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PERiScope Public Employee Retirement Systems

New accounting rules for public pension plans in the United States took effect beginning in 2014. Successful implementation of the new rules requires an understanding of a variety of technical concepts regarding the various newly required calculations. In this multi-part PERiScope series, we explore these technical topics in detail.

GASB 67/68 – Special Funding Situations

Jennifer Sorensen Senta, FSA, MAAA

This final *PERiScope* article in the Governmental Accounting Standards Board (GASB) Statements No. 67 and 68 miniseries discusses special funding situations. When a plan operates with a special funding situation in place, the major accounting metrics under GASB 68 must be adjusted to reflect this relationship. In particular, plan employer(s) may recognize a smaller net pension liability (NPL) when a special funding situation applies; adjustment may also be made to employer expense and deferred inflows/outflows.

A *special funding situation* arises when a non-employer contributing entity (NECE) has a legal responsibility to contribute directly to the plan, and either of the following criteria hold:

a) The amount of the NECE's required contributions does not depend on a factor unrelated to pensions.

b) The NECE is the only entity legally required to make contributions to the plan.

The most well-known special funding situations involve state-wide retirement systems that cover public school teachers. If the state (i.e., an entity that is not the employer of the teachers) has a legal obligation to directly contribute part or all of retirement system's funding and meets the criteria outlined above, a special funding situation exists and the state is considered to be an NECE.

Did you know? Milliman's GASB 67/68 Task Force has released a full miniseries on technical and implementation issues surrounding GASB 67 and 68. Each article has been released through PERiScope. This article is the final article in the series.

Visit www.milliman.com/GASB6768 for all the latest resources on the new statements and to view the rest of the miniseries on technical issues.

Note that the existence of a special funding situation will not result in plan employers being exempt from reporting under GASB 68: As specified in the GASB 68 implementation guide Q&A #2 and #3, even if a special funding situation exists and the NECE is responsible for 100% of the contributions to a pension plan, the participating employers are still subject to GASB 68.

Determining when a special funding situation applies

Care must be taken to determine whether a special funding situation applies with respect to a particular plan. Plans with an NECE that does not meet the criteria for a special funding situation will potentially need to make other adjustments to GASB 68 reporting items, and will not apply the special funding situation rules.

In particular, in determining whether a special funding situation applies, the GASB 68 implementation guide emphasizes the legal obligation of the NECE to make the contributions to the plan. It also emphasizes the fact that the contributions must be made directly to the plan, rather than passing through any intermediary or being paid directly to employers in order to fund their contributions to the plan.

A situation where the funds contributed to the plan by the NECE are reimbursable under a federal grant does not qualify as a GASB 68 special funding situation, as discussed in the GASB 68 implementation guide Q&A #29.

If an NECE meets the definition of a special funding situation, but the NECE's contributions are expected to reduce to zero in the future, the special funding situation still applies for the purposes of GASB 68. The non-zero projected contributions must be taken into account when determining the NECE's proportionate share, as discussed in the GASB 68 implementation guide Q&A #32.

The non-employer contributing entity

The NECE should recognize a proportionate share of the plan's collective net pension liability. This proportionate share should be calculated in a manner consistent with the determination of the NECE's portion of future contributions to the pension plan (but the calculation should exclude contributions to separately finance specific liabilities of either an NECE or a particular employer). As noted in the GASB 68 implementation guide Q&A #234, the NECE is not required to use the same basis to calculate its proportionate share as a cost-sharing employer uses to calculate its own proportionate share.

Once the NECE has determined its proportionate share of the NPL, it should apply this same proportion to recognize its share of the plan's collective pension expense and deferred inflows and outflows related to pensions.

Note that if an NECE is in a special funding situation with multiple pension plans, the NECE may aggregate its recognized liabilities across all such plans.

Changes in the NECE's proportionate share, as well as actual NECE contributions during the measurement period that differ from the NECE's proportionate share of total plan contributions, must be quantified in each year and systematically recognized in the same manner as would occur for a typical plan employer. For more information, see the previous article in this *PERiScope* series on proportionate share allocation.

When an NECE in a special funding situation recognizes contributions made after the measurement date as a deferred outflow, note that per the GASB 68 implementation guide Q&A #223, the NECE is the only entity allowed to recognize this as a deferred outflow (no portion of this deferred outflow will be recognized by employers as a deferred outflow).

Single or agent multiple-employer plans

A single or agent multiple-employer plan with a special funding situation may recognize a net pension liability less than the total collective net pension liability calculated for GASB 67 purposes. The employer should calculate its GASB 68 net pension liability as the collective net pension liability, less the NECE's proportionate share of the collective net pension liability, as discussed above. Note that for agent multiple employer plans, the "collective net pension liability" refers to the collective net pension liability for a particular employer.

The single or agent employer should then determine its own proportionate share as the ratio of the employer net pension liability, calculated as outlined above, divided by the collective net pension liability. The employer will then recognize only its proportionate share of collective deferred inflows and outflows related to pensions.

Note that in this situation, the employer's annual financial reporting expense will not be adjusted due to the special funding situation; the employer will recognize the full collective pension expense regardless of the proportionate share of its net pension liability and deferred inflows and outflows. However, the employer should recognize a revenue amount equal to the NECE's proportionate share of the pension expense.

Cost-sharing multiple-employer plans

For a cost-sharing multiple-employer plan, each employer recognizes its own proportionate share of the collective net pension liability (NPL). When a special funding situation applies, the contribution requirements of the NECE will affect the employer's proportionate share of the NPL. As stated in GASB 68 paragraph #92, if the pension plan defines a specific relationship between the contributions of the NECE and the contributions of the employer, then the employer's proportionate share of the NPL should be calculated on that basis.

As an example, if the NECE's contributions are defined as a percentage of all employer contributions (e.g., the NECE contributes 75% of each employer's contributions), then each employer's proportionate share of the NPL will be based on the applicable net percentage of its own total contribution requirement (in this example, 25% of its total contribution requirement).

An additional interesting example outlined by GASB 68 paragraph #92 is a situation where the NECE is responsible for all contributions relating to past service (e.g., contributions to systematically eliminate unfunded accrued liability over time), while the employer bears responsibility for all ongoing/future service/normal cost contributions. In this situation, since the employer is not responsible for contributions pertaining to the past service cost, GASB 68 specifies that the employer's proportionate share of the NPL would be 0%.

Pension expense and deferred inflows and outflows related to pensions should be recognized by employers in the usual way, allocated according to the employer's proportionate share (which itself already takes into account any adjustment for the NECE's contribution, as discussed above). However, for the recognition of expense, the employer should also recognize that portion of the NECE's proportionate share of collective pension expense that is "associated with the employer." The employer will also recognize as revenue this same amount (i.e., the portion of the NECE's proportionate share of collective pension expense that is associated with the employer).

GASB mandates no specific basis for determining the amount of the NECE's proportionate share that is associated with the employer; however, the GASB 68 implementation guide Q&A #225 states that the determination should be consistent with "the relationship of the employer to the total of all employers that are provided support as a result of the special funding situation."

An individual employer's proportionate share will almost certainly change from measurement date to measurement date, and the financial impact of this change must be quantified. In addition, to the extent that an employer's actual contributions during the year are different from its proportionate share of total plan contributions, this difference must also be tracked and systematically recognized in the employer's accounting.

The effect of these two differences should be calculated and recognized in the same way as when a special funding situation does not apply. For more details, see the previous article in this *PERiScope* series on proportionate share allocation.

Jennifer Sorensen Senta, FSA, MAAA, is a consulting actuary with the Seattle office of Milliman. Contact her at jennifer.senta@milliman.com.