

Minnesota Volunteer Fire Relief Association

Working Group Meeting

Office of the State Auditor

Tuesday, October 11, 2016

11 a.m. to 1 p.m.

I. Call to Order

Chair Auditor Otto.

II. Review and Approval of Working Group Meeting Minutes

Exhibit A. Draft September 29, 2016 Meeting Minutes

III. Discussion of Options to Raise Benefit Levels if a Municipality does not Ratify

Exhibits B and C.

- “90% Rule” Description (B)
- Maximum Benefit Level Background Information (C)

IV. Discussion of Technical Clarification for Ratification Requirements

Exhibit D.

V. Discussion of Technical Clarification for Legal Compliance Audits

Exhibit E.

VI. Other Business

- LCPR Discussion

VII. Next Meeting

Thursday, October 20, 2016

11 a.m. to 1 p.m.

Office of the State Auditor

VIII. Adjournment

Volunteer Fire Relief Association Working Group

Office of the State Auditor
Thursday, September 29, 2016
11 a.m. to 1 p.m.

Members Present

Luke Fischer, City of Plymouth Administrative Services Director
Bruce Hemstad, Bemidji Fire Relief Association Secretary (defined benefit lump sum plans)
Dave Jaeger, Mahnomon Fire Relief Association Vice President (defined benefit lump sum plans)
Ron Johnson, Minnesota State Fire Department Association Representative (defined contribution plans)
Aaron Johnston, Coon Rapids Fire Relief Association Treasurer (defined contribution plans)
Philip Jones, Eden Prairie Fire Relief Association Trustee (defined benefit monthly/lump sum plans)
Michael Kruse, Falcon Heights Fire Relief Association Treasurer (defined contribution plans)
Susan Lenczewski, Legislative Commission on Pensions and Retirement Executive Director
Rebecca Otto, State Auditor
Nealon Thompson, Minnesota State Fire Chiefs Association Representative (defined benefit monthly/lump sum plans)
Kevin Wall, Lower Saint Croix Valley Fire Relief Association President (defined benefit lump sum plans)

Members Excused

Steve Donney, City of Harmony Mayor

Others Present

Ramona Advani, Deputy State Auditor and General Counsel
David Andrews, Public Employees Retirement Association Representative
Rachel Barth, Legislative Commission on Pension and Retirement Deputy Director
Bill Braun, Public
Mary Chamberlain, Abdo, Eick & Meyers, LLP Representative
John Forde, Public
Colleen Hartmon Bollom, Harmon & Hartman Financial Group Representative
Rose Hennessy Allen, Office of the State Auditor Pension Director
David Kenney, Office of the State Auditor Assistant Legal Counsel
Brian McKnight, Wells Fargo Advisors Representative
Representative John Persell
Nathan Preuss, Bemidji Fire Relief Association Representative
Mark Schulte, Van Iwaarden Associates Representative

The following motions were duly made, seconded and approved:

RESOLVED to approve the January 27, 2016, Working Group Meeting Minutes;
RESOLVED to adopt the amended Working Group Purpose Statement; and
RESOLVED to adopt the Working Group Process Statement.

I. Call to Order

Auditor Otto called the meeting to order.

II. Introductions

The Working Group members and others in attendance introduced themselves and identified the community they are representing.

III. Review and Approval of Working Group Meeting Minutes

The members reviewed the January 27, 2016, meeting minutes that had been provided in advance. Hemstad made a motion to adopt the minutes. Jaeger seconded the motion that was then adopted unanimously. Thompson abstained as he was not in attendance at the January 27, 2016 meeting.

IV. Working Group Process Discussion

- Working Group Meeting Schedule

The members reviewed the Working Group Meeting Schedule and shared their known scheduling conflicts.

- Working Group Purpose Statement

The members reviewed the Working Group Purpose Statement, which is the same as the Purpose Statement agreed upon last year. Auditor Otto suggested an amendment to the first sentence, so that it would read “To identify and work through current and pressing relief association issues while maintaining effective and efficient Office of the State Auditor oversight.” Hemstad made a motion to adopt the Purpose Statement as amended. Johnson seconded the motion that was then adopted unanimously.

- Working Group Process Statement

The members reviewed the Working Group Process Statement, which is the same as the Process Statement agreed upon last year. The members agreed that unanimous consent be required for a proposal to move forward. A topic can be reconsidered if there is only one dissenting vote. No changes to the Process Statement were proposed. Johnson made a motion to adopt the Process Statement. Johnston seconded the motion that was then adopted unanimously.

- Working Group Membership List

The members reviewed the Working Group Membership List and forwarded contact information changes to Hennessy Allen. Auditor Otto reminded the members that the Membership List is posted on the Office of the State Auditor (OSA)’s website.

V. Update on 2016 Legislative Proposals

Auditor Otto provided the members with an update on the Working Group bill that was introduced this past legislative session. All of the Working Group proposals were included in the Omnibus Retirement Bill, which was passed by both the House and Senate but was then vetoed by the Governor at the end of May. The veto related to provisions within the bill for the statewide retirement systems and was unrelated to any of the Working Group provisions. Hennessy Allen walked through the Working Group provisions. Auditor Otto asked if the Working Group members wanted to move forward

with the proposals. Thompson shared concerns he had with the provision that would clarify the prohibition on the concurrent accrual of service credit in the Public Employees Retirement Association and a volunteer fire relief association for the same hours of service. Thompson was concerned that the proposal was not widely known among the fire chiefs and that it could cause unintended consequences. It was agreed that the topic would be revisited by the Working Group this fall. All other provisions should move forward with updated effective dates of January 1, 2018.

VI. Discussion of Working Group Topic Suggestions

Auditor Otto explained that topic suggestions have been received for the Working Group's consideration. Hennessy Allen walked through the list of proposed topics. The members agreed to rank them before the next meeting.

The members discussed the topic suggestion brought forth by the Bemidji Fire Relief Association (Relief Association). Hemstad explained that following the investment market recovery and the new supplemental state aid program, the Relief Association has a sizable surplus and wants to increase its benefit level. The City of Bemidji is hesitant about ratifying any benefit level increase after its experience during the last market downturn and because of a desire for equity among city departments. It was agreed that the topic would be revisited at a future Working Group meeting.

VII. Discussion of Corporate Stock Restriction

Kenney explained that statute defines lists of authorized investment securities for public pension plans. The investment securities can be owned directly, or indirectly through mutual funds or exchange-traded funds. Mutual funds and exchange-traded funds are not considered securities, but a method for public pension plans to buy securities. OSA staff have identified a problem with the corporate stock provision within the expanded list of authorized investment securities, which authorizes investment in *any* corporate stock including mutual funds or exchange-traded funds. This outcome is inconsistent with other portions of the expanded list that require the underlying assets of mutual funds and exchange-traded funds to be directly-permissible investments on the expanded list.

Kenney explained that the loophole in the corporate stock provision would allow relief associations to invest in mutual funds and exchange-traded funds that are high-risk and speculative, and inappropriate for a public pension plan. The members reviewed draft language that would make the corporate stock provision consistent with the expanded list requirement that underlying assets of mutual funds and exchange-traded funds be permissible direct investments on the expanded list. The members agreed to revisit this topic at a future Working Group meeting.

VIII. Other Business

It was agreed that the Other Business agenda item would be carried forward to the next Working Group meeting.

IX. Next Meeting

Tuesday, October 11, 2016
11 a.m. to 1 p.m.
Office of the State Auditor

X. Adjournment

The meeting was adjourned shortly after 1:00 p.m.

Exhibit B

“90% Rule” Description

Topic:

Generally, relief associations are required to obtain ratification from the affiliated municipality or independent nonprofit firefighting corporation of a benefit level change before the change becomes effective. There is authority, if certain conditions are met, for a relief association to increase its benefit level without obtaining ratification. This allows relief associations that are well-funded to make benefit level changes even if the affiliated municipality or independent nonprofit firefighting corporation does not support the change.

However, there is a risk if a relief association decides to increase benefits on its own. If the benefit level is increased without ratification and a contribution should subsequently become required, the benefit level is no longer effective without ratification and any future benefits can only be paid using the ratified benefit level (i.e., the relief association must drop its benefit level to the last ratified level).

Whether a relief association is required to obtain ratification depends on if the relief association has a surplus and if the municipality is required to provide financial support. To determine whether municipal ratification is required, a relief association first calculates its current-year liabilities using the current-year benefit level. Next, the relief association calculates its current-year liabilities using the proposed (increased) benefit level. If the increase in the accrued liabilities exceeds 90 percent of the prior-year surplus, ratification is required.

In addition, the benefit increase must not result in the financial requirements of the special fund to exceed the expected amount of the future state aid to be received by the relief association. If the benefit increase results in the financial requirements to exceed the expected state aid, ratification of the benefit increase is required.

Statute:

424A.02 DEFINED BENEFIT RELIEF ASSOCIATIONS; SERVICE PENSIONS.

...

Subd. 10. **Local approval of bylaw amendments; filing requirements.** (a) Each defined benefit relief association to which this section applies must file a revised copy of its governing bylaws with the state auditor upon the adoption of any amendment to its governing bylaws by the relief association or upon the approval of any amendment to its governing bylaws granted by the governing body of each municipality served by the fire department to which the relief association is directly associated. Failure of the relief

association to file a copy of the bylaws or any bylaw amendments with the state auditor disqualifies the municipality from the distribution of any future fire state aid until this filing requirement has been completed.

(b) If the special fund of the relief association does not have a surplus over full funding under section 424A.092, subdivision 3, paragraph (c), clause (5), or 424A.093, subdivision 4, and if the municipality is required to provide financial support to the special fund of the relief association under section 424A.092 or 424A.093, no bylaw amendment which would affect the amount of, the manner of payment of, or the conditions for qualification for service pensions or ancillary benefits or disbursements other than administrative expenses authorized under section 69.80 payable from the special fund of the relief association is effective until it has been ratified as required under section 424A.092, subdivision 6, or 424A.093, subdivision 6. If the special fund of the relief association has a surplus over full funding under section 424A.092, subdivision 3, or 424A.093, subdivision 4, and if the municipality is not required to provide financial support to the special fund under this section, the relief association may adopt or amend without municipal ratification its articles of incorporation or bylaws which increase or otherwise affect the service pensions or ancillary benefits payable from the special fund if authorized under section 424A.092, subdivision 6, or 424A.093, subdivision 6.

(c) If the relief association pays only a lump-sum pension, the financial requirements are to be determined by the board of trustees following the preparation of an estimate of the expected increase in the accrued liability and annual accruing liability of the relief association attributable to the change. If the relief association pays a monthly benefit service pension, the financial requirements are to be determined by the board of trustees following either an updated actuarial valuation including the proposed change or an estimate of the expected actuarial impact of the proposed change prepared by the actuary of the relief association. If a relief association adopts or amends its articles of incorporation or bylaws without municipal ratification under this subdivision, and, subsequent to the amendment or adoption, the financial requirements of the special fund under this section are such so as to require financial support from the municipality, the provision which was implemented without municipal ratification is no longer effective without municipal ratification, and any service pensions or ancillary benefits payable after that date must be paid only in accordance with the articles of incorporation or bylaws as amended or adopted with municipal ratification.

Exhibit C

Maximum Benefit Level Background Information

Topic:

Statute requires that relief associations with defined-benefit plans (lump-sum, monthly, and monthly/lump-sum combination plans) calculate annually the maximum allowable benefit level. The Office of the State Auditor (OSA) provides relief associations with a form called the Maximum Benefit Worksheet (MBW) for performing the calculation.

The calculation is an average of a relief association's non-investment primary revenue sources for the prior three years on a per-member basis. The primary revenue sources included in the calculation are the amounts of state aid and municipal contributions received, and ten percent of the relief association's surplus.

If a relief association pays a service pension using a benefit level that exceeds the maximum allowable benefit level, statute requires that penalties be imposed. The penalties are disqualification from receiving fire state aid and a requirement that the relief association treasurer recover the amount of the overpaid service pension from any retired firefighter who received an overpayment. In 2015, a Working Group change provided the OSA with discretion when a good faith error occurs to exempt a relief association from the penalty.

Issue:

Relief associations have questioned the appropriateness of the calculation used to determine the maximum allowable benefit level. In years when investment markets are performing poorly and a relief association has a deficit, the association may receive large required contributions from the municipality. These large municipal contributions increase the maximum allowable benefit level. Conversely, a relief association with a surplus may not be authorized to increase its benefit level, even though sufficient funds are available, because the association is limited by the calculated maximum.

There also is a misunderstanding of what the maximum allowable benefit level represents. Relief association members see the maximum as the benefit level that the relief association should be operating at or the benefit level that can be established without causing a deficit. Neither of which are necessarily true. Trustees on relief association boards receive pressure from their members to increase benefits when the maximum allowable benefit level is higher than the relief association's actual benefit level.

Background:

These issues were discussed during several Working Group meetings in the fall of 2014. Larry Martin, former Executive Director of the Legislative Commission on Pensions and Retirement, shared with the Working Group that prior to the creation of the flexible service pension maximums, only one maximum lump-sum benefit level and one maximum monthly benefit level existed. Relief associations were required to obtain special legislation to increase their benefit levels above these maximums. The single limits were not effective and led to the creation of the Volunteer Firefighter's Relief Association Financing Guidelines Act of 1979 that put in place much of the law related to volunteer fire relief associations.

The flexible service pension maximums require that relief associations pay about 70 percent of the ongoing normal cost of the benefit level. The three-year average on which the calculation is based minimizes fluctuations in contributions or investment earnings that would be experienced from one year to the next. Mr. Martin recommended that communities determine what benefit level is needed to retain firefighters and then put a plan in place, which may require ongoing municipal contributions, for the relief association to reach that benefit level. The Working Group members agreed that generally, over time, the calculation is working as intended.

Suggestions:

Suggestions made by the 2014-2015 Working Group include the following:

- Provide education to relief associations and their affiliated municipalities on the purpose of the MBW.
- Consider changing the name of the MBW form.
- Consider providing a calculation on the OSA website that uses a five-year average as a tool for relief association trustees.
- Discuss whether required municipal contributions should be included in the calculation, or limit the calculation to voluntary contributions, only.

Exhibit D

Clarification of When Ratification is Required

Topic:

Generally, relief associations are required to obtain ratification from the affiliated municipality or independent nonprofit firefighting corporation of a benefit level change before the change becomes effective.

Whether a relief association is required to obtain ratification depends on if the relief association has a surplus and if the municipality is required to provide financial support. Currently, ratification is required if the relief association does not have a surplus and if the municipality is required to provide financial support (see Scenario 1 below). Ratification is not required if the relief association has a surplus and the municipality is not required to provide financial support (see Scenario 2 below).

We have seen some relief associations fall into scenarios not anticipated by the statute. This happens when a relief association does not have a surplus but the municipality is not required to provide financial support (see Scenario 3 below), and when a relief association has a surplus and the municipality is required to provide financial support (see Scenario 4 below). While unusual, it is not uncommon to find relief associations with a deficit but no contribution requirement, or a surplus and a contribution requirement.

Scenario	Surplus	Required Contribution	Ratification Required
1	No	Yes	Yes
2	Yes	No	No
3	No	No	?
4	Yes	Yes	?

If a relief association falls into a scenario not anticipated by the statute, the Office of the State Auditor generally makes a conservative interpretation and recommends that municipal ratification of the benefit level be obtained. The Working Group could consider changes to the statute to define whether ratification is required for the scenarios described above.

Exhibit E

Legal Compliance Audits

Topic:

A volunteer fire relief association (relief association) is a governmental entity that receives and manages public money to provide retirement benefits. Under Minn. Stat. § 6.65, the Office of the State Auditor (OSA) prescribes minimum procedures and the audit scope for auditing the books, records, accounts, and affairs of political subdivisions in Minnesota. This law provides that the minimum scope of such audits “must include financial and legal compliance audits.” This is why the OSA promulgates the legal compliance audit guides that CPAs use when they audit local governments and relief associations.

Prior to 2008, Minn. Stat. § 6.65 referred not to “political subdivisions,” but to “counties and local governments in Minnesota,” which clearly included relief associations. The 2008 change in the statute was accompanied by a general definition of “political subdivision,” as it is used in Minn. Stat., Ch. 6, which can be found in Minn. Stat. § 6.465, subd. 2. This definition works for the rest of Minn. Stat., Ch. 6, but has the unfortunate and unintended consequence of rendering unclear the application Minn. Stat. § 6.65’s legal compliance audit requirement to relief association audits.

An optional change provided below clarifies that relief association audits are required to follow the minimum audit procedures prescribed by the OSA. This change is in keeping with the practice that auditors should already be following and is consistent with the requirements of all other local units of government.

Optional Change:

69.051 FINANCIAL REPORT, BOND, EXAMINATION.

Subdivision 1. **Financial report and audit.** (a) The board of the Bloomington Fire Department Relief Association and each volunteer firefighters relief association as defined in section 424A.001, subdivision 4, with assets of at least \$500,000 or liabilities of at least \$500,000 in the prior year or in any previous year, according to the applicable actuarial valuation or according to the financial report if no valuation is required, shall prepare a financial report covering the special and general funds of the relief association for the preceding fiscal year, file the financial report, and submit financial statements.

(b) The financial report must contain financial statements and disclosures which present the true financial condition of the relief association and the results of relief association operations in conformity with generally accepted accounting principles and in compliance with the regulatory, financing and funding provisions of this chapter and any other applicable laws. The financial report must be countersigned by:

(1) the municipal clerk or clerk-treasurer of the municipality in which the relief association is located if the relief association is a firefighters relief association which is directly associated with a municipal fire department; or

(2) by the municipal clerk or clerk-treasurer of the largest municipality in population which contracts with the independent nonprofit firefighting corporation if the volunteer firefighter relief association is a subsidiary of an independent nonprofit firefighting corporation and by the secretary of the independent nonprofit firefighting corporation; or

(3) by the chief financial official of the county in which the volunteer firefighter relief association is located or primarily located if the relief association is associated with a fire department that is not located in or associated with an organized municipality.

(c) The financial report must be retained in its office for public inspection and must be filed with the governing body of the government subdivision in which the associated fire department is located after the close of the fiscal year. One copy of the financial report must be furnished to the state auditor after the close of the fiscal year.

(d) Audited financial statements must be attested to by a certified public accountant or by the state auditor and must be filed with the state auditor within 180 days after the close of the fiscal year. Audits must be conducted in compliance with generally accepted governmental auditing standards, and section 6.65 governing audit procedures. The state auditor may accept this report in lieu of the report required in paragraph (c).