



## Got You Covered!

By Michele Mark Levine

One set of terms stands out as a source of frequent confusion in the world of postemployment benefits accounting and financial reporting: covered payroll and covered-employee payroll.

In the labyrinthine world of postemployment benefits (PEB) accounting and financial reporting — which includes both pensions and other, non-pension benefits such as retiree health care (OPEB) — one set of terms stands out as a source of frequent confusion: *covered payroll* and *covered-employee payroll*. Both are payroll-related measures that can provide context to defined benefit postemployment obligations,<sup>1</sup> but they are useful, available, and need to be disclosed in required supplementary information (RSI) in different situations.

The Governmental Accounting Standards Board (GASB) defines *covered payroll* as “[t]he payroll on which contributions to a pension plan are based.”<sup>2</sup> Borrowing phrasing from an older (now superseded) definition, it is the amount “paid to active employees on which contributions to a pension plan are based. For example, if pension contributions are calculated on base pay including overtime, covered payroll includes overtime...”<sup>3</sup> If the contributions were instead calculated on base pay *excluding* overtime compensation, then overtime pay would be excluded from covered payroll. Covered payroll is the amount of *payroll* that is “covered” by the contributions. Generally, payroll that is excluded from the calculation of pension plan contributions is the same as that which is excluded from the calculation of pension ben-

*efits*, which is sometimes referred to as being “non-pensionable.”<sup>4</sup> Covered payroll is projected and used in actuarial calculations of pension liabilities.

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**Both covered payroll and covered-employee payroll can provide context to defined benefit postemployment obligations.**

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*Covered-employee payroll*, on the other hand is the total amount of the “payroll of employees that are provided with pensions through the plan.”<sup>5</sup> Building on the examples above, overtime compensation would be included in covered-employee payroll, *whether or not included in the calculation of contributions*, because it is part of the total payroll of the employees who are members of the pension plan. In the case of covered-employee payroll, it is the *employees* — not the payroll — being referred to as “covered.” Because covered-employee payroll is not affected by different policies regarding pensionable and non-pensionable elements of pay, it can be viewed as a more “standard” measure among governments than covered payroll. For the same reason, a ratio of net pension or OPEB liabilities to covered-employee payroll may be a more useful “common-sized” measure than that of the net liabilities to covered pay-

roll, when comparing governments of various sizes. However, separate plans might not always have access to the covered-employee payroll for participating employers, so — when required — that measure is reported only by employers, not by the plans themselves.<sup>6</sup>

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In understanding why covered payroll or covered-employee payroll are required to be disclosed and used in ratios of net postemployment benefit liabilities in different situations, it may be helpful to think about pension and OPEB arrangements individually. Although they are conceptually very similar, pension benefits are more commonly administered through actuarially or statutorily funded plans that are operated through GASB PEB trusts; and pension benefits, and therefore contributions, are usually based on pay.

Covered payroll is a measure known to pension plans, as it is the basis on which contributions are made into the plan. It is required to be included in RSI of generally accepted accounting principle financial statements issued by pension plans that operate through trusts that meet the requirements put forth by GASB (a GASB PEB trust).<sup>7</sup> To permit comparison of the relative pension obligations of plans of various

sizes, a ratio — net pension liability as a proportion of covered payroll — is also required to be disclosed in RSI for those plans. Similarly, employers who provide pension benefits through GASB PEB trusted plans include both the covered payroll and the ratio of net pension liability to covered payroll in their own RSI, for each plan through which they provide benefits. Covered payroll, however, is not a useful concept unless contributions are based on payroll. If there is no portion of total payroll that is covered (or uncovered), only total payroll is a meaningful measure.

Sometimes OPEB contributions are also based on measures of pay,

although that is less commonly the case. More often, those retirees who receive health and other OPEB do not receive different levels of benefits based on their salaries as employees. OPEB are instead usually based on the retirees' length of service (or on having achieved at least a minimum length of service), and possibly age, prior to retirement. OPEB are less likely to be funded, or may be only minimally funded, and are often directly paid for administered by employers. As a result, covered-employee payroll is the appropriate payroll-related measure for OPEB, except when they are both (1) provided through a plan using GASB

Exhibit 1: RSI Disclosures by Defined Benefit Pension and OPEB Plans.

| Payroll-related Measures | Pension                      | OPEB  |
|--------------------------|------------------------------|---|
| GASB PEB Trusted Plans   | Covered Payroll <sup>1</sup> | None, unless contributions are based on pay, in which case covered payroll is disclosed. <sup>2</sup> |

- Notes
- 1. GASB Cod. Sec. Pe5.128.
  - 2. GASB Cod. Sec. Po50.130

Exhibit 2: RSI Disclosures by Employers.

| Payroll-related Measures                   | Pension                               | OPEB  |
|--|---------------------------------------|---|
| Benefits provided through a GASB PEB Trust | Covered Payroll <sup>1</sup>          | Covered-employee Payroll, unless contributions are based on pay, in which case covered payroll is disclosed. <sup>2</sup> |
| Non-trust PEB                              | Covered-employee Payroll <sup>3</sup> | Covered-employee Payroll <sup>4</sup>   |

- Notes
- 1. GASB Cod. Sec. P20, paragraphs 146 and 183.
  - 2. GASB Cod. Sec. P50. Paragraphs 154 and 197.
  - 3. GASB Cod. Sec. P22, paragraphs 137 and 159.
  - 4. GASB Cod. Sec. P52, "Postemployment Benefits Other Than Pensions — Reporting For Benefits Not Provided Through Trusts That Meet Specified Criteria — Defined Benefit," paragraphs 139 and 163.

PEB trust, and (2) contributions to that plan are based on pay. Again, however, covered-employee payroll is information that is known to employers, but not necessarily to separate OPEB plans when they are used.

To summarize, see Exhibit 1 for RSI disclosures by defined benefit Pension and OPEB *plans* and Exhibit 2 for RSI disclosures by *employers*. ■

#### Notes

1. Defined benefit postemployment benefits (PEB) are those that do not meet the definition of defined contribution PEB, as provided in Governmental Accounting Standards Board (GASB) *Codification of Governmental Accounting and Financial Reporting Standards* (Cod.) Section (Sec.) Pe6, “Pension Plans Administered Through Trusts That Meet Specified Criteria — Defined Contribution,” paragraph 106, for pension plans; or

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### Covered-employee payroll is information that is known to employers, but not necessarily to separate OPEB plans when they are used.

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GASB Cod. Sec. Po51, “Postemployment Benefit Plans (Other Than Pension Plans) Administered Through Trusts That Meet Specified Criteria — Defined Contribution” paragraph 104, for OPEB plans.

2. GASB Cod. Sec. P20, “Pension Activities — Reporting for Benefits Provided through Trusts That Meet Specific Criteria — Defined Benefit,” paragraph 523.

3. GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, paragraph 44 [Superseded].

4. However, covered payroll is specifically defined based on the calculation of required contributions, not retiree benefits.

5. GASB Cod. Sec. P22, “Pension Activities — Reporting for Benefits Not Provided through Trusts That Meet Specific Criteria — Defined Benefit,” paragraph 517.

6. Initially, in Statements Nos. 67 and 68, GASB had required that covered-employee payroll be the reported payroll-related measure for pension plans and employers. However due to the possible unavailability of that amount to plans, as well as other concerns, Statement No. 82 GASB changed the requirement to covered-payroll for pension benefits provided through trusted plans.

7. GASB Cod. Sec. Pe5, “Pension Plans Administered Through Trusts That Meet Specified Criteria — Defined Benefit,” paragraph 101.

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MICHELE MARK LEVINE is the director of GFOA’s Technical Services Center.



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