Questar III BOCES
Other Post-Employment Benefits and Budget/Fiscal Practices

February 2014

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Table of Contents

I. Executive Summary

II. Introduction: Establishing the Task Force on Questar III’s OPEB and Budget/Fiscal Practices

III. History
   A. The History of Questar III treatment of OPEB
   B. The History of GASB and OPEB

IV. Other BOCES Experiences
   A. OSC reports on Ulster County BOCES accrual methods and its funding of long-term liabilities
   B. OSC reports on the Nassau County BOCES use of “reserves”
   C. The experience of the Rockland County BOCES
   D. Practices of other BOCES regarding allocating OPEB to the Administrative and Program Budgets

V. External opinion and guidance
   A. Questar III inquiry of the Office of the State Comptroller
   B. Opinion of other CPA firms
   C. Legal opinion regarding OSC audit authority
   D. Opinion of the New York State Education Department
   E. GASB technical guidance—Questar III can use full accrual accounting

VI. Allowable reserves available for use by a BOCES

VII. Questar III current budget and OPEB practice
   A. Questar III budget and fiscal practices
   B. How Questar III specifically budgets, bills for and accrues liability for OPEB
   C. The OPEB obligation arising from contracts and grants
   D. How Questar III reflects OPEB obligations in the Administrative Budget

VIII. Options
   A. Annuity Insurance Contracts
   B. Considerations and options for liquidating the accrual
   C. Options for future action
D. “Pay as you go” and the Administrative and Service Budgets

E. Identifying the sources of contribution to the OPEB accrual – a Forensic Analysis

F. Refinement of possible options regarding the future of Questar III OPEB

IX. Task Force preliminary consensus

X. Final Summary and Recommendation
I. Executive Summary

For more than 10 years, Questar III has been accruing funds to pay for Other Post-Employment Benefits (OPEB), specifically health insurance for retirees. This practice started at a time when Questar III was the recipient of significant funding through contracts and grants. While these contracts and grants would terminate, the obligation to pay retiree health insurance for employees hired/working under these contracts/grants would not. Consequently, Questar III set aside funds from contracts and grants which included funding for overhead such as OPEB.

In addition, Questar III provides services both to component and to non-component school districts statewide. Over time there are variations in the amount of services purchased by school districts; new services are initiated, and some services are discontinued. Once again, while the amount and source of funds for purchased services changes over time, the OPEB obligation for retirees does not change.

Finally, in the event that Questar III was to no longer exist, the full obligation for all liabilities incurred by Questar III, such as OPEB, would become the liability of its component school districts. Questar III believed that to avoid the possibility of this burden falling to its component districts, it was reasonable to set aside funds to meet this obligation.

As of June 30, 2012, Questar III accumulated $21.4 million toward its OPEB liability.

In support of this practice, Questar III used full accrual accounting, recorded in its general fund, as a basis for recognizing the OPEB long-term liability. This practice was authorized in policy by the Questar III Board of Education. After this practice was approved by the Board of Education, information was shared annually with all component school districts advising them of the policy and the practice. The external auditors for Questar III reviewed this practice and acknowledged it as appropriate. In addition, during the time of this practice the Office of the State Comptroller (OSC) audited Questar III and did not express any concerns associated with the accrued funds.

In recent years OSC audited three other BOCES. In one case the BOCES set aside funds in a reserve that could not be used for OPEB obligations, according to statute. Therefore, OSC required that these funds be returned to those component districts. In two other cases, a practice similar to that used by Questar III was disclosed and the audited BOCES were directed to return the funds to component districts. As a consequence of these audits, several Questar III components districts requested a review of this practice. On January 25, 2013 District Superintendent James N. Baldwin held a meeting with component superintendents and board members discussing this practice, and announced that he would form a Task Force to review the matter and make a recommendation to the Questar III Board of Education regarding future action in order to address components’ concerns.

The Task Force was comprised of component district superintendents and business officials, as well as Questar III staff. The Task Force was chaired by Paul Puccio, Questar III Board member and Audit Committee chair.
Over the course of six meetings, Task Force members analyzed the history of Questar III’s accounting practice and its process for budgeting and rate setting which reflected funding for OPEB obligations. The Task Force also consulted the Government Accounting Standards Board (GASB), reviewed the experience of other BOCES, and reviewed information from OSC and the New York State Education Department (SED). Throughout the course of its work the Task Force fully vetted all options from continuing current practices, to discontinuing current practice and liquidating the accrued funds. A variety of options to liquidate the funds were explored. The Task Force also examined ways to budget funds to meet OPEB obligations including: placing 100 percent of the obligation in the Administrative Budget; splitting the cost of this obligation between the Administrative and Program Budgets; using reserves; purchasing annuity insurance contracts; and funding trusts.

One of the primary issues explored by the Task Force was whether or not the use of full accrual accounting by Questar III was appropriate. All local governments in New York State, including schools, are required to use modified accrual accounting. This method only recognizes short-term obligations. Long-term obligations, beyond 12 months, cannot be recognized. Therefore most municipalities budget OPEB costs for currently retired former employees in their annual budget on a “pay-as-you-go” basis. Given that 90 percent of its revenues are received from services and from contracts and grants, Questar III believed that under GASB standards Questar III could be deemed a “service agency” and thus use full accrual accounting. This position was affirmed by the GASB.

Despite GASB’s affirmation that Questar III’s accounting practice was appropriate, on October 11, 2013, Questar III District Superintendent James N. Baldwin received an official letter from the OSC stating that Questar III must discontinue its practice of accumulating funds and holding them for the OPEB liability. Any funds accumulated in excess of current OPEB expenditures were to be return to school districts. Irrespective of the position of GASB, under New York State Municipal Law, OSC asserted its authority to establish accounting standards for use by all governmental municipalities in New York State. OSC policy requires that all municipal governments use modified accrual accounting practices. Therefore, Questar III is required to discontinue its current practice of accruing funds to meet its future OPEB liabilities and to return the accrual to its sources.

Determining the sources of funding and the amounts received from each source is a complex task. Accrual funds were received based on the consumption of services provided by Questar III. Services were purchased by component school districts, and by non-component school districts statewide. The amount of services purchased as well as the rates charged for services varied over time.

Other funds were collected through the Questar III Administrative Budget which was annually approved by the component districts. The source of these funds was based upon the Relative Weighted Average Daily Attendance (RWADA) formula. This formula reflects a proportionate share of total cost allocated to each district, based upon its annual student census as a percentage of the total student census of the entire BOCES. Because every district’s student census changes yearly, the amount collected annually from each school district also varied.
Finally, many grants and contracts made contributions to the accrued funds. These contracts and grants came from a variety of sources including federal and state funds. Many of these contract and grants had funding levels that changed annually and all had termination dates.

Given all of these variables, determining how much money was actually collected for OPEB each year, from each of the sources, requires a very complex and detailed process.

The Task Force recognizes that from the perspective of equity, the amount contributed by each funding source, especially from each of the component districts, had to be specifically identified so as to provide a fair distribution of the accrued funds equal to the amount contributed by each component district. Similarly, all funds contributed to the accrual from all other sources should be identified (contracts and grants) and those contributors given a choice to receive a refund of monies collected for OPEB.

After receipt of the OSC letter, the Task Force reconvened to review and accept the findings, and to prepare recommendations to the Questar III Board of Education.

**Task Force Recommendations**

Because of the issue of fairness and equity associated with the sources of funds, especially from the component districts, the Task Force concluded that it would be necessary to conduct an independent and full forensic audit to determine the actual amounts contributed by every contributor over the course of the time that funds were set aside for OPEB.

The Task Force also recognized that because OPEB obligations are required to be treated as a current liability under modified accrual accounting, and because of the issues of compliance with SED regulations, the full amount of the “pay-as-you-go” OPEB obligation should be reflected in the annual Administrative Budget. The component districts would vote on the full Administrative Budget. However, to return funds to the districts and to minimize the impact of the growth in the Administrative Budget on component districts, the total amount of accrued funds identified for each district would be used to offset the impact of the Administrative Budget. Questar III would only bill each district for its share of the Administrative Budget, the net amount of an annual allocation of funds from that district’s share of the accrual. The amount of the deduction would decrease annually, and the Administrative Budget bill to each district would grow annually, until the full amount of the accrual was liquidated and the full share of the Administrative Budget was billed to each district.

Task Force members recommend that three options be made available for review by all of the component districts. The amount of funds contributed by each district would be liquidated on a declining basis using a five-, seven-, or 10-year period of time. Each district would review the implications of each of these three options and District Superintendent James Baldwin will
choose one option to be used by all of the districts. The choice of only one option for all components is necessary to assure uniformity of state aid projections for all school districts.

All members of the Task Force agreed that in order to protect the BOCES and its component districts, a legal review of all actions in response to the findings is necessary. Once liquidation of the accrual has occurred, there would be no remedies to any further disputes without direct financial impacts on Questar III and its components.

After the chosen option has been recommended to and approved by the Questar III Board of Education, Questar III will secure OSC and SED approval of the process for liquidating these funds and for implementing future Program and Administrative Budgets, prior to implementation.

All of the elements in the process described above may require considerable time to implement. In this regard the Task Force requests that Questar III explore the methodologies used by other BOCES and use that information in determining the most expeditious method for carrying out these tasks.

Since all accounting principles require that all contributors be treated the same, and $2.6 million of the $21.4 million was derived from contracts and grants, it will be necessary to contact the entities which contributed to the accrued OPEB funds and determine if they require their share of the funds to be returned. Disposition of any funds not returned to contractors and grantors would most likely be held as “fund balance” in the Special Aid account, which is the only BOCES fund account permitted to have a fund balance. Furthermore, consistent with modified accrual accounting standards, Questar III would hold a 12-month estimate of future OPEB costs in its General Fund

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The Questar III Board of Education greatly appreciates the time and work effort of all members of the Task Force. Questar III staff prepared and assembled significant detailed background materials which were thoroughly and diligently reviewed by all members of the Task Force. Many meetings were spent in positive discussion of all positions and options regarding the treatment of OPEB. The outcome of the Task Force efforts must be considered a hallmark of collaborative effort amongst the component school districts and Questar III.
II. Introduction: Establishing the Task Force on Questar III’s OPEB and Budget/Fiscal Practices

On January 25, 2013 Questar III District Superintendent James Baldwin assembled superintendents, business officials, and board members from all of the component school districts within the BOCES. The purpose of this meeting was to disclose and discuss the practice of Questar III to accumulate funds to meet the long-term obligation of the BOCES for Other Post-Employment Benefits (OPEB) for its employees. At the close of this meeting Superintendent Baldwin announced that he would request that the Questar III Board of Education assemble a task force of representatives from the component districts to examine Questar’s practices with regard to OPEB and the fiscal operations and policies, which, in part, resulted in the accumulation of this liability. He also invited all superintendents and business officials to indicate their willingness to serve on this task force.

On March 21, 2013, the Questar III Board of Education, at its regular business meeting, approved the creation of this task force and appointed its membership. The task force was to be chaired by Paul Puccio, the chair of the Questar III audit committee. The members of the task force are:

**Superintendent Members:**

John Carmello – Troy
Jim Hoffman – Averill Park
Brian Howard – Troy
Sally Shields – Rensselaer
Karen McGraw – New Lebanon
Neil Howard – Taconic Hills
Kate Farrell – Catskill
Randy Squier – Coxsackie-Athens

**Business Official Members:**

Lisa Kyer – Lansingburgh
Tammy Sutherland - Greenville
Mike Chudy – Chatham
Carrie Nyc–Chevrier – Questar III

**Questar III Staff Support:**

Lynn MacDonald – Business Office
Meghan Heimroth– Central Business Office
Stephen Golas – State Aid Planning Service
Ray Cerrone – Questar III Internal Audit / GASB 45 Service
On March 29, 2013, Questar III Board President Robert Gibson forwarded a memorandum to all Questar III component superintendents and task force members. In this memorandum the Board President charged the task force as follows:

The Questar III board has requested the task force to issue recommendations to the board and district superintendent by June 30, 2013.

The task force will identify and analyze options to improve the financial operations and related policies of Questar III and make recommendations to the Questar III Board and administration to address recommended change. The Board expects that the task force recognize that Questar III: has a moral, contractual, and statutory obligation to its employees; has service and fiduciary responsibilities to component districts; must meet requirements for sound and solvent fiscal practices; and must address expectations for transparency. It is important that any recommendations to the Board, as an outcome of this effort, must conform to these expectations.

Attached to this memorandum was a schedule of meetings for the task force, and for each meeting an identified set of topics and questions that were to be explored.

Both of these items are contained in Appendix A of this report.

Regarding OPEB, four major questions were raised at the meeting of January 25, 2013; these questions and answers to them will be discussed:

A. Is the accounting for OPEB used by Questar III a legitimate accounting practice? The GASB publication number 34 describes different methods to account for long-term liabilities; how do these methods apply to districts and to BOCES?

B. Under what auspices or authority does the Governmental Accounting Standards Board (GASB) exist?

C. What does the law say about BOCES meeting long-term post-employment obligations?

D. Is the Questar III accrued liability for OPEB actually a reserve, and if so, what is the legal basis for maintaining this reserve? What have other BOCES done to address OPEB and how has the Comptroller and others opined on the issue through audits and other publications?
III. History

A. The History of Questar III treatment of OPEB

Questar III defined itself as a governmental service agency, and as such followed the accrual basis of accounting. The use of full accrual accounting for service organizations is permitted under GASB 34 because unlike governments, of which school districts are one form, a service agency has no taxing authority and receives most of its revenue from charges for services it provides. Under this full accrual method of accounting, Questar III recorded the liability for OPEB in the current year regardless of when in the future that liability will be paid. When using a modified accrual accounting methodology, governments, like school districts, are only permitted to record a liability for the period of 12 months subsequent to the close of their fiscal year.

Historically, Questar III recognized that there are extensive long-term costs associated with retiree’s health insurance obligations. The premiums paid for retirees on a pay-as-you-go basis were only a fraction of the true cost. Questar III determined that retiree health insurance should be treated like the pension plan, and as a consequence Questar III began to accumulate funds for this long-term liability by setting aside a portion of its administrative budget and funds from its services and contracts revenue. In 2004 when GASB 45 was issued, this liability was recorded for the first time in the general fund of Questar III’s annual financial statements. In recognition of this obligation, Questar III management proposed a plan to charge participating districts and grant and contract agencies more for retiree health insurance than the cost of a pay-as-you-go method. This plan was approved by the Questar III Board of Education on October 8, 2009. At that time, the plan mirrored the recommendations of New York State Comptroller Thomas DiNapoli found in the 2008 publication titled GASB 45: Reporting the True Cost of Other Post-Employment Benefits (see Appendix B) which states:

“...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.”

In a letter dated February 4, 2010 (see Appendix C), which was sent to all component district board members, Questar III explained its accounting policy for OPEB.

Each year since that time the amount charged to participating districts and granting agencies exceeding the cost of the pay-as-you-go method has been recorded as a liability in the general fund. This practice has been explicitly identified and recognized in the annual financial statements reviewed by Questar III’s external auditors Cusack and Co.

Task force members made a variety of requests of Questar III staff at their first meeting on April 15, 2013. They requested a letter dated February 4, 2010 to the component districts from Superintendent Baldwin regarding OPEB practices at Questar III. They also requested a copy of the agenda and attendance sheet from a meeting on November 19, 2009 of the business officials of the component districts regarding OPEB. A request was also made for Questar III to poll other BOCES to find out what accounting methods they were using, and at that time, the response from four BOCES indicated that
they were using modified accrual accounting and were paying for OPEB on a pay-as-you-go basis. Questions were raised about the health insurance plans available to Questar III employees. This information was provided to task force members along with the same information for all of the components in the BOCES. Task force members were advised that all of the financial statements, which note the accrual for OPEB, were available for them to review online at the Questar III website.

These additional background materials are contained in the Appendix C.

B. The History of GASB and OPEB

Regarding the history and authority of the Governmental Accounting Standards Board (GASB) specifically, GASB is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles for all state and local governments. It was established in 1984 by the Financial Accounting Foundation and by 10 national associations of state and local government officials. As such it is not a governmental agency but rather an operating component of the Financial Accounting Foundation, which is a private sector, not-for-profit entity. GASB standards are not federal laws or regulations and the organization does not have enforcement authority. Compliance with GASB standards is enforceable under the laws of some individual states and through the audit process. At the conclusion of an audit, an opinion is rendered on the fairness of financial statement presentations in conformity with Generally Accepted Accounting Principles (GAAP).

In May 1990 GASB issued Statement No. 11, Measurement Focus and Basis of Accounting – Governmental Fund Operating Statements. Under this statement relevant transactions and events associated with the financial operations of the government need to be recognized when incurred, not when paid. Hence, at that time, Questar followed this guidance.

In 2001 GASB issued Statement No. 34, ASIC Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments. In this statement GASB identified a distinctly different treatment of accounting practices for special purpose governments such as a BOCES. These practices differ from those of a governmental entity such as a school district. Special purpose governments receive their revenue from fees and charges from services provided to others, rather than from taxes as is the case with most governments. Special purpose governments, such as the BOCES are permitted to use full accrual accounting, while regular governmental entities such as school districts, towns, villages, etc., are required to use modified accrual accounting. This distinction between full and modified accounting rests on how liabilities are treated. Under full accrual accounting liabilities are recorded when incurred, regardless of when paid. Under modified accrual accounting liabilities are recorded when paid, with the exception that a future liability payable up to 12 months beyond the close of the fiscal year can be recorded in the financial statements.

When the GASB 45 statement was issued in June 2004, a significant change was required regarding the treatment and identification of OPEB. As part of the financial statements, governments of all types were required to compute the long-term liability associated with its obligation to pay for future OPEB. All governments have responded to this requirement and calculated these costs, which are recorded in
the financial statements of the entity. This liability for almost all jurisdictions creates a significant unfunded liability for the governments. This requirement was established in order to create comparability with the financial practices of non-governmental entities that were always required to record these obligations.

Subsequent to the issuance of GASB 45, the Office of the State Comptroller (OSC) proposed legislation in both 2008 and again in 2012 that would authorize the creation of OPEB trusts for New York State and its local governments. However, these efforts did not come to fruition. As such, there is no current specific authority under New York State law regarding state and local governments’ responsibility for and funding of this long-term post-employment obligation.

IV. Other BOCES Experiences

A. OSC reports on the Ulster County BOCES accrual methods and its funding of long-term liabilities

In an audit by OSC of the Ulster BOCES, the opinion issued was that the BOCES “consistently and inappropriately budgets for and accumulates appropriations for a portion of future retiree health insurance costs to fund that OPEB accrued liability... Because New York State does not currently have a statute which authorizes funding of this long-term liability, the approximate $12.8 million accrued in this liability would have been subject to refunds to the component districts.” The OSC went on to recommend that the BOCES change its accounting for this obligation and develop a plan to return the $12.8 million surplus to its component districts.

Ulster BOCES developed a plan to return the funds and it is now being implemented by offsetting the current pay-as-you-go amount each year with that part of the accrued liability, rather than issuing a check to each of the component districts. The decision against cutting checks is indicative of the potentially severe effect on state aid. Because there was an expenditure associated with the accrual of OPEB liability, districts received state aid on those expenditures. Consequently, if checks were cut to the districts in order to deplete the OPEB accrual, the state may seek to recover the state aid associated with those particular expenditures.

B. OSC reports on the Nassau County BOCES use of “reserves”

At the Nassau BOCES the method of accounting was different than that of the Ulster BOCES; however, the OSC response to the OPEB liability was similar. In this case the audit report stated that the BOCES had inappropriately retained $25.9 million of local district monies in an inappropriately used reserve fund. OSC specifically noted that the method used to establish and fund its reserves was inappropriate and that in particular the BOCES had inappropriately used the employee benefits accrued liability reserve (EBALR) to set aside funds to meet its OPEB obligation. Nassau BOCES responded to the OSC
audit by stating, “Although this practice (reserving funds for OPEB) is widespread (in at least 251 other school districts and BOCES), OSC has noted that the legislative authority for this mechanism is not yet in place.” The response went on to explain that it was the intent of Nassau BOCES to defray future OPEB costs and save taxpayers “$2.6 million in annual required contributions, resulting in possibly hundreds of millions of dollars in future cost savings.”

Unlike the Ulster BOCES, the Nassau BOCES issued checks to refund the OPEB liability to its component and participating districts. It did take 1.5 years of accounting review to determine the amount that was owed to each district. It is important to note that because the Nassau BOCES set aside the funds in a reserve expenditures were not recorded, therefore, state aid to the districts was not affected.

C. The experience of the Rockland County BOCES:

The task force learned via a conversation between one of its members and a business official at the Rockland BOCES, that a different approach had been used to return the funds accrued by the Rockland BOCES. In this instance, one of the component districts within the Rockland BOCES requested that it be given its share of accrued funds in the form of a check; all of the remaining districts elected to have the accrued funds used as an offset to future OPEB obligations, as in the case of Ulster. It is unclear what would happen to state aid in this case.

In summary, while GASB 34 will permit a BOCES to describe itself as a governmental special purpose service agency, and therefore recognize a long-term liability accrual for OPEB, OSC took the position in Ulster that it could not use full accrual accounting, and in Nassau that it could not use reserves to meet OPEB obligations.

D. Practices of other BOCES regarding allocating OPEB to the Administrative and Program Budgets

The SED BOCES Administrative Handbook 5 Operating Procedures and Policies requires BOCES to reflect OPEB obligations in the administrative budget, however this would cause administrative budgets to balloon. As a consequence, many BOCES have continued the practice of splitting OPEB obligations between the administrative and program budgets.

Questar III staff had the opportunity to survey seven other BOCES regarding their handling of OPEB obligations. One BOCES placed its entire pay-as-you-go amount in the program budgets. No retiree health insurance was budgeted in the administrative budget. Another BOCES had all of its pay-as-you-go obligations placed in the administrative budget. However, to keep the administrative budget lower, portions of administrative staff have been charged to the program budgets. Two of the BOCES (including Questar III) included a portion of the pay-as-you-go amount in the administrative budget and
the remaining cost in the program budget. The remaining four BOCES brought in an offset credit as a transfer from the program budget. The full pay-as-you-go amount is initially reflected in the administrative budget. After the credit is applied, the final budget is then approved and sent forward to the vote by the component districts.

This practice of putting the full OPEB obligation in the administrative budget and then applying a credit from the services budget is an alternative to just splitting the OPEB cost between administrative and program, which was the practice of Questar III. Based on research by the Task Force, it was found that this is a practice used by other BOCES.

V. External opinion and guidance

A. Questar III inquiry of the Office of the State Comptroller

At a meeting with OSC on April 16, 2013, Questar III specifically asked OSC if it could be recognized as a special purpose service agency, and thereby under GASB 34 be permitted to use full accrual accounting.

It must be noted that there are two distinct issues inherent in this matter. One issue is associated with the permissibility of the BOCES to use full accrual accounting as a governmental service agency. The second issue is whether or not a BOCES can accumulate funds to be set aside to meet the OPEB obligation, and in what structural fund can those monies be held? Questar III believed that it is permitted to treat itself as a special purpose service agency and to fund the OPEB obligation and hold these monies in the general fund.

In addition, a summary of the meeting with then Deputy Comptroller Steve Hancox, who supervised OSC’s auditors, was presented to the task force. At the meeting a very specific question was asked regarding whether or not it is permissible for Questar III to use the full accrual method of accounting. The question was worded this way so that OSC could answer it without setting a higher precedent. Their response could be framed so that it would be specific to Questar III based upon its interpretation of GASB 34 and would not necessarily apply to the broader issue regarding the setting aside of funds to meet the OPEB obligation.

During the meeting, District Superintendent Jim Baldwin asked about the status of the trust creation legislation, which has been introduced several times. OSC responded that it would be unlikely that this legislation will ever pass due to opposition from statewide public employee unions.

All of the prepared supporting materials and the minutes of the task force’s first meeting are set forth in the Appendix D of this report.

On October 11, 2013, the new Executive Deputy Comptroller, Andrew A. SanFilippo, sent a letter to District Superintendent Baldwin stating they would not authorize Questar III’s alternate bases of accounting and should report activities using the modified accrual basis of accounting and should only
record a liability when its payment to OPEB providers for premiums is actually due and expected to be liquidated with current financial resources, otherwise referred to as the “pay-as-you-go approach.”

Although, Questar III considered those funds due and payable because it intended to pay these funds into an OPEB trust should legislation be passed, OSC said this intention is irrelevant to when Questar III may recognize a liability pursuant to generally accepted accounting principles (GAAP), and Questar III cannot record the OPEB liability using the modified accrual basis of accounting.

Furthermore, OSC stated that Questar III should treat any portion of the cash accumulated for its OPEB liability in excess of the properly recognized amount of OPEB expenditures a surplus, and return it to the component school districts in accordance with applicable statues.

This letter can be found in Appendix E of this report.

B. **Opinion of other CPA firms:**

Over the course of the work of the task force, Questar III staff attempted to seek an opinion from outside accounting firms regarding Questar III’s accounting practices as well as those of its own external audit firm, which, for years, had reflected the accounting practices that permitted the accrued liability to be recognized and held by Questar III. While several accounting firms had been contacted, including the CPA firm which was the external audit firm for the Ulster BOCES, attempts to solicit a response were unsuccessful. Questar III staff eventually concluded that no CPA firm was willing to comment on this practice because their comment might reflect on their own accounting practice for their clients. GASB 34 permits a special purpose service agency, such as a BOCES, to elect to use full accrual accounting, which is consistent with the methodology employed by Questar III. However this is clearly a permissive action. In other words, agencies like a BOCES could choose to use either full or modified accrual accounting practices, which would result in distinctly different opinions associated with the permissibility of recognizing liabilities due to be paid more than 12 months into the future as accrued expenses on fund level financial statements (using full accrual accounting methods).

C. **Legal opinion regarding OSC audit authority:**

The task force also raised the question regarding the authority of the Office of the State Comptroller to require Questar III to change its practice and/or return the accrued liability. This question was posed to Questar III legal counsel to determine the authority of the Comptroller to impose audit findings.

In a memorandum (see Appendix F) the law firm of Whiteman, Hanna, and Osterman reported that they could find no specific authority of the Office of the State Comptroller to enforce audit findings and recommendations. However, the State Education Department does require that, subsequent to an audit report, the audited entity must file a “corrective action plan” (CAP). Under its regulations, the
State Education Department does have the authority to enforce plans of correction which are developed by the school district. Thus, while the Comptroller has no specific authority to enforce audit findings, the State Education Department, upon review and acceptance of a plan of correction, does have the authority to follow up and enforce the corrective action plan that addresses those specific audit findings.

D. Opinion of the New York State Education Department

Superintendent Baldwin had several conversations with high-level staff at the State Education Department (SED). While these conversations produced an informal opinion that acknowledged the prudence of any government legitimately setting aside funds to address its long-term obligations for OPEB, the State Education Department was unwilling to issue a formal position regarding the practice that has been carried out by Questar III.

E. GASB technical guidance—Questar III can use full accrual accounting

As a consequence, staff elected to seek “technical guidance” from GASB itself. Several telephone conversations eventually produced a result, which was summarized in a memo written by Questar III staff. This technical guidance, based upon the information provided by Questar III about the sources of its revenue, concluded that Questar III could recognize itself as a service agency, and, therefore, legitimately use full accrual accounting.

A question was again raised regarding whether or not GASB is the final authority on accounting practices, and it was reaffirmed that GASB is the authority for government accounting, just as FASB is for business accounting. All accountants use these authorities as safe guard against governments or other entities which might change the accounting rules for their own advantage. GASB is the final authority for Questar III accounting practices.

This technical guidance from GASB is contained in Appendix G.

VI. Allowable reserves available for use by a BOCES:

The Task Force raised the question of which reserves were available for use by BOCES. The following six reserves are available for use by a BOCES:

- **Career Education Instruction Equipment Reserve** – *Ed. Law 1950 (4)(ee)- Part 170.3(k)* of Commissioner’s Regulations - This reserve is ultimately used to replace instructional equipment.
- **Insurance Reserve** – *Ed. Law 1950 (4)(cc)* – To be used by BOCES only for liability and property loss claims.
• *Insurance Reserve – GML Section 6-n* – purpose of this reserve is to self-insure for the purpose of paying liability, casualty and other types of losses, claims and judgments for which BOCES is authorized or required to purchase or maintain insurance with several exceptions

• *Employee Benefit Accrued Liability Reserve (EBLAR) – General Municipal Law Section 6-p* – This reserve can be used by districts/BOCES to pay accrued time upon employee termination. This reserve is limited to documented liabilities – pay claims rather than pay-as-you-go. This reserve may not be used to set aside funds for OPEB benefits including health insurance costs.

• *Unemployment Insurance Reserve – General Municipal Law Section 6-m* – Reserve allows BOCES and districts to set aside funds on pay-as-you-go basis to reimburse claimants.

• *Retirement Contribution Reserve – General Municipal Law – Section 6-r* – This reserve is used to fund ERS but cannot be used to fund TRS.

Details regarding the specific requirements associated with each of these reserves are set forth in Appendix H.

It was also explained that a BOCES is restricted from transferring funds back and forth to the general fund from these reserves. A BOCES can only fund these reserves through a direct appropriation of funds through the budgeting process. Further, there is no availability of an unassigned fund balance for a BOCES.

**VII. Questar III budget and OPEB practice**

**A. Questar III budget and fiscal practices** (see Appendix I for details):

Questar III’s practice that lead to the creation of the OPEB accrual and the funds contained therein, did not arise out of a specific appropriation that resulted in additional funds to be contributed to the accrual each year. Rather, the mathematical process which yielded the identification of these funds was a function of, in part, the residual balance, net of refunds to districts, and a function of liberal estimates of the rate increases projected for health insurance premiums. This was done to assure that there were sufficient funds in the health insurance accounts to meet the obligations that will arise during the year and to address fluctuations in cost due to new hires and changes in the election among different plans by employees.

In addition, this residual balance, which funded the accrual for OPEB, also derived from the rate setting and fiscal practices of Questar III for the services that it provides to both component and non-component districts. Consequently, the task force was provided with detailed information on the budgeting and rate setting practices of Questar III which could potentially lead to surplus funds that become the contribution to the accrual. Detailed information about this process is contained in the appendix.
In general, whether associated with special education services or other services offered by Questar III, there was a degree of risk that was recognized and compensated for in the budgets and rates used in the fiscal affairs between Questar III and its components.

With specific respect to special education, one of the major concerns that must be addressed by Questar III is the fact that there are often substantial differences between the preliminary service requests of components and the final service requests. It is often the case that districts underestimate the service needs for special education, but when faced with actual enrollment they are forced to request services that exceed the preliminary requests. At the time that components decide upon their actual service needs for special education, Questar III must immediately address that need in order to enroll children to meet their IEP requirements in a timely manner. In those years when Questar III was not able to quickly respond to service requests, there were often delays in the local district’s ability to respond to the IEP requirements and consequently the districts were made vulnerable because of the inability to enroll the children in Questar III services.

To avoid this potentially negative impact on component districts, Questar III used a relatively liberal approach to estimating the program budgets for special education services. Similarly when it set rates for the specific elements of special education service within the program budget, it also exercised a liberal approach to the formulation of these rates. The revenue stream that flowed from districts to Questar III was derived by multiplying the enrollment by the rate or fee. While liberal estimates were used, if done properly, and if projections hold, there would be a reasonable balance between cost and revenue. But it was also likely that there would be a surplus of revenue over expense. This is rational given the fact that Questar III must be in a position to meet obligations for children with disabilities and at the same time ensure that it can cover costs associated with the delivery of those services.

In a similar fashion, Questar III develops budgets for the various programs associated with services purchased by both component and non-component districts. Once again, since there is always a difference between the preliminary service requests and the final service request. Questar III used the same approach as previously discussed to estimate its program costs and rates. Thus, there were times when the various accounts were in deficit and other times when they were in surplus. If they were in surplus, these surplus funds were used to pay refunds using the same conceptual framework of providing a stable and predictable revenue stream to the local districts. Any remaining balance of liability, after the refunds were paid, became a contribution to the accrual for future OPEB obligations.

While this methodology resulted in an unpredictable annual amount of funds contributed to the OPEB accrual, Questar III expected that in both its budgeting and rate setting practices there would be a surplus of funds to meet the OPEB future liability. As previously described, Questar III paid its current obligation for retirees’ health insurance by drawing from two sources of funds. Specific funds for this purpose were appropriated in the administrative budget, and the balance of funds to meet the obligation was drawn against the accrued OPEB liability. The surpluses that were produced after refunds were paid were then used to replenish the liability account drawn upon to pay current obligations, and to provide for some growth in the OPEB accrual. Again, while the amount of the
contribution to the accrual was not predicted or set specifically in the budgeting and rate setting process, there was an expectation that there would be a surplus that contributes to the growth in the OPEB accrual.

Information contained in Appendix I clearly demonstrates that the amount actually contributed to the accrual on a year-by-year basis fluctuated considerably. In all cases, this fluctuation is attributed to significant variations in the enrollment or volume of services purchased when compared to the original budget estimates. Sometimes there were significant deficits in some of the service accounts, and in the year of deficits the accrual would be smaller. In the year of unanticipated surpluses, there may be larger than normal contributions to the accrual. The objective was to achieve neutrality between revenues and expenses while assuring a steady predictable revenue stream of refunds to components, restoration of OPEB accrued liability used to meet current obligations, and to provide a responsible increase in the OPEB accrual for future liabilities.

All of the budgeting and rate setting processes used by Questar III are reviewed annually by the superintendents of component school districts. Committees comprised of superintendents address areas such as special education, staff development, itinerant services, business and health insurance practices, etc. In these committees, programmatic decisions are vetted based upon program and service changes desired by components, and other factors that may influence both the type and volume of services required by component districts. The objectives of these committees are to assure that the current needs of component districts are met, that future needs are addressed, and that there are no surprises that arise for component districts as they formulate their own budgets. There must be reasonable congruence between the costs that Questar III will have in addressing components needs and the budgets that are passed at the local district level. In order to assure this, it is extremely important that programmatic and financial decisions are vetted by superintendents.

B. How Questar III specifically budgets, bills for and accrues liability for OPEB:

Information was presented to the task force by Questar III staff regarding the mechanics of how Questar III addressed OPEB obligations. At year end, staff identified the current year obligation to meet OPEB requirements. A portion of that OPEB obligation would have been reflected in the administrative budget approved for that fiscal year, and that source of funds would then be used to meet part of the OPEB obligation. The balance of the OPEB obligation would be paid for by drawing funds against the OPEB accrual, which is retained in the general fund. With these two sources of funding the OPEB obligation for the current year is paid.

Once the amount of the total OPEB obligation has been determined, all OPEB costs not paid from the administrative budget, were proportionally allocated to each of the CoSers and charged to the districts. These charges became district expenses and thus were eligible for BOCES state aid, which was ultimately paid to the districts.
After this is done, all of the accounts within the Questar III general fund were closed out. These included all accounts charged to both the administrative budget and to the CoSer budgets. Because of differences between the amounts budgeted for each CoSer and the actual Questar III expenditures for purchased services from school districts, there may have been a positive balance of funds remaining. This likelihood is also attributed to the practice by Questar III of liberally projecting insurance rate increases in its budgeting processes. (This was done to assure Questar III’s ability to meet all health insurance obligations for active and retired employees.) As a consequence, it was very likely that there would be surplus funds remaining after the closeout.

All surplus funds were then combined, and from this amount the projected refund to districts was deducted and eventually paid. It is important to note, that as a matter of practice, Questar III sought to pay out refunds at a stable and predictable level, year to year. It did so because it believes that a stable, predictable and certain revenue stream from the refund is preferable to districts in order to prevent radical and widely fluctuating revenues to the districts. This assured that the revenue from refunds did not contribute to fluctuating property taxes.

After the refund total was subtracted from the surplus funds, the balance was then added to the accrual for OPEB to restore funds paid from the accrual for current OPEB expenses and to increase the total amount of the accrual.

This methodology, applied annually, led to the increase in the accrual to its current level of $21m.

C. The OPEB obligation arising from contracts and grants:

Questar III often executes contracts and grants. In doing so, its employees earned OPEB for health insurance. Some districts have raised the question of why this is done since it has resulted in growth in the OPEB liability.

Contracts and grants provide both direct and indirect benefits to component districts. Grants support a variety of activities including adult education, incarcerated youth, English as a second language, GED test administration, career pathway development, professional development, career and technical education, and youth leadership. Grants from federal funds provide professional development for components. There is also an indirect benefit of grants to adult education students who become more employable thus giving back to the community.

Because Questar III uses existing employees to administer and carry out grants and contracts, revenues from these sources are used to offset expenses contained in the administrative budget. This provides a direct offset to the administrative budget cost, which is passed on to component districts. Only grants and contracts that had payroll expenses were charged a prorated portion of OPEB. Without grants, components would lose programmatic opportunities and monetary benefits to the General Fund budget.
Questar III staff also explained that the recent contracts and grants Questar III entered into all provided for OPEB expenses and were accounted for and placed in the accrual.

D. How Questar III reflects OPEB obligations in the Administrative Budget:

It was Questar III’s practice to make an estimate of its OPEB actual expenditures as part of its ongoing budget practices each year. The approach produced a liberal estimate of the impact of inflation on health insurance rate increases and service volume based upon the possibility of significant changes in enrollment in various options of the health insurance program. Once a final estimate was developed, a portion of that estimate, somewhere between 55 and 65 percent, was placed in the administrative budget. The balance of the estimated expenses was then projected to be included in the program budgets, and rates were established for services that would be purchased by both component and non-component districts. The amount of estimated actual expenses that was placed in the administrative budget was eventually voted on by all component districts. The program budgets and the rates were then approved by the Questar III Board of Education. Once approved, they became the sources of funding to meet the actual expenditures for health insurance for retirees.

VIII. Options

B. Annuity Insurance Contracts:

The task force discussed the possibility of purchasing annuity insurance contracts in order to meet the OPEB obligation in the future. Annuity contracts can be purchased to provide a payout on a periodic basis at some time in the future. A contract could be purchased for each employee to fund that employee’s specific OPEB obligation in the future. The amount of this annuity would be based upon actuarial assumptions associated with that specific employee. An annuity contract could also be purchased for a group of employees. And, as in the case of the GASB 45 calculations, actuarial assumptions would be made regarding that group of employees, and this would in turn determine the amount in the contract required to meet the payout obligation.

It is also important to note that the premium amount to be paid for these policies is a function of the current interest rate environment. If at the time a contract is purchased, the interest rates paid on the cash amount held in the contract are high, then earnings on that principal amount will also be high. As such the premium to be paid would reflect the higher rate of earnings on the principal and therefore less money would have to be paid, up front, to meet the long-term obligation. If interest rates were low, then earnings would be low, and thus the amount of premium would have to be higher in order to compensate for the lower rate of interest earnings on the principal amount.
Currently the interest environment is at the lowest point that it has been in recent memory. Projections are that interest rates will only rise in the future. Consequently if an entity were to purchase annuity contracts today, in this low interest rate environment, the amount required to be set aside as principal would have to be substantially greater than if one were to purchase the same payout amount, at a time in the future when interest rates are high. When interest rates are high, a lower principal would yield the same return and thereby meet the future payout requirement. Therefore, it is not advised to purchase annuity insurance contracts at the current time.

E. Considerations and options for liquidating the accrual:

The Task Force discussed three significant potential consequences that would ensue from the return of the accrual to component districts as a means to liquidate the accrual. These options were discussed prior to receiving word from OSC must indeed return the accrual to component districts.

- First, there was a concern about how the accrued liability would actually be allocated to the component districts. One methodology would be to return the monies based upon the RWADA formula. This methodology would result in a potential inequity among districts. For those districts that purchased significant amounts of CoSer services, but proportionally had a relatively small RWADA, they would be returned fewer funds than they actually contributed to the accrual. Large districts with a large proportion of the total RWADA for the BOCES and a proportionally smaller amount of purchased services would receive more of the funds than they actually contributed to the total OPEB accrual. The only way to avoid this inequity is to analyze the sources of the accrual from each district’s share of the administrative budget as well as their respective COSER purchases for every year that there was an addition to the accrual. (See Identifying the sources of contribution to the OPEB accrual: A forensic analysis, page 27.)

- Second, if the liquidation was carried out by distributing funds directly to component districts as cash payments, there would be the potential that state aid would have to be returned to the New York State government. Because of the methodology that is employed by Questar III, the annual OPEB cost, and the amount of additional funds contributed to growth in the accrual were actually expensed through both the administrative and COSER programs. As such, state aid was paid on those expenses to the benefit of the component districts. The effect of returning the funds as a cash payment to the component districts would be to negate the expenditure upon which state aid had been paid and thereby set up a scenario which might require state aid to be returned to New York State, despite the fact that it had already been collected and spent by the local districts. However, cash returned directly to New York State is placed in the General Fund and does not result in any benefit to the State appropriations for aid to public schools. Therefore, it is imperative that the funds be returned in the form of a
credit, whereby components’ bill from Questar III, based on the RWADA formula, would be reduced by the allocated amount from the accrual on a graduated basis.

- Third, from an accounting perspective there has to be consistency associated with the return of these funds to all payers. If the funds attributable to the components, which are but one source of revenue to the accrual, were returned, it could be argued that Questar III would similarly have to return that portion of the accrual which was attributable to revenues from federal and state grants, contracts, and services purchased by non-component districts as well.

F. Options for future action

Prior to receiving guidance from OSC insisting Questar III return the accrual to component districts, Questar III staff developed a variety of options for future action and identified the pros and cons associated with each option. In addition, each of these options was presented to the Task Force in detail through an accompanying spreadsheet which corresponds to each option. Each of these options and its analysis follows.

1. Fully liquidate the accrual and return the funds to their sources.
   - The pros for this option include: a portion of the accrued liability will be returned to the districts; BOCES rates may decrease if program budgets no longer contribute to OPEB; and BOCES aid on the administrative budget will increase.
   - The cons for this option include but are not limited to: components will be responsible for fully funding OPEB costs related to employees funded through grants/contracts; the Questar III administrative budget will increase to fund the cost of retirees, thereby increasing the administrative budgets of component districts. This could be problematic if a component school district had a budget defeat and was forced to adopt a contingency budget which includes a cap on the administrative component of the district budget.

Because the growth in the administrative budget would continue to rise over time with this option, the 10-percent cap on Questar III administrative expenditures would be reached. If the administrative budget exceeds 10 percent of the program budget, the amount of expense beyond the 10-percent limit is ineligible for state BOCES Aid even though it must be paid by the component districts. In addition, if Questar III were to be required to operate under a contingency budget, the increasing annual OPEB costs would still be paid by components as a contingent expense. As a consequence, there is no way to avoid the loss of state BOCES Aid once the BOCES 10-percent administrative cap is exceeded.

2. Continue the current practice of accruing OPEB funds from program budgets – including grant and contract budgets. (See Appendix J for full list of pros and cons.)
• Some of the pros of this option are: Questar III is in a better position to meet its OPEB obligations, relieving component districts from having to bear the full cost in the future; legacy costs generated from grants and contracts will be partially funded by continuing to accrue OPEB to grant and contract budgets; districts will continue to be fully aided on OPEB expenditures; current retiree health insurance expenses will continue to be partially covered by the accrued liability, which will help keep the Questar III administrative budget lower.

• Some of the cons of this option include: districts pay more for services; and possible future loss of state aid for components should SED determine accrued OPEB expenditures are not state aid eligible.

3. Cease to increase the OPEB accrual and gradually use it to offset the annual current cost of retiree health insurance (similar to Ulster BOCES). (See Appendix J for full list of pros and cons.)

• Some of the pros of this method are: districts will not be subject to a state aid adjustment; the administrative budget will use the accrual to gradually offset annual OPEB expenses; BOCES service rates may decrease.

• Some of the cons include: there will be an equity issue as districts that purchase relatively few Questar III services, compared to those district’s share of RWADA, will benefit to a greater degree from the accrual; interest earnings used to offset the administrative budget will gradually decline; there is another equity issue because BOCES Aid earned on program budgets will decrease; the amount available to put in an OPEB trust (if authorizing legislation is ever enacted) will diminish over time. The drawdown and ultimate depletion of the accrual may lead to cash flow issues that will require Questar III to issue Revenue Anticipation Notes. Interest on these notes will be charged to components as part of the administrative budget. There may be a large increase in the Questar III administrative budget once the OPEB accrual is exhausted, requiring districts to budget for the spike in expenditures; the legacy costs associated with grants and contracts will no longer be offset making components responsible for fully funding these OPEB costs.

4. Through annual budget appropriations, place the money into allowable reserves and distribute any funds remaining to local districts. (See Appendix J for full list of pros and cons.)

• Pros for this option include: districts will either get a portion of funds returned to them or will benefit from offsetting the annual cost of retiree health insurance premiums in the administrative budget; Questar III service rates may decrease; Questar III will be able to save for large equipment purchases for CTE programs; reserves will help maintain Questar III’s fiscal health; reserves reduce future costs that would fall on components.

• Cons for this option include: reduced amount may be returned to districts or applied to annual retiree health insurance costs. The drawdown and ultimate depletion of the accrual may lead to cash flow issues that will require Questar III to issue Revenue Anticipation Notes. Interest on these notes will be charged to components as part of
the administrative budget. Rising future OPEB costs for districts; components will be responsible for fully funding legacy costs related to grants and contracts; admin budget will increase to cover pay-as-you-go method, negatively affecting component annual budgets and admin cap; budgeting for the whole amount of retiree health insurance in the admin budget will expedite Questar III reaching the 10-percent administrative cost cap and, likewise, administrative costs are capped when school districts are forced to adopt a contingency budget.

5. Continue to accrue OPEB against grants and contracts in the Special Aid Fund but discontinue accruing OPEB liability in the general fund. – Pros and cons for this are similar to the other options depending on which method is chosen to address the General Fund Accrual. However, continuing to accrue OPEB from the grants and contracts would address the concern of having funds set aside to help address legacy costs of employees funded through various grants and contracts.

Spreadsheets which demonstrate the application of each of these options can be found in Appendix J of this report.

After considerable discussion among task force members, it was apparent that three fundamental questions had to be resolved: 1) Would Questar III continue its practice of distributing OPEB costs between the administrative budget and the services budget? This question is independent of further questions which are: 2) Would Questar III return the accrual to the payers that contributed to it, and 3) In the future, will Questar III maintain or change its budgeting practice, which ultimately led to the creation of the accrual for future OPEB obligations?

The question was also raised as to what would be an appropriate amount to hold in the accrual if the Task Force recommends Questar III discontinue the practice and return a portion of the accrued liability. It would take many years into the future, if ever, for there to be sufficient OPEB accrual to meet the OPEB obligation or to adequately fund a trust or an annuity contract. In response to this question, there was an observation that Questar III would probably want to retain at least 12 months of future OPEB obligations as a current liability, under modified accrual accounting practices. When one looks out at a 10-year horizon, the annual OPEB “pay-as-you-go” amount would be approximately $5 million. In addition, approximately $2.6 million has been collected from federal and other sources which was specifically set aside to meet future obligations, and therefore should be retained by Questar III. As a reflection of these numbers, the financial analysis which accompanied the five options presented by Questar III staff, assumed that $14 million of the $21 million would be returned and $7 million would be held as a proper amount to meet future obligations and be consistent with modified accrual practices.

There is another option with regard to assessing the right amount of OPEB funds to be held in the accrual. An examination of OPEB expenditures budgeted in 2013-14 shows that $2.9 million is required next year to meet current OPEB liabilities – this is the pay-as-you-go amount. In 10 years, this obligation will grow to be $5.1 million. Since the annual “pay as you go” amount will grow to
approximately $5 million, Questar III could potentially justify holding $5 million as a current liability accrual. Another approach to analyzing the appropriate amount is to look at the aggregate expenditures for OPEB over this same 10-year horizon. Adding together all annual payments from now until 10 years out, the aggregate payout for OPEB is estimated to be $36.6 million. Taking the budgeted amount for pay-as-you-go and multiplying it by 10 years results in $14.5 million. The administrative budget would have to grow by an accumulated amount of $22 million over the 10-year period above the base level of current budgeted expenditures in order to meet the OPEB obligations. Coincidentally, Questar III has $21 million, which could be used as a transition fund, or as a pay-back fund.

Finally the Task Force discussed the prudency in which to retain the OPEB accrued liability on the assumption that legislation would eventually be approved to allow a trust to be established to hold funds set aside to meet OPEB obligations. However this was discussed prior to receiving official opinion from OSC.

Significant changes may also take place with regard to the obligation of employers to meet OPEB cost. At this time there is no clarity regarding the implementation of the federal Affordable Care Act. It is conceivable that coverage under this legislation, coupled with Medicare coverage, could result in a significant change in the liability of employers for OPEB in the future. In addition, given population trends, it is also clear that once the entire Baby Boom generation retires there will be fewer new retirees. However, this may be partly offset by increased longevity in that population.

G. “Pay-as-you-go” and the Administrative and Service Budgets:

The “pay-as-you-go” method would require that there be a shift of OPEB cost from the services budgets to the administrative budget, and there would also be growth in the administrative budget, over time, based on GASB 45 projections.

The administrative budget in 2013-14 is set at $4.238 million. $1 million of OPEB cost would have to be added to the administrative budget to reflect the cost that has been historically allocated in the program budget, an additional 25-percent increase. Growth in OPEB cost is projected, under GASB 45 projections, to increase by about $200,000 per year, or 5 percent a year for each of the next 10 years. If one then adds a 2-percent inflation rate, the administrative budget would likely grow by about 7 percent per year, and this would have to be paid for by the districts based on the RWADA method.

There would be a corresponding reduction in program budget since all of the OPEB obligation would be reflected in the administrative budget. It is important to note that in the 2013-14 fiscal year, no funds are built into the program budget for OPEB. The SED BOCES Administrative Handbook 5 Operating Procedures and Policies requires BOCES to reflect OPEB obligations in the administrative budget, which would have caused administrative budgets to balloon. As a consequence, many BOCES have continued the practice of splitting OPEB obligations between the administrative and program budgets.
Questar III staff also provided Task Force members with information regarding the contingent budget concept as applied to the administrative budget. A contingent budget may not exceed the prior year’s administrative budget, except for expenditures for supplemental retiree costs, including health insurance. The contingency budget is calculated by deducting the prior year retiree health insurance costs from the prior administrative budget and adding back the cost of the upcoming year’s retiree health insurance. Thus, the administrative budget, even in the event of a contingent budget, actually contains funds to meet what will be current year “pay-as-you-go” OPEB expense. The OPEB current costs are also included in the program budgets and service rates, but these are not subject to contingent budget exclusions.

H. Identifying the sources of contribution to the OPEB accrual – a forensic analysis:

To carefully identify the source of contributions to the OPEB accrual would require 4 steps: 1) identify the amount of money generated for OPEB from grants and contracts: $2.6 million; 2) subtract current liability amount: for example, $5 million using the 10-year-out projected obligation; 3) examine the administrative budget charges to local districts each year since the accrual began based upon their RWADA proportional share each year; 4) review the services budget to see how much was spent by each district on each CoSer, and what proportion of the OPEB expense had been allocated to each CoSer, each year.

I. Refinement of possible options regarding the future of Questar III OPEB

Given all of the background materials and information presented, Questar III staff prepared several options for final review by the Task Force. Please note: these options were formulated prior to receiving the official opinion form OSC on October 11, 2013.

Option A: Place 100 percent of the pay-as-you-go amount in the administrative budget. This will require an initial “bump up” in the administrative budget by about $1 million. Based upon this methodology the administrative budget would grow from about $4 million to more than $5 million. Subtracting the administrative budget from the current gross budget of $55 million would yield approximately 10 percent of the administrative budget compared to the program budget. Consequently, within a very short time, it is highly predictable that the cap of 10 percent on administrative cost would be exceeded, and state aid disallowed for that portion of the administrative budget that exceeds 10 percent. Task force members discussed that there would be considerable financial and political problems associated with both the growth in the administrative budget and the piercing of the 10-percent cap on administrative cost. This could lead to defeat of the BOCES Administrative Budget, significant
reductions in purchases of services or even the possibility of some districts threatening to withdraw from BOCES altogether. Note: it is not possible to withdraw from a BOCES but it is possible to discontinue purchasing services. However, they would still be responsible for their share of administrative and capital budgets.

**Option B:** Continue current practice whereby approximately 55 to 65 percent of the pay-as-you-go amount is budgeted in the administrative budget and the balance is distributed in the program budgets. In addition, through a liberal estimate of the growth in health insurance premiums, there would continue to be a surplus of funds made available to contribute to the growth of the accrual.

**Option C:** Continue current practice whereby 55 to 65 percent of the pay-as-you-go amount is budgeted in the administrative budget and the balance is reflected in the program budgets. However, every effort would be made to estimate health insurance premium increases at a level that would not anticipate any contribution toward increases in the accrual. Even with this option, it must be recognized that there is always the probability that there might be a surplus which could be applied to the accrual or added to the refund paid to component districts.

**Option D:** Pay down the accrual in equal installments over the course of approximately 15 years. This will delay, but not avoid, a “bump up” in the administrative budget at the end of this period of time.

**Option E:** Pay down the accrual using equal installments of $500,000 per year to offset the pay-as-you-go amount. The estimated length of time to liquidate the accrual would be 28 years and at that time there would be minimal “bump up” in the administrative budget.

**Option F:** Apply a sliding scale of payments from the accrual as an offset to the pay-as-you-go amount. This will also produce a possible “bump up” in the administrative budget at some time in the future. However, this will slow the process of growth in the administrative budget, which will delay the piercing of the 10-percent cap on administrative costs for a few years more than other methods.

**Special note:** With the exception of Option A, and explicitly in Option B, all of the other options presented can be implemented by continuing to split the OPEB costs between the administrative and program budgets. The proportions of this split can, of course, be altered over time resulting in different impacts, especially with regard to piercing the 10-percent cap on BOCES administrative cost.

**IX. Task Force preliminary consensus**

Prior to receiving official opinion from Office of the State Comptroller and the State Education Department, and with little assurance they would in fact ever receive one, the Task Force deliberated whether to continue current practice or discontinue current practice using one of the previously described options.
Throughout the discussions of the task force, there has been a theme which reflects a consensus opinion that there should not be any cash return of the accrued liability to the component districts. Rather, if there is to be a return, or liquidation of the accrual, it should be done by applying it as an offset to ongoing costs. This eliminates concerns associated with accounting methodologies that would argue for returning cash to all payers in a uniform fashion, including non-components, federal and state grantors, and contractors. It also avoids questions associated with the possibility of having to return state aid already paid on past OPEB costs.

However, the Task Force came to the consensus that the most definitive decision would in fact be made only with guidance from OSC and SED regarding the permissibility to retain funds to meet the OPEB obligation. Task Force members felt strongly that this would be the best way to form a decision about the current disposition of this accrued liability and about future practices in managing Questar III’s obligation to meet OPEB expenses.

See appendix K for complete minutes from the June 5 and 12, 2013 meetings where Task Force members vocalized their opinions for future action.

X. Final Summary and Recommendation:

The majority recommendations from the final November 13, 2013 meeting are as follows (minutes from this meeting can be found in Appendix L):

For fiscal year 2012–13, Questar III will use past practice – this will result in a contribution to the accrual, but that addition to the accrual will, in part, be spent in 2013-2014 because there is no planned replenishment of, or addition to the accrual in the budget for 2013-14.

As per official opinion from OSC, the Task Force recommends Questar III return any portion of the accrual in excess of the properly recognized amount of OPEB expenditures as surplus, and return it to the contributing sources. Because the payments contributed to the accrual were derived from sources associated with the RWADA formula, the specific rates for services purchased annually by both components and non-component districts, and from grants and contracts, it is necessary to very accurately identify the specific amounts of funds contributed to the accrual, each year and from each source. This will require an independent, in-depth forensic analysis to determine actual amounts and sources of the accrual.

This should be done by applying a credit over five, seven or 10 years as an offset to ongoing costs. This eliminates concerns associated with accounting methodologies that would argue for returning cash to all payers in a uniform fashion, including non-components, federal and state grantors, and contractors. It also avoids questions associated with the possibility of having to return state aid already paid on past OPEB costs, as well as a large “bump up” to the administrative budget.
Going forward, Questar III should budget the full “pay-as-you-go” amount in the administrative budget and will be subject to component districts’ boards of education vote. Not only does this method meet SED regulations, but it guarantees Questar III can meet the moral, contractual, and statutory obligation to its employees.

The Task Force recommends Questar III seek an independent legal analysis of the process and outcomes prior to implementation on any plan of action.