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PERiScope
Public Employee Retirement Systems

New accounting rules for public pension plans in the United States are set to take effect beginning in 2014. Successful implementation of the new rules will require 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. See sidebar for more information on the final upcoming technical article in this series.*

GASB 67/68 – Proportionate Share Allocation

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This *PERiScope* article in the Governmental Accounting Standards Board (GASB) Statements No. 67 and 68 miniseries discusses the allocation of financial reporting liabilities for cost-sharing multiple employer plans.

Under the new GASB 67/68 rules, a cost-sharing multiple-employer pension plan is a plan that is used to provide pensions to employees of more than one employer, and plan assets are pooled such that they can be used to pay the benefits of the employees of any employer.[1] Other plan types defined under the new GASB statements include single employer plans (where a plan involves only one employer), and agent employer plans (where assets of one employer may not legally be used to pay the benefits of the employees of any other employer). For cost-sharing plans, a "proportionate share" for each employer must be developed to distribute the aggregate plan liability and expense among the employers' financial statements. Note that under GASB 68, the component government units of a single employer plan may be required to provide a similar division of accounting metrics using the rules for cost-sharing plans.

COST-SHARING MULTIPLE-EMPLOYER PLANS

For plans that meet the GASB 67/68 definition of a cost-sharing multiple employer plan, an aggregate plan total pension liability (TPL) and net pension liability (NPL) will be developed for purposes of GASB 67, while an aggregate plan pension expense (PE) will be developed for purposes of GASB 68. These accounting metrics must then be allocated to the various participating employers. The allocation method relies on a determination of a "proportion" attributable to each employer; this proportion is then applied to the relevant aggregate plan figures to determine the "proportionate share" of liability and pension expense each employer must recognize.

1 See GASB Statement No. 68, paragraph 12.

Generally, the cost-sharing allocation process will involve three major steps, as discussed below.

Step 1: Identify the employers for financial reporting purposes

The first step in the cost-sharing allocation process is to determine which employers will require a proportionate share allocation. In particular, the involved parties should be aware that the employers identified for GASB reporting purposes may be different from the employers who, for example, have separate liability calculation or contribution rate information prepared in the funding valuation.

Typically, the identification of employers who require a cost-sharing allocation will be performed by plan staff or plan/employer accountants. As a best practice, the actuary should review the list for reasonableness if enough information is available.

Did you know? Milliman's GASB 67/68 Task Force is releasing a miniseries on technical and implementation issues surrounding GASB 67 and 68. Each article will be released through PERiScope. Look for the following article in coming months:

- **Special funding situations**

Additionally, a Frequently Asked Questions document will be maintained, with links to relevant miniseries articles as they become available.

Visit www.milliman.com/GASB6768 for all the latest resources on the new statements.

Step 2: Determine who will perform the allocation calculations

One key consideration in determining the proportionate shares is how each employer's auditor will gain confidence in the calculation of its proportionate share. As GASB made clear in the GASB 68 implementation guide, the proportionate share percentages attributable to the individual employers need not add up to 100%. This is because each employer is permitted to use a different method for the proportionate share calculation, so long as the method is reasonable. The key here is to ensure that each employer's auditor has the desired level of access to, and understanding of, the proportionate share calculation.

In practice, this will result in a case-by-case assessment of who will perform the proportionate share calculations. In cases where only a small handful of employers participate in the plan, it may make sense for the plan (with assistance from the plan actuary and accountant) to be responsible for calculating and publishing proportionate share figures for each participating employer. However, for some plans with a large number of participating employers, it may make sense for each individual employer to bear the responsibility for determining its own proportionate share. In the latter case, the individual employers should work with their accountants and auditors (and actuaries, if applicable) to determine a proportionate share in accordance with the GASB 68 guidance, as outlined in Step 3 below.

Step 3: Determine the basis for allocation

Regardless of who is to perform the allocation calculation for a cost-sharing employer, the responsible party must determine the basis for the proportionate share calculation.

GASB 68 requires that the proportion for each employer be consistent with the determination of plan contributions. The standard encourages the use of the "projected long-term contribution effort" of each employer to the plan. However, such a projection is not mandated, and in many cases a proportion that meets this intent may be reasonably approximated by a more mathematically simple measurement.

For example, some potentially relevant alternate bases for the proportion calculation are as follows:

- Payroll for each employer in the most recent fiscal year.
  - If the amounts that employers contribute are tied to payroll, and no employer includes members in more than one contribution group, payroll for each employer may be a valid approximation of contribution effort by employer.
- Actual contributions made by each employer in the most recent fiscal year.
  - If the relative contribution levels by employer are expected to remain steady in future years, the actual contributions made by employers may be a reasonable basis for the calculation of proportionate share.
- Any other reasonable method.

If possible, the employer's auditor should be consulted during the process of the determination of proportionate share, to ensure the auditor's complete access to the details of the method of calculation.

Special cases

Note that some special cases may require additional consideration. For example, employers with zero contributions may be entitled to a 0% proportionate share, i.e., they would not recognize any portion of the total plan net pension liability or pension expense if no *special funding situation* applies to the plan (see sidebar on page 3 for more information on special funding situations). This reinforces the idea that the proportionate share should reflect the commitment of an employer to contribute toward the plan. If an employer bears no future financial responsibility to the plan, then under the new accounting standards it might not recognize any accounting liability or expense with respect to the plan.

Another special case is the situation where a non-employer contributing entity makes contributions to the plan but does not meet the definition of a special funding situation. In this case, the proportionate share for each employer must take into account the contributions made by non-employer contributing entities "that provide support for" that employer. This case is addressed in the GASB 68 implementation guide question/answer #130.

Another special case arises for an employer whose contributions are projected to decrease to zero in the near future. Employers in this situation will need to recognize a proportionate share greater than zero, as discussed in GASB 68 implementation guide question/answer #133. In this case, the projected future contribution effort of the employer, inclusive of the years with a positive expected contribution amount, might be a suitable basis for determining proportionate share, the key being that the positive expected future contributions of the employer must be taken into consideration.

Changes in proportionate share and employer contributions

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 makes actual contributions during the year that are different from its allocated proportionate share of contributions, this difference must also be tracked and accounted for.

First, if an employer's proportion has changed since the prior measurement date, this change in proportion should be multiplied by the employer's share of the NPL and deferred inflows and outflows as of the beginning of the measurement period. The resulting changes in NPL and deferred inflows and outflows must then be amortized over the expected remaining service life of all plan members (both active and inactive members), calculated as of the beginning of the measurement period. Note that the amortization period takes into account all plan members, as opposed to the members of an individual employer. The first year of amortization related to these changes is included in the current reporting period employer pension expense; the remaining amortization base is treated as a deferred inflow or outflow.

Similarly, each employer must calculate the difference between the actual amount contributed by the employer (and by a non-employer contributing entity on behalf of the employer, when not in a special funding situation) and the proportionate share allocated to the employer of all such contributions by all employers and applicable non-employer contributing entities during the period. As with the change in proportionate share, this difference in contributions must be amortized over the expected remaining service life of all plan members, calculated as of the beginning of the measurement period. Again, note that the amortization period takes into account all plan members, as opposed to the members of an individual employer. The first year of amortization related to these charges is included in the current reporting period employer pension expense; the remaining amortization base is treated as a deferred inflow or outflow.

Note that for GASB 68 purposes, the total net deferred inflow or outflow due to the change in proportionate share and the difference between actual and allocated contributions may be treated as a single deferred inflow or outflow and amortized on a net basis for simplification. More details may be found in GASB 68 paragraphs 54 through 56, and the GASB 68 Implementation Guide.

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Special funding situations

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

- The amount of the non-employer contributing entity's required contributions does not depend on a factor unrelated to pensions
- The non-employer contributing entity 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 pay part or all of the contributions to the retirement system and meets the criteria outlined above, the state is considered to be a non-employer contributing entity, which gives rise to a special funding situation. When a plan involves a special funding situation, the recognition of proportionate share for any contributing employers will be affected. The next article in this *PERiScope* miniseries will cover special funding situations in detail.