Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting

New Pension Standards

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans,* revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions,* revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014. This whitepaper was prepared by the AICPA State and Local Government Expert Panel (SLGEP) and is intended to describe accounting and auditing issues facing governmental employers (employers) that participate in *cost-sharing multiple-employer defined benefit pension plans* (cost-sharing plan or plan), as well as best practice solutions to address these issues.

What Has Changed – Employers Must Recognize Proportionate Share of Collective Pension Amounts[1]

As background, a cost-sharing plan is one in which the participating employers pool their assets and their obligations to provide defined pension benefits. That is, plan assets can be used to pay retirees of any participating employer in the plan. Such plans frequently have a large number of participating employers, often in the thousands.

Prior to implementing GASB Statement No. 68, employers participating in a cost-sharing plan recognize annual pension expense equal to their contractually required contribution to the plan. Pension liabilities result from the difference between contributions required and contributions made.

Once GASB Statement No. 68 is implemented, employers will be required to recognize a liability as employees earn their pension benefits (that is, as they provide services to the government). For the first time, employers participating in cost-sharing plans will recognize their proportionate share of the collective pension amounts for all benefits provided through the plan. Pension amounts to be recognized by employers include the net pension liability,[2] deferred outflows of resources, deferred inflows of resources, and pension expense. To the extent that a long-term obligation to provide pension benefits (that is, total pension liability) is larger than the value of the assets available in the plan to pay pension benefits, there is a collective net pension liability for which each employer will need to report its proportionate share in their financial statements. This is significant because the employer's proportionate share of collective net pension liability will appear on the face of the employer's accrual-based financial statements for the first time, along with the employer's other long-term liabilities. In many cases, the net pension liability will be material, perhaps more so than any other long-term liability appearing in the financial statements. Further, changes in the net pension liability will be recognized immediately as pension expense, or reported as deferred outflows of resources or deferred inflows of resources, depending on the nature of the change, which could result in reporting four possible categories of deferrals for presentation purposes.[3] Theoretically, the pension amounts reported individually by each employer participating in a cost-sharing plan will equal the collective pension amounts for the plan as a whole.

Employer Challenges - Recognizing Proportionate Share of Collective Pension Amounts and Related Auditor Issues

A major challenge faced by each employer participating in a cost-sharing plan is how the employer will obtain all necessary information to support its proportionate share of the collective net pension liability,

[1] Some cost-sharing plans include special funding situations which are situations where a nonemployer entity is legally responsible for making contributions directly to a pension plan that is used to provide pensions to the employees of another entity or entities (e.g., state government contributes to a local government plan). This paper does not address special funding situations. If such a situation exists, the accounting treatment for the employer would be different than that described in this paper. See GASB Statement No. 68, *Accounting and Financial Reporting for Pensions,* for more information.

[2] In this paper references to a net pension liability also apply to situations in which the fiduciary net position exceeds the total pension liability resulting in a net pension asset.

[3] The four possible categories of deferrals include: (1) differences between expected and actual experience with regard to economic or demographic factors (that is, differences between expected and actual experience); (2) net difference between projected and actual earnings on pension plan investments; (3) changes of assumptions about future economic or demographic factors or of other inputs (that is, changes of assumptions); and (4) changes in proportion and differences between employer contributions and proportionate share of contributions.

deferred outflows of resources, deferred inflows of resources, and pension expense. In order to calculate each employer's proportionate share of these collective pension amounts, individual proportions will have to be determined by measuring each employer against the total of all of the employers participating in the plan.

Similarly, employer auditors will be challenged in terms of obtaining sufficient appropriate evidence in order to opine on the pension amounts included in employer financial statements. AU-C section 500, *Audit Evidence*, states that the objective of the auditor is to design and perform audit procedures that enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

While the GASB considered these challenges in developing GASB Statement No. 67, it concluded that the issues would be best addressed through coordination and communication between the plans and employers. There is no question that significant interaction between the plans, participating employers, and related auditors will be needed for purposes of corroborating pension amounts in employer financial statements.

The following sections further describe additional background on some of the more detailed challenges that will need to be overcome.

Limitations with the Audited Statements of the Plan
Under GASB Statement No. 67, the financial statements of cost-sharing plans include only the net pension liability for the plan as a whole but do not include deferred outflows of resources or deferred inflows of resources by category or pension expense for all participating employers. Additionally, the plan financial statements do not include each participating employer's share of the collective pension amounts. Participating employers will need information beyond what is provided in the audited financial statements of the plan to determine their proportionate share of the collective pension amounts.

Methods of Allocation
The basis of an employer's allocation of the collective pension amounts should be consistent with the manner in which contributions to the plan are determined. Although GASB Statement No. 68 encourages an allocation method, often prepared by an actuary, based on an employer's projected long-term contribution effort to the plan as compared to the total projected long-term contribution efforts of all employers contributing to the plan (that is, the actuarial method), the standard allows for other allocation methods to be used, including allocations based on historical measures such as actual contributions or covered payroll. Allocations based on historical measures are likely to be more easily substantiated than the actuarial method. However, the use of such a historical measure may not be appropriate in certain circumstances, for example if there are different classes of benefits.

Responsible Parties – Allocation Percentages
An allocation percentage is necessary to derive an employer's proportionate share of the collective pension amounts. GASB Statement No. 68 does not specify which party (that is, plans or employers) is responsible for calculating the allocation percentages. However, cost-sharing plans are in the best position to perform this calculation because they have all necessary information to do so, including the data supporting the allocation measure for each individual employer (that is, the numerator of the calculation) and for all employers (that is, the denominator of the calculation).

Employers wishing to calculate their own allocation percentages face two challenges. First, if individual employers calculate their own allocation, different employers participating in the same plan might allocate collective pension amounts using different bases. Second, employers may not have the necessary data to accurately calculate the allocation. Participating employers would be able to support their individual amount (that is, the numerator of the calculation), but would not likely have access to all employers' corresponding amounts (that is, the denominator of the calculation).

Responsible Parties – Collective Pension Amounts

As previously discussed, the audited financial statements of cost-sharing plans include only the net pension liability for the plan as a whole, and do not include deferred outflows of resources or deferred inflows of resources by category, or pension expense in total for all participating employers. While deferred outflows of resources and deferred inflows of resources by category and pension expense are not disclosed in the plan financial statements, they are expected to be calculated by the actuary of the plan and included in the actuarial valuation report. Since these amounts relate to all participating employers, it is extremely unlikely that the employer and their auditors would have access to necessary information for the plan as a whole to calculate and verify the collective pension amounts. Clearly, the cost-sharing plans and their actuaries are in the best position to determine these amounts.

Best Practice Solution for Allocation of Pension Amounts

To overcome the various challenges described above, the AICPA SLGEP recommends that cost-sharing plans calculate each employer's allocation percentage and collective pension amounts. This approach will promote consistency in the calculation, as well as minimize the overall effort and cost incurred by all parties involved. The following discussion provides details regarding this recommendation.

Schedule of Employer Allocations and Allocation Method to be Used

The AICPA SLGEP recommends cost-sharing plans prepare a schedule of employer allocations and related notes to the schedule. This schedule would display the proportionate relationship of each employer to all employers and each employer's allocation percentage. The AICPA SLGEP further recommends the plan engage its auditor to obtain reasonable assurance and report on the schedule of employer allocations and related notes to the schedule. Such a schedule could be presented as a stand-alone schedule or included as a supplemental schedule to the plan's financial statements. Regardless, the plan auditor would form an opinion and report on the schedule in accordance with AU-C section 805, *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement.*[4] Note that the AICPA SLGEP is not recommending that the plan auditor provide an in-relation-to opinion as discussed in AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*. This is because the limited assurance provided by an in-relation-to opinion is not sufficient for employers and their auditors to use for purposes of determining that allocation percentages are accurate and reliable.

As discussed in the "Methods of Allocation" section above, the basis of an employer's allocation of the collective pension amounts should be consistent with the manner in which contributions to the plan are determined (that is, the actuarial method or allocations based on historical measures). An example of a schedule of employer allocations based on actual employer contributions is provided below.

[4] The AICPA Audit and Attest Standards Team is currently developing a series of auditing interpretations that will include guidance for plan auditors when auditing such a schedule.

EXAMPLE COST SHARING PENSION PLAN
Schedule of Employer Allocations
6/30/20X5

Employer		20X5 Actual Employer Contributions	Employer Allocation Percentage	
Employer 1	$	2,143,842	36.376	%
Employer 2		268,425	4.554	
Employer 3		322,142	5.466	
Employer 4		483,255	8.199	
Employer 5		633,125	10.742	
Employer 6		144,288	2.448	
Employer 7		95,365	1.618	
Employer 8		94,238	1.599	
Employer 9		795,365	13.495	
Employer 10		267,468	4.538	
Employer 11		403,527	6.847	
Employer 12		165,886	2.815	
Employer 13		68,454	1.161	
Employer 14		6,240	0.106	
Employer 15		2,144	0.036	
Total	$	5,893,764	100.000	%

Cost-sharing plans will need to consider the level of rounding or precision (that is, the number of decimal places) used in preparing the allocation calculation. The relative size of the various employers participating in the plan is a key consideration in determining how to round the allocation percentages. That is, if a cost-sharing plan includes one or more very small employers and other larger employers, the calculation likely will require more precision (that is, more decimal places). For example, in the illustrative schedule above, Employer 15 had actual pension contributions of $2,144 and an employer allocation of .036% (that is, .00036), using five decimal places. Rounding to anything less than four decimal places would result in no allocation to Employer 15.

Schedule of Pension Amounts by Employer

In addition to the recommended schedule of employer allocations, the AICPA SLGEP also recommends that cost-sharing plans prepare a schedule of pension amounts by employer and related notes to the schedule. The AICPA SLGEP further recommends the plan engage its auditor to obtain reasonable assurance and report on total net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the sum of all participating entities included in this schedule. Such a schedule could be presented as a stand-alone schedule or included as a supplemental schedule to the plan's financial statements. Regardless, the plan auditor would form an opinion on each element described above and report on the schedule in accordance with AU-C section 805.[5] Note that the AICPA SLGEP is not recommending that the plan auditor provide an in-relation-to opinion as discussed in AU-C section 725. This is because the limited assurance provided by an in-relation-to opinion is not sufficient for employers and their auditors to use for purposes of determining that each

[5] The AICPA Audit and Attest Standards Team is currently developing a series of auditing interpretations that will include guidance for plan auditors when auditing such a schedule.

element described above is accurate and reliable. In performing the audit of the schedule, the plan auditor may utilize audit evidence obtained during the audit of the financial statements for the public employee retirement system (PERS) as a whole. However, in determining the appropriateness of utilizing such evidence, the plan auditor may need to consider whether the audit procedures were designed at the individual plan level or for the PERS financial statements as a whole.

The schedule of pension amounts by employer would include the net pension liability, the various categories of deferred outflows of resources and deferred inflows of resources, and pension expense for all participating employers including differences between expected and actual economic experience; differences between projected and actual investment earnings, net;[6] and changes of assumptions. Further, each employer is required to recognize two additional types of deferred outflows of resources and deferred inflows of resources related to (1) the net impact from changes in proportion (that is, the allocation percentage) between periods; and (2) differences between actual contributions made by an employer and their proportionate share of total contributions calculated based on the allocation percentage. The proportionate share of the plan pension expense also needs to be adjusted for the amortization of these two additional types of deferrals. While these additional deferrals and amortization amounts can be calculated separately by each employer, the plan may choose to prepare a schedule of pension amounts by employer that includes this information. Doing so would minimize the potential for error by employers.

Accordingly, the AICPA SLGEP recommends that the plan prepare a schedule of pension amounts by employer using the allocations discussed previously in this paper. An example of a schedule of pension amounts by employer follows:

[6] In accordance with GASB Statement No. 68, the various categories of deferred outflows of resources and deferred inflows of resources are required to be disclosed by participating employers and cannot be netted, except for investment experience (that is, the differences between projected and actual investment earnings).

EXAMPLE COST SHARING PENSION PLAN
Schedule of Pension Amounts by Employer
As of and for the year ended 6/30/20X5

		Deferred Outflows of Resources					Deferred Inflows of Resources				Pension Expense		
Entity	**Net Pension Liability**	**Differences Between Expected and Actual Experience**	**Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments**	**Changes of Assumptions**	**Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions**	**Total Deferred Outflows of Resources**	**Differences Between Expected and Actual Experience**	**Changes of Assumptions**	**Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions**	**Total Deferred Inflows of Resources**	**Proportionate Share of Plan Pension Expense**	**Net Amortization of Deferred Amounts from Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions**	**Total Employer Pension Expense**
Employer 1	$ 45,224,620	438,859	1,569,847	1,404,206	695,426	4,108,338	355,917	–	726,425	1,082,342	1,907,283	12,375	1,919,658
Employer 2	5,661,780	54,942	196,533	175,796	84,231	511,502	44,558	–	74,326	118,884	238,777	(1,793)	236,984
Employer 3	6,795,628	65,945	235,892	211,001	117,354	630,192	53,481	–	98,465	151,946	286,596	(8,088)	278,508
Employer 4	10,193,442	98,917	353,838	316,502	161,215	930,472	80,222	–	165,453	245,675	429,894	3,021	432,915
Employer 5	13,355,038	129,597	463,584	414,668	199,845	1,207,694	105,103	–	197,645	302,748	563,229	(9,900)	553,329
Employer 6	3,043,487	29,534	105,646	94,499	53,453	283,132	23,952	–	48,453	72,405	128,355	599	128,954
Employer 7	2,011,585	19,520	69,827	62,459	33,458	185,264	15,831	–	35,345	51,176	84,836	625	85,461
Employer 8	1,987,964	19,291	69,007	61,725	35,425	185,448	15,645	–	16,453	32,098	83,839	(5,712)	78,127
Employer 9	16,777,717	162,811	582,393	520,941	248,356	1,514,501	132,040	–	284,543	416,583	707,576	8,405	715,981
Employer 10	5,641,888	54,749	195,843	175,178	95,465	521,235	44,401	–	44,356	88,757	237,938	(1,188)	236,750
Employer 11	8,512,562	82,606	295,490	264,312	136,453	778,861	66,993	–	148,543	215,536	359,005	1,254	360,259
Employer 12	3,499,761	33,962	121,485	108,666	52,145	316,258	27,543	–	64,354	91,897	147,597	453	148,050
Employer 13	1,443,418	14,007	50,104	44,818	23,156	132,085	11,360	–	33,453	44,813	60,874	(205)	60,669
Employer 14	131,785	1,279	4,575	4,092	1,968	11,914	1,037	–	894	1,931	5,558	147	5,705
Employer 15	44,757	434	1,554	1,390	1,456	4,834	352	–	698	1,050	1,888	7	1,895
Total for All Entities	$ 124,325,432	1,206,453	4,315,618	3,860,253	1,939,406	11,321,730	978,435	–	1,939,406	2,917,841	5,243,245	–	5,243,245

Schedule of Collective Pension Amounts – Another Alternative

The AICPA SLGEP recommends the schedule of pension amounts by employer illustrated above because it provides all the elements each employer needs to prepare its financial statements. However, since some of the deferred outflows of resources and deferred inflows of resources and related amortization can be calculated directly by the employer using the percentages in the illustrative schedule of employer allocations above (that is, employer specific amounts), a simpler schedule could be prepared by the plan as illustrated below. If the plan chose to prepare this alternative schedule, the AICPA SLGEP recommends the plan engage its auditor to obtain reasonable assurance and report on the net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and pension expense included in this schedule in accordance with AU-C section 805.

EXAMPLE COST SHARING PENSION PLAN
Schedule of Collective Pension Amounts
As of and for the year ended 6/30/20X5

	Deferred Outflows of Resources				Deferred Inflows of Resources			
Net Pension Liability	Differences Between Expected and Actual Experience	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	Changes of Assumptions	Total Deferred Outflows of Excluding Employer Specific Amounts *	Differences Differences Between Expected and Actual Experience	Changes of Assumptions	Total Deferred Inflows of Excluding Employer Specific Amounts *	Plan Pension Expense
$ 124,325,432	1,206,453	4,315,618	3,860,253	9,382,324	978,435	–	978,435	5,243,245

* Employer specific amounts that are excluded from this schedule are the changes in proportion and differences between employer contributions and proportionate share of contributions as defined in paragraphs .54 and .55 of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions.*

Under this alternative, each employer would need to calculate two additional types of deferred outflows of resources and deferred inflows of resources which are employer specific amounts. These amounts relate to (1) the net impact from changes in proportion (that is, the allocation percentage) between periods; and (2) differences between actual contributions made by an employer and their proportionate share of total contributions calculated based on the allocation percentage.

Employer and Employer Auditor Responsibilities

The employer is solely responsible for its financial statements and, therefore, is responsible for evaluating the information used to recognize and disclose pension amounts in its financial statements. Similarly, the employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer and employer auditor may use the plan auditor's report on the schedules to provide evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated.

Before using the work of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedules are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes. Further, the employer and employer auditor have a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage (that is, the numerator of the calculation), recalculate the allocation percentage for the employer, and recalculate the pension amounts allocated to the employer based on the allocation percentage.

Ramifications if Best Practice Solutions Not Adopted

If a cost-sharing plan issues financial statements, but does not prepare the above described schedules or if it does prepare the above described schedules but does not engage its auditor to opine on them as recommended by the SLGEP, it is unlikely that employer auditors will be able to accumulate sufficient appropriate audit evidence necessary to provide unmodified opinions on opinion units of the government financial reporting entity that have material allocated pension amounts. It is important to emphasize that unaudited information provided by the plan to its employers to support allocations or pension amounts would not be sufficient appropriate audit evidence for their auditors to base their opinions. Some have questioned whether, in absence of the recommendations in this paper being implemented, additional work by the employer and employer auditor could be performed to adequately verify unaudited amounts provided by the plan. The AICPA SLGEP believes that such an alternative approach would likely not be practical. Employers and their auditors have no direct access to key data of the other employers participating in the plan that supports the employer's proportion of the collective pension amounts. Thus, while the AICPA SLGEP acknowledges that the solutions proposed in this paper are recommendations, it believes that there are few, if any, alternatives that employers and their auditors could efficiently and effectively utilize to obtain sufficient appropriate evidence on which to base their pension amounts or the audit opinions, respectively.

Looking Forward

The AICPA is working to develop additional auditing guidance for plan auditors and employer auditors in various forms. For example, the AICPA Audit and Attest Standards Team will be issuing a series of auditing interpretations relating to some of the concepts in this paper, as well as providing guidance on the plan auditor's responsibilities when auditing the schedules described above. A separate paper titled, *Single-Employer and Cost-Sharing Multiple Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements*, has also been released that discusses the role of census data in single-employer and cost-sharing plan financial statements and the plan auditor's responsibility for such census data. Additionally, a separate series of SLGEP whitepapers and auditing interpretations relating to agent multiple-employer plans and a new governmental pension chapter for the AICPA Audit and Accounting Guide, *State and Local Governments* are under development. The chapter will cover various plan and employer auditor considerations, including the ramifications when an employer auditor is not able to obtain sufficient appropriate evidence in order to opine on the pension amounts included in employer financial statements.