

# PUBLIC PERSPECTIVES

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FROM ANDERSON ZURMUEHLEN & CO., P.C.

## A “Tax Free” Roth Conversion?

“No such thing!” would be the likely response from astute tax lawyers and CPAs. And they would be correct. Mostly.

This article will suggest some outside the [traditional financial planning] box thinking that can accomplish the equivalent of a “tax free” Roth conversion. But first, some background.

Last year the rules changed. Prior to 2010 if an individual taxpayer made more than \$100,000 modified adjusted gross income (AGI), he or she could not convert a Traditional IRA to a Roth IRA. However, from 2010 on, all taxpayers can convert regardless of AGI.

### So, why convert?

Good question. At the risk of oversimplification, there are three very good reasons to prefer a Roth IRA over a Traditional IRA.

First, when it comes time to take distributions from your retirement plan, Roth IRA withdrawals are tax free while Traditional IRA withdrawals are generally fully taxable. To say it another way, the growth inside a Roth IRA is tax free growth, whereas the growth inside a Traditional IRA is tax deferred growth.

Second, there is no required minimum distribution at age 70½ from a Roth IRA. Many seniors resent the fact that they are required to take money out of their Traditional IRA following age 70½. Forcing



someone to take money out of a Traditional IRA not only pushes up the tax bracket but also subjects more Social Security benefits to income taxes. This mandatory withdrawal is particularly frustrating for senior citizens in an economic climate that includes market volatility and low interest rates.

Third, contributions to Roth IRAs are possible after age 70½. A Traditional IRA, on the other hand, does not permit contributions during or after the year the taxpayer turns 70½. There are contribution limitations, but not conversion limitations. The current (2010) threshold of \$167,000 AGI for married couples of any age filing a joint return probably allows a majority of individuals to contribute—even in retirement!

### Why doesn't everyone convert?

Here's the catch. Since your Traditional IRA is funded with pre-tax dollars, converting Traditional IRA assets to a Roth IRA is a taxable event. In other words, when money is taken out of the Traditional IRA the taxpayer will likely experience increased taxable income by the amount withdrawn from the Traditional IRA.

*(Continued on page 4)*

### Contributing authors:

Paul Sepp

Jim Soft



[www.azworld.com](http://www.azworld.com)

BILLINGS .....	406.245.5136
BOZEMAN .....	406.556.6160
BUTTE .....	406.782.0451
HELENA .....	406.442.1040
MISSOULA .....	406.721.7800

# Segregating Retiree Amounts: The Hidden Catch in OPEB Accounting

**T**he Problem  
Local governments and their auditors have been dealing with the accounting and disclosure rules for other post-employment benefits (OPEB) for almost two years now. The focus of attention has been the actuarial calculations required by GASB Statement No. 45, and the related disclosures of the annual required contribution (ARC) and unfunded OPEB liability. But there was a provision in GASB 45 that many if not most government accountants and auditors may have overlooked.



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**What the Standards Say**  
Paragraph 95 of GASB 45 amended GASB 10 on risk pools to prohibit the inclusion of retiree amounts in an internal service fund used to account for health benefits for current employees. The following Q & A is set forth in Section 8.3.1 of GASB's Staff Implementation Guidance – Comprehensive Implementation Guide 2009/2010:

**Q**—An employer provides healthcare benefits to both active employees and retirees through the same plan. May the employer continue to account for the retiree healthcare benefits along with the active-employee benefits under the requirements of Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, rather than applying the requirements of Statement 45, if the retiree benefits are accounted for based on claims events that already have occurred?

**A**—No. Statement 45 amends paragraph 2 of Statement 10 to exclude entirely from the scope of Statement 10 accounting for transactions resulting when an entity provides healthcare benefits to its retirees. The employer should account separately for the healthcare benefits for active employees and for retirees in the group and should account for the retiree healthcare benefits in accordance with the requirements of Statement 45.

**How This Affects Montana Local Governments**  
Many Montana local governments use an internal service fund to account for self-insured health benefits for both their current employees as well as retirees. Most local governments set premium rates for participants based on pro-

jected claims costs for both current and retired participants without any specific consideration of amounts for these two classes of participants. As a result, the accounting records for these internal service funds were never designed to separately identify amounts for retirees. While it may be relatively easy to segregate current year premiums and claims cost for retirees, it is not so simple to segregate certain balance sheet accounts without a significant amount of historical analysis or estimation.

GASB 45 states that amounts related to retirees should be reported in an agency fund. Since an agency fund cannot report fund balance, there will implicitly be either a liability to, or a receivable from, the internal service fund.

**Addressing the Problem**  
So what are we to do? The first consideration is to determine whether the inclusion of retiree amounts in the internal service fund is material to the financial statements taken as a whole. If they are not, then a disclosure can be made in the OPEB footnote along the following lines:

*Generally accepted accounting principles require that amounts related to retirees be excluded from the internal service fund used to account for health benefits for current employees. Management of Any Government, Montana has determined that such amounts are not material to the financial statements and, accordingly has not segregated them in the accompanying financial statements.*

How do you determine whether retiree amounts are material to the financial statements? The question is, what basis for materiality should be used. It should be noted that the internal service fund used to account for health benefits and the agency fund that would be created if retiree amounts were segregated both “roll up” into the “aggregate remaining funds” opinion unit. If the segregation of retiree amounts into an agency fund would create a material misstatement between the income statement and balance sheet for this opinion unit, then it would be necessary to segregate the retiree amounts or, alternatively, have a qualified opinion on the financial statements.

The exclusion of retiree amounts could also have a material effect on expenses and net assets in

the government-wide financial statements. However, because the materiality threshold for this opinion unit is typically much larger, it is less likely to create a material misstatement at the government-wide level.

If it is determined that there would be a material misstatement, and a qualified opinion is not acceptable, then the next step is to segregate retiree amounts from the internal service fund. This process is highly dependent on the nature of the internal service fund's activities. For example, it may be relatively easy to identify actual amounts of premium revenue, claims expense, premiums receivable and claims payable for retirees, but it may require some assumptions and estimation to determine how to allocate plan administration expenses, investment income, property taxes or other revenues, and other items that are not spe-

cifically attributable to retirees. Even cash and investments must be evaluated to determine what portion, if any, relates to retirees. The process of segregating retiree amounts is not just a one-time effort; every year, a similar process must be undertaken to segregate current year amounts for retirees.

#### In Conclusion

I am not sure this was what GASB intended for smaller local governments who use internal service funds to account for their health benefits, but it is the current rule. It would be nice if GASB would reconsider the rule and provide some relief for smaller entities in the same way they did for the actuarial calculations. We can only hope! ■

## EMPLOYEE SPOTLIGHT: Paul Sepp, Shareholder, CPA, CBA, CISA, CGFM

At Anderson ZurMuehlen, our people are one of our greatest strengths and help set our firm apart. Because of this, it seems fitting to give you some insight into the people that make Anderson ZurMuehlen great.

Paul Sepp has 39 years of experience in public accounting, five of which were with the national accounting firm of Arthur Young. He received his undergraduate degree from the University of Illinois and his Masters degree from the University of Denver, both with high honors. Paul joined Anderson ZurMuehlen as a Shareholder in 2005 through a merger with his former firm, Elmore & Associates, P.C. He currently serves as Technical Director for the firm's attest services and oversees the audits of over twenty governmental and nonprofit organizations.

In addition to being a Certified Public Accountant, Paul is a Certified Business Appraiser, a Certified Information Systems Auditor, and a Certified Government Financial Manager. He is a member of the American Institute of Certified Public Accountants, the Information Systems Audit and Control Association, the Association of Government Accountants, and the Montana Society of CPAs, where he has served as a director. Additionally, he has served as chairman of the Montana Society's Governmental Audit Quality Control Committee and as chairman of the Not-for-Profit Committee, where he was instrumental in developing the state's first not-for-profit conference. For the past six years, Paul has chaired the Montana Society's Ethics Committee.

A member of the Institute of Business Appraisers and the National Association of Forensic Economics, Paul has a sig-

nificant practice in business valuation and litigation support services. He has served as expert witness in a variety of economic damages cases, ranging from employment discrimination and personal injury to intellectual property and contractual damages.

Among his many accomplishments, Paul has written numerous articles on quality control, governmental auditing, consulting, and other topics. His articles have appeared in the *Journal of Accountancy*, *Practical Accountant*, *Matthew Bender's Practice Update*, the *MACo Newsletter*, *PKF North America's Consulting Services Newsletter*, and the *Montana Society's CPA Line Items*.

Paul has been happily married to his wife Marsha for thirty-eight years, and they have six children and five grandchildren. He serves as treasurer of the Missoula Sunrise Rotary and as chairman of the University of Montana's Excellence Fund Business Drive. Paul is a member of the Missoula Alliance Church and enjoys golf, fishing, gourmet cooking, football, and traveling with Marsha.

Paul Sepp is just one of the many great people at Anderson ZurMuehlen committed to the continued success of your organization. ■



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**Anderson ZurMuehlen & Co., P.C.**  
Discovery Block  
828 Great Northern Boulevard  
PO Box 1040  
Helena, Montana 59624-1040

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## A “Tax Free” Roth Conversion? (Continued...)

**Is there any way to get money from a Traditional IRA into a Roth IRA without increasing the tax bill?**

Yes! Through charitable gift planning, the taxpayer can generate income tax deductions equal to the amount of income withdrawn from the Traditional IRA. This can result in a dollar for dollar offset without giving up the earning power or use of the asset given to charity!

A Charitable Life Estate enables the taxpayer to make a gift of a personal residence or farm but still retain use of the asset for life. This type of arrangement generates an immediate deduction that is historically large due to our current low interest rates. The taxpayer continues to use or farm the property, but concurrently generates a large charitable deduction that facilitates a “tax free” Roth conversion!

Another option is a Charitable Life Income Gift, such as a Charitable Gift Annuity or Charitable Remainder Trust. By taking low yielding assets and using them to fund a Charitable Life Income Gift, the taxpayer generates yet another charitable deduction to offset the tax from the Traditional IRA withdrawal. Further, in our current low interest rate en-

vironment, chances are good that the rate of payment from the Charitable Gift Annuity or Charitable Remainder Trust will exceed rates being realized on most other fixed income assets (such as CDs, Treasury Bonds, etc.).

It seems likely that most people would choose a Roth IRA over a Traditional IRA if they knew they weren’t going to have to face increased taxes on the conversion. So, consider engaging a charity to help you convert your Traditional IRA into a Roth IRA...“tax free”!

By guest writer Jim Soft, President  
Yellowstone Boys and Girls Ranch Foundation

