
________________________
[Name]
President, Board of Education

FOR THE DISTRICT:  
________________________
[Name]
President, Board of Education

Date: ____________________  
Date: ____________________
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**[Insert Payment Schedule]**

The Payment Amount as set forth above shall be returned in the form of a credit against the amount that the District otherwise is required to contribute to Questar III for non-component district CoSer charges in each of the school years set forth in the Payment Schedule above. If the portion of the Payment Amount to be returned in any school year exceeds the amount that the District must otherwise remit to Questar III, the excess balance shall be added to the portion of the Payment Amount to be returned in the next subsequent school year pursuant to the above Payment Schedule. If any such excess balance remains after the final year of the Payment Schedule, the excess balance shall be credited against the District’s required contribution to Questar III in the next subsequent school year, and any additional school years as may be necessary to fully return the Payment Amount to the District. In no case shall Questar III be required to return any portion of the Payment Amount in the form of a cash payment to the District, or in any other manner except as set forth herein.

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maintain or cooperate with any action, proceeding or claim in law or equity, of any nature or in any forum, against Questar III in relation to the Accrual Amount and/or Questar III’s OPEB accruals up to the date of execution of this Agreement, which shall include but not be limited to any action, proceeding or claim in law or equity, seeking to recover (a) any portion of the Accrual Amount beyond that which is set forth in this Agreement, or (b) any other payment or relief that relates in any way to the Accrual Amount and/or Questar III’s OPEB accruals up to the date of execution of this Agreement.

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6. The District and Questar III hereby each respectively affirm that the execution of this Agreement has been authorized by action of its Board of Education.

FOR QUESTAR III:

______________________________  FOR THE DISTRICT:

[Name]  
President, Board of Education

[Name]  
President, Board of Education

Date: ___________________  Date: _________________