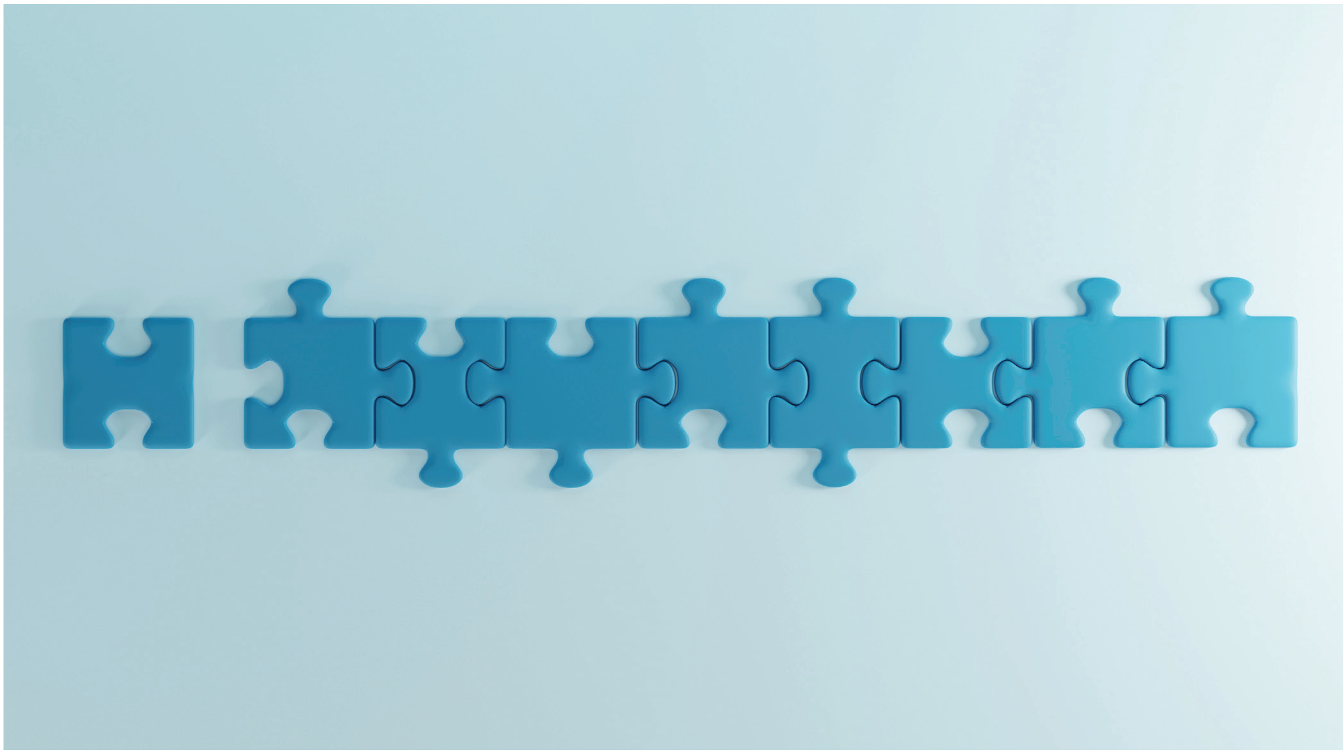

ACCOUNTING

Inside Stories #2

Accounting and Financial Reporting When Multiple Governments Within One Financial Reporting Entity Are a Single Employer for a PEB Plan

BY MICHELE MARK LEVINE, TODD BUIKEMA, AND SUSANNAH FILIPOVIC

As we often discuss in this space, generally accepted accounting principles (GAAP) for governments set by the Governmental Accounting Standards Board (GASB) use a financial reporting model that is based on the financial accountability of elected officials. In government, financial statements can include any number of legally separate governmental entities in cases where elected officials of one government are financially accountable for the affairs of other governments. This is the second of several articles exploring some of the complexities that arise from this special form of consolidation, called a financial reporting entity.[1] The first article in the series, "Distinguishing Between Internal Cash Flows and Internal Resource Flows," was published in the October 2023 issue of *GFR* (gfoa.org/gfr-october-2023). For a refresher on when and how multiple governments should be included in a single financial reporting entity, please review the article "Puzzling Pieces: Component Unit Identification, Classification, Disclosure and Display," *GFR*, April 2022 (https://www.gfoa.org/gfr-april-2022).

Refresher on Defined Benefit Postemployment Benefits and Plans[2]

Accounting and financial reporting for employers' postemployment benefits (PEB) obligations, including both pensions and other postemployment benefits such as retiree health insurance (OPEB), is arguably one of the most complex aspects of accounting and financial reporting for governments. This is particularly the case when those obligations are based on the level of benefits that beneficiaries will receive, called *defined benefits*. This contrasts with *defined contribution benefits*, an obligation for an employer to contribute a specific amount of money for each employee during the employee's working life, with the final level of benefits being determined only by the purchasing power of those contributions and any investment income or losses that may have accrued. For defined benefits (DB), many assumptions are necessary for an actuary, using complex mathematical models, to estimate what the final actual costs of those future defined benefits will be to the employers, and to estimate the employer contributions that should be made to fully fund those costs by the time employees retire.

Most PEB, especially pensions, are administered through formal arrangements that (1) take in contributions, (2) safeguard and invest those funds, and (3) use those funds to make payments to beneficiaries in accordance with the benefit terms. Those arrangements, as they pertain to defined benefits, are referred to as *DB pension plans* or *DB OPEB plans*. Contributions to DB PEB plans may be received from employers, employees, and sometimes from third parties called *nonemployer contributors* (such as a state contributing to a pension plan covering teachers employed by local school districts). Most of these plans, especially DB pension plans, are administered through *trust or equivalent arrangements* that meet GASB's criteria to be accounted for as having their own assets, independent of the employers and members, by legally:

1. Preventing employers and nonemployer contributors from taking back their contributions (contributions are *irrevocable*),
2. Limiting the use of plan assets exclusively to the payment of plan benefits, including administrative costs of the plan (assets are *dedicated*), and
3. Protecting plan assets if any involved party goes bankrupt (assets are *protected*).

Some governments do not use such trusts to accumulate and invest contributions and to pay benefits. Even if those governments otherwise set aside resources to pay future benefits, because the assets are not in trusts that meet these three specified criteria, those assets are considered to be assets of the government and not of the plan, and thus cannot reduce the reported PEB liability. As most governments do use formal pension plans administered through trusts that meet the above criteria (*trusted plans*) for defined benefit pensions, this article will focus exclusively on such trusted DB PEB plans.

There are three kinds of trusted governmental PEB plans through which governments provide DB PEBs:[3]

1. Single-employer plans provide benefits only for retirees of a single employer, although *all individual employer governments within a single financial reporting entity are considered to be a single employer for this purpose*.
2. Agent multiple-employer plans (*agent plans*) are those in which many employers participate for investment and administrative economies of scale, but assets contributed by or on behalf of each employer's employees are accounted for separately, and those assets and the investment returns on those assets can only be used to pay benefits to retirees of that employer. *One or more employer governments within a single financial reporting entity may be a single employer for purposes of an agent plan.*
3. Cost-sharing multiple-employer plans are those in which many employers participate. These plans may separately estimate costs and have different contribution rates for different plan members, but all the plan's assets are legally available to pay benefits for any member, regardless of employer. Employers in cost-sharing plans are therefore also sharing risk.

Accounting and financial reporting when multiple governments within one financial reporting entity are a single employer for a trusted DB PEB plan

As mentioned above, multiple legally separate governments that are included in a single financial reporting entity (a primary government and one or more of its component units, or multiple component units of the same primary government) may be a single employer in a single-employer plan or in an agent plan. Nonetheless, when reported in stand-alone financial statements of any employer component unit, the recognized amounts for PEB liabilities and deferred resource flows, the note disclosures, and the required supplementary information (RSI) and notes to RSI, should follow the requirements for a cost-sharing plan, using the reporting-entity-wide amounts provided by the plan as if they were the collective amounts for all employers in a cost-sharing plan.[4]

The proportionate share for an individual government employer (such as the primary government or a component unit) may be actuarially determined by the plan's actuary as of the date of the most recent actuarial valuation. However, an actuarial determination of proportionate share might be a separate actuarial service, because—as discussed above—the plan recognizes only a single employer for the financial reporting entity. If not determined actuarially, GAAP requires

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Note to reader: The content in this article is highly abridged and interpreted in an attempt to simplify many complex concepts. This article alone should not be relied on by governments in accounting for and reporting postemployment benefit obligations.

the use of a ratio. The two options for the ratio are:[5]

1. Based on contributions as of the most recent plan measurement date:
   a. (The individual government employer's contribution, as assessed) / (Total of contributions for all the government employers within the financial reporting entity),
2. Based on estimated relative long-term contributions:
   a. (The individual government employer's projected long-term contributions to the pension plan) / (Total projected long-term contributions of all employers within the financial reporting entity)
   b. While the latter is preferred, as a practical matter it may be difficult to estimate future changes in the relative contributions of various individual employers if not actuarially determined.[6]

Note that if a government employer provides benefits through more than one single-employer or agent DB PEB plan for which purpose it is treated as part of a single employer, this allocation process will need to be followed for each such plan.

To prepare stand-alone financial statements, each individual government employer that is a component unit within the financial reporting entity treated as part of the single employer for plan purposes will need to determine its proportionate share, measured as discussed above, of key plan amounts. The collective amounts that must be allocated are (1) net pension/OPEB liability, (2) deferred outflows of resources from pension/OPEB, by source, and (3) deferred inflows of resources from pension/OPEB, by source.[7] Each component unit government that issues stand-alone statements unit will also need to measure its pension/OPEB expense for the fiscal year, by adjusting the change in its net pension/OPEB liability during the year by the amounts of current year flows that are deferred into future periods and the amortization for the year of previously deferred resource flows.[8]

When the primary government prepares its entity-wide statements (which are the financial reporting entity's overall financial statements), in note disclosures and RSI, it will reflect the amounts reported by the plan, in total as one plan, and will follow the requirements for a single-employer plan or an agent plan, as appropriate. However, the net pension/OPEB liability, deferred resource flows from pension/OPEB, and pension or OPEB expense reported for (1) the primary government, including its blended component units, and (2) for each discretely presented component unit (DPCU) that is displayed individually, will be that employer's (or group of employers') proportionate share of the total. For DCPUs that are displayed in aggregate on the government-wide financial statements, the total of the included DPCUs' proportionate shares will be reported.

Exhibit 1 illustrates the way DB PEB liabilities and deferred resource flows balances should be measured and recognized in financial statements of a primary government (PG) and in the stand-alone financial statements of that PG's component units. Exhibit 2 similarly illustrates which kind of note disclosures, RSI, and notes to RSI should be reported with each of those set of financial statements.

The table in Exhibit 3 uses an example to summarize this financial reporting information and serves as a summary for much of this article.

But before we move on from this topic, it's worth mentioning a closely related matter. GFOA's Certificate of Achievement for Excellence in Financial

EXHIBIT 1 | AMOUNTS REPORTED IN STATEMENTS OF NET POSITION

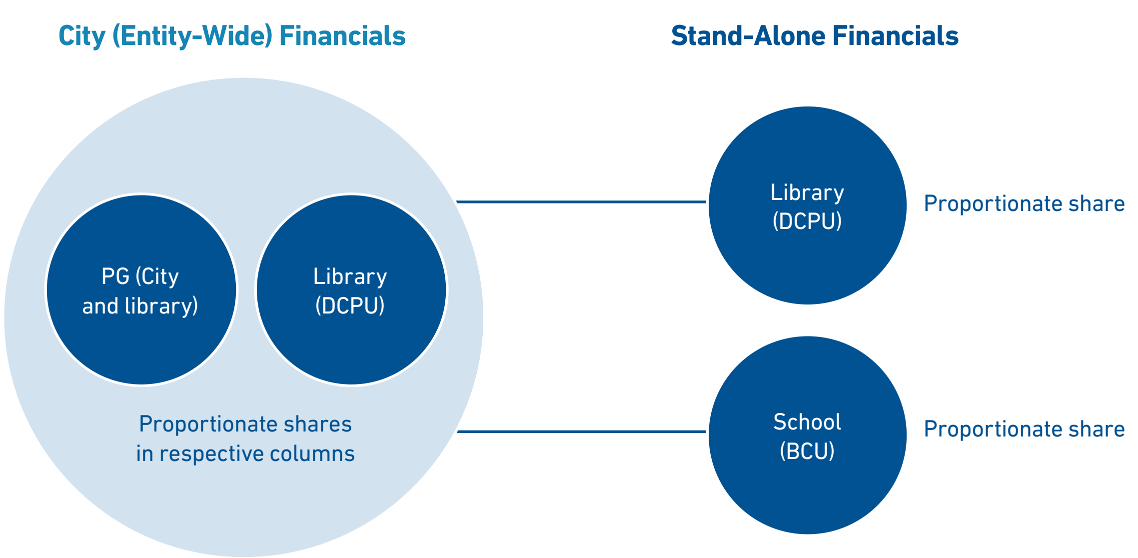
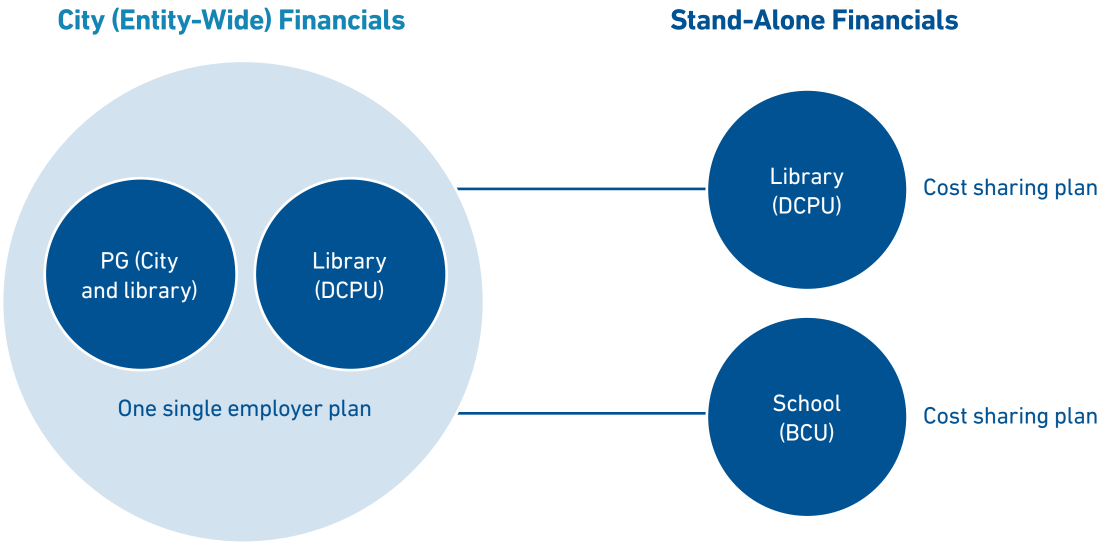


EXHIBIT 2 | NOTE DISCLOSURES, REQUIRED SUPPLEMENTARY INFORMATION (RSI), AND NOTES TO RSI



Reporting accepts applications for and reviews annual comprehensive financial reports (ACFRs) prepared for reporting entities that are less than a whole government, if the reporting entity is accounted for separately from the rest of the government in one or more individual funds. For these reports, if governments allocate PEB liabilities to the reported fund(s), we require that the government's PEB liabilities and deferred resource flows from pension/OPEB are allocated to the reporting entity following the same approach discussed in this article, and the appropriate note disclosures and RSI-like tables and notes to those tables, as if it too were a participant in a cost-sharing plan.

Watch this space for other **Inside Stories** discussing other topics related to activities internal to a financial reporting entity or with related parties, such as accounting for certain complex financial activity with blended component units and joint ventures.

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EXHIBIT 3 | EXAMPLE SUMMARY TABLE

Assumption: A City and its component units, a library and a school, provide defined benefit pensions through one trusted single-employer plan. The library is a discretely presented component unit (DPCU) and the school is blended component unit (BCU) of the City, which is the primary government (PG).

In these financial statements:	Prepared for this entity:	The Statement of Position will report pension liabilities and deferred resource flows in the amount of:	Note Disclosures, required supplementary information (RSI) and notes to RSI will be prepared based on the requirements for:
City (financial reporting entity-wide)	City	• Proportionate shares for City (PG) and School (BCU), in the PG columns, and • Proportionate shares for Library in DCPU column	A single-employer plan, using the total amounts for the plan
Stand-alone	Library, a DPCU of the City	Proportionate shares for library	A cost-sharing plan, using the library's proportionate share of the plan amounts
Stand-alone	School, a BCU of the City	Proportionate shares for school	A cost-sharing plan, using the school's proportionate share of the plan amounts

[1] For authoritative guidance on defining a financial reporting entity, see GASB Cod. Sec. 2100.

[2] For complete guidance on employer accounting for defined-benefit pension and other postemployment benefits (OPEB) provided through trusted plans, see GASB Cod. Sec. P20 for pension plans and P50 for OPEB plans. The content in this article is highly abridged and interpreted and should not be solely relied by governments in accounting for and reporting postemployment benefit obligations.

[3] Accounting and financial reporting by governmental employers' contributions to cost-sharing multiple-employer plans that that have no predominant state or local government employer (such as tradespeople's union-run ERISA plans), are excluded from this discussion. The criteria for identifying this type of plans are found in GASB Cod. Sec. P20. 112, and the financial reporting and disclosure requirements are found in Cod. Sec. P20.227-.232.

[4] GASB Cod. Sec. P20.117, P20.707-1 – .707-3.

[5] This discussion assumes there are no nonemployer contributors on behalf of any of the employers within the financial reporting entity. For a complete explanation of the proportionate share calculations when there are nonemployer contributors, both for those nonemployer contributors in special funding situations and those that are not, see GASB Cod. Sec. P20.114-.115, .148a., and .185-.193.

[6] These formulas are adapted from those required of employers in cost sharing plans, found in GASB Cod. Sec. P20.148.

[7] If an individual employer's proportionate share, as discussed below, changes between measurement dates the net effect of the change would be measured as discussed in GASB Cod. Sec. P20.154, and would be accounted for as an additional deferred inflow of resources or deferred outflow of resources, as appropriate.

[8] GASB Cod. Sec. P20.707-1.