Memorandum

R-132-3246

To: The Honorable Ron Young
Ohio House of Representatives

From: Lynda Jacobsen, Attorney LJ

Date: April 24, 2018

Subject: Government employer liability for pension system insolvency

You recently asked whether a government employer in Ohio, such as a community college, would be liable for pensions due its employees if the public employee pension system became insolvent. Your question was prompted in part by changes to government accounting standards that require government employers to include this liability in their financial reports.

According to the Auditor of State, the accounting changes do not reflect actual pension liability. Instead, it appears that pension systems, and not government employers, would be liable for any insolvency. However, this answer is not determinative, as only a reviewing court could make a final decision following the failure of the pension system.

Accounting standards requiring the reporting of pension liabilities

In 2012, the Government Accounting Standards Board (GASB) issued Statement 68, which revised governmental accounting standards to require government employers to include as liabilities in their financial reports long-term obligations for their employees' pension benefits. These reporting changes took effect in 2014. As a result, financial reports for public employers such as Lakeland Community College may reflect significantly higher liabilities than they did under the prior reporting standards. At the time the new standards were implemented, Auditor of State Dave Yost addressed the impact of the changes in a press release:

> The concern in Ohio is that the GASB 68 requirement for local governments to report this liability could dramatically distort the financial condition of a local government.

> However, failing to comply with GASB 68 standards would result in modified audit opinions and mean that Ohio fails to follow national accounting standards.[1]

In short, because the new standards require a government employer to report pension liabilities as liabilities of the employer, financial reports make it appear that a government employer now has significantly higher liabilities.

Who is responsible for Ohio's government pension liabilities?

This then, prompts the question of whether a government employer would be responsible for its employees' pensions if the pension system to which its employees belong is unable to pay them. In other words, is the government employer *actually* responsible for those pension liabilities if the pension system should fail, or is this merely a paper liability?

The Auditor of State concluded, in the same press release, that the liability shown in the new financial reports is unrelated to the actual liability for funding employee pensions:

> It is important to keep in mind that this new standard creates an *accounting* liability rather than a legal liability. In Ohio, there are no legal means to enforce the unfunded liability of the pension system as against the public employer.[2]

Based on various provisions of state law, it seems likely that the Auditor is correct and that local government employers would not be liable for employee pensions in the case of pension system insolvency. However, it is not possible to provide a definitive answer to the question, as only a reviewing court could make that determination. Since the Ohio public pension systems have not failed, no court has been required to determine liability in those circumstances. The following factors, nevertheless, lend support to the Auditor's position.

Legal requirements for public employers and pension systems

Ohio law specifies who is responsible for maintaining public pension funds. Because the five public pension systems[3] generally have parallel statutory provisions, the Public Employees Retirement System (PERS) law can serve as an example. The law

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[1] *Staying Out of the Red: The Real Bottom Line on GASB 68*, Ohio Auditor of State, June 9, 2014 (accessed April 13, 2018).

[2] "Staying Out of the Red: The Real Bottom Line on GASB 68," Ohio Auditor of State, June 9, 2014 (emphasis in original), https://ohioauditor.gov/news/blogarticles/Details/29 (accessed April 13, 2018).

[3] Ohio's five state systems are the Public Employees Retirement System (PERS), Ohio Police and Fire Pension Fund (OP&F), State Teachers Retirement System (STRS), School Employees Retirement System (SERS), and State Highway Patrol Retirement System (SHPRS).

governing PERS imposes on the PERS Board the duty to maintain the fund. It provides that:

> The members of the public employees retirement board shall be the trustees of the funds created by section 145.23 of the Revised Code. The board shall have full power to invest the funds. The board and other fiduciaries shall discharge their duties with respect to the funds solely in the interest of the participants and beneficiaries; for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the public employees retirement system. . .

The law further requires that the Board, in maintaining the fund, act "with care, skill, prudence, and diligence."[4] Under this language, the Board has a fiduciary duty, or owes the highest standard of care, to maintain the pension fund for the benefit of the participants and beneficiaries. There is no similar requirement for local government employers to maintain the pension fund or authority for those employers to invest retirement moneys.

Additionally, statutes impose on the Board, but not government employers, the duty of determining employer contribution rates. The Board is authorized to increase the rates based on calculations made by its actuaries. For employees other than law enforcement and public safety officers, there is a statutory maximum of 14%. Once the Board determines the rates, it certifies the percentages to government employers, who must pay the contributions on a monthly basis.[5]

And government employers have no discretion to not pay the mandated percentages of employee salary. A government employer that fails to pay is subject to interest and penalties.[6] Furthermore, PERS may bring an action against the government employer for a court order to force it to make the required contributions.[7]

Thus, while the pension fund law imposes fiduciary and other duties on the pension system board to maintain the fund, local government employers have no similar responsibility to maintain the fund, invest its moneys, or otherwise manage it.

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[4] R.C. 145.11(A). Similar requirements for the other systems are found in R.C. 742.11(A) (OP&F), 3307.15(A) (STRS), 3309.15(A) (SERS), and 5505.06(A) (SHPRS).

[5] R.C. 145.48 and 145.51. For the other systems' employer contribution requirements, see R.C. 742.33, 742.34, and 742.35 (OP&F); 3307.28 (STRS); 3309.49, 3309.491, and 3309.51 (SERS); and 5505.15(B) (SHPRS).

[6] R.C. 145.51. For the other systems' penalties, see R.C. 742.352 (OP&F), 3307.292 (STRS), and 3309.51 (SERS). Due to the manner in which SHPRS employer contributions are paid, the SHPRS law does not contain penalties for failure to pay.

[7] *State ex rel. Public Emp. Retirement Bd. v. Baker*, 169 Ohio St. 499 (1959).

Because those employers have no duty or authority over the pension fund or moneys within the fund, it seems unlikely that they would be deemed liable if the fund should fail.

Declaration of pension system liability by the General Assembly

This perspective is further supported by language the Ohio General Assembly adopted as part of a concurrent resolution addressing the GASB 68 standard. In H.C.R. 40 of the 130th General Assembly, the legislature set forth its understanding of Ohio's pension system liabilities, stating that "Ohio's state retirement systems are uniquely structured, in that the management of pension liability lies with the retirement systems." Moreover, it stated its understanding that the GASB 68 changes do not impact this liability:

> GASB standards 67 and 68 are accounting standards, not funding standards, and do not affect the actual liability or required contributions of Ohio's public retirement systems or Ohio's public employers.

The resolution was adopted in the House of Representatives with a 90-0 vote, and in the Senate with a 32-0 vote.

What the systems say in their documents

The pension systems, themselves, indicate a similar understanding of liability in their GASB 68 documents. For example, PERS, in a document explaining the GASB standards, states that GASB 68 makes government employers responsible for reporting, but not funding, a portion of PERS' pension liability. It goes on to state that "OPERS, in conjunction with the Ohio General Assembly, is and will continue to be responsible for managing the net pension liability."[8]

Similarly, the School Employees Retirement System (SERS) published a document explaining the GASB 68 changes. It acknowledges that the GASB 68 reporting requirements for pension liabilities suggest "that the school district is responsible for paying that liability, when it is not. As the pension system, SERS is responsible for developing a funding policy to pay for pension liabilities."[9]

Thus, the pension systems appear to uniformly agree that they, and not local government employers, are responsible for pension liabilities, even in light of the GASB changes. Although this is not binding upon a reviewing court, it further demonstrates

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[8] "Explaining the new GASB standards for public pensions," OPERSource, December 2013, https://www.opers.org/pdf/government/OPERSource/2013/OPERSourceDec2013.pdf (accessed April 19, 2018).

[9] "GASB's New Pension Accounting Standards – Changes You Need to Know," School Employees Retirement System of Ohio, April 2014, https://www.ohsers.org/gasb-67-and-68 (accessed April 19, 2018).

that the general belief is that the local government employers are not responsible for pension liabilities, despite the inclusion of those liabilities in their financial reports.

Auditor of State's financial report instructions

The Auditor of State has established a website specifically focused on the impact of GASB 68. It includes guidance for local government employers on the information required to be included in their financial reports, including sample financial reports and frequently asked questions. The website is available at http://www.ohioauditor.gov/references/gasb68.html.

In one of the model documents available on that website, the Auditor includes language that local governments may use in their financial statements to describe their pension liability. The model language states that, "In Ohio, there is no legal means to enforce the unfunded liability of the pension system *as against the public employer*."[10]

Summary

According to the Auditor of State, the GASB 68 requirement that local government employers include employee pension liabilities in their financial statements does not indicate that those employers bear any responsibility for the actual pension liabilities. Although only a reviewing court could ultimately make that determination, both statutory language and pension system documents indicate an understanding that the pension systems, and not the local government employers, are ultimately responsible for pension system liabilities. Since none of the Ohio public pension systems have become insolvent, however, no court has yet ruled on this issue.

For additional information regarding the GASB 68 standard, as well as for model language that a local government could use in its financial reports to indicate the extent of its pension system liability, you may wish to contact the Auditor of State.

I hope this information is of assistance to you. If I can be of further service, please contact me at (614) 466-5709 or Lynda.Jacobsen@lsc .ohio.gov.

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[10] "Management's Discussion and Analysis," http://www.ohioauditor.gov/references/gasb68.html (accessed April 20, 2018).