Implementation Guide No. 2015-1
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IMPLEMENTATION GUIDE OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD

Implementation Guide No. 2015-1

June 2015

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INTRODUCTION

1. The objective of this Implementation Guide is to provide guidance that clarifies, explains, or elaborates on GASB Statements and Interpretations.

IMPLEMENTATION GUIDANCE

Applicability of This Implementation Guide

2. The requirements of this Implementation Guide apply to the financial statements of all state and local governments unless narrower applicability is specifically provided for in the pronouncement addressed by a question and answer.

3. This Implementation Guide supersedes all previously issued Implementation Guides, including the 2013–2014 Comprehensive Implementation Guide.

Disclosures Related to Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

4. Questions and answers in this paragraph address disclosures related to deposits with financial institutions, investments (including repurchase agreements), and reverse repurchase agreements.

1.1 Introduction

1.1.1. [Not used in GASBIG 2015-1]

1.1.2. [Not used in GASBIG 2015-1]

1.1.3. [Not used in GASBIG 2015-1]

1.1.4. [Not used in GASBIG 2015-1]

1.1.5. [Not used in GASBIG 2015-1]

1.2 Scope and Applicability of Statements 3 and 40

1.2.1. [Not used in GASBIG 2015-1]

1.2.2. [Not used in GASBIG 2015-1]

1.2.3. [Not used in GASBIG 2015-1]

1.2.4. [Not used in GASBIG 2015-1]

1Terms defined in paragraph 5 are shown in boldface type the first time they appear in this paragraph.
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1.2.5. [Not used in GASBIG 2015-1]

1.3 General Disclosure Principles

1.3.1. [Not used in GASBIG 2015-1]

1.3.2. Q—Statement No. 40, Deposit and Investment Risk Disclosures, paragraph 4, requires investment disclosures to be organized by investment type, a level of aggregation previously required by Statement No. 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements. What is an “investment type”?

A—Statement 40 Deposit and Investment Risk Disclosures, does not define investment type. Prescribing a list of investment types may mislead readers of the financial statements considering the diversity of investments that may carry similar terminology but exhibit diverse risks. Different investment terms and risks are features that give investments differing forms. For example, a government may hold two U.S. Treasury investments, one a 10-year bond and the other an interest-only strip. Although both are U.S. Treasury securities, they exhibit significantly different risk characteristics. By not prescribing investment types, practitioners are able to apply professional judgment and select investment types that fit the facts and circumstances; however, investments with significantly different risk profiles should not be aggregated into a single investment type.

1.3.3. Q—are “cash equivalents” an investment type?

A—No. “Cash equivalents” should not be considered an “investment type” for purposes of Statements 3 and 40 disclosures, as amended. Although both three-month commercial paper and three-month U.S. Treasury bills meet the definition of cash equivalents in Statement No. 9, Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting, paragraph 9, significant differences in the risk profiles of the two investments make it necessary to present them as separate investment types in the Statements 3 and 40 disclosures, as amended. (See Question 1.26.6.)

1.3.4. Q—for purposes of applying paragraph 4 of Statement 40, can different investment portfolios be disclosed by a government as separate “investment types”? That is, can the disclosure simply present “deferred compensation plan assets” and “retirement plan assets”? If not, how should they be disclosed?

A—Different investment portfolios do not constitute “investment types.” Financial statement users could discern only limited information about the deposit and investment risks in the pension plan’s portfolio if those investments are reported in the Statement 40 disclosure simply as “pension plan assets.” The government should group the different investments within the portfolio into types as explained in paragraph 4 of Statement 40—for example, U.S. Treasuries, corporate bonds, or commercial paper.

1.3.5. Q—for purposes of presenting investments by type as required by paragraph 4 of Statement 40, may sizable portions of an investment portfolio be described as “Other”? 
Disclosures Related to Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

A—No. It is not appropriate to present significant amounts of a government’s portfolio in this way, unless the narrative of the note disclosure describes the composition of the “Other” or “Miscellaneous” category.

1.3.6. Q—Sometimes it may not be readily apparent what a government’s different investment types are by the labels that are presented in the note disclosure. If this is the case, should the government provide some explanation about those investment types?

A—If a term is not well understood in common usage or if users in general would not understand the nature of a particular investment type by the label it has been given, preparers should provide a brief description or use a different term that would be more widely understood. For example, an investment fund that purchases companies through leveraged buyouts and is presented in the note disclosures as “leveraged buyouts” or “LBO” could be described as a “leveraged buyout fund.”

1.3.7. [Not used in GASB 2015-1]

1.3.8. Q—A government has a position in an external investment pool that is sponsored by another government. Does the investment-type disclosure “look through” to the investments of the pool, or should the investment be characterized as an investment in an external investment pool?

A—A position in an external investment pool is in itself a type of investment. Therefore, a government’s position in an external investment pool should be characterized as an investment in an external investment pool. An investment-type disclosure “looking through” to the investments of the external investment pool is not required.

1.4 Level of Detail

1.4.1. [Not used in GASB 2015-1]

1.4.2. Q—Can a government present deposit and investment disclosures by portfolio?

A—The level-of-detail guidance provided in paragraph 5 of Statement 40 indicates that disclosures generally should be made for the primary government, including its blended component units, with additional risk disclosures as necessary. A government should consider the risks of its portfolios as risks of the primary government when determining the appropriate level-of-detail disclosures. Disclosures for the primary government may be aggregated by portfolio. For example, a government holding separate portfolios for governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types should disclose such risks of those portfolios when the risk exposures are significantly greater than the deposit and investment risks of the primary government.

1.4.3. Q—Can a single nonmajor fund cause the reported nonmajor funds in the aggregate to have interest rate risk that is significantly greater than that of the primary government?

A—Yes. A government may have a nonmajor fund with an investment that is exposed to interest rate risk. Depending upon the magnitude of the investment’s interest rate risk as related to the total interest rate risk of the aggregated nonmajor funds (for example, nonmajor governmental funds) and the primary government, the government may be required to report the interest rate risk of the aggregated nonmajor funds in accordance with paragraph 5 of
Statement 40. Disclosures for nonmajor funds should be made if the risk within the aggregated nonmajor fund total is significantly greater than the interest rate risk of the primary government. For example, a government may hold a variable-rate investment with a coupon set at 1.5 times the 3-month London Interbank Offered Rate (LIBOR) in a nonmajor special revenue fund. If this investment’s risk exposure is significant to the total of aggregated governmental nonmajor funds and the primary government’s interest rate risk exposure as a whole is significantly less than that of the aggregated governmental nonmajor funds, the appropriate interest rate risk disclosures should be made for the aggregated governmental nonmajor funds.

1.4.4. Q—A government manages its investments according to maturity. Short-term investing activities are conducted in an internal investment pool. Longer term investments for specific funds—such as debt service reserve and capital projects funds—are purchased on an individual basis. Should short-term and long-term investing activity be delineated in the investment disclosures?

A—Statements 3 and 40, as amended, focus on the deposit and investment risks of the primary government and permit aggregation of such disclosures. However, a government may choose to segregate certain of its investing activities to disclose the risks associated with each maturity. The existence of large differences in investing practices, such as internal pooling or purchasing discrete investments, may be indicative of a need for separate disclosure at the fund level for the weighted average maturity when the risk exposure is significantly greater than that of the primary government. See Illustration 4 in nonauthoritative Appendix B1-2.

1.4.5. Q—What level of detail should be applied to discretely presented component unit deposit and investment risks?

A—Current guidance regarding component unit level-of-detail requirements can be found in paragraph 63 of Statement No. 14, The Financial Reporting Entity, as amended:

Notes essential to fair presentation in the reporting entity basic financial statements encompass:

a. Governmental and business-type activities, major funds individually, and nonmajor funds in the aggregate of the primary government including its blended component units.

b. Major discretely presented component units considering the nature and significance of each component unit’s relationship to the primary government.

Determining which discretely presented component unit disclosures are essential to fair presentation is a matter of professional judgment and should be done on a component unit-by-component unit basis. A specific type of disclosure might be essential for one component unit but not for another depending on the individual component unit’s relationship with the primary government.

1.4.6. Q—are governments required to disclose risks that were greater during the year than at the end of the reporting period or to disclose investments held during the year but not as of the end of the reporting period?

A—No. Statement 40, as amended, focuses on the impact of the risk exposure at the date of the statement of net position of the primary government, including its blended component units, as a whole, except when deposit or investment risks are not apparent because of other deposit
or investment balances. Statement 40, as amended, looks at the risk exposure as of that date as an indicator for potential loss of resources. Risks not present at that date do not offer the same level of predictive value, and therefore the government should evaluate its risk exposure as of the date of the financial statements regardless of the activity between funds during the reporting period. For example, a government holds an investment in XYZ corporate bonds that receive a rating downgrade. If the government moves the bond from its capital projects fund to its general fund during the year, no disclosure of the investment’s risk exposure during the time it was held in the capital projects fund needs to be disclosed.

1.4.7. Q—A county government’s investments are divided among three separately elected officials. Should investment disclosures be presented for each elected official?

A—No. Statement 40 provides guidance on the level of detail of deposit and investment risk disclosures in paragraph 5. Disclosures generally should be made for the primary government, including its blended component units, with additional risk disclosures as warranted based on risk exposure as discussed in paragraph 5.

Statements 3 and 40 do not address separate disclosures indicating the division of responsibility within the primary government. A government with a diversified responsibility for investments should consider the risks of those individual responsibility units to be risks of the primary government, or another level of detail as provided in paragraph 5 of Statement 40, in determining the appropriate level-of-detail disclosures.

1.4.8. Q—Are all deposit and investment risk disclosures required to be made in a single note?

A—No. Statements 3 and 40, as amended, do not require separate or additional presentations for governmental and business-type activities, major funds, nonmajor funds in the aggregate, or fiduciary fund types, as provided for in paragraph 5 of Statement 40. However, if a separate presentation is made for a separate investment area, such as a pension trust fund, a cross-reference between the primary disclosures required by Statements 3 and 40, as amended, and the separate pension trust fund disclosure could help the financial statement users better understand the Statements 3 and 40 disclosures in relation to the cash and investments presented in the statement of net position.

Paragraph 65 of Statement 3 requires disclosure of the types of investments authorized by legal or contractual provisions. Some governments present this information in the summary of significant accounting policies (SSAP) separately from the note that presents the other disclosures required by Statements 3 and 40, as amended, about deposits and investments. If this is done, references between the deposit and investment disclosure and the SSAP could be made. These references could help financial statement users find all information appropriate to their evaluation of investment risk.

1.5 Deposit and Investment Policies

1.5.1. Q—Does Statement 40, as amended, define investment policy or require an investment policy to be formally adopted?

A—Diversity in practice prevents specifically defining what is meant by either a deposit or investment policy. However, for the purposes of Statement 40, as amended, an investment policy is considered to be a formally adopted policy that sets forth a government’s allowable deposits or investments. An investment policy may be formally adopted through legal or
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contractual provisions or by other means, usually by the governing board. However, a government’s informal policies or general investment practices are not a required disclosure. For these policies and practices, the government would disclose that no policy had been adopted if a required disclosure was applicable. For example, historically an airport authority has invested in securities rated in the top category of credit risk as issued by nationally recognized statistical rating organizations (NRSROs). The airport authority is not required by an investment policy to invest in top rated securities but has been doing so for the past 10 years absent any investment policy. In this case, the authority would disclose that no credit risk policy has been adopted.

Paragraph 6 of Statement 40 indicates that only brief disclosures are required and a government should not include all details of its investment policies in its disclosures. Many investment policies are extremely long and can be quite detailed. If broad cash management and investment policies have been adopted, only a brief description of the policy that is related to the risks discussed in Statement 40 should be disclosed.

1.5.2. Q—If a local government’s investment policy is more stringent than its statutory investment authority, is it necessary to disclose its statutory investment authority? For example, a government’s investment policy may limit its exposure to credit risk by permitting the government to invest in only U.S. government obligations or those obligations explicitly guaranteed by the U.S. government.

A—Yes. Disclosure is required for both the government’s investment policy and the statutory investment authority. Although certain provisions of Statement 3 have been changed by the issuance of Statement 40, the requirement to disclose the types of investments authorized by legal or contractual provisions (Statement 3, paragraph 65) was not amended, superseded, or rescinded. (See Questions 1.6.1 and 1.7.1–1.7.3.) Information about the government’s ability to invest in the instrument is important to a user’s evaluation of potential risk.

1.5.3. Q—A state government issues a bond that contains specific covenants related to the investment of the proceeds. Should this be considered an investment policy?

A—Yes. The disclosure of relevant deposit or investment policies communicates to the readers of the financial statements a government’s tolerance for risk. The disclosure of such policies, when identified risks warrant such a disclosure, serves to indicate the risk tolerance information that Statement 40 was designed to convey.

1.5.4. Q—A government’s investment policy is limited to complying with its state’s investment statutes. What investment policy disclosures should be made?

A—State laws vary, and many only identify authorized investments. If a government’s investment policy is limited to complying with its state’s investment statutes, the relevant portions of the state statute relating to the risks required to be disclosed under Statement 40, as amended, should be disclosed. When state law has not addressed a risk, such as interest rate risk, the disclosure should indicate that the reporting government has not adopted an investment policy on that point.

1.5.5. Q—A government’s investment policy indicates that the government is restricted to investments in obligations of the U.S. government, or those obligations explicitly guaranteed by the U.S. government. Is a credit risk investment policy disclosure required?
1.6 Legal or Contractual Provisions

1.6.1. Q—Paragraphs 65 and 66 of Statement 3, as amended, require disclosures about the legal and contractual provisions that govern a government’s deposits and investments. What are the sources of legal provisions for purposes of these disclosures?

A—Footnote 9 of Statement 3 lists various forms of legal provisions, including constitutions, ordinances, and governing body orders. Legal provisions are those requirements that carry the force of law.

Legislation that governs the deposits and investments of a state government or its local political subdivisions usually is in one of three forms. The first form provides a detailed list of permissible deposits and investments (a legal list) and other requirements, such as for custody of collateral on deposits and of investment securities. Many state statutes use this form. The second form, commonly used for pension fund and other fiduciary investments, is a prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care. Additional investment objectives may be given in a prudent-person or prudent-expert rule, for example, to consider safety of principal before investment yield. The third form of state deposit and investment legislation is home-rule authority, which allows local governments to enact their own investment legislation. Sometimes local governments are given home-rule authority in some investment areas (such as investment selection) and detailed statutory requirements in others (such as a requirement to have collateral on deposits).

State investment legislation, supplemented by legal requirements established by the governing body or other oversight body of the state or local governmental entity or agency, should be used in applying the requirements of paragraphs 65 and 66, as amended. For example, if state statutes provide that the investments of a pension plan should be guided by a prudent-person rule and there are no other legal requirements concerning investments for the system, the prudent-person rule should be the basis for the disclosures required by paragraphs 65 and 66, as amended. If, however, the system’s board of trustees establishes detailed investment policies and board actions constitute legal requirements, the disclosures should be based on the board’s policies. Similarly, local ordinances enacted by a local government with home-rule authority should be the basis for the disclosures.

Although important to an entity’s portfolio management, investment policies that are not legal requirements are not required to be used as a basis for paragraphs 65 and 66 disclosures, as amended. For example, if state law is silent on custodial arrangements for investment securities but it is the policy of the office of the state treasurer to have independent third-party custody, that policy is not a legal provision. Therefore, although violation of that custodial policy should be of concern to management, Statement 3 does not require its disclosure in the notes to financial statements. (See Question 1.8.1 for a discussion about disclosure of significant violations of legal and contractual provisions.)

1.7 Disclosure of Types of Investments Authorized

1.7.1. Q—Paragraph 65 of Statement 3, as amended, requires disclosure of the types of investments authorized by legal or contractual provisions. How detailed should this disclosure be?
A—The disclosure should be brief but informative. The objective of the disclosure is to give users basic information about the government’s investment environment and its potential risk.

The disclosure can include a citation of the legal provisions that list authorized investments, but that should not be the only information provided. On the other hand, users should not be given needless detail. If the list of investment types authorized by legal or contractual provisions is long and detailed, appropriate summary information could be given. For instance, a state law listing permissible investments may be several pages long, including, for example, the specific U.S. agency obligations in which local governments may invest. In this situation, the note disclosure might summarize these authorized investments as “various U.S. agency obligations.”

If legal provisions require only that investments be selected on the basis of a prudent-person or prudent-expert rule, only that information need be disclosed. That is, the government does not need to disclose the types of investments it selects in adherence with the prudent-person rule, unless another legal requirement requires the use of specific investment types.

1.7.2. Q—Is disclosure required if an investment type is authorized by legal provisions but is never used because of management policy?

A—Yes. Paragraph 65 of Statement 3, as amended, requires the government to disclose that the investment type is authorized. One of the objectives of the Statement 3 disclosures is to inform financial statement users about potential future risk. Information about the government’s ability to invest in the instrument is important to a user’s evaluation of potential future risk. This is because management policy against using the investment type could be changed in the future without legislative action, thus changing the government’s potential risk.

1.7.3. Q—Paragraph 65 of Statement 3, as amended, requires additional disclosure about differences in the types of investments authorized for different funds, fund types, or component units. When is this disclosure required?

A—Whether this disclosure is needed in a particular situation is a matter of judgment, but paragraph 65, as amended, establishes guidance for when minimal additional disclosure is required. Disclosure of the differences in authorized investment types is required if (a) the types authorized for different funds, fund types, or component units differ significantly from those authorized for the primary government and (b) the investment activity of the fund, fund type, or component unit is significant in comparison to the activity of the combined entity’s investment activity. An investment type is significantly different if its form differs significantly from those of other investments. Taken together, conditions (a) and (b) minimize the situations in which additional disclosures should be made.

For example, suppose that a government is authorized to invest the moneys of both the pension trust fund and the general fund in U.S. government securities, and that it also may invest the moneys of the pension trust fund in corporate equity securities. Equity securities are a significantly different form of investment from U.S. government securities. If the investment activity of the pension trust fund is significant in comparison to the investment activity of the combined entity, Statement 3 requires a statement that the pension fund is additionally authorized to invest in corporate equity securities. A separate list of all of the pension fund’s authorized investment types is not needed.
1.8 Disclosure of Violations

1.8.1. Q—Paragraph 66 of Statement 3 requires disclosure of significant violations during the period of any legal or contractual provisions for deposits and investments. What is a significant violation, and how detailed should the disclosure be?

A—This disclosure arises from the basic governmental financial reporting principle of reporting compliance with finance-related legal or contractual provisions. (See Question 1.6.1 for a discussion of what constitutes legal provisions.)

What constitutes a significant violation is a matter of professional judgment. However, significant connotes qualitative as well as quantitative features. A significant violation would not necessarily be restricted to one that involves a large dollar investment or a large dollar risk of loss. Qualitative features to be considered include the specific wording of the legal or contractual provisions, the reason for the provisions, the current political environment, whether such a violation would affect the actions or accountability assessment of the financial statement users, and whether the lack of control that allowed a small dollar violation potentially could allow a future violation involving a much larger dollar investment or larger dollar risk of loss. For example, suppose a government that is required by law to fully collateralize uninsured deposits had a small amount of uncollateralized deposits during the reporting period because it has no procedures to monitor the value of collateral. This situation could be considered a significant legal violation because the lack of procedures could result in higher levels of uncollateralized deposits in the future. Moreover, some believe any violations of legal provisions relating to collateral requirements and the use of unauthorized investment types are inherently significant in a qualitative sense and should be disclosed, regardless of the dollar amount involved.

This disclosure should only be as detailed as needed to inform users. Note also that paragraph 9 of Statement No. 38, Certain Financial Statement Note Disclosures, requires disclosure of actions taken to address such violations.

1.8.2. [Not used in GASBIG 2015-1]

1.9 Credit Risk

1.9.1. Q—Do the credit quality ratings of all NRSROs need to be disclosed? What if a government invests in a security that receives split ratings? That is, NRSROs issued different ratings on the same security. What credit quality disclosures should be made?

A—There are several recognized NRSROs at this time. Currently, the Securities and Exchange Commission (SEC) reviews the qualifications of applicant credit quality rating firms to determine if they meet the criteria for becoming an NRSRO. Statement 40, as amended, does not specifically address whether the credit quality ratings of all NRSROs need to be disclosed.

Many securities have ratings from more than one NRSRO, and sometimes those ratings differ. When multiple ratings exist and the government is aware of the different ratings, the rating indicative of the greatest degree of risk should be presented. However, a government may also choose to disclose additional credit quality ratings, thereby presenting the user with additional credit risk information from which to ascertain the credit risk of the investment.
Disclosures Related to Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

1.9.2. Q—Does the rating of each debt investment need to be disclosed, or can the ratings be aggregated?

A—Consistent with the requirements in paragraph 4 and paragraph 7, as amended, of Statement 40, credit risk disclosures may be aggregated by investment type or by credit quality rating. A portfolio consisting of various debt investments with differing credit quality ratings may be aggregated and displayed by credit quality. For example, a government holds debt investments that have the two highest credit quality ratings issued by the NRSROs: Fitch Ratings (AAA and AA), Moody’s Investors Service (Aaa and Aa), and Standard & Poor’s (AAA and AA). The government may choose to disclose that its investment portfolio contains AAA/Aaa/AAA rated government securities and AA/Aa/AA rated corporate bonds. A government holding investments with split ratings should, at a minimum, aggregate each investment with the rating indicative of the greatest degree of risk. (See Question 1.9.1.)

1.9.3. Q—If a debt investment is unrated but its issuer is rated, should the credit risk of the issuer be disclosed?

A—No. Displaying the credit quality ratings of issuers may be misleading as to the credit risk of the individual debt investment. The credit quality rating is intended to measure the probability of timely repayment of principal and interest on the debt securities being issued by the borrowing institution. An issuer’s debt issues may have different credit quality ratings. If the debt investment is unrated but the issuer is rated, governments should indicate that the debt investment is unrated, as required by paragraph 7 of Statement 40, as amended.

1.9.4. Q—Do all positions with credit exposure need to be listed separately? For example, how would a large portfolio disclose the credit quality rating of its investments?

A—To avoid unreasonably long disclosures, a government may choose to present aggregated credit risk disclosures for its portfolio of investments. Such disclosures may include the percentage of the portfolio constituted by each of the investment types with different categories of ratings. See Illustration 6 in nonauthoritative Appendix B1-2.

1.9.5. Q—Statement 40, as amended, requires that the credit quality ratings of NRSROs be disclosed, but it does not specifically identify to what detail the disclosures are required to be made. Ratings issued by the NRSROs can be quite detailed. For example, since October 1996, Moody’s Investors Service (one of the NRSROs) has applied numerical modifiers 1, 2, and 3 in each generic rating classification from Aa to B. The modifier 1 indicates that the issue ranks in the higher end of its generic rating category, the modifier 2 indicates a midrange ranking, and the modifier 3 indicates that the issue ranks in the lower end of its generic category. Although they do not use numerical modifiers, other NRSROs use pluses and minuses as modifiers. Should credit quality disclosures include such detail as numerical modifiers?

A—Credit quality modifiers are not a required disclosure.

1.9.6. Q—A certain external investment pool is a 2a7-like pool as defined by Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools, as amended, but is not rated. Is a credit risk disclosure required?

A—Yes. Although the SEC’s Rule 2a7 of the Investment Company Act of 1940 includes restrictions on the type of investments a pool may hold, a 2a7-like pool may still be exposed to
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credit risk. If the pool is rated, the credit quality of the 2a7-like pool should be disclosed, or if the pool is unrated, the disclosure should indicate that fact.

1.9.7. Q—Is a debt security issued by a federal government-sponsored enterprise (GSE) that has only the implicit guarantee of the federal government and is held by a state or local government as an investment subject to credit risk disclosures?

A—Yes. A credit risk disclosure is required if a GSE only has the federal government’s implicit guarantee (paragraph 7 of Statement 40, as amended). However, as the structure of financial markets change, whether a GSE has an implicit or an explicit guarantee may change. A credit risk disclosure is based on the status of a federal guarantee as of the date of the financial statements.

1.9.8. [Not used in GASBIG 2015-1]

1.9.9. Q—A government limits its corporate debt investments to the two highest credit quality ratings. Is it required to disclose dollar values for each rating, or may the disclosure indicate that all corporate debt investments have the two highest ratings?

A—As defined in the standard, credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Although credit risk exposure is not a quantitative risk, the magnitude of a government’s credit risk exposure may be conveyed by disclosing the dollar value for each rating category. A disclosure indicating that all corporate debt investments have the two highest ratings as issued by NRSROs is not sufficient to clearly communicate the credit risk of those investments.

1.9.10. Q—are repurchase agreements and bankers’ acceptances subject to credit risk disclosures?

A—Repurchase agreements are not subject to credit risk disclosures if the securities underlying the repurchase agreement are exempt from credit risk disclosures. Securities underlying repurchase agreements often take the form of U.S. Treasuries or obligations explicitly guaranteed by the U.S. government, which are not considered to have credit risk. Bankers’ acceptances constitute an irrevocable primary obligation of the accepting bank, a contingent obligation of the drawer, and an obligation of any other institution that has endorsed the acceptance. However, because bankers’ acceptances are not obligations of the U.S. government, nor are they explicitly guaranteed by the U.S. government, they are not afforded the credit risk exemption provided in paragraph 7 of Statement 40, as amended, and their credit risk should be disclosed. (See also Question 1.43.3, which addresses custodial credit risk for investments in repurchase agreements.)

1.9.11. Q—After the close of the fiscal year but before the financial statements are prepared, a debt investment’s credit quality rating is downgraded. Should this be reported as a subsequent event?

A—Statement No. 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, as amended, requires disclosure of a subsequent event when the omission of the disclosure would cause the financial statements to be misleading. Whether or not a debt investment’s credit quality rating downgrade is significant to the reporting entity’s financial statements calls for the exercise of professional judgment. Restrictions on the types of investments allowed by legal or statutory provisions and by the
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government’s investment policy may prevent a government from having a large credit risk exposure in a single entity’s investment (concentration of credit risk). A single investment’s downgrade after the date of the financial statements generally may not represent a subsequent event requiring disclosure. However, should a government have a concentration of credit risk in a single investment, credit quality rating downgrades after the date of the financial statements may expose the government to a significantly higher level of credit risk that may require disclosure as a subsequent event. For example, a bond downgraded after the date of the financial statements on account of a bankrupt issuer may indicate a large investment loss for the government. If the value of the investment is significant to the government’s total investment portfolio, disclosure of such an event may be required.

1.9.12. Q—A government invests in a mutual fund that restricts its investments to obligations of the U.S. government or those explicitly guaranteed by the U.S. government. Is the credit quality rating of this mutual fund required to be disclosed?

A—Yes. Despite the holdings within the fund’s portfolio, mutual funds are exposed to some degree of credit risk. Although certain U.S. government securities and agencies are guaranteed, mutual funds that invest in these securities are not.

1.9.13. Q—If a bond mutual fund is unrated but substantially all of the underlying securities within the fund are rated, should the government disclose the average rating of the underlying investments?

A—A mutual fund may not be rated by NRSROs for various reasons, including the inability to rate certain of the holdings within the mutual fund portfolio. Statement 40, paragraph 7, as amended, requires that the government disclose the fact that the mutual fund investment is not rated.

1.10 Custodial Credit Risk

1.10.1. [Not used in GASBIG 2015-1]

1.10.2. [Not used in GASBIG 2015-1]

1.10.3. Q—Is collateral associated with securities lending or derivative-instrument activities subject to custodial credit risk disclosures?

A—Both collateral associated with securities lending and that associated with derivative-instrument activity are subject to custodial credit risk disclosures only when the collateral is reportable as an asset of the government. Paragraph 7 of Statement No. 28, Accounting and Financial Reporting for Securities Lending Transactions, provides that “[s]ecurities lending transactions collateralized by letters of credit or by securities that the governmental entity does not have the ability to pledge or sell unless the borrower defaults should not be reported as assets and liabilities in the balance sheet.” Paragraph 10 of Statement 40 addresses the disclosure requirements for securities lending collateral. Collateral associated with derivative-instrument activities is subject to the same exception-based custodial credit risk disclosures provided for in paragraph 8 or 9 of Statement 40 depending upon the nature of the collateral (deposit or investment).
1.10.4. Q—Are investments in money market funds—sometimes referred to as money market mutual funds—subject to custodial credit risk disclosures?

A—No. Money market funds are a type of open-ended mutual fund that are not subject to custodial credit risk disclosures (paragraph 9 of Statement 40).

1.11 Definition of Securities

1.11.1. Q—Uninsured deposits and investment securities may be exposed to custodial credit risk based on the custody of collateral and investment securities as identified in paragraphs 8 and 9 of Statement 40. What are “securities”? Do governments have investments that are not “securities”?

A—Investment securities are transferable financial instruments that evidence ownership or creditorship. Securities that often are held by or pledged to state and local governments include U.S. Treasury bills, notes, and bonds; federal agency and instrumentality obligations, including asset-backed securities; corporate debt instruments, including commercial paper; corporate equity instruments; negotiable CDs; bankers’ acceptances; shares of closed-end mutual funds; and shares of unit investment trusts. Securities are issued in both paper and book entry form and include those instruments that could expose a government to a potential for loss if another party has custody of them. (See Questions 1.20.1, 1.21.1, 1.22.1, and 1.23.1.)

Investments without a transferable financial instrument that evidences ownership or creditorship are not securities. Thus, the term securities does not include investments made directly with another party (for example, some limited partnerships), real estate, or direct investments in mortgages and other loans. Investments in open-end mutual funds, pools managed by other governments, annuity contracts, and guaranteed investment contracts (GICs) also are not considered securities for purposes of custodial credit risk classification as discussed in Questions 1.48.2, 1.50.1, 1.52.1, and 1.54.1, respectively.

Investments that are not securities are not disclosed as being exposed to custodial credit risk. This treatment is based on paragraph 9 of Statement 40. However, this exemption from custodial credit risk disclosure does not mean that such investments are without credit risk. Instead, it means that they are not securities that are exposed to custodial credit risk.

1.12 Custody of Securities

1.13 The Identity of the Securities Custodian

Note: Proper evaluation of custodial credit risk depends on the identity of the investment securities custodian and how the investment securities are held. This section on the identity of the investment securities custodian should be read together with the section on how the investment securities are held, starting at Question 1.17.1.

1.14 Counterparty

1.14.1. Q—What is a counterparty for purposes of determining custodial credit risk?
A—For purposes of custodial credit risk, a counterparty pledges collateral or repurchase agreement securities to the government, or sells investment securities to or buys them for the government. For collateral on deposits in financial institutions, the pledging financial institution is a counterparty. For brokerage accounts, the broker or dealer is a counterparty. For repurchase agreements, the seller-borrower in the repurchase agreement is a counterparty. More than one party can be a counterparty in a single transaction for purposes of custodial credit risk. For example, the counterparties in a repurchase agreement can include both the seller-borrower and the broker-dealer or financial institution that acquires the repurchase agreement for the government.

Usually, investment securities are purchased in the securities markets—for example, the over-the-counter market and the stock markets. In these transactions, governments and perhaps even their brokers will not know the party that previously owned the securities. Although that selling party technically is a counterparty, the operations of these markets effectively eliminate that party’s identity and thereby its rights to the securities. Instead, the important counterparty for purposes of custodial credit risk of investments that are acquired in securities market transactions is the acquiring broker-dealer.

However, if investment securities are acquired outside of the securities markets—for example, through a direct or private purchase—identifying the party that previously owned them is important to proper disclosure of custodial credit risk. This is because the previous owner may be able to retain access and rights to the securities. To properly disclose the investment in this situation, the preparer should evaluate whether the custodian is either the previous owner of the securities or the trust department or agent of the previous owner. In these transactions, either the government’s investment officers or the acquiring broker-dealer will know the identity of the previous owner.

1.14.2. Q—Can an investment adviser or manager be a counterparty for the purpose of determining custodial credit risk?

A—An investment adviser may or may not be a counterparty. If an adviser’s only function in the acquisition of investments is to advise on which types of investments or which particular investments to acquire, the adviser is not a counterparty for purposes of custodial credit risk. On the other hand, if the adviser acquires those investment securities for the government, whether working as a broker or through a broker, the adviser is a counterparty.

An investment manager is responsible for managing a portfolio, including acquiring investments, and is a counterparty because of the acquisition function.

1.15 Agent

1.15.1. Q—The term agent is used in both Statements 3 and 40, as amended. What does the term agent mean?

A—For purposes of custodial credit risk disclosures, the term agent as used in Statements 3 and 40, as amended, is meant within a narrow area of responsibility—that of custodial agent only. A government’s custodial agent has a contractual relationship with the government to hold, at the discretion of the government, securities owned by or pledged to the government.
1.15.2. Q—If a counterparty is under contract to serve as a government’s custodial agent, are the investment securities held by the agent exposed to custodial credit risk?

A—If the counterparty has custody, the investment securities are exposed to custodial credit risk as provided for by paragraph 9 of Statement 40. If a financial institution or broker-dealer is both the government’s counterparty and the custodial agent in the transaction, its identity as the counterparty takes precedence in determining whether deposits and investment securities are exposed to custodial credit risk. That is, custodial credit risk disclosures are required if the investment securities held by the counterparty are uninsured and are not registered in the name of the government.

1.15.3. Q—The government’s custodial agent was the broker for some investments; however, other investments were acquired through a different brokerage firm. Are all the investment securities that the custodian is holding exposed to custodial credit risk?

A—No. Only those uninsured investment securities, not registered in the name of the government, for which the securities custodian is the counterparty are exposed to custodial credit risk.

1.15.4. Q—Usually, a government’s custodial agent settles an investment transaction by paying for the securities when they are delivered. Does being involved in settlement mean that the custodial agent is buying the securities for the government and is thus a counterparty?

A—No. Being involved in the settlement function does not confer counterparty status on a party that otherwise is the government’s custodial agent only. “Buying securities for the government” means placing the order for the securities, not simply paying for them. Settlement is a normal function for a securities custodian.

1.15.5. Q—What makes a custodian an agent of the government? Does the government have to select the custodian? Is a written contract needed?

A—A securities custodian is the government’s agent if it acts as the representative of the government to protect the government’s rights in the securities. In evaluating whether the custodian is the government’s agent, the preparer should examine the conditions under which the custodian will release the securities. Factors of (a) who selects the custodian and (b) written evidence may provide additional evidence of an agency relationship.

Releasing Securities: The function of a custodial agent is to hold and release securities. To determine whether the custodian is the government’s agent, one should determine whether the custodian acts at the direction of the government in holding and releasing securities. The more important of these two functions is the release of securities because improper release can expose the government to risk of loss.

A custodian that is the government’s agent will release the government’s investment securities to the government or to someone else at the government’s direction without having to obtain approval from anyone else. Further, the government’s custodial agent will not release the securities to someone other than the government without the government’s approval. A custodian that releases securities owned by the government at someone else’s direction and without the government’s approval is not acting as the government’s agent.
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The conditions for release of collateral or repurchase agreement securities pledged to the government differ from the conditions for release of securities owned by the government. This difference is because both the pledgee government and the pledgor counterparty have rights in the securities. A custodian that is the government’s agent will not release the securities to the pledgor counterparty or to someone else at the pledgor’s direction unless the government (a) approves, (b) informs the custodian it has completed its transaction with the pledgor counterparty, or (c) commits an act of default. Because of the pledgor counterparty’s rights in the securities, however, a custodian that is the government’s agent probably also will not release the securities to the government or to someone else at the government’s direction unless the pledgor counterparty also (a) approves or (b) commits an act of default. This requirement for the custodian also to protect the rights of the pledgor counterparty does not necessarily diminish the fact that the custodian is the government’s agent. (See further discussion of three-party custodial arrangements in Questions 1.36.1 and 1.53.1.) If a custodian will release collateral or repurchase agreement securities to the pledgor counterparty without the approval of the government, the custodian is not acting as the government’s agent, even if the government subsequently is informed of the release.

Often, a collateral pledge agreement or repurchase agreement permits the pledgor to substitute securities of equal or greater value with the custodian without the specific approval of the pledgee government. Such a situation would not change the fact that the custodian is the government’s agent because the collateral pledge or repurchase agreement constitutes the government’s prior approval for the release of the securities. However, if the custodian permits substitution by the pledgor counterparty in the absence of the government’s current or prior approval, evidence that the custodian is the government’s agent would be diminished or eliminated.

Selection of Custodian: The government’s selection of the custodian would provide additional evidence that the custodian is the government’s agent. However, a custodian that is not selected by the government may still be the government’s agent. For example, the custodian for a tri-party repurchase agreement program usually is selected by the repurchase agreement counterparty. However, the tri-party custodial agreement establishes the custodian as agent both of the government and of the repurchase agreement counterparty. On the other hand, the government’s selection of the custodian does not automatically establish an agency relationship between the custodian and the government. That is, the custodian still has to represent the government in the custody transaction.

Written Evidence: In many cases, an agency relationship between a government and a custodian is established in writing. Sometimes, this writing is a contract. In other cases, legal provisions serve as written evidence of the nature and scope of the custodian’s responsibilities. For example, the statutes that require deposits with financial institutions to be collateralized often provide for the types of entities that may hold the collateral and the responsibilities the custodian has to protect the government’s interests in the collateral.

The absence of written evidence does not mean the custodian cannot be the government’s agent. However, the preparer would need to more closely evaluate the actual relationship between the government and the custodian to determine whether an agency relationship exists. That is, in the absence of writing, the matters of how the custodian’s operations protect the government’s interests and who selects the custodian become more important in establishing that the custodian is the government’s agent.
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1.15.6  Q—Is a legal opinion needed to determine whether a custodian is the government’s agent?
A—Although agency is a matter of law, preparers generally have not found it necessary to obtain a legal opinion to determine whether the custodian is the government’s agent. This is because custodial arrangements usually are clear concerning whether the custodian is acting as the government’s agent. However, if the factors discussed in Question 1.15.5 have been considered and questions continue about which party the custodian is representing, the preparer could consult with the government’s legal counsel.

1.16 Special issues concerning trust departments and bank holding companies

1.16.1  [Not used in GASBIG 2015-1]

1.16.2  Q—Is a financial institution’s safekeeping department the same as a trust department?
A—No. A financial institution provides safekeeping services as a normal business function. A trust department is a separate fiduciary function authorized by and regulated under various state and federal laws. The term trust department as used in paragraphs 8 and 9 of Statement 40 refers only to the trust departments of financial institutions such as commercial banks and savings banks. Assets held by those trust departments as custodial agents for outside parties are considered legally separate from the assets of the financial institution and are held strictly on a fiduciary basis. Safekeeping departments are not considered trust departments for the purpose of custodial credit risk. Custody by a safekeeping department should be evaluated as custody by a financial institution rather than as custody by a trust department.

1.16.3  [Not used in GASBIG 2015-1]

1.16.4  Q—Are investment securities exposed to custodial credit risk if they are both acquired through and held in custody by the same trust department?
A—Yes. The investment securities would be exposed to custodial credit risk because they are held by the counterparty. In this situation, there is no segregation between the acquisition and custody functions. As discussed in Question 1.15.2, custody by the counterparty always results in exposure to custodial credit risk regardless of other relationships.

1.16.5  Q—Governments often use trust departments as trust or fiscal agents—for example, to hold bond reserves or amounts that shortly will be used to pay debt principal and interest. In these situations, the trust department both acquires and holds investment securities under the provisions of a trust agreement that details the trust department’s fiduciary responsibilities. Are these “amounts held in trust” exposed to custodial credit risk?
A—Statement 40, as amended, requires custodial credit risk disclosures for investment securities when the counterparty is the custodian (see Questions 1.15.2 and 1.16.4) but does not address the particular situation of trust agreements. Professional judgment is necessary in light of the actual responsibilities of the trustee to determine whether the trustee is acting in the stead of the public funds treasurer or as the treasurer’s counterparty.

1.16.6  Q—What is a bank holding company? Are deposits and investment securities considered to have custodial credit risk when the counterparty and the custodial agent are subsidiary banks of the same bank holding company?
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A—A bank holding company controls one or more banks and may own subsidiaries with operations closely related to banking.\(^2\) When branch banking was severely limited, bank holding company statutes allowed banking systems to develop by permitting common ownership of several banks. Generally, the Bank Holding Company Act provides that a holding company has control over a bank if it owns, controls, or holds 25 percent or more of the voting stock of the bank.

Federal banking law recognizes a relationship between affiliated banks, despite their separate legal form. Through the cross-guarantee provisions of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, an insured depository institution is liable for any loss incurred by the Federal Deposit Insurance Corporation (FDIC) in connection with the default of or assistance provided to a commonly controlled insured depository institution.\(^3\)

When the counterparty and the custodial agent are subsidiary banks of the same bank holding company, the deposits and investment securities are exposed to custodial credit risk. If, however, the deposits are insured, the deposits are not exposed to custodial credit risk. Depository insurance is covered in Sections 1.29–1.34.

1.16.7. Q—Is a deposit exposed to custodial credit risk if collateral is pledged by one affiliate of a bank holding company and it is held in the trust department of another affiliate bank in the government’s name?

A—No. The custodial trust department would be viewed as the counterparty’s trust department and the deposit would be held in the government’s name. No custodial credit risk disclosures would be required.

1.16.8. [Not used in GASBIG 2015-1]

1.16.9. [Not used in GASBIG 2015-1]

1.17 How the Investment Securities Are Held

**Note:** Proper evaluation of custodial credit risk depends on the identity of the securities custodian and how the securities are held. This section on how the securities are held should be read together with the section on the identity of the securities custodian, starting at Question 1.14.1.

1.17.1. Q—How does one determine whether a security is or is not “held in the government’s name”?

A—Holding in the government’s name means that the custodial systems and records indicate the government’s rights in the securities. The way in which securities are “held in the government’s name” differs between investment securities and collateral and repurchase agreement securities. There also are differences between paper and book entry securities. Questions 1.18.1–1.25.1 discuss issues relating to this criterion in different circumstances in which the custodian is a party other than the counterparty.

\(^2\)For the purpose of this guidance, controlled banks and nonbank subsidiaries are described as being affiliates of one another.

\(^3\)12 United States Code (U.S.C), Section 1815(e).
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1.18 Collateral and repurchase agreement securities versus investment securities

1.18.1. Q—For collateral on deposits with financial institutions and for securities underlying repurchase agreements, do custodial systems and records have to show that the government is the owner of the securities to be considered “held in the name of the government” and consequently exempt from custodial credit risk disclosures? If not, what should the custodian’s systems and records show? Are there differences in how the criterion is applied to collateral and repurchase agreement securities compared with investment securities?

A—If securities are pledged to a government, whether to secure deposits or to secure repurchase agreements, the custodian’s records and its system of holding the securities would not show that the government is the owner. The pledgor is the owner. The records and systems would, however, have to show that the government is the pledgee to be considered “held in the name of the government” and consequently be excluded from custodial credit risk disclosures.

The custodial systems and records needed to meet this criterion for investment securities are somewhat different. The government is the owner of these securities and, to be considered “held in the name of the government” and excluded from custodial credit risk disclosures, the custodian’s records and its system of holding the investment securities have to show that the government, and not the custodian or some other party, is the owner of the securities.

1.19 Paper securities

1.20 Registered in the government’s name

1.20.1. Q—Some investment securities are issued in paper form; that is, a certificate provides evidence of ownership. Sometimes security certificates are registered in the government’s name. How does one determine if these investment securities are “held in the name of the government” and consequently not exposed to custodial credit risk if they are registered in the government’s name and held by a custodian?

A—If investment securities are registered in the government’s name and they have not been endorsed, they are not exposed to custodial credit risk. If the government has endorsed the registered securities, they should be evaluated as bearer securities or as street name or nominee name securities as discussed in Questions 1.21.1 and 1.22.1, respectively.

1.21 Bearer securities

1.21.1. Q—Some paper securities are issued in or endorsed to bearer form; the bearer or holder of the certificate is presumed to be the owner. Are bearer securities owned or pledged to a government and held by a custodian subject to custodial credit risk disclosures?

A—To meet the “held in the name of the government” criterion for bearer securities owned by the government, two conditions have to exist. First, the custodian is required to have physical custody of the securities (or, as discussed in Question 1.24.1, another party should be holding the physical securities in the name of the custodian for the benefit of the custodian’s clients). Second, the custodian’s internal records should identify the government as the owner of the bearer securities. For bearer securities pledged to the government as collateral for deposits or for repurchase agreements, the only difference for meeting the criterion is that the custodian’s internal records should identify the government as the pledgee of the securities.
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1.22 Street name and nominee name registration

1.22.1. Two terms often used in describing how a government’s investment securities are registered are street name and nominee name. What does it mean to have securities in street or nominee name?

A—Fundamentally, investment securities held in street name and nominee name are the same for custodial credit risk purposes. Both terms indicate that the investment securities are issued in or endorsed to the name of a securities depository, broker-dealer, or other financial services company, on behalf of the true beneficial owners of the investment securities.

The term nominee name denotes arrangements used principally by institutional investors and financial agents (such as bank and trust companies) for the registration of securities held by them for their own account or the accounts of customers. In most instances, the nominee is a partnership formed solely for the purpose of acting as record holder of the investment securities. Perhaps the largest use of nominee name arrangements is by securities depositories on behalf of their participants.

The term street name is used by the securities industry to denote securities registered in the name of a brokerage firm or its nominee. Such securities frequently belong to customers of the firm.

Investment securities are held in street or nominee name to allow the transfer of the beneficial ownership of securities from one party to another without re-registration and with a minimum of physical movement of the paper. The use of street or nominee names for the registration of paper securities does not change the fact that a custodian is “holding in the name of the government.” This is because of the presumption underlying the use of street or nominee name registration that another party may be the true beneficial owner.

Investment securities in the nominee name of a securities depository are referred to as “book entry” securities. Questions 1.23.1–1.23.4 discuss how to evaluate book entry systems for purposes of applying the “held in the name of the government” criterion. For investment securities owned by a government and registered in or endorsed to the street or nominee name of the custodial broker-dealer or other financial agent, the “held in the name of the government” criterion is met if the custodian’s internal records identify the government as the owner of the investment securities. If the securities are pledged to the government as collateral for deposits or for repurchase agreements, the only difference in meeting the criterion is that the custodian’s internal records should identify the government as the pledgee of the securities.

1.23 Book entry securities

1.23.1. What is a book entry system for investment securities? How are investment securities in book entry systems owned by or pledged to governments?

A—Book entry is a system that eliminates the need for physically moving bearer-form paper or re-registering securities certificates to transfer ownership. There are two types of book entry systems. The first is a system operated by or for the issuer of the securities. An example is the system operated by the Federal Reserve for the securities of the U.S. Treasury and various U.S. government agencies. The securities in the Federal Reserve System are referred to as book entry securities; these securities do not exist in paper form, but only as entries on the
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automated records of the Federal Reserve System. The second type of book entry system is a securities depository system, such as that operated by the Depository Trust Company (DTC). In a depository system, paper securities are held by the depository in bearer form or registered in the depository’s nominee name. A depository also may hold securities in the Federal Reserve’s book entry system.

A government’s access to the investment securities in these book entry systems generally is through the accounts of members or participants of the system, generally financial institutions and broker-dealers. Governments do not have their own accounts to hold book entry securities except in limited situations involving the Federal Reserve and Treasury systems as described in Question 1.23.3. (See also Question 1.36.1 on Federal Reserve pledge accounts.) Members and participants can use separate accounts for securities belonging to their customers. Different systems refer to these customer accounts differently—for example, using the term custodial or fiduciary. Some depository system participants have opened separate accounts for large governmental investors, such as retirement systems.

For a government’s book entry investment securities to meet the “held in the name of the government” criterion, two conditions have to exist. First, the investment securities should be held in the book entry system in an account designated as a customer account. (Alternatively, the investment securities can be in a street name or nominee name account. As discussed in Question 1.22.1, there is the presumption with the use of street and nominee names that another party may be the true beneficial owner.) Second, the member or participant custodian’s internal records should identify the government as the owner or pledgee of the securities. (See also Question 1.24.1 on the use of correspondents.)

1.23.2. Q—If investment securities are in the Federal Reserve System or a depository book entry system, can the operator of the system be considered the custodian of the investment securities?

A—No, except for situations of joint custody of pledged securities. (See Question 1.36.1 for an example of a joint custody arrangement.) Book entry system operators do not control the movement of securities among members or participants or among a member’s or participant’s separate accounts. The systems are simply the “vault” in which securities are held. Governments generally do not have their own accounts in the Federal Reserve or DTC book entry system; they have access to those systems through the accounts of the Federal Reserve members or DTC participants. Usually, only financial institutions and broker-dealers are members or participants. The Federal Reserve or DTC generally should not be considered to be the party that holds the securities. Instead, the custodian of book entry securities generally is the member or participant in whose account the investment securities are held. (See also Question 1.24.1 on the use of correspondents.)

1.23.3. Q—What kinds of accounts may governments maintain with or through Federal Reserve Banks?

A—Described below are the three types of accounts that permit governments to directly hold U.S. government and federal agency book entry securities. Governments can obtain detailed information about these accounts from the district banks of the Federal Reserve. (See also Question 1.36.1 on Federal Reserve pledge accounts.)

Book entry safekeeping accounts for state treasurers: One financial officer of a state, generally the state treasurer, may have up to two accounts in only one Federal Reserve Bank or Branch
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for the safekeeping of securities—an investment account for the state’s own securities and a customer account for the securities of the local governments in the state. Except as discussed below, the states are not allowed to have accounts with which to make funds (cash) transactions. Therefore, for the state to purchase or sell securities at the same time it delivers or receives cash, the state has to work through the accounts of a financial institution that has both a funds account and a securities account with the Federal Reserve. Securities purchased and sold have to be transferred between the state’s safekeeping account and the financial institution’s securities account. Because of this, safekeeping accounts are practical mainly for securities that are to be held on a long-term basis.

TREASURY DIRECT: A government also may have an account with the U.S. Treasury in the Bureau of Public Debt’s book entry system known as TREASURY DIRECT. Any individual or organization may maintain an account in the TREASURY DIRECT system. Like the state treasurers’ safekeeping accounts, TREASURY DIRECT accounts may not be used for cash transactions and are practical mainly for holding securities on a long-term basis.

State-owned limited-purpose trust companies: A state may form a limited-purpose trust company if permissible under the laws of the state. Such a trust company ordinarily would be eligible to obtain access to an account at a Federal Reserve Bank which would permit funds transfers and book entry security transactions. The state’s account at the trust company would enable the state to take or make delivery of book entry securities at the same time it delivers or receives funds without going through the accounts of a financial institution.

To have a funds account, a state is required to establish a limited-purpose trust company through an act of its legislature. The trust company is required to obtain a guaranty of its obligations from the state, and the state is required to waive its sovereign immunity for any claims the Federal Reserve has for any liability the trust company incurs with respect to the funds account.

1.23.4. Q—A government invests in commercial paper issued by a corporation. No paper certificate is issued; instead, the corporation operates a book entry system for those securities. Are these investment securities that are subject to custodial credit risk disclosures?

A—If the government is not the owner of record, custodial credit risk should be evaluated in the same manner as it would be with other book entry investment securities. (See Question 1.23.1.)

1.24 The custodian’s use of correspondents

1.24.1. Q—What if the government’s investment securities are not in the possession of the custodian; that is, what if the securities are in the possession of another party that serves as the custodian’s custodian? What conditions have to be evaluated to properly determine whether the investment securities are held in the government’s name?

A—This is a fairly common situation because many financial institutions and broker-dealers use “correspondents” for custody of securities, both those they own and those they hold for clients. To simplify the following discussion, the named custodian is referred to as “Custodian A” and the correspondent is “Custodian Z.”

For Custodian A to be found to be holding the government’s investment securities in the name of the government, Custodian Z’s records and procedures should recognize that the investment
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Securities belong to Custodian A’s clients. Therefore, Custodian Z should hold the investment securities in the name of Custodian A for the benefit of Custodian A’s clients. For this to be true, two conditions should exist. First, Custodian Z should hold the investment securities in bearer form, in street or nominee name, or in a customer account in a book entry system. Second, Custodian Z’s records should show that the investment securities are owned by Custodian A’s clients. That is, Custodian A should be holding the investment securities in a street name, nominee name, or customer account with Custodian Z. Custodian Z does not need to know which investment securities are owned by which of Custodian A’s individual clients.

If these two conditions do not exist, Custodian A cannot be found to be holding the investment securities in the name of the government. This is because either (a) Custodian Z is not holding in a custodial position for Custodian A or (b) Custodian Z believes the investment securities are owned by Custodian A. In either case, the government’s rights to the investment securities are not clear—and the government should disclose the investment securities as being exposed to custodial credit risk.

However, if Custodian Z knows and acknowledges that specific investment securities are owned by or pledged to the government, the investment securities would not be exposed to custodial credit risk. However, in the absence of special arrangements, it is unlikely that a correspondent will know and acknowledge that specific investment securities are owned by or pledged to the government.

1.24.2 Q—A government purchases investment securities from Bank A and uses an unaffiliated Bank Z for custody. Bank Z is the government’s regular custodial agent and holds the investment securities in the government’s name. However, Bank Z uses Bank A as its correspondent for settlement of all transactions and safekeeping of all securities. Bank A is holding the securities for Bank Z on behalf of Bank Z’s customers. Are these investment securities subject to custodial credit risk disclosures?

A—No. The investment securities are not exposed to custodial credit risk because Bank Z is performing the custody function for the government despite its use of Bank A as a correspondent. The facts of the question show that Banks A and Z are unaffiliated and the government’s use of Bank Z for custody and Bank Z’s use of Bank A as a settlement and safekeeping agent are ordinary and regular business arrangements.

1.25 Obtaining information about how securities are held

1.25.1 Q—How does a government obtain information about how its investment securities are being held?

A—The government’s investment officers and external investment advisers and managers are able to supply much of the information that financial statement preparers need about how investment securities are being held. A custodian that is the government’s agent also will be able to provide information about the form of the investment securities (bearer, registered, or book entry) and whether correspondent custodians, street or nominee names, and custodial or fiduciary book entry accounts are being used. Safekeeping or trust receipts or some other notification from the custodian (such as periodic statements) and written confirmations with the custodian can provide information about whether its internal records identify the government as the owner or pledgee of securities.
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If a custodian that is the counterparty’s trust department or agent provides the government with notification about securities owned by or pledged to the government, that custodian is able to provide the government with the necessary information about custodial operations.

If a custodian that is the counterparty’s trust department or agent does not provide the government with safekeeping or trust notices, it also may not be a useful source of information about custodial operations. This is because the custodian may not be “holding in the government’s name” and may not be aware that the government has a valid interest in the securities. In this situation, as well as situations in which the counterparty is the custodian, information can be obtained from or through the counterparty. Although the deposits and investments would be subject to custodial credit risk disclosures in these situations, understanding the custodial operations will allow the government to be better informed about the nature of the custodial credit risk in the arrangement.

1.26 Language and Format of the Presentation

1.26.1. [Not used in GASBIG 2015-1]
1.26.2. [Not used in GASBIG 2015-1]
1.26.3. [Not used in GASBIG 2015-1]
1.26.4. [Not used in GASBIG 2015-1]
1.26.5. [Not used in GASBIG 2015-1]
1.26.6. Q—Is a reconciliation from the disclosures required by Statements 3 and 40, as amended, to the statement of net position/balance sheet required? If it is, there appears to be a conflict between Statements 3 and 40, as amended, and Statement 9. Statement 9 provisions may result in statement of net position/balance sheet reporting of “cash and cash equivalents” that differs from deposits. How can a reconciliation between disclosures required by Statements 3 and 40, as amended, and the statement of net position/balance sheet be accomplished given the provisions of Statement 9? How do the provisions of Statement 14 affect the reconciliation?

A—Statements 3 and 40, as amended, do not require a reconciliation between the disclosures required by those Statements and the statement of net position/balance sheet. However, some preparers have presented one. The different perspectives on financial reporting taken in Statements 3 and 40 and in Statement 9 change the nature of the reconciliation, especially by adding some reconciling items. However, some preparers may continue to believe a reconciliation between the disclosures and the statement of net position/balance sheet would be useful to financial statement users.

If a government reports cash and cash equivalents in its statement of net position/balance sheet, that account might exclude some items that are treated in the disclosures required in Statements 3 and 40, as amended, as deposits—for example, nonnegotiable CDs with an original maturity over three months. Cash and cash equivalents also might include some items that are treated in disclosures required by Statements 3 and 40, as amended, as investments—for example, commercial paper and bankers’ acceptances. Statement 9, footnote 5, also allows many investments in open-end mutual funds and external and internal cash management or investment pools to be reported as cash. These funds and pools are reported as investments in
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disclosures required by Statements 3 and 40, as amended. All of these items of difference, therefore, would be part of a reconciliation between the disclosures required by Statements 3 and 40, as amended, and the statement of net position/balance sheet if one is presented.

The provisions of Statement 14 result in separate Statements 3 and 40 disclosures for discretely presented component units. In addition, it is possible that not all of those component units will require Statements 3 and 40 disclosures. Because Statement 14 requires that disclosures distinguish between information pertaining to the primary government and that of its discretely presented component units, it follows that a reconciliation could similarly distinguish between the primary government and its discretely presented component units. For the primary government total column presented on the statement of net position, the most likely approach would be to provide reconciliations for the primary government (including its blended component units), the relevant discretely presented component units, and any fiduciary funds.

1.27 Specific Issues on Deposits with Financial Institutions

1.28 Valuation and Presentation Issues

1.28.1. Q—Should a deposit’s custodial credit risk be based on the bank balance or the book balance of the deposits?

A—The bank balance of a deposit is the amount shown on the financial institution’s records, and the book balance is the amount shown on the government’s records. Differences, if any, result primarily from deposits in transit and outstanding checks. The bank balance—the amount for which the financial institutions actually are liable as of the government’s financial reporting date—is the government’s risk exposure. This disclosure is intended to communicate the credit risk associated with deposits at financial institutions. Classifying deposits based on the book balance would not achieve the objective of this disclosure.

1.28.2. Q—In disclosing custodial credit risk of deposits with financial institutions, should uncollected funds be included as part of the bank balance?

A—Generally, uncollected funds are not included in the bank balance of deposits exposed to custodial credit risk. As a practical matter, however, they often are. Uncollected funds arise when a government makes a deposit in a financial institution and the government’s account is credited for the deposit, but the depository financial institution has not yet received the money from the payor’s financial institution. The amount of such uncollected funds can be significant, in some cases amounting to millions of dollars daily.

If the FDIC liquidates a financial institution, the authority of the liquidation trustee is limited to those funds actually in the possession of the financial institution at the time it enters into liquidation. Funds collected after that time would be returned to the depositor rather than placed in the pool of assets managed by the liquidation trustee. Therefore, uncollected funds are not exposed to credit risk from the depository financial institution and should not be considered part of the bank balance.

Governments may not know precisely when their bank collects funds. Governments will know their posted balance. Balances are posted when deposits are made, and the posted balance obviously would include uncollected funds. Therefore, the posted balance would be greater than the collected funds balance.
Using the posted balance for deposits is a practical alternative to trying to determine the collected funds balance. If a portion of the posted balance is uncollateralized and uninsured, and the preparer believes that a significant portion of those deposits may represent uncollected funds, the preparer may wish to consult with the financial institution to determine the collected funds balance, so as not to misrepresent the custodial credit risk exposure of the government’s deposits.

Deposits made into an account may not be available for withdrawal for some period of time. Using the available balance as the bank balance also may be practical, provided that a financial institution’s policy for making funds available to a government is consistent with the financial institution’s collection of those funds. In some cases, however, it would not be appropriate to use the available balance. These would be cases in which the period between posting and availability of a deposit does not coincide with the actual collection of funds by the depository financial institution. As a result, the available balance may not include funds that have been collected, because of a lag between when a bank collects funds and when the bank allows its customers to use the funds. Therefore, the available balance may be less than the collected funds balance. Using the available balance in this situation would not fully report the government’s credit risk exposure in deposits with financial institutions.

1.28.3. Q—In disclosing deposits exposed to custodial credit risk, should accrued interest be included as part of the bank balance?

A—Yes. Accrued interest should be included in the bank balance for purposes of reporting custodial credit risk. The deposit disclosure is based on bank balance, which should measure the full liability a financial institution has for a government’s deposits, including accrued interest.

1.28.4. [Not used in GASB 2015-1]

1.28.5. Q—How should governments value the collateral covering deposits for purposes of applying paragraph 8 of Statement 40? That is, should they use fair value or par value?

A—Governments should use the fair value of collateral rather than par value or any other measure. Using fair value will express the amount of protection a government has to offset the credit risk associated with the deposits. Quantifying custodial credit risk based on the par value of collateral would not achieve this objective.

1.28.6. Q—In determining custodial credit risk for deposits, what does “uncollateralized” mean? Should the distinction between collateralized deposits exposed to custodial credit risk (Statement 40, paragraphs 8b and 8c) and “uncollateralized” deposits (paragraph 8a) be made in the note disclosure?

A—There is a fundamental difference in risk between deposits that are not collateralized and those that are, even though the collateral is held by the pledging financial institution, or by its trust department or agent but not in the government’s name. (If an uninsured deposit is not collateralized, a government has no security in the event of default. If an uninsured deposit is collateralized, a government does have security against such a default, even though custodial arrangements may pose potential risk.) Therefore, even though all of these situations subject a government to custodial credit risk, a government’s note disclosure should appropriately describe its particular situation.
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For example, if a government’s deposits are not collateralized, the note disclosure should describe that deposits exposed to custodial credit risk are uncollateralized. If a government’s deposits are collateralized but the custodial arrangements result in the deposits being exposed to custodial credit risk, the government should use language that describes that situation—for example, “collateralized with securities held by the pledging financial institution.” For the note to describe this condition as uncollateralized could mislead the reader about the nature of the risk. If a government has some deposits that are uncollateralized and some that are collateralized but considered to have custodial credit risk because of the custodial arrangements, the government’s description of custodial credit risk could indicate both conditions. See Illustration 8 in nonauthoritative Appendix B1-2 for an example disclosure.

1.29 Deposit Insurance

1.29.1. [Not used in GASB/GASB 2015-1]

1.29.2. Q—Paragraph 8 of Statement 40 states that one of the criteria for evaluating whether a deposit is exposed to custodial credit risk is that it is not covered by depository insurance. What constitutes insurance for this purpose?

A—Depository insurance includes federal deposit insurance, such as that maintained by the FDIC; state deposit insurance; and multiple financial institution collateral pools that insure public deposits. It also might include commercial insurance. Details about federal deposit insurance are addressed in Questions 1.30.1, 1.30.2, and 1.31.1, state deposit insurance in Question 1.32.1, multiple financial institution collateral pools in Question 1.37.3, standby letters of credit issued by the Federal Home Loan Bank in Question 1.33.2, and commercial insurance in Question 1.34.1.

1.30 Federal Deposit Insurance Corporation

1.30.1. Q—What organization provides federal deposit insurance on deposits in banks and savings associations?

A—The FDIC provides federal deposit insurance for accounts maintained in FDIC-insured banks and savings associations. FDIC insurance is backed by the full faith and credit of the U.S. government. Not all banks and savings associations are insured by the FDIC.

1.30.2. Q—What sources are available to determine FDIC coverage?


1.30.3. [Not used in GASB/GASB 2015-1]

1.30.4. [Not used in GASB/GASB 2015-1]

1.30.5. [Not used in GASB/GASB 2015-1]
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1.30.6. [Not used in GASBIG 2015-1]

1.30.7. [Not used in GASBIG 2015-1]

1.30.8. [Not used in GASBIG 2015-1]

1.30.9. [Not used in GASBIG 2015-1]

1.30.10. [Not used in GASBIG 2015-1]

1.30.11. [Not used in GASBIG 2015-1]

1.30.12. [Not used in GASBIG 2015-1]

1.30.13. [Not used in GASBIG 2015-1]

1.30.14. [Not used in GASBIG 2015-1]

1.30.15. [Not used in GASBIG 2015-1]

1.30.16. [Not used in GASBIG 2015-1]

1.30.17. Q—How do the custodial credit risk disclosure requirements of Statement 3, as amended by Statement 40, apply to deposits that participate in a deposit placement service?

A—As a deposit broker, a deposit placement service takes a government’s deposit that exceeds a single depository institution’s FDIC-insured limits and distributes that deposit among other institutions. The objective of the distribution is that each individual placement is under the various separate institutions’ insured limits, providing FDIC insurance for the aggregate deposit. For example, if the FDIC-insured limit per bank deposit cannot exceed $250,000 and a government has a $960,000 deposit, a deposit placement service spreads the government’s $960,000 deposit into 4 CDs at 4 different banks in the amount of $240,000 each, covering the entire deposit by FDIC deposit insurance.

CDs that are acquired through a placement service should be evaluated as deposits. Whether a deposit is FDIC insured depends on whether the terms and agreements surrounding the deposit comply with the requirements of FDIC insurance. Those requirements include, for example, documentation and disclosure requirements, such as the manner in which the records of the custodian or sub-custodian institution identify the depositor. The evaluation should consider whether the government also has other deposits at institutions that participate in the deposit placement service such that the government’s total deposits at any institution might exceed the FDIC-insured limit.

Deposits held overnight in the relationship bank (the bank that receives a deposit and returns that deposit to the depositor) prior to the issuance of a CD through a placement service, or after maturity but before being withdrawn by the depositor, may not be covered by FDIC insurance. In those cases, the evaluation of custodial credit risk should consider whether the deposits are collateralized or otherwise insured. Deposits that are neither insured nor collateralized as specified by paragraph 8 of Statement 40 should be addressed in a custodial credit risk disclosure.
1.31 National Credit Union Share Insurance Fund

1.31.1 Q—Some states permit public funds to be deposited in credit unions. What organization provides federal deposit insurance on deposits in credit unions, and what sources are available to determine the coverage provided?

A—The National Credit Union Administration (NCUA), an independent agency of the U.S. government, provides insurance for accounts in member credit unions through the National Credit Union Share Insurance Fund (NCUSIF). Not all credit unions are insured by the NCUSIF. To obtain a general understanding of NCUSIF coverage, refer to the NCUA website at www.ncua.gov. For specific information about coverage of public funds, consult the NCUA rules and regulations relating to insurance coverage (12 C.F.R. Part 745).

1.32 State insurance funds

1.32.1 Q—Deposits in some financial institutions are not federally insured; instead, they are covered by state insurance funds. Does such coverage allow the deposit to be considered insured?

A—Yes. Coverage by state insurance funds usually protects deposits from custodial credit risk. However, there have been limited instances of state insurance funds that were unable to cover insured losses. If the state insurance fund is not covering losses, the deposits should be reported as exposed to custodial credit risk.

1.33 Letter of credit

1.33.1 [Not used in GASB1G 2015-1]

1.33.2 Q—Are deposits that are covered by irrevocable standby letters of credit issued by the Federal Home Loan Bank exposed to custodial credit risk?

A—No. An irrevocable letter of credit can be considered a form of insurance if the bank or the bank’s affiliate did not issue it and it provides a scope of coverage substantially the same as that provided by federal deposit insurance.

1.34 Commercial insurance

1.34.1 Q—Can insurance or a surety bond provided by a commercial insurance company prevent deposits from being subject to custodial credit risk disclosures?

A—For a commercially insured deposit not to be exposed to custodial credit risk, the scope of coverage provided by a commercial insurance company would have to be substantially the same as that provided by federal deposit insurance. The same risks would have to be covered. That is, the insurance would have to cover all types of losses, not only certain types of losses (for example, only losses from theft).

1.35 Special Collateral Arrangements

1.36 Federal Reserve pledge accounts
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1.36.1. Q—If collateral securities are held in a Federal Reserve pledge account, are the related deposits exposed to custodial credit risk?

A—No. A Federal Reserve pledge account is an account in which securities have been segregated on the books of the Federal Reserve and identified as being pledged to a specific public entity with the Federal Reserve serving as the custodian. In this instance, the pledgee is known to the Federal Reserve, and the Federal Reserve provides pledge-related notices directly to the pledgee. The pledge account is in the name of the pledgor financial institution, but the pledgor does not have the ability to access the securities while they remain in the pledge account. Any release or substitution of pledged collateral can be done only with the permission of the pledgee government.

In the case of Federal Reserve pledge accounts, the Federal Reserve Bank acts as the government’s agent and holds the collateral securities in the government’s name. Therefore, deposits secured by collateral held in these accounts are not subject to custodial credit risk disclosures.

For information about using a Federal Reserve pledge account, governments should contact their investment advisers or managers, financial institutions, or district bank of the Federal Reserve.

1.36.2. [Not used in GASB1G 2015-1]

1.37 Collateral pools

1.37.1. Q—What is a single financial institution collateral pool? How does a government determine whether its deposits in the pool are subject to custodial credit risk disclosures?

A—In a single financial institution collateral pool, one financial institution pledges a pool of collateral against all the public deposits it holds.

A government’s determination of custodial credit risk is the same as the pool’s determination: For example, if the fair value of pool collateral is equal to 90 percent of all uninsured public deposits held by the financial institution, and the collateral securities are held by the pledging financial institution’s trust department in the name of the pool, 90 percent of the uninsured deposits of each government are covered by the pool and 10 percent are exposed to custodial credit risk.

Pool deposits: To determine the applicability of custodial credit risk disclosures for deposits secured by a single financial institution collateral pool, one should determine the fair value of the collateral in the pool and the total uninsured deposits covered by the pool. Generally, this is not information that an individual government can obtain or verify. Many jurisdictions have assigned a state official (for example, the state’s banking commissioner or treasurer) the ability or the authority to administer collateral pools, and governments should contact that official to obtain custodial credit risk information.

How the securities are held: Some have questioned how to determine whether the deposits are “held in the name of the government” when collateral secures the deposits of more than one individual government. Some assume that because particular securities are not held in the name of particular entities, the criterion can never be met for pools, and all uninsured deposits covered by pools are always exposed to custodial credit risk. This is not the case. Custodians
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of pooled collateral generally are required to hold the securities in the name of the collateral pool (that is, collectively for the governments secured by the collateral). Provided that this is the case and that an individual government is recognized by the custodian, pledging financial institution, or pool administrator (whichever maintains the “official” list of pool participants) as one of the governments covered by the collateral pool, the “held in the name of the government” criterion is met for that individual government.

Who the securities custodian is: Pooled collateral might be held by the pledging financial institution, automatically requiring custodial credit risk disclosures for all uninsured deposits covered by the pool. Sometimes, the trust department of the pledging financial institution has custody of the pool securities, resulting in deposits not subject to custodial credit risk disclosures, provided that the trust department holds the securities in the name of the pool and the value of the pool meets or exceeds the amount of uninsured deposits.

However, sometimes a third-party custodian holds the collateral. If this is the case, a determination should be made about whether the custodian is the pledging financial institution’s agent or, instead, the agent of the pool (and thus the agent of the governments secured by the pool). (See Questions 1.15.1 and 1.15.5 for the discussion on determining whose agent a custodian is.) Once again, this is a determination best made on a pool-wide basis by the pool administrator. If the custodian acts as the agent of the pool administrator (for example, by obtaining the administrator’s approval for all releases of collateral), the uninsured deposits of all governments covered by the pool would not be exposed to custodial credit risk because the collateral is held by the government’s agent in the government’s name.

1.37.2. Q—Suppose a government that is covered by a collateral pool cannot obtain the information it needs to determine whether its deposits are exposed to custodial credit risk—for example, because there is no state official with the ability or authority to act as a pool administrator. How would a preparer’s inability to obtain information affect the required activity disclosures?

A—If a government cannot obtain the information necessary to determine the custodial credit risk of deposits covered by collateral pools, it should disclose that fact along with any important information regarding custodial credit risk that it is able to provide.

1.37.3. Q—What is a multiple financial institution collateral pool? How should governments evaluate deposits that are collateralized by such a pool?

A—Multiple financial institution collateral pools are discussed in (nonauthoritative) paragraph 11 of Statement 3. In a multiple financial institution collateral pool, a group of financial institutions holding public funds pledge collateral to a common pool. Statutes authorizing these pools specify the amount of collateral that is required to be pledged by each financial institution—usually a certain percentage of the uninsured public deposits it holds. If any member financial institution fails, the entire collateral pool becomes available to satisfy the claims of governmental entities.

In many jurisdictions that have multiple financial institution collateral pools, if the value of the pool’s collateral is inadequate to cover a loss, additional amounts would be assessed on a pro rata basis to the members of the pool to ensure that there will be no loss of public funds. As a result, a multiple financial institution collateral pool that provides for additional assessments is similar to deposit insurance and does not require disclosure of custodial credit risk.
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However, if a multiple financial institution collateral pool cannot make additional assessments, the deposits should be considered collateralized rather than insured. The extent to which the pool collateralizes those deposits is determined by comparing each individual member financial institution’s total uninsured public deposits with the fair value of the pool’s assets. For example, if the pool’s asset value exceeds the total uninsured public deposits of an individual member financial institution, all uninsured public deposits with that financial institution should be considered fully collateralized. If, however, the pool’s value is only 50 percent of the total uninsured public deposits of a member financial institution, each of that financial institution’s uninsured public deposits would be only 50 percent collateralized. Evaluating a multiple financial institution collateral pool that cannot make additional assessments for purposes of determining custodial credit risk involves many of the same issues and considerations as with a single financial institution collateral pool, discussed in Questions 1.37.1 and 1.37.2.

1.38 Specific Deposit Accounts

1.39 Certificates of deposit

1.39.1. [Not used in GASBIG 2015-1]

1.40 “Money market” accounts

1.40.1. Q—What are the “money market” accounts offered by financial institutions? Are they like money market mutual funds, which are not exposed to custodial credit risk?

A—Financial institution “money market” accounts are simply deposits that pay interest at a rate that is set to make the accounts competitive with money market mutual funds. These money market accounts should be treated like any other deposit account for purposes of custodial credit risk.

1.41 Bank investment contracts

1.41.1. Q—What are bank investment contracts (BICs)? Are they exposed to custodial credit risk?

A—A BIC is a general obligation instrument issued by a bank, typically to a pension plan, that provides for a guaranteed return on principal over a specified period. Statement 31 categorizes BICs as one form of an interest-earning investment contract. Other types of financial institutions—for example, savings associations—also issue investment contracts that, for purposes of applying Statements 3 and 40, as amended, are treated like BICs.

BICs and investment contracts with other types of financial institutions should be analyzed as to their custodial credit risk within the requirements of paragraph 8 of Statement 40 because they are deposits with financial institutions. BICs that permit “benefit responsive withdrawals or transfers” as defined by federal law are not covered by FDIC insurance (12 C.F.R. §330.3(g)). Some financial institutions pledge collateral to secure uninsured BICs.

(See Question 1.54.1 for a discussion of guaranteed investment contracts [GICs]. Although a GIC is an instrument similar to a BIC, a GIC is treated differently than a BIC for purposes of applying Statements 3 and 40, as amended, because it is not a deposit with a financial institution.)

1.42 Specific Issues on Investments
Disclosures Related to Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

1.43 Valuation and Presentation Issues

1.43.1. [Not used in GASBIG 2015-1]

1.43.2. Q—Is a repurchase agreement’s fair value related to the fair value of the securities underlying the repurchase agreement? If not, is it important to know the fair value of those securities?

A—Statement 31 considers repurchase agreements to be interest-earning investment contracts. (See Questions 6.17.1–6.17.4.) The fair value of a repurchase agreement is not based on the value of the underlying securities.

However, the fair value of the underlying securities is important for determining exposure to custodial credit risk. If the fair value of the securities is less than the reported amount of the repurchase agreement, that shortfall represents an unsecured position and should be disclosed as an exposure to custodial credit risk. (See also Question 1.43.3.)

1.43.3. Q—Is a government exposed to custodial credit risk on the portion of the reported amount of any repurchase agreement that exceeds the fair value of the underlying securities?

A—Yes. Custodial credit risk includes the portion of the reported amount of any repurchase agreement that exceeds the fair value of the underlying securities. The disclosure of the repurchase agreement’s custodial credit risk is consistent with Statement 40 and paragraph 68c of Statement 3, as amended.

1.43.4. Q—Investment transactions are affected by trade and settlement dates. What is the trade date and the settlement date? Does the use of one accounting method versus the other affect the determination of custodial credit risk disclosures?

A—The trade date is the date an investment order is made. The settlement date is the date on which the investment securities are delivered or received in exchange for the cash payment. In purchases and sales of investment securities, it is normal for the order to be made on one day and settled at a later date. Governments should follow trade date accounting. Trade date accounting results in differences between the investment securities accounted for and the investment securities that are exposed to custodial credit risk. Under trade date accounting, the government accounts for investment securities that have been ordered, even though the government has given no consideration and the investment securities remain in the possession of the counterparty pending settlement. Unsettled purchases are exposed to custodial credit risk only to the extent that the counterparty holds a deposit or margin account against them. A government using trade date accounting also may have relieved its investment account of unsettled sales. Even though the government is not exposed to market risk on those investment securities, it still is exposed to custodial credit risk that could result in losses before settlement. Therefore, preparers using trade date accounting should consider making disclosures of investment securities sold but not yet settled in determining custodial credit risk disclosures.

1.44 Brokerage Insurance

1.45 Securities Investor Protection Corporation
Disclosures Related to Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

1.45.1. Q—What organization provides protection for cash and investment securities held in customer accounts by broker-dealers, and what sources are available to determine the coverage provided?

A—The Securities Investor Protection Corporation (SIPC), which was created under federal law as a nonprofit membership corporation funded by its members, provides protection for cash and investment securities held in customer accounts by member broker-dealers. With some exceptions, all brokers and dealers registered with the SEC, other than banks registered as municipal securities dealers, automatically are members of the SIPC. General information about the SIPC’s protection may be found on its website at www.sipc.org. For more detailed information about SIPC protection, refer to the Securities Investor Protection Act of 1970 (15 U.S.C. §78aaa et seq., as amended) and the SIPC regulations (17 C.F.R. Part 300).

1.45.2. [Not used in GASBIG 2015-1]

1.45.3. [Not used in GASBIG 2015-1]

1.45.4. [Not used in GASBIG 2015-1]

1.46 Commercial insurance

1.46.1. Q—Many broker-dealers have insurance to supplement SIPC protection for their customers. Does this commercial insurance protect a government’s investment securities from exposure to custodial credit risk?

A—Statements 3 and 40 do not describe the conditions of additional insurance coverage that would protect a government’s investment securities from custodial credit risk. It is reasonable, however, that to be considered adequate, the scope of coverage provided by a commercial insurance company would have to be substantially the same as the protection provided by the SIPC. For the scope of coverage to be considered substantially the same, the same risks would have to be covered. That is, the insurance would have to cover all types of broker-dealer failures, not only certain types of losses (for example, only losses from theft). Preparers also may need to evaluate whether other conditions exist that may make private-sector insurance dissimilar to SIPC protection and thus subject the investment securities to custodial credit risk disclosures.

1.47 Specific Investment Instruments

1.48 Mutual funds and unit investment trusts

1.48.1. Q—What is a mutual fund? What is the difference between an open-end mutual fund and a closed-end mutual fund? What is a unit investment trust?

A—An investment company operates a mutual fund by selling shares of its stock to investors; it invests, on the shareholders’ behalf, in a diversified portfolio of securities. An open-end mutual fund creates new shares to meet investor demand; a closed-end fund has a constant number of shares. The value of an investment in an open-end fund depends directly on the value of the underlying portfolio; the value of an investment in a closed-end fund depends on the market supply and demand for the shares rather than directly on the value of the company’s portfolio. An open-end mutual fund generally does not issue certificates; instead, it sends out periodic
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statements showing deposits, withdrawals, and dividends credited to the investor’s account. A closed-end fund does issue certificates, and the securities are traded on a stock exchange. Statement 3 uses the term mutual fund to refer to an open-end fund.

A unit investment trust also holds a diversified portfolio of securities. Unlike a mutual fund, the portfolio of an investment trust is fixed; once structured, it is not actively managed, except for some limited surveillance. That is, cash received from income and maturing investments is not reinvested but is distributed to shareholders of the trust. Unit investment trust shares are securities and are traded.

1.48.2. Q—Are investments in mutual funds and unit investment trusts subject to custodial credit risk disclosures?

A—Shares in closed-end mutual funds and unit investment trusts are securities and should be analyzed for custodial credit risk depending on brokerage insurance and on who holds the securities and how they are held.

Open-end mutual funds are not securities and, according to paragraph 9 of Statement 40, are exempt from custodial credit risk disclosures. The relationship between the investor in an open-end mutual fund and the investment company is a direct contractual relationship. There is no document or other evidence of ownership that, if lost or stolen, would result in a loss to the investor. Therefore, the government’s investment is not directly exposed to custodial credit risk. Certainly, the fund securities that provide the basis for the participant’s income and protection of its principal can be exposed to custodial credit risk. However, that is the fund’s risk, not the individual investor’s risk. (See also Question 1.11.1.)

1.48.3. Q—In paragraph 29 of the Introduction and Background Information section, Statement 3 defines a mutual fund as an open-end investment company registered with the SEC. Some mutual funds are entities established under state law to serve local or special-purpose governments and have received a “no-action” letter from the SEC. Is a government’s investment in such a fund subject to custodial credit risk disclosures?

A—No. Investments in mutual funds that are established by state law to serve local or special-purpose governments and that have received a “no-action” letter from the SEC are not exposed to custodial credit risk.

1.49 Investments made by other governments

1.50 Investment pools

1.50.1. Q—Many governments have investments in pools managed by another government—for example, a state treasurer’s pool for local and special-purpose governments. Paragraph 9 of Statement 40 exempts the participating government’s pooled investments from custodial credit risk disclosures. Does this lack of disclosure mean there is no risk to the participating governments?

A—No. Not disclosing the custodial credit risk of investments in pools managed by other governments is not meant to imply that risk does not exist. However, as with investments in open-end mutual funds, a participating government’s investment is not directly exposed to custodial credit risk; the pool faces the custodial risk. The pool’s custodial credit risk will be disclosed in a financial report prepared in conformity with generally accepted accounting
principles (GAAP) and issued by the government managing the pool. Governments in the pool may make reference in their own financial statements to the financial statements that make Statements 3 and 40 disclosures, as amended, for the pool.

1.50.2. [Not used in GASBIG 2015-1]

1.50.3. Q—A single government is the dominant participant in an investment pool managed by another government, generally owning over 95 percent of the pool assets. This dominant participant influences the pool’s investment policies and practices, and its financial condition is significantly affected by those policies and practices. Does paragraph 9 of Statement 40 continue to exempt this dominant participating government from disclosure of custodial credit risk, as paragraph 69 of Statement 3 did?

A—In this situation, an exemption would be contrary to the objective of Statement 40 disclosures. The situation considered in providing the Statement 3, paragraph 69, exemption for investment pools was that of a state-wide local government investment pool managed by the state treasurer in which individual local governments have no control over the treasurer’s policies and only a small interest in the total pool. In the situation described in this question, the dominant participant in substance controls the investment pool.

The dominant government should consider making all custodial credit risk disclosures if applicable. Also, the government should consider disclosing its dominance in the pool and referring its financial statement users to the Statements 3 and 40 disclosures in the GAAP financial statements of the pool.

1.51 Individual investments

1.51.1. Q—A county treasurer makes investments on behalf of school districts within the county. The investments are specific U.S. government securities for each district and not a part of an investment pool. The investments are placed in individual investment accounts (paragraph 20 of Statement 31) on behalf of the districts. Would these investment securities be subject to custodial credit risk disclosures?

A—The investment securities are subject to custodial credit risk disclosures, if applicable, by the school districts because the districts own specific investments. Paragraph 9 of Statement 40 provides an exception for pooling because a government investing in a pool does not own investments specifically identifiable to it; however, the government owns a portion of a group of commonly owned investments. Provided that the county treasurer’s internal records identify the individual school districts as owners, the investment securities would not be exposed to custodial credit risk if the investment securities are held by the county treasurer’s agent in the county’s name. The school districts face only the same custodial credit risk that the treasurer faces. The county treasurer, functioning in his or her official capacity as investment manager for the districts, is not considered an outside party that poses custodial risk as a financial institution or broker-dealer performing the same function would; therefore, the treasurer should not be considered a counterparty for financial reporting purposes.

1.52 Section 457 deferred compensation plan assets
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1.52.1. Q—Do Statements 3 and 40, as amended, apply to Internal Revenue Code (IRC) Section 457 deferred compensation plan assets? If so, what are the typical Section 457 plan investment options, and are they subject to custodial credit risk disclosures?

A—As discussed in Question 1.2.4, Statements 3 and 40, as amended, apply to all deposits and investments reported on the face of a government’s financial statements. This would include any IRC Section 457 deferred compensation plan assets that the government reports. Section 457 plans typically allow participants to invest in annuity contracts, GICs (see Question 1.54.1), and open-end mutual funds (see Questions 1.48.1 and 1.48.2). If a Section 457 plan were to allow participants to invest in securities (for example, direct investments in U.S. government securities), those plan assets should be considered in the custodial credit risk disclosures. Some Section 457 plans also permit an investment option of deposits with financial institutions. Question 1.31.1 discusses deposit insurance for Section 457 plan deposits.

1.53 Tri-party repurchase agreements

1.53.1. Q—What is a tri-party repurchase agreement, and are such investments exposed to custodial credit risk?

A—In a tri-party repurchase agreement, the custodian serves as agent both of the buyer-lender and of the seller-borrower by agreeing, in the event of default by one, to protect the interests of the other. The custodian holds the securities underlying the agreement in the names of both repurchase agreement parties (the buyer-lender as pledgee and the seller-borrower as owner).

If the government is a direct party to the tri-party agreement and the custodian is the trust department of a financial institution that is the seller-borrower of the repurchase agreement, the government’s investment would not be exposed to custodial credit risk, provided that the fair value of the underlying securities meets or exceeds the reported amount of the repurchase agreement. If the custodian is an affiliate of a financial institution that is the seller-borrower of the repurchase agreement, the government’s investment would be exposed to custodial credit risk.

Sometimes governments are not direct parties to a tri-party agreement. Instead, they purchase the investment through or from a financial institution or broker-dealer that is the buyer-lender in the tri-party agreement. Sometimes the government’s investment is in an individual repurchase agreement. Other times, the government participates in a “repurchase agreement pool,” purchasing only a portion of a repurchase agreement in which the financial institution or broker-dealer is the buyer-lender. The financial institution or broker-dealer that purchased the investment for or sold it to the government is the counterparty, and the securities are being held by the counterparty’s agent in the counterparty’s name. In these cases, the government would report these investments as subject to custodial credit risk disclosures.

1.54 Guaranteed investment contracts

1.54.1. Q—Are GICs exposed to custodial credit risk?

A—A GIC is a general obligation instrument issued by an insurance company, typically to a pension plan, that provides for a guaranteed return on principal over a specified period. Statement 31 considers GICs to be interest-earning investment contracts. The general assets of the issuing company support the GIC. Investment contracts issued by noninsurance companies are similar in substance to GICs and, except for those issued by financial
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institutions, are treated like GICs for purposes of applying Statements 3 and 40, as amended. (BICs and investment contracts with other financial institutions are discussed in Question 1.41.1.)

GICs are not exposed to custodial credit risk because they are direct contractual investments and are not securities. (See Question 1.11.1.)

1.55 Foreign investments

1.55.1. Q—Are foreign investments subject to custodial credit risk disclosures?

A—Yes. Custodial credit risk disclosures are required for investments made in foreign markets. Governments need to determine whether these investments are securities and, if so, identify whether they are subject to the custodial credit risk requirements of paragraph 9 of Statement 40. Specifically, governments should determine the mechanics of the clearing process, whether the securities are held in paper or book entry form, and the function of any intermediaries in the process. Some foreign markets use a depository system and others do not. The length of the settlement process varies greatly from market to market, with transactions in some markets taking months to settle. A government’s custodian often uses correspondents to hold securities in the country where they were purchased. Governments with foreign investment portfolios should work with the portfolio managers or custodians to meet custodial credit risk reporting requirements for their portfolio.

1.55.2. [Not used in GASBIG 2015-1]

1.56 Concentration of Credit Risk

1.56.1. Q—Should investments in affiliates and subsidiaries of parent corporations be aggregated for determining the concentration of credit risk of an issuer?

A—Affiliates and subsidiaries of parent corporations may be engaged in similar activities and may have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. In these cases, a government should consider the credit risk of the parent company, its affiliates, and its subsidiaries in determining whether a government holds a concentration of credit risk.

1.57 Interest Rate Risk

1.57.1. Q—Statement 40 specifies five interest rate risk disclosure methods. May a method be used that is not one of the five?

A—No. The GASB’s research indicates that the five interest rate risk disclosure methods prescribed in paragraph 15 of Statement 40 are commonly used in practice. The selection among the five methods was permitted to allow a government to choose a disclosure method that is most consistent with the manner in which the government manages its interest rate risk. Because these five methods can adequately communicate a government’s interest rate risk exposure, no additional alternatives are permitted.

1.57.2. Q—May different interest rate risk disclosure methods be used in succeeding years?
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A—Yes. Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, paragraph 66, indicates that “[a] change in accounting principle results from adoption of a generally accepted accounting principle different from the one used previously for reporting purposes. The term accounting principle includes not only accounting principles and practices but also the methods of applying them” (footnote omitted). Similar to a government using different methods to disclose interest rate risk among its various investment portfolios or funds within the same year, a government may choose to present different interest rate risk disclosures from year to year. To be consistent with its own management practices, a government may need to adopt a different method of reporting interest rate risk in subsequent years to accommodate a change in management, to accommodate a change in portfolio composition, or for other varying reasons. Any government choosing to change interest rate risk disclosure methods also should disclose the nature and reason for the change in accordance with paragraph 75 of Statement 62.

1.57.3. Q—When a debt investment carries a call option, is there a preferable way of disclosing the call option?

A—The majority of the interest rate risk disclosure methods outlined in paragraph 15 of Statement 40 can adequately communicate the effects of call options on debt investments. However, governments using the specific identification method of disclosing interest rate risk will need to separately disclose any call options existing on their debt investments. Call options may be identified in the narrative disclosure or may be footnoted to a schedule displaying the government’s exposure to interest rate risk. (See Questions 1.60.1, 1.62.1, and 1.63.3.)

1.57.4. Q—May one interest rate risk disclosure method be used for short-term investments and another used for long-term investments?

A—Yes. Governments may choose among the interest rate risk disclosure alternatives provided in paragraph 15 of Statement 40 so that their disclosure methods are consistent with the way the government identifies and manages interest rate risk. A government may manage its overall interest rate risk by separately identifying the interest rate risk associated with different maturity investments. Investments with interest rates that are fixed for longer periods of time are likely to be subject to more variability in their fair values as a result of future changes in interest rates. To better manage this risk, a government may, for example, choose a more sophisticated method of measuring interest rate risk and may therefore have the information available to disclose that risk using a more complex disclosure model. Allowing a government to report interest rate risk using different methods based on the terms of the investments will enable the government to better align its disclosures with its management practices.

1.57.5. Q—What should be considered the maturity of a mutual bond fund when preparing the interest rate risk disclosure?

A—Maturity measures the length of time until a bond issuer is required to pay its investors. Because mutual bond funds invest in many debt issues with different maturity dates, the maturity date of the fund is not fixed. Unlike a 2a7 or a 2a7-like fund, the net asset value for a bond fund changes.

Bond funds generally own many debt investments with differing maturities, so a bond fund reports duration or average maturity—the average of all the debt investment maturities in a
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fund’s portfolio, weighted by the par value of each investment. For example, a mutual bond fund with a weighted average maturity of 8.5 months could be reported using the segmented time distribution as an investment with a maturity of less than one year.

1.57.6. Q—A mutual bond fund or external investment pool has demand features, permitting participants to withdraw their positions with short notice. Does this feature cause the investment’s maturity to be very short term and presented as having a maturity of less than one year, such as under the segmented time distribution method?

A—No. Consideration should be given to the distinction between a mutual bond fund’s or external investment pool’s maturity and the flow of deposits and withdrawals. Governments may add moneys to mutual bond funds or external investment pools or withdraw moneys based on cash flow needs rather than when the investments mature. As stated in Question 1.57.5, a bond fund (and by extension an external investment pool) may report average maturity weighted by the par value of each bond. It is the focus on the bond fund’s or external investment pool’s maturity that should be considered when designating the investment into the appropriate time distribution for interest rate risk disclosure.

1.57.7. Q—A government holds a variable-rate investment with a coupon that resets every three months. How does the reset impact the government’s interest rate risk disclosure?

A—Statement 40 defines interest rate risk as “the risk that changes in interest rates will adversely affect the fair value of an investment.” The fair value of repricing securities (debt investments with a coupon that resets on a specific date or frequency) is generally less susceptible to fluctuations in value because the variable-rate coupon resets back to the market rate on a periodic basis. Interest rate risk disclosure methods that consider investment time horizons and maturities (weighted average maturity, segmented time distribution, and duration) generally make assumptions regarding the maturity of the investment for interest rate risk purposes. Effectively at each reset date, a debt investment with a variable-rate coupon reprices back to par value, thus eliminating the interest rate risk on the investment at each periodic reset. Similar to the actual maturity of the investment, the debt investment’s price will not fluctuate when the coupon rate is equal to the market rate of interest, and consequently many governments may assume that the maturity for interest rate risk purposes is the length of time until the next reset date rather than the stated maturity. In accordance with paragraph 15 of Statement 40, governments should disclose any maturity assumptions that affect interest rate risk information.

However, governments holding investments with variable-rate coupons should consider the effects of caps, floors, and collars (a combination of caps and floors) in the determination of the investments’ maturities. For example, a government holds a variable-rate investment having a 3-month coupon reset with a cap of 4 percent. If interest rates at the time of the reset were 5 percent, the cap would prevent the investment from repricing to par, causing the fair value of the investment to remain below par and take on the characteristics of a fixed-rate bond, should interest rates remain over the cap of 4 percent.

Both the repricing of the debt investment’s coupon to the market rate and the shorter assumed maturity of the instrument tend to lower the magnitude of the interest rate risk associated with the debt investment. However, as previously noted, variable-rate investments with coupon resets may also be coupled with a cap, a floor, or a collar. Such features may prevent reset to par at each reset date, affecting both the maturity and the fair value of the investment. A
government should analyze the effects of these features on the fair value of its investments when determining interest rate risk.

1.57.8. Q—Should the financial statements of a governmental 2a7-like pool disclose the interest rate risk of its debt investments?

A—Yes. The interest rate risk disclosures required by paragraphs 14–16 of Statement 40, as amended, apply to all government organizations, including 2a7-like pools.

1.58 Disclosure Methods

1.59 Segmented Time Distribution

1.60 Specific Identification

1.60.1. Q—Under the specific identification method, how would a government illustrate a debt investment with a variable coupon that resets each quarter?

A—The specific identification method requires a government to list its investments and the investments’ respective maturities. For interest rate risk purposes, the government may consider a variable-rate debt investment with a quarterly reset to have a maturity equal to the length of time until its next reset date.

In addition to the identification of the investment, the government should disclose, either as a narrative or as a footnote to the schedule, the maturity assumption related to the investment’s coupon reset and the terms of the investment in accordance with the provisions of paragraph 16 of Statement 40, as amended.

1.61 Weighted Average Maturity

1.61.1. Q—Under the weighted average maturity method of disclosing interest rate risk, what are the cash flows assumptions that are used in the calculation? Do they include such items as principal payments occurring on a periodic basis prior to maturity, interest payments, or the effects of callable bonds?

A—The weighted average maturity method expresses investment time horizons—the time when investments become due and payable—in years or months, weighted to reflect the dollar size of individual investments within an investment type. The cash flows assumptions associated with the weighted average maturity method focus on the maturity value of the instrument, taking into consideration principal payments occurring on a periodic basis prior to maturity. The weighted average maturity method also requires governments to make assumptions as to the effective maturity of callable investments, which should be disclosed. (See Question 1.57.3.)

1.62 Duration

1.62.1. Q—Does Statement 40 specify which method of duration should be applied?
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A—No. There are three common types of duration used to report interest rate risk—Macaulay duration, modified duration, and effective duration. Duration methods can be calculated using analytical software.

Macaulay duration is a measurement of the weighted average term to maturity of a bond’s cash flows whereby the weighting is based on the present value of each cash flow divided by the price.

Modified duration is a measure of the price sensitivity of a bond to interest rate movements. It is equal to the Macaulay duration divided by \((1 + \frac{\text{bond yield}}{k})\) where \(k\) is the number of compounding periods per year.

Effective duration is a method of disclosing interest rate risk that measures the expected change in value of a fixed-income security or portfolio for a given change in interest rates. Because effective duration makes assumptions regarding the most likely timing and amounts of variable cash flows, it is particularly useful for measuring interest rate risk of callable bonds, collateralized mortgage obligations, and other mortgage-backed securities.

Both modified duration and effective duration provide a measure of risk that changes proportionately with market rates. For example, if interest rates fell by 1 percent, the value of a security or portfolio having a modified or effective duration of 3.0 generally would increase in price by 3 percent. Duration methods can be calculated using analytical software.

Duration, as a measurement of the impact of interest rates on bond prices, is only an approximation. Effective duration tends to be a more accurate measure of interest rate risk when there are large changes in prevailing interest rates, unlike both Macaulay and modified duration whose error magnifies as the changes in prevailing rates get larger.

Whereas effective duration makes assumptions regarding the most likely timing and amounts of variable cash flows, Macaulay and modified duration do not take into account such variable cash flows. Some believe that neither modified duration nor Macaulay duration is accurate for debt investments or portfolios with call options, mortgage securities, or put options. Accordingly, effective duration, and similar variations, may need to be utilized when analyzing a bond portfolio consisting of bonds with call options, prepayment provisions, and any other variable cash flows to better gauge the effect of a change in interest rates on the fair value of the portfolio.

1.63 Simulation Model

1.63.1. Q—What are examples of acceptable simulation models for the disclosure of interest rate risk?

A—Acceptable simulation models include those that illustrate the changes in the fair value of a bond or portfolio for a given change in interest rates (sensitivity analysis) or incorporate value-at-risk (VaR) analysis into its investment portfolio assessment to determine its potential future financial losses within a given timeframe. Sensitivity analysis models express potential loss in future income, fair values, or cash flows from hypothetical changes in interest rates. An example of a sensitivity analysis model is a shock or stress test in which interest rates across a yield curve are assumed to simultaneously increase. An illustration of such a disclosure is provided in nonauthoritative Appendix B1-2, Illustration 7. A VaR model expresses potential loss in future income, fair values, or cash flows over a selected period of time, with a selected
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likelihood of occurrence from changing interest rates. Examples of VaR models are variance/co-variance, historical simulation, and Monte Carlo simulation. The variance/co-variance model, for example, relies on statistical relationships to describe how changes in different markets can affect a portfolio of instruments with different characteristics and market exposures.

1.63.2. Q—Can a government holding mortgage-backed securities or securities with call options utilize an option-adjusted spread (OAS) simulation model to disclose its interest rate risk?

A—Yes. As noted in Question 1.63.1, Statement 40, as amended, does not address the type of simulation model that a government is required to use to disclose its interest rate risk. OAS is the spread relative to a risk-free interest rate that equates the theoretical present value of a series of uncertain cash flows of an instrument to its current market price. OAS can be viewed as the compensation an investor receives for assuming a variety of risks, less the cost of any embedded options. Evaluating the OAS of an investment requires the determination of the component of a security’s yield that is attributed to embedded options. Governments choosing to utilize an OAS model may find that they can incorporate assumptions regarding the uncertainty of cash flows associated with such variable securities that would otherwise need to be disclosed under the requirements of paragraph 16 of Statement 40, as amended, for highly sensitive investments. Generally when constructing an OAS model, a government would need to simulate a sufficiently large number of random future interest rate scenarios, or interest rate paths, and then apply a prepayment model to project cash flows along each simulated path. OAS models can be generated with specialized investment software.

1.63.3. Q—Should a simulation model include the effects of interest rate decreases?

A—Only when a decrease in interest rates would adversely affect the instrument’s or portfolio’s fair value. The simulation model is designed to estimate changes in an investment’s or a portfolio’s fair value, given hypothetical changes in interest rates. Many investments or portfolios illustrate adverse changes in fair values from increasing interest rates; however, governments may have investments or portfolios in which the opposite would be true. In these cases, governments using the simulation model would disclose the scenario in which a decrease in interest rates would adversely affect the instrument’s or portfolio’s fair value. The simulation model method of disclosing interest rate risk is designed to show how changes in interest rates will negatively affect an investment’s or a portfolio’s fair value.

1.64 Highly Sensitive Investments

1.64.1. Q—What factors may be considered in the determination of whether an investment’s fair value is highly sensitive to interest rate changes?

A—Factors that may influence the determination of a highly sensitive investment include the term-to-maturity of the investment, the likelihood of exercise of any embedded options, whether any caps or floors may be reached, the size of the portfolio relative to the government or the government’s cash needs, the consequences of liquidity tightening by the state or local government, and the investment objective of the portfolio (for example, general fund—short term, versus pension fund—long term) among others.

1.64.2. Q—A government holds a fixed-rate bond with a long term to maturity. Is this bond considered an investment that is highly sensitive to changes in interest rates?
A—Yes. Because of factors described in Question 1.64.1, this investment’s fair value may be highly sensitive to changes in interest rates. However, because such an investment’s maturity information may have been disclosed in the basic interest rate risk disclosure (Statement 40, paragraph 15), no additional disclosure as a highly sensitive investment may be required. The magnitude of price fluctuations experienced by debt investments as a result of interest rate changes varies dramatically between short-term and long-term maturities. The longer it takes for a debt investment to mature, the more fair value will decline when interest rates increase because the holder is subject to the lower coupon rate for a longer period of time. There is a large difference between the fair value fluctuations of debt investments that mature in 1 or 2 years versus debt investments that may mature in 15 years or more. For example, if interest rates rise from 6 to 7 percent, a 6 percent coupon bond with 1 year remaining to maturity will theoretically lose 1 percent of its fair value. However, a bond with a 6 percent coupon maturing in 20 years will theoretically see a drop in its fair value by approximately 10 percent. Hence, the fair value of long-term debt investments tends to be more sensitive to interest rate changes than the fair value of short-term debt investments.

1.64.3. Q—What are some asset-backed securities that are highly sensitive to changes in interest rates?

A—Because mortgage borrowers have the option of prepaying their mortgages, asset-backed securities such as mortgage pass-through securities issued by Fannie Mae (Federal National Mortgage Association), Ginnie Mae (Government National Mortgage Association), and Freddie Mac (Federal Home Loan Mortgage Corporation) are examples of common highly sensitive investments.

Prepayment options embedded in some investments cause those investments to be highly sensitive to changes in interest rates. Prepayments by the obligees of the underlying assets reduce the total interest payments to be received by holders of the asset-backed investments. Generally when interest rates fall, obligees tend to prepay the assets (for example, mortgagors prepaying mortgages to take advantage of the lower rates through refinancing), thus eliminating the stream of interest payments that would have been received under the original amortization schedule. This reduced cash flow diminishes the fair value of the asset-backed investment. However, if the asset-backed investment is not able to be prepaid, it is less likely to be susceptible to interest rate changes.

1.64.4. Q—What are examples of other investments that could be considered investments with fair values that are highly sensitive to changes in interest rates?

A—Examples of other investments that may be highly sensitive to interest rate changes are structured notes—such as range notes and index amortizing notes, step-up notes and bonds, variable-rate investments with coupon multipliers, and coupons that vary inversely with a benchmark index. (See Questions 1.64.9 and 1.64.10.) Range notes are investments whose coupon payment varies (for example, either 6 percent or 3 percent) depending on whether the current benchmark (for example, 30-year Treasury) falls within a predetermined range (for example, between 4.75 percent and 5.25 percent). The significant interest rate spread that these investments cover and their reliance on a benchmark interest rate generally cause such notes to be considered highly sensitive investments.

Index amortizing notes are a form of structured note whereby the outstanding principal value amortizes according to a predetermined schedule that is usually linked to a designated index.
With these investments, payment schedules are not stable. The timing of future cash flows and, consequently, the average life and the yield-to-maturity of the note remain uncertain. When the underlying index rises above a certain level, the average life of the note usually becomes longer. Conversely, should the index drop below the established level, the principal quickly amortizes according to the schedule. Changes in interest rates can have a substantial impact on the cash flows to be received and, consequently, the fair value of the note.

Step-up notes are another form of an investment that may be highly sensitive to changes in interest rates. In a step-up note, the investor holds a note that grants the issuer the option to call the investment on certain specified dates. At each call date, should the issuer not call the note, the coupon rate of the note increases (steps up) by an amount specified at inception. The call feature embedded within a step-up note causes the fair value of the instrument to be highly sensitive to interest rate changes.

1.64.5. Q—Are collateralized mortgage obligations (CMOs) considered to be investments with fair values that are highly sensitive to interest rate changes?

A—CMO securities come in a wide variety of forms with different cash flows and expected maturity characteristics that have been designed to meet specific investment objectives. The CMO structure enables the issuer to direct the principal and interest cash flow generated by the collateral to the different tranches in a prescribed manner to meet these different investment objectives. Depending on the type of tranche held, the CMO security may or may not be considered an investment with a fair value that is highly sensitive to interest rate changes. Tranches usually not highly sensitive to changes in interest rates may be considered highly sensitive on account of higher-than-expected prepayments that may make what appears to be a more stable tranche become volatile. The longer the term to maturity of a particular CMO tranche, the more susceptible the tranche is to fluctuations in fair value. (See Questions 1.64.6–1.64.8.)

1.64.6. Q—Are interest-only (IO) tranches of CMOs highly sensitive to interest rate changes?

A—Yes. IO tranches pay owners only some part of the interest paid on mortgages (in the case of a collateralized mortgage obligation) in the underlying pool. Consequently, the fair value of an IO tranche is based on the cash flows associated with the interest payments on the outstanding mortgages that make up the underlying pool. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayment by homeowners who are taking advantage of lower rates to refinance their mortgages. Prepayment of the underlying mortgages causes the fair value of the IO to decline on account of the decrease in interest cash flows caused by the prepayments. The risk of prepayment in IO tranches is so significant that the investor in the IO tranche may not be able to recover any portion of the initial investment, and the fair value of the tranche may decline to zero. The severity of the potential fair value loss associated with IO tranches leads them to be classified as investments highly sensitive to changes in interest rates.

1.64.7. Q—Are principal-only (PO) tranches of CMOs highly sensitive to interest rate changes?

A—The fair values of most PO tranches (in the case of a CMO) are highly sensitive to prepayment rates and therefore interest rates. If interest rates are falling and prepayments accelerate, the value of the PO tranche will increase. On the other hand, if rates rise and prepayments slow, the value of the PO tranche will drop. The uncertainty of the timing of the
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cash flows makes the fair value of a PO tranche highly sensitive to changes in interest rates, due to the relationship between interest rates and prepayments.

1.64.8. Q—What are examples of investments with fair values that are not highly sensitive to interest rate changes?

A—Examples of investments that have fair values that are generally not sensitive to interest rate changes are certain tranches of CMOs. CMOs are mortgage-backed securities that are composed of several classes of bonds all backed by the same mortgage collateral. These classes of bonds are known as tranches—related securities offered at the same time, but having different risks, rewards, or maturities. For example, a CMO structure might have tranches with 1-year, 2-year, 5-year, and 20-year maturities. Tranches that are not generally highly sensitive to changes in interest rates are planned amortization class (PAC) tranches, some targeted amortization class (TAC) tranches, and sequential-pay CMO tranches.

PAC tranches use a mechanism similar to a “sinking fund” to establish a fixed principal payment schedule that directs cash-flow irregularities caused by faster- or slower-than-expected prepayments away from the PAC tranche and toward another “companion” or “support” tranche. Accordingly, the payment schedule, yield, and average life of the tranche are expected to remain stable until maturity. PAC payment schedules are protected by priorities that ensure that PAC payments are met first out of principal payments from the underlying mortgage loans. These characteristics of PAC tranches make them fairly insensitive to interest rate changes that may cause the underlying mortgages to be prepaid. TAC tranches are similar to PAC tranches, although they specify a prepayment rate at which the principal payment schedule is fixed.

Sequential-pay CMOs have tranches that pay in a strict sequence. Each tranche receives regular interest payments, but the principal payments received are made to the first tranche alone, until it is completely retired. Once the first tranche is retired, principal payments are applied to the second tranche until it too is fully retired, and the process continues until the last tranche is retired. Generally the first few tranches in a sequential-pay CMO, similar to PAC tranches, are fairly insensitive to interest rate changes because even if the underlying mortgage holders choose to prepay, the first tranche will continue to receive principal payments from other tranches until the first is retired.

1.64.9. Q—A government holds a variable-rate investment with a multiplier. Is this an investment with a fair value that is highly sensitive to changes in interest rates?

A—A variable-rate investment with a multiplier may be considered to be an investment with a fair value that is highly sensitive to changes in interest rates because small changes in interest rates will be amplified by the underlying multiplier. These larger changes in the coupon payment affect the amount of future cash flows to be received by the holder of the bond, which consequently affects the fair value of the investment. Whereas variable-rate investments usually reprice back to par on interest rate reset dates, the fair value of variable-rate investments with multipliers may significantly change depending on the nature of the multiplier. Paragraph 16a of Statement 40 identifies a variable-rate investment that has a coupon based on 1.25 times the 3-month LIBOR rate as a highly sensitive investment. However, a variable-rate investment with a coupon rate set at 1.05 times the 3-month LIBOR would not necessarily qualify for the same categorization considering that the effect of the multiplier, while present, may not greatly impact the fair value of the investment.
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Additionally, consideration needs to be made regarding whether the simple multiplier causes the instrument to take on the characteristics of an inverse floater. Paragraph 16b of Statement 40 identifies one such inverse floater as a highly sensitive investment. (See Question 1.64.10.)

1.64.10. Q—Is a variable-rate investment with a coupon that varies inversely with a benchmark index an investment with a fair value that is highly sensitive to changes in interest rates?

A—A variable-rate investment with a coupon that varies inversely with a benchmark index may be highly sensitive to changes in interest rates. As depicted in paragraph 16b of Statement 40, a variable-rate investment with a coupon set at 4 percent minus the 3-month LIBOR with a floor of 1 percent is shown to be an example of a highly sensitive investment. Usually with most variable-rate debt investments, as interest rates change, the fair value of the debt investment reprices to par at each interest rate reset date. However, with inverse floater instruments, not only does the fair value of the debt investment change as interest rates change, but the fair value changes according to both the change in the market rate of interest and the rate of interest paid by the coupon. For example, if the 3-month LIBOR from paragraph 16b were to increase from 1.5 percent to 3.0 percent, the fair value of the debt investment would be calculated using a coupon rate of 1 percent instead of 2.5 percent, causing an investment that had a positive fair value to become an investment with a negative fair value.

A simulation model depicts the monetary impact that changes in interest rates have on a variable-rate investment with a coupon that varies inversely with a benchmark index. See Illustration 7 in nonauthoritative Appendix B1-2.

1.64.11. Q—Paragraph 16 of Statement 40 indicates that for investments that are highly sensitive to changes in interest rates, “[d]isclosure information for similar investments may be aggregated.” For governments holding significant concentrations of highly sensitive investments with varying terms, how may the government choose to display the aggregated disclosure requirements?

A—Provided that the portfolio percentage disclosures do not confuse the content of the disclosures, a government may choose to aggregate its highly sensitive investment terms as percentages of the total portfolio. Governments may have long-term strategic asset allocation policies that provide diversification over many asset classes in order to reduce interest rate risk. For example, a pension plan holds a portfolio of 125 individual highly sensitive investments. Thirty of the investments represent 20 percent of the fair value of the portfolio and contain coupon multipliers ranging from 1.25 to 2.5 times the 3-month LIBOR rate. The public employee retirement system (PERS) in this case may disclose that 20 percent of the fair value of its portfolio is invested in securities with coupon multipliers ranging from 1.25 to 2.5 times the 3-month LIBOR. Alternatively, a government may choose to aggregate its highly sensitive investment terms by dollar value. For example, the PERS may indicate that $25 million of the portfolio’s investments are contained within securities with coupon multipliers ranging from 1.25 to 2.5 times the 3-month LIBOR.

1.64.12. [Not used in GASBIG 2015-1]

1.64.13. Q—In disclosing a portfolio’s sensitivity to interest rate changes, a simulation model communicates the effects of volatile investments. In this case, would the additional disclosures for highly sensitive investments required by Statement 40, paragraph 15, be necessary?
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A—The interest rate risk disclosure methods listed in paragraph 15 of Statement 40 range in sophistication from the simple to the complex. Some of the methods in paragraph 15 for disclosing interest rate risk may incorporate sufficient information required of highly sensitive investments so that additional disclosures may not be required. A disclosure that describes the effects of interest rate changes on aggregate portfolio values in both increasing and decreasing interest rate assumptions may include many, if not all, of the investment terms that paragraph 16 of Statement 40, as amended, would require to be disclosed. (See Question 1.63.3.) Specific additional disclosures that should be reported for highly sensitive investments when a simulation model is used to disclose interest rate risk have not been prescribed.

1.64.14. Q—How would the presence of interest rate floors and caps affect the determination of highly sensitive investments?

A—Interest rate floors and caps set the minimum and maximum interest rates to which a variable-rate investment is exposed, reducing the magnitude of fluctuations in fair value caused by interest rate changes. The effects of the cap, floor, or a combination of the two (known as a collar) need to be considered in determining whether an investment is highly sensitive to changes in interest rates. Investments containing a cap, a floor, or a collar may be considered highly sensitive investments because of the associated interest rate option. (See Question 1.64.1.)

Investments containing an interest rate option also may be highly sensitive notwithstanding the presence of interest rate floors and caps. For example, a government owns a variable-rate investment with a coupon that is set at 1.75 times the 3-month LIBOR with a cap of 4 percent, an investment that would be considered highly sensitive if no cap were present. When LIBOR reaches 2.28 percent, the variable-rate investment’s coupon will be capped at 4 percent (2.28 percent × 1.75). If LIBOR stays between 2.28 percent and 4 percent, the fair value of the investment remains over par; however, when LIBOR rises above 4 percent, the investment acts as a fixed-rate investment with a coupon of 4 percent, and its fair value drops accordingly to increases in LIBOR. If the bond has a long maturity, it may be considered to be an investment with a fair value highly sensitive to changes in interest rates. (See Question 1.64.2.)

1.65 Foreign Currency Risk

1.65.1. Q—Should interest rate risk of debt investments denominated in foreign currencies be included in the interest rate risk disclosure?

A—Yes. Governments are not required to segregate investments denominated in foreign currencies from their other investment risk disclosures. Governments may choose to include the interest rate risk of such investments within their interest rate risk disclosures or may choose to present all of the investment risks that the foreign-denominated investment bears within the foreign currency risk disclosure. For example, a government may choose to display its exposure to interest rate risk using the specific identification method. In that case, the government may list each foreign investment by investment type, the currency in which they are denominated, the maturity of each investment, and the investments’ fair values.

1.65.2. Q—Are foreign currency risk disclosures limited to debt investments?

A—No. Foreign currency risk disclosures should be made for all investments denominated in a foreign currency, including debt, equity, and real estate investments.
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1.65.3. [Not used in GASBIG 2015-1]

1.65.4. Q—A government has an investment in an international mutual fund. How much foreign currency disclosure detail is required?

A—A government’s investment in an international mutual fund does not require disclosure of the individual investments within the fund. Provided that the government does not hold a significant portion of its assets in the international mutual fund, disclosure of the fair value and type of the investment is sufficient to acknowledge the government’s exposure to foreign currency risk.

1.65.5. Q—In order to manage its exposure to foreign currency risk, a private-purpose trust enters into a foreign currency overlay—a management plan utilizing derivative instruments that is designed to enhance returns while reducing overall portfolio volatility caused by foreign currency risk. In the trust’s foreign currency risk disclosure, how should the effects of the overlay be described?

A—A government implementing a foreign currency overlay should disclose the foreign currency risk inherent in its underlying investments in accordance with paragraph 17 of Statement 40. Foreign currency investments that are derivative instruments contained within the overlay program are subject to the same foreign currency disclosures as the underlying investments. Additionally, foreign currency derivative instruments should be disclosed in accordance with Statement No. 53, Accounting and Financial Reporting for Derivative Instruments.

1.65.6. Q—A government holds stock of a U.S. corporation that has offshore operations. Does this investment expose the government to foreign currency risk for purposes of Statement 40 disclosures?

A—No. Foreign currency risk is limited to investments denominated in a foreign currency. (See Statement 40, paragraph 6.) Examples of investments that expose a government to foreign currency risk would be bonds denominated in the British pound and an investment made in Japanese yen in a corporation’s stock that trades on Japan’s Tokyo stock exchange.

1.66 Other Disclosures and Issues

Also see paragraph 11 for discussion of disclosure requirements for governmental external investment pools and for sponsors of such pools.

1.66.1. [Not used in GASBIG 2015-1]

1.66.2. [Not used in GASBIG 2015-1]

1.66.3. [Not used in GASBIG 2015-1]

1.66.4. Q—Statement 31, paragraph 15, requires disclosure of involuntary participation in an external investment pool. What constitutes involuntary participation?

A—Participation should be considered involuntary if external requirements mandate that participants place particular moneys with a particular external investment pool or with a
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particular investment pool sponsor. For example, if state law designates the county treasurer as the treasurer of all operating funds of school districts in the county, the participation of the school districts in the county pool should be considered involuntary. This is the case even though the treasurer may offer the school districts a choice of one of three pools; their participation with the pool sponsor is required by state law. If, instead, a school district invests its operating funds with the county treasurer based on the requirements of the school district’s governing board or a bond indenture developed by that board, that participation is not involuntary because it is not externally imposed.

1.66.5. [Not used in GASB 2015-1]

1.66.6. [Not used in GASB 2015-1]

1.66.7. Q—What amortized cost policies are required to be disclosed?

A—A governmental entity should disclose the alternatives it has selected in applying Statement 31. For example, a city may have elected to report certain money market investments at amortized cost or a governmental external investment pool may have elected to report certain debt securities at amortized cost. Further, a government’s election regarding the maturity period for the use of amortized cost (for example, one year) should be disclosed.

1.66.8. Q—Statement 31 requires disclosure of any income from investments associated with one fund that is assigned to another fund. Specifically, what kind of disclosure should be made?

A—Income from investments associated with one fund that is assigned to and reported as revenue of another fund should be disclosed. A statement should be made that interest has been assigned and the amount of the interest should be disclosed. The total assigned interest may be aggregated for this disclosure; individual funds and amounts need not be detailed. No specific disclosure is required if an entity reports investment income in the fund reporting the investment and transfers the income to another fund.

1.66.9. Q—If an entity discloses realized gains and losses, what additional disclosures are required?

A—Statement 31 generally prohibits the separate display of realized gains and losses on the face of the financial statements. However, it permits disclosure in the notes to the financial statements, provided the nature of those amounts and their relationship to the net change in the fair value of investments also is disclosed. That additional disclosure, which also is required if realized gains and losses are displayed in the separate reports of governmental external investment pools, is intended to inform financial statement users about the differences between measurements made based on the cost basis and those made on the fair value basis. Paragraph 15 of Statement 31 describes the required disclosures.

1.66.10. Q—A city government reports its investments using fair value and wishes to disclose realized gains and losses. How should realized gains and losses be computed—as the difference between the proceeds of the sale and the original cost of the investment, or as the difference between the proceeds of the sale and the amortized cost of the investment?

A—Statement 31, paragraphs 13 and 15, requires that fair value realized gains and losses be computed as the difference between the proceeds of the sale and the original cost of the
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investments sold. Disclosure of the amortized cost method of calculating realized gains and losses (calculated as the difference between the proceeds of the sale and amortized cost) is not required because of concerns about the burden of keeping additional amortized cost accounting records. Amortized cost-based realized gains and losses may be presented in addition to, but not instead of, original cost-based realized gains or losses, provided that the method of determining realized gains and losses is fully disclosed. (See Question 1.66.9.)

1.66.11. [Not used in GASBIG 2015-1]

1.66.12. [Not used in GASBIG 2015-1]

1.66.13. [Not used in GASBIG 2015-1]

1.67 Different Fiscal Year-Ends

1.67.1. Q—How should a reporting entity present disclosures required by Statements 3 and 40, as amended, if the fiscal year-end of the primary government differs from the fiscal year-end of one or more component units? Should information about the deposits and investments of component units be presented as of the primary government’s fiscal year-end?

A—If the fiscal year-ends of the primary government and its component units are different, the reporting entity financial statements should include disclosures required by Statements 3 and 40, as amended, from the different fiscal year-ends. Presentation of component unit information as of the primary government’s fiscal year-end is not required (Statement 14, paragraphs 53 and 54, as amended, paragraph 59, and paragraph 60, as amended).

1.68 Reverse Repurchase Agreements

See paragraph 11.

1.69 Effective Date

1.69.1. [Not used in GASBIG 2015-1]

Glossary

5. This paragraph contains definitions of certain terms as they are used in paragraph 4. The items may have different meanings in other contexts.

Affiliates

Companies that are subsidiaries of a common parent or holding company. (See also Bank holding company.)

Agent

a. Generally, a person or firm empowered to act for another. An agent is the substitute or representative of its principal and derives its authority from the principal.

b. For purposes of custodial credit risk disclosures, the term agent is meant within a narrow area of responsibility—that of custodial agent only. A government’s custodial agent has a contractual relationship with the government to hold, at the discretion of the government, securities owned by or pledged to the government. If a financial institution or broker-dealer is both the counterparty and
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the custodial agent in a transaction, its identity as the counterparty takes precedence for classification purposes.

Available balance
The amount of a demand deposit account balance that is available for withdrawal. Often, deposits made into an account are not available for withdrawal for some period of time. (See also Collected funds balance.)

Bank holding company
A company that controls one or more banks and also may own subsidiaries with operations closely related to banking. Generally, the Bank Holding Company Act provides that a holding company has control over a bank if it directly or indirectly owns, controls, or holds with power to vote 25 percent or more of the voting stock of a bank.

Bank investment contract (BIC)
A general obligation instrument issued by a bank, typically to a pension plan, that provides for a guaranteed return on principal over a specified period. Other types of financial institutions also issue investment contracts that, for purposes of Statements 3 and 40, as amended, are treated like BICs. (See also Guaranteed investment contract.)

Bearer securities
Securities whose owners are not registered on the books of the issuer, or registered securities that have been endorsed in blank. Bearer securities are payable to the holder.

Book entry system
A system that eliminates the need for physically moving bearer-form paper or re-registering securities certificates to transfer ownership. To allow securities to be owned and transferred, an accounting system is established for or by the securities issuer or by a central depository. Individual investors hold securities of the systems through the accounts of system members or participants.

Brokerage insurance
For purposes of Statements 3 and 40, as amended, brokerage insurance includes SIPC (Securities Investor Protection Corporation) protection and commercial insurance. (See also Securities Investor Protection Corporation, as defined in Statement 3, paragraph 116.)

Collected funds balance
The amount of a deposit account represented by collected funds. Collected funds include only those deposits made by the account holder that have been received by the depository financial institution from the payor’s financial institution. (See also Available balance.)

Custodian
The entity responsible for possession and safeguarding of securities.

Customer account
An account in a book entry system that indicates that the account owner does not own the securities but is holding them for someone else.

Deposits with financial institutions
Deposit accounts in banks, savings and loan associations, and credit unions.
Federal Reserve pledge account
An account in which securities have been segregated on the books of the Federal Reserve and identified as being pledged to a specific public entity with the Federal Reserve serving as the custodian. In this instance, the pledgee is known to the Federal Reserve, and the Federal Reserve provides pledge-related notices directly to the pledgee. The pledge account is in the name of the pledgor financial institution, but the pledgor does not have the ability to access the securities while they remain in the pledge account. Any release or substitution of pledged collateral can be done only with the permission of the pledgee government.

Guaranteed investment contract (GIC)
A general obligation instrument issued by an insurance company, typically to a pension plan, that provides for a guaranteed return on principal over a specified period. The general assets of the issuing company support the GIC. Investment contracts issued by noninsurance companies are similar in substance to GICs, and except for those issued by financial institutions, are treated like GICs for purposes of Statements 3 and 40, as amended. (See also Bank investment contract.)

Insurance
For purposes of custodial credit risk disclosures, insurance relates only to guarantees on the performance of the custodian. (See also Brokerage insurance and Depository insurance, as defined in Statement 40, paragraph 19.)

Investment types
Investments are of different types when they take different forms. Different investment risks, such as market risk and issuer credit risk, are basic features that give one investment a different form from another. Investment types illustrated in the nonauthoritative appendices to Statements 3 and 40, as modified, include repurchase agreements, U.S. government securities, bankers’ acceptances, commercial paper, and corporate bonds.

Legal provisions
Requirements that carry the force of law, including those arising from constitutions, statutes, charters, ordinances, resolutions, governing body orders, and intergovernmental grant or contract regulations.

Mutual fund
An investment company operates a mutual fund by selling shares of its stock to investors, and it invests, on the shareholders’ behalf, in a diversified portfolio of securities.

a. An open-end mutual fund creates new shares to meet investor demand, and the value of an investment in the fund depends directly on the value of the underlying portfolio. An open-end mutual fund generally does not issue certificates; instead, it sends out periodic statements showing deposits, withdrawals, and dividends credited to the investor’s account. Investments in open-end mutual funds are not subject to custodial credit risk disclosures.

b. A closed-end mutual fund has a constant number of shares, and the value of an investment in the fund depends on the market supply and demand for the shares rather than directly on the value of the company’s portfolio. A closed-end fund does issue certificates, and the securities are traded on a stock exchange. Investments in closed-end mutual funds are subject to custodial credit risk disclosures.

National Credit Union Share Insurance Fund (NCUSIF)
A fund administered by the National Credit Union Administration, an independent agency of the U.S. government, to provide deposit insurance for accounts in member credit unions.
Nominee name
A term that denotes arrangements used principally by institutional investors, financial agents, and securities depositaries for the registration of securities held by them for their own account or the account of customers. In most instances, the nominee is a partnership formed solely for the purpose of acting as the record holder of the securities.

Street name
A term used by the securities industry to denote securities registered or held in a book entry system in the name of a brokerage firm or its nominee. Such securities frequently belong to customers of the firm.

Tri-party repurchase agreement
A repurchase agreement in which the custodian serves as agent both of the buyer-lender and of the seller-borrower by agreeing, in the event of default by one, to protect the interests of the other. The custodian holds the securities underlying the agreement in the names of both repurchase agreement parties (the buyer-lender as pledgee and the seller-borrower as owner).

Trust department
A department of financial institutions, such as commercial banks, savings banks, and savings and loan associations, that is authorized by and regulated under various state and federal laws. Assets held by trust departments as custodial agents for outside parties are considered legally separate from the assets of the financial institution and are held strictly on a fiduciary basis. Nonfinancial institution broker-dealers do not have trust departments. Safekeeping departments are not trust departments.

Unit investment trust
A diversified portfolio of securities. The portfolio is fixed; once structured, it is not actively managed. Cash received from income and maturing investments is not reinvested but is distributed to shareholders of the trust. Unit investment trust shares are securities and are traded. Investments in unit trusts may be subject to custodial credit risk disclosures.

Cash Flows Reporting
6. Questions and answers in this paragraph address issues related to cash flows reporting.

2.1 Introduction

2.2 FASB Statement 95

2.2.1. [Not used in GASBIG 2015-1]

2.3 Scope and Applicability of Statement 9

2.4 Reporting Entity Issues
2.4.1. Q—Paragraph 456 in the Basis for Conclusions of Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, explains that users interested in cash flow information about a specific component unit should refer to the component unit’s separately issued financial statements. If a component unit does not issue separate financial statements, is cash flow information for the component unit required to be presented in the reporting entity’s comprehensive annual financial report (CAFR)?

A—Yes. If a component unit does not issue separate financial statements, fund financial statements for that component unit should be included in the reporting entity’s CAFR. Therefore, if the component unit has proprietary funds, cash flow statements for those funds would be included in the major component unit information in the reporting entity’s CAFR as supplementary information.

2.4.2. Q—Does Statement 9 apply to component units when they are included in a governmental financial reporting entity? Does it matter if the component units are blended or discretely presented?

A—Generally, a statement of cash flows is not required for discretely presented component units. (See Questions 2.4.1 and 4.28.10.) Paragraph 125 of Statement 34, as amended, requires discrete presentation of component unit financial data in the reporting entity’s statement of net position and statement of activities—there is no “government-wide” cash flows statement. However, the balances and transactions of blended component units are included as if they were balances and transactions of the primary government itself. Therefore, if a component unit is “blended” as an enterprise fund, a statement of cash flows would be required for that fund, either presented separately as a major fund or aggregated with other nonmajor enterprise funds.

2.4.3. Q—A public university uses the business-type (BTA) activities model and has a closely related fund-raising foundation that meets the component unit criteria in Statement No. 39, Determining Whether Certain Organizations Are Component Units. The foundation’s financial statements will be included through discrete presentation. Is the university required to include the foundation’s cash flow information in its statement of cash flows?

A—No. Paragraph 125 of Statement 34, as amended, states that the discrete presentation requirements are met by displaying component unit financial data in the statements of net position and activities. Even though that requirement is stated in terms that apply to reporting governmental activities, the standard should be comparably applied, in substance, to the BTA model. That is, component unit data should be included by discrete presentation in the statements of financial position (statement of net position/balance sheet) and changes in financial position (statement of revenues, expenses, and changes in net position). Paragraph 125 does not include a requirement to display component unit cash flow information.

2.5 Public Employee Retirement Systems and Pension Trust Funds

2.5.1. Q—Are PERS prohibited from presenting a statement of cash flows? If a statement of cash flows is presented, should it conform to the Statement 9 requirements, as amended, or can the presentation be modified?

A—PERS are not required to present a statement of cash flows; however, they are not precluded from presenting it as supplementary information. Statement 9 establishes standards
Cash Flows Reporting

...for the basic financial statements; it does not prescribe requirements for data presented as supplementary information. PERS that present a statement of cash flows as supplementary information may choose, but are not required, to present that statement in accordance with the provisions of Statement 9, as amended.

2.6 Colleges and Universities

See Questions 2.4.3 and 2.7.2.

2.6.1. [Not used in GASBIG 2015-1]

2.6.2. [Not used in GASBIG 2015-1]

2.6.3. [Not used in GASBIG 2015-1]

2.7 Other Applicability Issues

2.7.1. Q—In the private sector, certain investment companies are exempted from presenting a statement of cash flows. Are public-sector investment pools similarly exempt?

A—Yes. Paragraph 17 of Statement 31, as amended, states that “... annual financial reports for governmental external investment pools should include a statement of net position and a statement of changes in net position. ... A statement of cash flows is not required to be presented.” Paragraph 18 of that Statement, as amended, requires sponsoring governments to use investment trust funds to report the external portions of their investment pools. It states that “... the sponsoring government should present for each investment trust fund a statement of fiduciary net position and a statement of changes in fiduciary net position.”

2.7.2. Q—Should agency cash flows be included in the statement of cash flows for a university that reports using the BTA model?

A—A statement of cash flows is required for proprietary funds and entities that use proprietary fund accounting. A statement of cash flows is not required for fiduciary funds. Therefore, if the university does not use fiduciary funds, and instead includes the agency cash and cash equivalent balances with the cash and cash equivalents reported on the university’s statement of net position, the receipts and disbursements pertaining to agency activity should be included.

2.7.3. Q—Should a proprietary fund that has no operating income or loss present a statement of cash flows?

A—Yes. A statement of cash flows should be presented for all proprietary funds even if operating income is zero. Transactions other than those resulting in operating income create cash flows that should be presented in the statement of cash flows. If there is no operating income or loss for the period, the reconciliation of operating income to net cash flow from operating activities would begin with zero. Adjustments and reconciling items should be presented as additions to and deductions from zero to arrive at the amount of net cash flow from operating activities.

2.7.4. [Not used in GASBIG 2015-1]
2.8 Financial Reporting of Cash Flows

2.9 Purpose of a Statement of Cash Flows

2.10 Focus on Cash and Cash Equivalents

2.11 Definition of Cash and Cash Equivalents

2.11.1. Q—Is the definition of cash equivalents limited to investments with an original maturity of three months or less?

A—Generally, the three-month criterion is the deciding factor. The definition of cash equivalents in Statement 9, paragraph 9, first refers to short-term, highly liquid investments that are (a) both readily convertible to known amounts of cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Although this definition appears to be somewhat broad, the reference to “three months or less” provides more specific guidance.

Because the definition of cash equivalents is a vital part of a cash flow presentation, a uniform definition should be used by all governmental enterprises. Therefore, generally only investments with original maturities of three months or less meet the definition of cash equivalents.

2.11.2. Q—When should the term original maturity be applied to investment purchases?

A—Original maturity is based on the date the governmental enterprise purchases an investment. If, on the purchase date, a qualifying investment will mature in three months or less, it meets the definition of a cash equivalent. The evaluation should be made only once, as of the purchase date. (See footnote 6 of Statement 9 for further explanation.)

2.11.3. Q—How should a negative cash balance be presented in the statement of cash flows?

A—For purposes of the statement of cash flows, a negative cash balance should be assumed to be zero. This is consistent with traditional balance sheet reporting of zero cash and a liability for the negative amount. Because the accumulation of cash flows during the period results in a negative cash balance, an adjustment should be made to the cash flow amounts. An increase to zero in cash balance should be incorporated into the statement of cash flows by reporting an inflow in the noncapital financing activities category. This presentation reports the circumstances as if the banking system (or cash management pool) implicitly financed the negative cash situation. In the subsequent period, an assumption should be made that the “loan” was repaid, and a noncapital financing outflow should be reported.

The presentation of implicit financing contradicts the requirement that cash flows not be reported unless they actually occur. The alternatives to this solution, however, are impractical and also have their own inconsistencies and contradictions. (See Example B in nonauthoritative Appendix B2-1.)

2.12 Investments and Cash Equivalents Definition Policy

2.12.1. Q—What are the cash flow statement ramifications of opting to treat an investment instrument that meets the definition of a cash equivalent as an investment?
A—If an instrument is treated as a cash equivalent, its conversion to or from cash or another cash equivalent would not be reported on the statement of cash flows. The transaction is analogous to the transfer of cash between two checking accounts. If, on the other hand, an instrument is treated as an investment, its conversion to or from cash or a cash equivalent should be reported in the investing activities category of the statement of cash flows, and the cash flows usually should be presented gross.

2.12.2. Q—Can restricted cash equivalents be treated as investments if similar unrestricted cash equivalents are treated as cash equivalents?

A—Yes. Identifying restricted cash equivalents that are similar to unrestricted cash equivalents as investments is acceptable according to the provisions of paragraph 11 of Statement 9. As long as an entity formulates and discloses a specific policy for defining cash equivalents, it may elect to treat any type of cash equivalents as investments. For example, Treasury bills with 60-day maturities in a restricted portfolio may be treated as investments even if unrestricted Treasury bills with the same maturities are treated as cash equivalents. (Paragraph 52 of the Statement 9 Basis for Conclusions states that “... governmental enterprises may choose to treat their restricted cash equivalents or unrestricted cash equivalents as investments.”)

2.13 Cash Management and Investment Pools

2.13.1. Q—When attempting to determine whether a participant is using an internal cash management or investment pool as a demand deposit account, is it important to consider the pool’s liquidity?

A—Yes, to some extent. A participant’s equity in an internal cash management or investment pool should not be considered cash unless the participant is able to withdraw cash at any time without prior notice or penalty. (Footnote 5 of Statement 9 acknowledges that cash includes “deposits in other kinds of accounts or cash management pools that have the general characteristics of demand deposit accounts in that the governmental enterprise may deposit additional cash at any time and also effectively may withdraw cash at any time without prior notice or penalty.”) If the pool is not liquid enough to enable a participant to make such demands on the pool, the participant is not able to use its equity in the pool as a demand deposit account. Stated another way, an investment pool should be evaluated as if it were a mutual fund. To some extent, the pool’s investments affect the ability of participants to use the pool as a demand deposit account. Also important are the number of participants and the likelihood that their withdrawals could overburden the pool. For cash flow reporting purposes, the equity in a pool that is not sufficiently liquid to enable withdrawal without prior notice or penalty should be treated as an investment.

2.13.2. Q—Can an internal investment pool that is not being used by some participants as a demand deposit account be treated as cash by those participants who do use their equity in the pool as a demand deposit account?

A—Yes. The determination of whether a pool is being used as a demand deposit account should be made by each participant, independently of how other participants use the pool. If the pool is managed in such a way as to allow the governmental enterprise making the evaluation to deposit and withdraw funds as if it were a demand deposit account, that governmental enterprise’s equity in the pool could be considered cash.
2.13.3. Q—Does restricted cash that is pooled by a bond paying agent meet the definition of a cash management or investment pool?

A—For cash flow reporting purposes, a pool operated by a bond paying agent is very similar to a mutual fund or an internal cash management or investment pool. If the bond paying agent pools the assets it receives from various sources and allocates investment earnings to all participants, the assets should be viewed as equity in a pool. According to footnote 5 of Statement 9 (and explained in paragraph 50 of the Basis for Conclusions), equity in a pool should be treated as either cash or an investment. If the governmental enterprise is able to deposit additional cash at any time and also effectively may withdraw cash at any time without prior notice or penalty, the equity in the pool may be treated as cash. If not, it is an investment.

Because the equity in the pool is restricted, there may be a question about whether the governmental enterprise may withdraw cash at any time. Even though the governmental enterprise may not be able to access its equity in the pool because the assets are legally restricted, it is able to withdraw cash by directing the bond paying agent to pay bondholders or others for whom the assets are restricted. The legal restrictions affect the governmental enterprise’s access to the assets and the timing of payment to bondholders, but the restrictions do not change the characteristics of the account in which the assets are held. Statement 9, paragraph 8, disregards restriction of use as a factor in determining whether an asset meets the definition of cash or a cash equivalent.

2.13.4. Q—Does the issuance of warrants reduce cash?

A—Yes. The issuance of warrants, rather than the subsequent acceptance by the treasurer of the warrants, effectively reduces cash. That reduction of cash creates a cash flow. The substance, rather than the legal form, of the warrants should prevail. In a warrant system, participants draw down an available cash balance by issuing warrants. The system operates essentially as an internal cash management pool. It is irrelevant whether a warrant has been redeemed, just as it is irrelevant whether a check has been cashed, for determining cash balance. (See Question 2.11.3 for further explanation of cash flow timing.)

2.13.5. Q—Is there a cash flow to be reported in the statement of cash flows if an internal cash management pool engages in reverse repurchase agreement transactions with a third party?

A—No. If a reverse repurchase agreement is transacted through an internal cash management or investment pool, there are no cash flows directly into or out of an individual fund participating in the pool. The pool receives the borrowed cash and is obligated to “repurchase” the instrument at a later date. Reverse repurchase agreement activity in an internal cash management or investment pool should have no effect on the participants’ statements of cash flows—neither on the cash flows reported nor on the beginning and ending balances of cash and cash equivalents.

Interpretation No. 3, Financial Reporting for Reverse Repurchase Agreements, as amended, explains that, when a pool engages in a reverse repurchase agreement, the participating funds should be allocated to the related asset and liability and the interest income and expense. An allocation, however, is not a cash transaction to be presented in the statement of cash flows.
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2.14 Relationship with GASB Statements 3 and 40

2.14.1. Q—How does the definition of cash equivalents correspond with the definitions of deposits and investments in Statements 3 and 40?

A—Statements 3 and 40 distinguish between deposits with financial institutions and investments. The two are mutually exclusive. The Statement 9 definition of a cash equivalent overlaps the definitions of deposits and investments. A cash equivalent, when evaluated for Statement 3 and 40 purposes, is either a deposit or an investment. That is, a 60-day certificate of deposit is a deposit with a financial institution, and a Treasury bill purchased 60 days before its maturity is an investment. But for cash flow reporting purposes, both qualify as cash equivalents because their original maturities are three months or less. The fact that a cash equivalent is a deposit or an investment has no effect on the presentation of the statement of cash flows.

2.14.2. Q—How should differences between the Statement 9 definition of cash equivalents and the Statements 3 and 40 definitions of deposits and investments be reconciled?

A—The Statement 9 definition of cash equivalents affects reported cash flows and beginning and ending cash and cash equivalent balances, as well as presentation of the related assets on the statement of net position/balance sheet. Statements 3 and 40 primarily address disclosure in the notes to the financial statements. The financial statement presentation requirements of Statement 9, as they relate to the presentation of cash equivalents, take precedence over discussions of deposits and investments in Statements 3 and 40. There is no requirement to reconcile the disclosures required by Statement 3, as amended, or Statement 40, as amended, to the statement of cash flows or to the statement of net position/balance sheet; however, some believe a reconciliation provides useful information. (See Question 1.26.6. See also Questions 2.31.1 and 2.31.2 for a discussion of the Statement 9 requirements for articulation between the statement of cash flows and the statement of net position/balance sheet.)

2.15 Identifying a Cash Flow

2.15.1. Q—When has a cash flow occurred?

A—Sometimes there may be a question as to whether a cash transaction has occurred. It may be confusing to identify a cash flow in a banking environment. Generally, cash flows only if it changes hands; that is, ownership of cash legally changes. In an internal exchange transaction conducted totally within a bank, a cash transaction occurs only if a debit or credit is made to a governmental enterprise’s bank account. For example, a service charge or interest income is considered to be a cash transaction on the date the bank posts the amount to the account. After that date, the interest amount is available for withdrawal or the amount posted for the service charge is no longer available for withdrawal. Another example is a loan granted by a bank. If the loan proceeds are credited to the borrower’s bank account, a cash flow occurred. If the bank remitted the proceeds directly to the vendor, a noncash financing activity occurred. (See Question 2.32.1 for a discussion of noncash transactions.)

2.15.2. Q—How should bond issuance costs and underwriter fees be presented in the statement of cash flows?

A—If bond issuance costs and underwriter fees were deducted from bond proceeds, the governmental enterprise experienced only one cash flow. The net amount of bond proceeds...
actually received should be presented as a cash inflow in the appropriate category (either capital and related financing or noncapital financing, depending on the purpose of the borrowing).

On the other hand, if a governmental enterprise receives the proceeds from the sale of bonds and pays bond issuance costs and underwriter fees separately, the following cash flows should be presented: The total amount of bond proceeds should be presented as a cash inflow in the appropriate category (either capital and related financing or noncapital financing, depending on the purpose of the borrowing). The costs and fees that are paid from the governmental enterprise’s cash or cash equivalents should be presented as cash outflows in the same category. (See Examples A, C, E, and F in nonauthoritative Appendix B2-1.)

2.15.3. Q—Are there cash flows associated with bond refundings?

A—Cash flow reporting of a defeasance of debt is addressed in paragraph 29c of Statement 9 and in Question 2.19.3. Paragraph 29c presumes that the refunding transaction resulted in cash flows. If the proceeds from the new bond issue are not converted into cash or a cash equivalent of the governmental enterprise before being used to defease the obligations associated with the refunded debt, there would be no cash flows to present in the statement of cash flows. (There are cash flows resulting from bond proceeds’ being placed in escrow if the escrow assets are reported on the balance sheet.) If the transaction does not affect cash or cash equivalents, it should be disclosed as a noncash financing activity. (See Questions 2.32.1 and 2.32.2 on noncash disclosures; see also Examples A and D in nonauthoritative Appendix B2-1.)

2.15.4. Q—Should a cash flow be presented if the proceeds of revenue bonds issued by a finance authority are remitted directly to another organization?

A—No. If bond proceeds are remitted directly to another organization, there are no cash flows to report. If, however, the proceeds are received by the governmental enterprise (deposited in a cash or cash equivalent of the governmental enterprise) for distribution to another organization, cash flows do occur. The governmental enterprise is operating as an intermediary. Because the cash inflow and the cash outflow do not meet the criteria of the capital and related financing, noncapital financing, or investing activities category, both should be presented in the operating activities category. The operating activities category is the residual category.

2.15.5. Q—If a certificate of deposit that does not meet the definition of a cash equivalent automatically rolls over at maturity, is there a cash flow?

A—No. A cash flow does not occur unless there is a deposit to or withdrawal from cash or a cash equivalent. Therefore, a rollover does not affect the statement of cash flows. The certificate of deposit is merely converted from one investment instrument to another.

2.15.6. Q—If a trustee is administering a restricted investment portfolio for a governmental enterprise, should the investing activities be presented in the governmental enterprise’s statement of cash flows?

A—Yes. The investing cash flows should be presented on the statement of cash flows as if the governmental enterprise were managing the investments. The trustee is managing investments that belong to the governmental enterprise and are held in the name of the governmental enterprise, even though they are restricted. The investment portfolio is presented in the
governmental enterprise’s statement of net position/balance sheet, and its performance is presented in the governmental enterprise’s operating statement. This arrangement is different from a cash management or investment pool arrangement, in which a fund manager commingles the assets provided by others. In a pool, each participant owns a share of the pooled assets and their earnings, rather than specific securities. (See Question 2.13.3.)

2.15.7. Q—How should the statement of cash flows display the net increase (decrease) in the fair value of investments?

A—The increase (decrease) in the fair value of investments is not a cash flow. However, changes in fair value (or amortization) of investments that meet the definition of cash equivalents in paragraph 9 of Statement 9 should be reported as cash flows from investing activities. These changes are readily convertible to known amounts of cash and are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. When the net increase (decrease) in the fair value of investments is reported in the change statement as part of operating income, the change is presented as an element in the reconciliation of operating income to net cash provided by operating activities. (See also Question 2.21.1.)

2.16 Gross versus Net Reporting

2.16.1. Q—Should a governmental enterprise that qualifies for netting its investing activities under paragraph 14 of Statement 9 test for qualification every year?

A—Statement 9 states that information about gross cash receipts and payments is generally more relevant than net cash flow information. Therefore, the provision allowing a governmental enterprise to report certain cash flows net is an exception that should be used only after careful consideration. A governmental enterprise that qualifies for netting in one year should not presume to qualify permanently because it is possible to meet the criteria in one reporting period but not in another. Paragraph 14 lists two criteria that should be met in order for a governmental enterprise to qualify for net reporting of investments, and both should be evaluated throughout the year: “(a) during the period, substantially all of the governmental enterprise’s assets were highly liquid investments (for example, marketable securities and other assets for which a market is readily available) and (b) the governmental enterprise had little or no debt, based on average debt outstanding during the period, in relation to average total assets.” The basic characteristics of a governmental enterprise that qualifies for this netting provision should be called into question if they are subject to change. Essentially, the exception was designed to facilitate the cash flow reporting of governmental enterprises engaged solely in managing a highly liquid investment portfolio. If high liquidity varied from year to year, the governmental enterprise would not meet the spirit of the exception in any year.

2.16.2. Q—Paragraph 19 of Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations, states that the measurement of a government’s pollution remediation expense should include all remediation work that the government expects to perform, reduced by expected recoveries from other parties and from policies that indemnify the government for its pollution remediation obligations. Should receipts of recoveries also reduce outflows reported on the statement of cash flows?

A—No. All cash flows for pollution remediation activities should be reported gross, in accordance with the provisions of Statement 9.
2.17 Classification of Cash Flows

2.17.1. Q—Can governments “indirectly” determine direct method cash flows?

A—Yes. Generally, governments can estimate certain direct method cash flow amounts by adjusting for beginning and ending receivables and payables. Exercise 7 in nonauthoritative Appendix B7-3 illustrates how that can be done.

2.18 Operating Activities—General

2.18.1. Q—Does the nature of a fund’s “operations” determine which cash flows should be presented in the operating activities category?

A—No. As stated in paragraph 7 of Statement 9, “the primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an entity during a period.” It was determined that the most useful presentation is to provide information about capital and related financing, noncapital financing, and investing activities, as well as cash flows from operating activities. The Statement defines the categories from a functional perspective. Although the operating activities category also is defined, it serves as the residual category. Therefore, cash flow transactions should be evaluated first according to the definitions of capital and related financing, noncapital financing, and investing activities before being included in the operating activities category.

The operating activities category of the statement of cash flows is not intended to be a cash-basis operating statement. The format prescribed in Statement 9 is intended to complement the accrual-basis financial statements. In addition, the presentation is not intended to imply that one category is more desirable than any other category. Therefore, there should be no predilection for classifying cash flows in the operating activities category or any other category.

2.18.2. Q—Should all items reported as part of operating income be included in the operating activities category?

A—Not necessarily. Classification of a transaction for operating statement purposes should not dictate its classification in the statement of cash flows. As discussed in Question 2.18.1, the transaction should be evaluated first according to the definitions of the capital and related financing, noncapital financing, and investing activities categories.

Paragraph 16 of Statement 9 states that “cash flows from operating activities generally are the cash effects of transactions and other events that enter into the determination of operating income.” It was believed that most nonoperating income items would be classified in other than the operating activities category. The reconciliation of operating income to cash flows from operating activities would have fewer reconciling items if the operating activities category were highly correlated to operating income. However, paragraph 16 definitively states that the operating activities category includes “all transactions and other events that are not defined as capital and related financing, noncapital financing, or investing activities.” Therefore, operating income should not be considered a criterion for classifying cash flows.

If a transaction is included in operating income and its resulting cash flow meets the definition of a category other than operating activities, the item should be presented as a reconciling item in the reconciliation of operating income to net cash flow from operating activities. For example, if a finance authority reports interest income as a component of operating income, the cash
received from interest income should be presented in the investing activities category. The reconciliation of operating income to net cash flow from operating activities should begin with reported operating income, and the interest income amount should be deducted as a reconciling adjustment to operating income, similar to depreciation. (See Questions 7.73.1–7.73.5.)

2.19 Debt

2.19.1. Q—Should debt proceeds be classified in the capital and related financing activities category if the proceeds are distributed to component units for capital purposes?

A—No. The debt proceeds should be presented as a noncapital financing cash inflow, and subsequent debt service payments should be presented as noncapital financing cash outflows. Whether a financing activity meets the definition of capital depends on the use of the proceeds. If a governmental enterprise distributes the proceeds, it is not using the proceeds to acquire, construct, or improve its own capital assets. Therefore, the debt should not be considered capital debt for purposes of the statement of cash flows. Distribution of debt proceeds is similar to grant transactions. With regard to grant transactions, the grantor should classify all grants (except for certain operating-type grants) as noncapital financing activities, regardless of whether the grantee uses the grant for capital or noncapital purposes. To preserve classification symmetry, the proceeds of debt issued for the purpose of making grants for capital purposes should also be treated as noncapital financing activities.

2.19.2. Q—How should interest earnings on capital debt proceeds that are temporarily invested before being used for construction be classified?

A—Investment earnings should be considered an investing activity. Classification of cash flows usually should be based on the nature of the transaction.

2.19.3. Q—How should bond refunding transactions be presented?

A—Paragraph 29c of Statement 9 provides guidance for classifying bond refunding transactions:

In a defeasance of debt, the proceeds of a refunding debt issue used to refund capital debt should be reported as a cash inflow in the capital and related financing category and the payment to defease the existing capital debt should be reported as an outflow in that category. Similarly, subsequent principal and interest payments on the refunding debt should also be reported as cash outflows in the capital category. If the refunding issue is in excess of the amount needed to refund the existing capital debt, the total proceeds and the subsequent principal and interest payments should be allocated between the capital category and the noncapital financing category based on the amounts used for capital and noncapital purposes.

If the new bonds result in an in-substance defeasance and cash flows actually occur (see Question 2.15.3), there should be symmetry in reporting the cash flows related to the refunding. The outflow to a trustee or fiscal agent to defease the debt should be presented in the same category as the debt service payment on the old debt. The proceeds should be classified as an inflow of the same category. The new debt assumes the characteristics of the old debt. Subsequently, the new debt issue should be classified in the same manner as the defeased
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debt. For example, if the original debt was for capital purposes, the new debt should be considered capital debt.

However, paragraph 29c explains that an entire refunding issue may not assume the characteristics of the old debt if the refunding debt exceeds the amount needed to defease the existing debt. If debt is issued for a dual purpose—to defease a noncapital debt issue and to finance new construction, for example—it should be allocated according to its purposes. The portion required to defease the old debt assumes the characteristics of the old debt. The remainder should be evaluated according to its purpose and is classified appropriately. (In this case, the remainder would be classified as a capital financing activity.) (See Example A in nonauthoritative Appendix B2-1.)

2.19.4. Q—Should a subsidy received to finance capital debt service be classified as capital or noncapital financing?

A—The subsidy should be reported by the recipient as an inflow in the capital and related financing activities category. A subsidy received specifically to finance capital debt service payments is an indirect way of financing capital acquisition, construction, or improvement. Therefore, it should be reported in the same way as a capital grant or other contribution received to defray capital costs. (See Example I in nonauthoritative Appendix B2-1.)

2.20 Nonoperating Income Items

2.20.1. [Not used in GASBIG 2015-1]

2.20.2. Q—How should royalty income be evaluated for statement of cash flows classification?

A—The asset underlying the royalties should be evaluated to determine whether it should be treated as an investment for cash flow reporting purposes. If it should, the royalty income should be classified as an investing activity. If not, it should be classified in the residual category—operating activities.

2.20.3. Q—How should contributions received by an enterprise fund that are not intended for capital purposes be classified?

A—Paragraph 21b of Statement 9 defines “noncapital” grants and subsidies as noncapital financing activities. A noncapital contribution to an enterprise fund would normally be used the same as a grant or subsidy; therefore, it should be classified as a noncapital financing inflow. (See Example I in nonauthoritative Appendix B2-1.)

2.20.4. Q—How should commodities donated to a school lunch program be reported if they are recorded as both an operating expense and nonoperating revenue on the operating statement?

A—Commodities are noncash items that should not be presented in the statement of cash flows. However, the amount of the expense will appear as a reconciling adjustment in the reconciliation of operating income to net cash flow from operating activities. (See Illustration B, Exhibit 29, in nonauthoritative Appendix B7-1.)

2.20.5. Q—How should the cash flows resulting from miscellaneous income and expense be classified?
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A—Miscellaneous cash flows should be included in the operating activities category even if the income or the expense is considered a nonoperating income item. The operating activities category is not limited to the cash flows resulting from operating income items. Unless the cash flows specifically meet the definition of the noncapital financing, capital and related financing, or investing activities category, they should be presented in the residual category—operating activities. If nonoperating income items, such as miscellaneous income or expense, are included in the operating activities category, an adjustment should be made to operating income in the reconciliation of operating income to net cash flow from operating activities. (See Example H in nonauthoritative Appendix B2-1.)

2.21 Investment Earnings

2.21.1. Q—Where should gains and losses on investments be presented?

A—Gains and losses, per se, should not be presented in the statement of cash flows. Rather, proceeds from the sale of the investments (including gains and net of losses) should be reported as a cash inflow in the investing activities category. (See also Question 2.15.7.)

2.21.2. Q—Investment earnings are sometimes (although rarely) included in operating income. Should the cash flows be classified as an operating activity?

A—No. Investment earnings should be classified in the investing activities category.

The statement of cash flows is not intended to replicate, on a cash basis, the operating statement. It is intended to complement the accrual-basis financial statements. The classification of cash flows provides functional information about financing and investing activities. This approach concentrates on the underlying nature of a transaction. Therefore, earnings on investments should be classified as investing activities, regardless of why the investments are made, what the earnings are used for, and where the income is reported on the operating statement. (Except that interest received on qualifying program loans should be classified as operating inflows. See Question 2.25.1.)

If investment earnings are included in operating income, the related cash flows should be presented as a deduction from operating income in the reconciliation of operating income to net cash flow from operating activities (just as depreciation is adjusted).

2.21.3. Q—How should interest on cash and cash equivalents be classified?

A—Interest earnings, by nature, are an investing activity; therefore, interest on cash and cash equivalents should be considered an investing activity. The discussion in the answer to Question 2.21.2 is relevant to this question. Even though cash and cash equivalents are not investments, the interest they earn should be classified the same as interest earned on investments. (See Examples A and H in nonauthoritative Appendix 2-1.)

2.21.4. Q—How should interest on customer deposits be classified?

A—Although customer deposit transactions are considered operating activities (see Question 2.24.1), interest earned on the deposits is an investing activity. As discussed in Question 2.21.2, regardless of whether the customer deposits are held as cash, investments, or restricted assets, the interest should be classified as investing activities. (However, distribution
of the interest to customers is an operating activity because the cash flow does not meet the
definition of any of the other categories.)

2.22 Taxes

2.22.1. Q—Should property taxes levied specifically for capital debt service requirements be classified as capital or noncapital financing?

A—Paragraph 24e of Statement 9 identifies property taxes received specifically to finance the acquisition, construction, or improvement of capital assets as a capital and related financing activities inflow. Property taxes levied specifically for capital debt service are indirectly financing the costs of capital acquisition, construction, or improvement by directly financing debt service. Therefore, the taxes received should be classified as capital and related financing activities. This link is necessary for symmetry in cash flow reporting.

2.22.2. Q—Would property taxes levied by a hospital district for care of indigent patients be classified as an operating activity?

A—No. Property taxes, unless levied for capital purposes, should be classified as a noncapital financing activity (Statement 9, paragraph 21d). Even if the amount levied is calculated to finance estimated costs of care of the indigent, it is not a charge for services. Instead, property tax payers are financing the care of the indigent. The nature of the receipt is a subsidy, which is defined in Statement 9 as a noncapital financing activities inflow. (See Example I in nonauthoritative Appendix B2-1.)

2.23 Investment Instruments

2.23.1. Q—How should transactions to provide for prize annuities be classified in a lottery’s statement of cash flows?

A—The discussion of debt defeasance in Question 2.19.3 is relevant to the issue of lottery annuities. If, for example, a lottery purchases an annuity in a prize winner’s name and the transaction meets the requirements for right of setoff, the purchase should be considered an operating activities cash outflow (as though it paid the prize winner directly). If, on the other hand, a lottery purchases a series of investments, such as federal Treasury STRIPS, in its own name to allow it to service its prize awards as they come due, there are (at least) three cash flows to report. The purchase of the STRIPS and the proceeds received at maturity are investing activities cash flows. The cash payment to the prize winner is an operating activities cash flow. (See Example H in nonauthoritative Appendix B2-1.)

2.23.2. Q—A state government authority received a cash payment in exchange for the future cash flows from the collections of significant delinquent accounts receivable. How should the cash payment received be reported in the statement of cash flows?

A—If the transaction meets the criteria in paragraph 6 of Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues, the receivables are considered to have been sold and the cash flows from that sale should be reported as cash flows from operations. If those criteria are not met, the transaction is considered to be a borrowing, and the cash flows would be classified in the noncapital or capital and related financing category, depending on the nature of the receivables.
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2.23.3. Q—How should hedging transactions be presented in the statement of cash flows?

A—Although Statement 9 does not specifically refer to hedging transactions, it does provide specific guidance for classifying the cash flows. A borrowing transaction should be considered a noncapital financing activity, and an investing transaction should be considered an investing activity.

2.24 Cash Flows Not Reported on the Operating Statement

2.24.1. Q—How should refundable customer deposits be classified?

A—Cash flows from deposits made by customers, and the eventual repayment of the deposits, should be classified as operating activities because the transactions do not meet the definitions of either the financing activities categories or the investing activities category. (The operating activities category is the residual category.) Although the deposits are refundable, they are not loans from customers. Therefore, these are not financing activities. And although the deposits may be invested or may otherwise earn interest (see Question 2.21.4), the receipts of the deposits are not investing activities. (See Example A in nonauthoritative Appendix B2-1.)

2.24.2. Q—How should a lender and a borrower present the cash flows resulting from interfund loans?

A—Statement 9 presumes that interfund cash flows are noncapital financing activities. The exceptions are specific: interfund services provided and used, interfund reimbursements, and receipts for capital purposes. Therefore, interfund loan activity should be classified as noncapital financing. However, if the loan is intended to finance capital acquisition, construction, or improvement, the borrower should classify the related cash flows in the capital and related financing activities category.

For example, for the borrower, an interfund loan received to cover a temporary cash deficiency would be considered a noncapital financing activity; however, an interfund loan received for the purchase of new vehicles would be considered a capital and related financing activity. In both cases, the lender would report those cash outflows as noncapital financing activity.

2.24.3. Q—How should capital contributed by developers and other individuals be classified?

A—Cash contributed specifically to defray the cost of acquiring, constructing, or improving capital assets should be presented in the capital and related financing activities category, as required by paragraph 24c of Statement 9. Noncash transactions (such as the contribution of water and sewer lines by a developer) should be disclosed in a schedule to the statement of cash flows. (See Questions 2.32.1 and 2.32.2; see also Examples A–C and I in nonauthoritative Appendix B2-1.)

2.24.4. Q—How should tap fees be classified?

A—The portion of a fee (tap fee, system development fee, connection fee) that is received to defray the operating costs associated with connecting a customer with a utility system and that is reported in operating income should be presented in the operating activities category. Any portion of the fee that is to be used for the specific purpose of defraying the cost of acquiring, constructing, or improving capital assets should be presented in the capital and related financing activities category. (See Question 2.24.3; see also Example A in nonauthoritative Appendix B2-1.)
Q—How should transactions of an education trust that is reported as an enterprise fund be classified?

A—An education trust accepts deposits from parents or others. In return for the deposits, college tuition payments will be made for students sometime in the future. The receipts should be reported as cash inflows in the operating activities category, and subsequent tuition payments also should be reported in the operating activities category. Cash flows from purchases and sales of the related investments and earnings on the investments should be classified in the investing activities category.

2.25  Program Loans

Q—What type of governmental loan programs, other than those for low-income housing mortgages and student loans, meet the paragraph 19 conditions for treatment as operating activities? Would a finance authority created to finance state building projects meet the provisions of paragraph 19?

A—Except for low-income housing mortgage programs and student loan programs, few, if any, programs qualify for special treatment under paragraph 19. The presumption should be to classify the making and collecting of all loans as investing activities. Paragraph 19 of Statement 9 provides an exception to the classification scheme set forth in the Statement by allowing the cash flows associated with making and collecting certain program loans to be presented in the operating activities category rather than the investing activities category. Only the cash flows associated with making and collecting the loans are affected. The underlying financing transactions should be classified as noncapital financing activities, and the investment of idle cash should be classified as investing activities.

In deciding to provide the exception in paragraph 19, the Board concluded that it would be inappropriate, in some circumstances, to classify loan activities as investing activities. The Board evaluated the characteristics of governmental loan programs as it deliberated which programs meet the intent of the paragraph 19 exception. It concluded that certain “loan programs” are the operating activities of a governmental enterprise. The loans are not typical investments because they are not necessarily intended to earn a profit. However, the Board did not intend for all loan programs to be classified as operating activities. The loan programs that qualify for special treatment under paragraph 19 are distinguished from other governmental loan programs because they are undertaken to provide a direct benefit to individual constituents.

There are no specific criteria in paragraph 19 of Statement 9 for determining which loan activities should be classified as operating rather than investing activities, nor is there an explanation of “direct benefits” being provided to “individual constituents.” There are only two examples of qualifying loan programs in paragraph 19—low-income housing and student loan programs. In the low-income housing mortgage program example, loans are made to individuals who might not otherwise qualify for a home mortgage. The program is intended to directly benefit the individuals receiving the loans. Usually, the interest rate on a loan provided by this type of program is below the market rate. A student loan program provides similar direct benefits to individuals—students in need of financing their education.

The Board expected few types of loan programs or finance authorities to meet the spirit of the exception provided in paragraph 19, even if making and collecting loans are the primary
operations of the enterprise. A finance authority that facilitates financing by serving as an intermediary or conduit generally would not qualify even if the project to be financed indirectly benefits the government or its constituents. For example, an authority created to finance government building projects (such as state office buildings or public university dormitories) would not qualify because the direct beneficiary is the government rather than individual constituents. In the example of a public university dormitory authority, debt is issued by the authority and the proceeds are loaned to universities for their dormitory construction projects. Although the students who eventually live in the dorms will benefit from the activity, the direct beneficiary of the dormitory authority is the university itself, which is part of the governmental financial reporting entity. Such an arrangement merely facilitates the government’s financing process. The substance of the arrangement is that the government issued bonds to serve its own needs.

It is unlikely that many finance authorities operate loan programs (other than low-income housing and student loans) that qualify for the exception provided in paragraph 19. An exception might be a loan program for elderly persons who are unable to pay their property taxes. (See Examples F and G in nonauthoritative Appendix B2-1.)

2.25.2. Q—How should the loan activity of a loan program that qualifies for inclusion in the operating activities category be presented in relationship to the cash flows of the other operating activities?

A—There are no provisions in Statement 9 detailing how program loan activities should be presented in the operating activities category. The minimum level of detail required is listed in paragraph 31 of Statement 9, as amended, and is discussed in Questions 2.29.1 and 2.29.2. For example, cash receipts from customers should be presented separately from other operating cash receipts, and cash payments to suppliers should be presented separately from other operating cash payments. Because borrowers in a qualifying loan program are neither suppliers nor customers (they are direct beneficiaries of the program), it would be appropriate to separately identify cash disbursements and collections of loans. It would also be useful to separate the collection of principal from interest received. The principal and interest components of normal loan collections are separately identified in the investing activities category. (See Example G in nonauthoritative Appendix B2-1.)

2.26 Interfund Activity

2.26.1. Q—How should interfund transfers be reported in the statement of cash flows?

A—The cash portion of an interfund transfer out should be presented in the noncapital financing activities category. A governmental enterprise fund receiving a transfer to be used for the specific purpose of defraying the cost of acquiring, constructing, or improving capital assets, however, should classify the cash inflow as a capital and related financing activity.

Noncash transfers should not be presented within the statement of cash flows. Instead, they should be presented in a separate schedule of noncapital investing, capital, and financing activities. (See Questions 2.32.1 and 2.32.2 for a discussion of noncash disclosures; see also Example B in nonauthoritative Appendix B2-1.)

2.26.2. Q—Can interfund loan activity be netted?
A—No. The preference for gross cash flow information over net cash flow information applies to interfund loan activity. Loan activity may qualify for net reporting only if the turnover is quick, the amounts are large, and the maturities are short (three months or less), based on paragraph 13 of Statement 9.

2.27 Other

2.27.1. Q—If there are cash flows associated with conduit debt (such as industrial development bonds), how should they be classified?

A—If there are cash flows through the governmental enterprise related to debt for which the enterprise does not report a liability, related cash flows should not be presented in the investing activities category or either of the financing categories. Instead, the cash flows should be presented in the residual category—operating activities. (See Question 2.15.4 for a discussion of identifying when a cash flow occurs.)

2.27.2. [Not used in GASBIG 2015-1]

2.27.3. Q—Where should insurance proceeds be presented?

A—Insurance proceeds are specifically identified in only one place in Statement 9. In accordance with paragraph 24d of the Statement, the capital and related financing activities category includes proceeds from insurance on capital assets that are stolen, damaged, or destroyed. Other insurance proceeds should be classified in the residual category—operating activities.

2.27.4. Q—What are the factors for determining whether a grant received meets the criteria for classification as an operating activity?

A—In Statement 9, the view was adopted that grants received generally should be treated as subsidies. Capital grants should be considered capital and related financing activities, and all other grants should be considered noncapital financing activities. However, it was recognized that certain arrangements that are called “grants” appear to be contracts for services. Grants of this type should be classified as operating activities. The determination of whether a grant is, in substance, a purchase of services requires the exercise of judgment. To be classified as an operating cash inflow, the grant should finance a program that the grantee would not otherwise undertake (for example, a senior citizens’ transportation service). Therefore, the grant is not subsidizing an existing program. It reimburses the costs of a new program, whose activity is inherently part of the operations of the grantor. A grant with these characteristics should be considered an “operating grant” as described in paragraph 17 of Statement 9. (See Example D in nonauthoritative Appendix B2-1.)

2.27.5. Q—How should lease activities be classified in the statement of cash flows?

A—Classification of leasing transactions depends on whether the lease is a capital lease or an operating lease. (See National Council on Governmental Accounting [NCGA] Statement 5, Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments, as amended, and Statement 62, paragraphs 211–271, as amended.) The capital and related financing activities category is directly affected by capitalization policies. (See paragraph 63 of the Basis for Conclusions of Statement 9.) If a lease is a capital lease, the cash flows (including the interest portion) should be included in the capital and related financing
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activities category, as an inflow in the lessor’s statement of cash flows and as an outflow in the lessee’s statement of cash flows. The lease transaction is essentially treated as an installment sale of a capital asset. The timing of the cash flows does not coincide with the date of the “sale,” but the cash flows are, nevertheless, payments for the purchase of a capital asset. (See the discussion of noncash disclosures in Question 2.32.1.)

Cash flows resulting from an operating lease, on the other hand, usually should be classified with operating activities. The lessee’s cash payments always should be presented as an operating activities outflow. The lessor’s cash receipts normally should be presented as an operating activities inflow; however, an evaluation should be made to determine whether lease revenue may be classified as an investing activities inflow. (See Examples B, C, E, H, and I in nonauthoritative Appendix B2-1.)

2.28 Content and Format Issues

2.29 Presentation of Individual Line Items

2.29.1. Q—What level of detail should be provided for individual line items in the statement of cash flows?

A—Gross cash flow information generally is required. Therefore, related transactions should not be netted. For example, bond proceeds should be reported separately from capital purchases made with the proceeds. Beyond that, the level of detail in the descriptions of the categories (in paragraphs 17–28 of Statement 9, as amended) and illustrated in nonauthoritative Appendix B2-1 provides a guideline for determining the appropriate level of detail in the statement of cash flows. For example, separating the principal and interest portions of debt service payments is considered useful.

The most specific guidance in Statement 9 as to level of detail in reporting is provided in the guidance for reporting cash flows from operating activities (paragraph 31, as amended). The discussion provides seven classes of information that serve as a minimum level of required detail.

a. Cash receipts from customers
b. Cash receipts from interfund services provided
c. Other operating cash receipts, if any
d. Cash payments to other suppliers of goods or services
e. Cash payments to employees for services
f. Cash payments for interfund services used, including payments “in lieu of taxes” that are payments for, and reasonably equivalent in value to, services provided or received
g. Other operating cash payments, if any.

In all cases, governmental enterprises are encouraged to provide further detail if the information would be useful.

2.29.2. Q—Should the cash outflows for payroll taxes and employee-related costs, such as fringe benefits, be reported with either “cash payments to employees for services” or “cash payments to other suppliers of goods or services,” or should they be reported separately?

A—Paragraph 31 of Statement 9, as amended, requires presentation of cash flows from operating activities by major class, and lists a minimum of seven classes. (See Question
2.29.1.) One of the major classes is “cash payments to employees for services.” Statement 9 does not provide a definition for this or any other of the major classes referred to in paragraph 31, as amended. It is reasonable to group cash payments for payroll taxes and fringe benefits with cash payments to employees, even though the cash is not paid directly to the employees. Payroll taxes and fringe benefits are paid on behalf of employees and are an integral part of employment costs.

On the other hand, further detail is encouraged if it would be useful. Therefore, it may be helpful to present cash flows for payroll taxes and fringe benefits separately from payments to employees if the amounts are significant.

2.29.3. Q—If an internal service fund purchases supplies from both vendors and other funds of the primary government, should it report its purchases from other funds separately from its purchases from vendors?

A—Paragraph 31 of Statement 9, as amended, states that interfund services provided and used should be presented separately from other operating transactions. The intent was to highlight interfund activity. Although the cash flows between the internal service fund and other funds of the government may seem identical to transactions with outside suppliers or vendors, the fact that the activity is “intra-entity” is noteworthy.

2.29.4. Q—If a state governmental enterprise (such as a workers’ compensation fund) has receipts from within the state’s entity and also from local government participants, should a distinction be made between “customers” inside and outside the entity?

A—Yes. Interfund activity should be distinguished from external operating transactions. As discussed in Question 2.29.3, paragraph 31 of Statement 9, as amended, states that cash flows from interfund services provided and used should be presented separately from other operating transactions. (See Example J in nonauthoritative Appendix B2-1.) However, there is no requirement to separate the cash flows with discretely presented component units from those involving external parties. Note, however, that paragraph 128 of Statement 34 requires disclosure of the nature and amount of significant transactions between the primary government and each major component unit.

2.29.5. Q—Should debt service interest payments that are capitalized be reported in the capital and related financing activities category as an outflow for interest on capital debt or as part of the capital acquisition outflow?

A—All interest payments associated with “capital debt” should be presented in the capital and related financing activities category as “cash payments to lenders and other creditors for interest.” The presentation of cash payments for interest should not be affected by the transaction’s presentation on the operating statement or the statement of net position/balance sheet. The fact that the amount of the cash flow is capitalized does not change the fact that the cash was paid to a lender for interest.

2.29.6. Q—Under the direct method for reporting cash flows from operating activities, are governments required to separately report transactions with discretely presented component units?

A—No. Paragraph 31 of Statement 9, as amended, requires separate reporting of cash flows from interfund services provided and used but does not require a similar distinction for transactions with component units. Governments may provide those additional details but are
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not required to do so. However, paragraph 128 of Statement 34 requires disclosure of the nature and amount of significant transactions between the primary government and each major component unit.

2.30 Reconciliation of Operating Income to Net Cash Flow from Operating Activities

2.30.1. Q—Can the reconciliation of operating income to net cash flow from operating activities be presented in notes to the financial statements?

A—No. The reconciliation is a requirement of cash flow reporting and should be presented as part of the statement of cash flows, as a separate schedule (preferably on the same page). Paragraph 67 of the Statement 9 Basis for Conclusions discusses this topic.

2.30.2. Q—In reconciling operating income to operating cash flows, should the changes in all asset and liability accounts and in deferred outflows of resources and deferred inflows of resources be reconciled?

A—Only those asset, deferred outflows of resources, liability, and deferred inflows of resources accounts that affect operating cash flow items should be included in the reconciliation of operating income to net cash flow from operating activities. For example, if a governmental enterprise holds a receivable related to grants from another government, that receivable should not affect cash flows from operating activities; therefore, it should not be a reconciling item. The receivable does, however, have an effect on the noncapital financing activities presentation (assuming the grant is an operating subsidy and not a capital grant). Grant revenues reported as nonoperating income in the flows statement should be adjusted by the receivable amount to arrive at the actual cash flows from the grant.

2.30.3. [Not used in GASB 2015-1]

2.31 Articulation to the Statement of Net Position/Balance Sheet

2.31.1. Q—Do the requirements of Statements 3 and 40, as amended, affect the articulation of the statement of cash flows to the statement of net position/balance sheet?

A—No. As discussed in Question 2.14.2, because Statement 9, as amended, addresses financial statement display and Statements 3 and 40, as amended, address disclosure in the notes to the financial statements, Statement 9, as amended, takes precedence in issues of financial reporting display. Statement 9, as amended, requires articulation between the statement of cash flows and the statement of net position/balance sheet, possibly requiring changes to certain statement of net position/balance sheet presentations. Paragraph 8 of Statement 9 states, “The total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows should be easily traceable to similarly titled line items or subtotals shown in the statements of financial position as of those dates.” Therefore, it would be inconsistent to include in the caption “cash and cash equivalents” items that do not meet the definition.

Statements 3 and 40, as amended, do not require articulation between the required disclosures and the statement of net position/balance sheet. However, some do trace the balances in the Statements 3 and 40 disclosures, as amended, to the statement of net position/balance sheet presentation. Because Statement 9, as amended, changes that presentation, a reconciliation
may be necessary when tracing these disclosures to the statement of net position/balance sheet. (See Question 1.26.6.)

2.31.2. Q—Is it possible to trace cash and cash equivalent balances to the statement of net position/balance sheet if participation in a cash management pool is reported as “equity in pooled cash” rather than as “cash and cash equivalents”?

A—Yes. Rather than require cash and cash equivalents per the statement of cash flows to be the same as similarly titled line items in the statement of net position/balance sheet, paragraph 8 requires that cash and cash equivalents be easily traceable to similarly titled line items in the statements of financial position. This flexibility was provided to allow restricted cash and cash equivalents to be presented separately in the statement of net position/balance sheet. A reconciliation is not necessary if a reader is able to easily trace the statement of cash flows amounts to similarly titled line items in the statement of net position/balance sheet.

This flexibility also is useful for various other articulation problems, such as the labeling conflict in this question. Because the equity in the pooled cash meets the definition of cash, it may be included in the balance of cash and cash equivalents. If it is labeled as “equity in pooled cash” on the statement of net position/balance sheet, a reader may not be able to easily trace from the statement of cash flows to the statement of net position/balance sheet. Therefore, a reconciliation may be provided—for example, at the bottom of the statement of cash flows—tracing the amounts per the statement of cash flows to the appropriate statement of net position/balance sheet line items. (See Example A in nonauthoritative Appendix B2-1.)

2.31.3. [Not used in GASBIG 2015-1]

2.32 Noncash Investing, Capital, and Financing Activities

2.32.1. Q—When is disclosure of noncash information required?

A—Paragraph 37 of Statement 9 requires that “information about all investing, capital, and financing activities of a governmental enterprise during a period that affect recognized assets or liabilities but do not result in cash receipts or cash payments in the period should be reported.” Disclosure of noncash information is required if a transaction meets all of these three characteristics:

a. *Is the transaction noncash?* Questions 2.15.1–2.15.6 provide guidance on identifying a cash flow. Some transactions include cash and noncash components. Only the cash portion of the transaction should be presented in the statement of cash flows. The noncash portion should be evaluated further.

b. *Does the transaction affect recognized assets or liabilities?* Noncash transactions that result in the recognition of assets and liabilities should be analyzed. Changes in the balance of an asset or a liability that are not attributable to cash transactions should be considered noncash transactions. For example, when an enterprise fund enters into a capital lease for a building, a noncash transaction occurs because a capital lease obligation and the building are recorded in the statement of net position. The inception of an operating lease, on the other hand, requires no disclosure because there is no effect on the statement of net position.

c. *Is the transaction an investing, capital, or financing activity?* A noncash transaction should be disclosed only when it (had it been a cash transaction) meets the definition of the investing, capital and related financing, or noncapital financing activities category. For
example, a capital lease transaction meets the definition of a capital and related financing activity. However, a customer account receivable balance that was used to offset an account payable to that customer is an operating activity and is not required to be disclosed. (See Examples A–D and G–I in nonauthoritative Appendix B2-1.)

Examples of noncash transactions include acquiring capital assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller or purchasing on credit and taking delivery of vehicles in the current period and paying for them in a future period, obtaining a capital asset by entering into a capital lease, refunding bond proceeds delivered directly to an irrevocable trust, changes in fair value of investments or derivative instruments, receiving donated capital assets, and transfers of capital assets between funds.

2.32.2. Q—How should noncash transactions be reported?

A—Paragraph 37 of Statement 9 states that noncash information “should be presented in a separate schedule, which may be in either a narrative or a tabular format, and it should clearly describe the cash and noncash aspects of transactions involving similar items. The schedule may be presented, if space permits, on the same page as the statement of cash flows.” Therefore, the format for presenting the noncash disclosures is flexible. For example, a governmental enterprise with only one transaction to disclose may find it most effective to describe the transaction in a sentence or two. Another governmental enterprise, with several noncash financing activities, may find it useful to arrange the information in a column. Whatever format is chosen, the disclosures should be made in a schedule to the statement of cash flows (preferably on the same page). (See Examples A–D and G–I in nonauthoritative Appendix B2-1.) As discussed in paragraph 68 of the Basis for Conclusions of Statement 9, the disclosures should not be separated from the statement of cash flows by being presented in the notes to the financial statements.

Risk Financing and Related Insurance Issues

3.4.1 Q—What factors should be considered in determining whether an entity should be accounted for as a public entity risk pool for the purposes of applying Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, as amended?
In determining if an entity is a public entity risk pool, all factors should be considered together. Paragraphs 10–12 of Statement 10 define a public entity risk pool as:

- a cooperative group of governmental entities joining together to finance an exposure, liability, or risk. Risk may include property and liability, workers’ compensation, or employee health care. A pool may be a stand-alone entity or be included as part of [another] governmental entity that acts as the pool’s sponsor.
- A governmental entity that is a pool’s sponsor may also participate in the pool for its own risk management function. . . .
- Stand-alone pools are established under authorizing statute by agreement of any number of state and local governmental entities. Stand-alone pools are sometimes organized or sponsored by municipal leagues, school associations, or other types of associations of governmental entities. A stand-alone pool is frequently operated by a board that has as its membership one member from each participating government. It typically has no publicly elected officials [of its own] or power to tax.

Paragraph 76, as amended, further clarifies the possibilities for entities to be considered public entity risk pools. It provides:

- If an entity provides insurance or risk management coverage separate from its own risk management activities to individuals or organizations outside the governmental reporting entity and there is material transfer or pooling of risk among the participants, that activity should be accounted for as a public entity risk pool. . . .
- If an entity provides risk transfer or pooling coverage combined with its own risk management activities to individuals or organizations outside its reporting entity, those activities should continue to be reported in a governmental fund or an internal service fund only as long as the entity is the predominant participant in the fund. If the entity is not the predominant participant in the fund, then the combined activities should be reported as a public entity risk pool, using an enterprise fund and the accounting and reporting requirements in paragraphs 19–50 [as amended]. . . .

[Footnote reference omitted.]

Applying the definitions in paragraphs 10–12 and paragraph 76, as amended, the key characteristics of a public entity risk pool can be derived as follows:

- The pool should comprise primarily governmental entities. It was intended that the provisions of Statement 10, as amended, specifically in paragraph 76, as amended, apply to risk financing groups of primarily state and local governments, while recognizing that there may be some cases where the group has a minority of participants—in terms of both representation and risk coverage—that are nongovernmental.
- The pool should be a cooperative effort. It was intended that participants would work together to finance risk. Evidence of a cooperative effort may be voluntary participation in the activity—even if participation is a participant’s last recourse. If a cooperative effort does not exist, then a governmental program may actually exist, and contributions from participants may actually be fees, assessments, or taxes—not premiums (required contributions). A governmental program could be accounted for in the general fund, a special revenue fund, or an enterprise fund depending on its nature. Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, paragraphs 29–32, offers guidance on when the general fund or a special revenue fund can be used. Statement 34, paragraphs 66 and 67, as amended, offers guidance on when an enterprise fund can be used.
Furthermore, the types of risks or benefits covered by a potential pool are required to be within the scope of Statement 10, as amended. Otherwise, the provisions of Statement 10, as amended, for public entity risk pools are not applicable.

3.4.2. Q—Is an entity required to transfer or pool risk in order to be considered a public entity risk pool?

A—No. The transfer or pooling of risk is not required to occur for an entity to be considered a public entity risk pool, but it is required to occur to meet the definition in Statement 10, paragraph 13, for risk-sharing pools. For example, a group of governments created a pool for losses related to law enforcement vehicles. Each participating government makes an annual payment from which claims against only that participant are paid. The payment cannot be used to pay claims of other participants. This example meets the definition of a public entity risk pool without transfer of risk. Paragraphs 18–50 of Statement 10, as amended by Statement No. 30, Risk Financing Omnibus, apply only to risk-sharing pools. If the transfer or pooling does not occur, then paragraph 51 applies. (See Questions 3.5.1 and 3.5.2 for discussions of pools without transfer of risk.)

3.4.3. Q—If a government, such as a state, sponsors a cooperative group of primarily nongovernmental entities that have joined together to finance risk and risk is transferred from the participating entities, is the arrangement a public entity risk pool?

A—No. If a risk financing group consists primarily of nongovernmental participants and there is a transfer of risk from the participants to the group, then an insurance enterprise exists, not a pool. Insurance enterprises should be reported in an enterprise fund using the provisions of Statement 62, paragraphs 400–430.

3.5 Types of Public Entity Risk Pools

3.5.1. Q—Does paragraph 51 of Statement 10 apply to a banking pool, as defined in paragraph 13?

A—Yes. Although paragraph 51 specifically addresses claims-servicing pools (account pools), it also applies to a banking pool arrangement that does not involve any transfer of risk. The banking pool will have revenue and administrative costs for loans it makes to pay claims for members. Accordingly, it should report assets or liabilities for net amounts collected or due from members and paid or to be paid to settle claims.

However, if this arrangement involves any acceptance, sharing, or pooling of risk, it is more in the nature of a risk-sharing pool and should be reported using the guidance in paragraphs 19–50 of Statement 10, as amended.

3.5.2. Q—Do pools that act only as insurance-purchasing pools (risk-purchasing groups) represent transfer of risk?

A—No. If a pool serves only to achieve economies of scale by purchasing commercial insurance products for its participants, and it does not retain or engage in the acceptance, transfer, or pooling of risk among participants, the participants in the pool have effectively transferred risk to commercial insurers—not to the pool—through policies obtained by the pool.

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4Terms defined in paragraph 8 are shown in **boldface type** the first time they appear in this paragraph.
Only the provisions of Statement 10, paragraphs 18 and 51, apply to this type of pool, which will have service revenue and administrative costs for procuring and maintaining policies for participants. The amounts collected from members and remitted to the insurance carriers would be recorded as additions to and deductions from a liability account, rather than as revenue and expense of the risk pool.

3.5.3. Q—Can a pool have the characteristics of more than one type of pool, as defined in paragraph 13 of Statement 10?

A—Yes. Paragraph 13 defines four types of pools: risk-sharing, insurance-purchasing, banking, and claims-servicing. Further, that paragraph states that “... a pool could serve only one or several of these functions” (the four basic types of pools). As an example, members of a property and liability public entity risk pool may pay actuarially determined contributions (premiums). These contributions may be used to pay claims up to an aggregate amount of $10 million and to procure excess insurance for claims that surpass the $10 million threshold. In this instance, the pool is both a risk-sharing pool (for aggregate claims of $10 million or less) and an insurance-purchasing pool (for aggregate claims over $10 million).

In any case, if there is any aspect of the pool that qualifies as risk-sharing or risk transfer among pool participants, or if the pool retains any risk, the pool should be accounted for as a risk-sharing pool. For example, if only 5 percent of a pool’s activities (that is, risk covered) involves pooling of risk and the remaining 95 percent involves purchasing commercial policies for participants’ risks, the pool should be accounted for as a risk-sharing pool. The requirements of paragraphs 18–50 of Statement 10, as amended, should be applied to the risk-sharing activities, and the requirements of the last two sentences of paragraph 51 should be applied to the insurance-purchasing activities.

3.5.4. Q—If premiums are not based on an actuarial evaluation or an analysis of anticipated losses, can a pool still be considered risk sharing?

A—Yes. The basis by which premium charges are assessed by a pool is not relevant to the risk-sharing determination.

3.6 Pool Sponsors

3.6.1. Q—For the purposes of applying paragraph 76 of Statement 10, as amended, what distinguishes the predominant participant in a risk management activity?

A—Paragraph 76, as amended, states:

If an entity provides risk transfer or pooling coverage combined with its own risk management activities to individuals or organizations outside its reporting entity, those activities should continue to be reported in a governmental fund or an internal service fund... only as long as the entity is the predominant participant in the fund.

In paragraph 126 of the Basis for Conclusions, it was acknowledged that determining whether the entity (the sponsor) providing risk transfer or pooling coverage is the predominant participant would require “preparer and auditor judgment.” One possible way to make this evaluation would be to look at some objective measurements. For example, payroll costs may be used as a basis for evaluating whether an entity is the predominant participant in a risk financing arrangement it sponsors for workers’ compensation coverage. The types of risk
coverage provided in a risk financing arrangement for property and liability coverage may also be used as a basis for evaluating whether an entity is the predominant participant. For example, a sponsor that has significant activities with higher risk than other entities—for example, an airport, a landfill, public transit, or a police force—may be the predominant participant.

3.6.2. Q—Can a state or local governmental entity have some involvement with a risk pool without participating (sharing or transferring risk, purchasing insurance, providing funds for losses, or using claims servicing) in the pool?

A—Yes. An entity, such as a state, can sponsor a pool without being a participant. As a sponsor, it may provide administrative services and account for the pool’s activities in a separate fund. The accounting for the pool should be guided by paragraphs 19–50 of Statement 10, as amended, if there is sharing or pooling of risk. The accounting should be guided by paragraph 51 if there is no sharing or pooling of risk. In either case, the pool should be reported in an enterprise fund, in accordance with paragraph 18.

3.7 Unemployment Compensation

3.7.1. Q—Are unemployment compensation claims that are provided under the joint state and federal unemployment insurance system within the scope of Statement 10?

A—Paragraph 3 excludes from the scope of Statement 10 the recognition and measurement of liabilities for unemployment compensation claims. NCGA Statement 4, Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences, as amended, and NCGA Interpretation 9, Certain Fund Classifications and Balance Sheet Accounts, as amended, provide guidance on those claims.

3.7.2. Q—If governments join together to finance unemployment compensation for their employees who are not eligible for benefits under the joint state and federal unemployment insurance system (for example, seasonal employees), is Statement 10 applicable?

A—Although paragraph 3 excludes from the scope of Statement 10 the recognition and measurement of liabilities for state or federal unemployment compensation claims, paragraph 1g states that the scope of the Statement includes “other risks of loss of participating entities assumed under a policy or participation contract issued by a public entity risk pool.” Encompassed within this broad language would be unemployment insurance that is separate from the joint state and federal unemployment insurance system and that is offered to local government employers through public entity risk pools.

3.8 Recognition and Measurement

3.9 Fund Type to Use

3.10 Revenue Recognition

3.11 Premiums

3.11.1. Q—When should premiums generally be recognized as revenue?

A—Statement 10, paragraph 19, states:
Premiums or required contributions ordinarily should be recognized as revenue over the contract period in proportion to the amount of risk protection provided. For those few types of contracts for which the period of risk differs significantly from the contract period, premiums should be recognized as revenue over the period of risk in proportion to the amount of risk protection provided. That generally results in premiums being recognized as revenue evenly over the contract period (or the period of risk, if different), except for those few cases in which the amount of risk protection changes according to a predetermined schedule.

For example, Pool A assesses premiums based on the experience of the individual participating governments. The policy between each participant and Pool A is for one year. Because the policy period is one year, the revenue should be recognized by Pool A evenly over the year unless “the amount of risk protection changes according to a predetermined schedule.” If Pool A’s fiscal year is different from the policy year, the pool should report a liability in the statement of net position to the extent that the policy year extends beyond the fiscal year being presented.

Besides premiums, pools may also derive revenue from assessments. These assessments generally are supplemental contributions required from participants when the pool’s revenues are not sufficient to cover losses. Paragraph 5 of Statement 30 provides that “[premium] deficiencies resulting from risk-sharing pool participation contracts also should be reported as revenue and assessments receivable at the time the pool determines that a deficiency is reasonably estimable, provided that the pool has an enforceable legal claim to the amounts and their collectibility is probable.” Pooling agreements usually specify if the pool has a right to assess participants to cover excess losses.

3.11.2. Q—When should the cost recovery method or the deposit method be used for premium revenue recognition?

A—in applying the provisions of Statement 10, paragraph 20, these two methods should be used only if both of the following two conditions are met:

a. The premiums are subject to adjustment because of provisions in the policy that make the ultimate premium dependent on some future measurements or loss experience.
b. The ultimate premium cannot be reasonably estimated.

For example, if $30,000 of premium revenue subject to adjustment has been received for the fiscal year on a retrospective policy and there is $10,000 in estimated claim costs for insured events for the same period, the cost recovery or deposit method should be used. Under the cost recovery method, revenue recognized in the current reporting period would be limited to $10,000. Additional revenue would be recognized in an amount equal to estimated claims costs as insured events occur until the ultimate premium can be reasonably estimated. Under the deposit method, no revenue would be recognized until the ultimate premium can be reasonably estimated. (See also Question 3.11.3.)

3.11.3. Q—What is the difference between recognizing revenue under the cost recovery method and recognizing revenue under the deposit method?

A—under both methods, revenue is not fully recognized until the ultimate premium can be reasonably estimated. The methods differ regarding the recognition of revenue before the
ultimate premium is known. With the cost recovery method, premiums are recognized as revenue throughout the duration of the policy, but only to the extent that claims costs have been incurred. The remainder of the premiums are recognized as revenue only when the ultimate premium is reasonably estimable. On the other hand, the deposit method does not recognize any premiums as revenue through the duration of the policy. Only when the ultimate premium is reasonably estimable are premiums recognized as revenue. (See also Question 3.11.2.)

The cost recovery method may be more appropriate for retrospectively rated policies. Ultimate premiums for those types of policies are typically based on claims experience. Throughout the policy period, as events that trigger coverage occur and claims costs are incurred, premium revenue can be recognized to the extent that claims costs are probable and estimable. The deposit method may be more appropriate for reporting-form policies, where, for example, the ultimate premium is based on a value of property (for property coverage) or on payroll (for workers’ compensation coverage) at some point in the future. At the point that the valuation is made, the ultimate premium can be determined.

3.12 Distributions, including dividends and refunds

3.12.1. Q—How do policyholder dividends (returns of contribution) differ from experience refunds?

A—Policyholder dividends are returns of premiums to participants based on the loss experience of the pool or of a specific class of policies, whereas an experience refund is based on an individual policyholder’s experience. For example, if each participant’s share is based on some predetermined allocation basis, which may be specified in the pooling agreement, the amounts returned are dividends. On the other hand, if the total amount to be returned to participants is based on the total loss experience of the pool but each participant’s share of the total amount is based on its own experience, the amounts returned are experience refunds.

Paragraph 32 of Statement 10 provides for the accounting of dividends, and paragraph 33 provides for the accounting of experience refunds.

3.12.2. Q—A state government’s risk pool has experienced high investment returns and wishes to make a distribution to pool participants. How is the distribution reported?

A—This distribution is based “on the experience of the pool” (Statement 10, paragraph 32) and should be reported as a policyholder dividend.

3.12.3. Q—Are policyholder dividends charged as a reduction of pool net position?

A—No. Paragraph 32 of Statement 10 provides that dividends “should be accrued as dividends expense using an estimate of the amount to be paid.” That expense should be recognized in the operating statement as an expense of the pool. If the policyholder dividend represents a return to participants from excess premiums for future catastrophe losses, the amount of the dividend should still be accrued as dividends expense.

3.12.4. Q—Do pools need to keep records of each participant’s share in the results of the pool by policy year, based on the provisions of Statement 10, as amended?

A—No. Although a pooling agreement may provide that a record of each participant’s share in the results of the pool be kept by policy year, there is no specific requirement for this record
keeping in Statement 10, as amended. However, this type of information may be needed for the calculation of policyholder dividends when the pool has a favorable loss experience overall or for a class of policies (as provided in paragraph 32), or for the calculation of experience refunds (as provided in paragraph 33). If the pooling agreement provides for assessments when the pool has adverse experience, individual account information may be necessary for this allocation as well. Furthermore, this type of information may be needed if the pool is terminated.

3.12.5. Q—A risk pool is dissolving and distributing significant resources to pool participants. How is the distribution reported?

A—Capital distributions should be reported as such on the statement of revenues, expenses, and changes in net position, below the “Income before other revenues, expenses, gains, losses, and transfers” subtotal.

3.13 Premium deficiency

3.13.1. [Not used in GASBIG 2015-1]

3.13.2. Q—How should a premium deficiency be calculated?

A—The premium deficiency calculation determines if unearned revenues are sufficient to meet claim costs, claim adjustment expenses, and policyholder dividends expected to be incurred over the remainder of the policy term. The premium deficiency should be adjusted in future periods as expected costs become incurred costs so that no liability remains at the end of the period covered by the contracts. Although these deficiencies appear to relate only to future periods, they are the result of the pool’s current-period underwriting efforts.

The calculation required by Statement 30, paragraph 4, as amended, should include the following:

a. Unearned premiums—The amount entered into the equation here should be the amount reported as a liability at the statement of net position date.

b. Expected claims costs—This amount depends on the types of policies involved.
   (1) If policies are occurrence based, this amount should include expected claims for events that the pool expects to occur after the statement of net position date and during the remainder of the policy period.
   (2) If policies are claims-made policies, this amount should be based on claims that the pool expects to be reported or filed between the statement of net position date and the date that the policy expires.
   (3) If policies are claims-paid policies and the liability for claims is not fixed until the pool has actually paid the claim, this amount should be based on expected claims to be paid after the statement of net position date but during the remainder of the policy period. However, if the policies are claims-paid policies and under any circumstances could provide for payment of claims on a claims-made basis, this amount should be based on claims that the pool expects to be reported or filed between the statement of net position date and the date that the policy expires.

For all types of policies, this amount should include future development on claims incurred after the statement of net position date. (See Question 3.17.1 for a discussion of incurred but not reported [IBNR] claims.)
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c. **Expected claim adjustment expenses**—This amount should include claim adjustment expenses, both allocated and unallocated (as defined in paragraph 23 of Statement 10), to be incurred in the course of investigating and settling expected claims. (See Questions 3.16.2 and 3.16.3 on claim adjustment expenses.)

d. **Expected dividends to policyholders or pool participants**—These are expected amounts of dividends, which are defined in paragraph 32 of Statement 10.

e. **Anticipated investment income**—The inclusion of this element is optional, as indicated in footnote 6 of Statement 10; however, pools are required to disclose whether this income has been considered in determining if a premium deficiency exists. If used, the anticipated investment income should be based on the investment of remaining cash from premium revenues (earned and unearned) on hand at the statement of net position date for the period from that date until all related claims are settled. This calculation should take into account the fact that the amount of remaining cash from premium revenues will decline as claims and related expenses are actually paid. If all premiums have already been used for policy claims at the statement of net position date, it would be inappropriate to report anticipated investment income.

_Incurred_ maintenance costs, which are defined in paragraph 31 of Statement 10, and acquisition costs should not be used in the calculation. Because these costs are period costs and cannot be attributed to past or future events, the Board intended to emphasize that there should be no _expected_ policy maintenance costs or acquisition costs associated with a premium deficiency.

If the sum of expected claims costs (item b), expected claim adjustment expenses (item c), and expected dividends (item d) reduced by anticipated investment income (item e) (if used), exceeds unearned premiums (item a), then a premium deficiency exists.

As discussed in paragraph 34 of Statement 10, this calculation ordinarily would not be done on an individual contract basis. Any liability that is reported as a result of this calculation should meet the same recognition criteria as other liabilities. That is, it should be probable and reasonably estimable, as discussed in paragraph 22 of Statement 10.

An example of a premium deficiency calculation appears in nonauthoritative Appendix B3-3.

3.13.3. Q—Should assessments of policyholders or participants be recognized for purposes of the premium deficiency calculation?

A—No. For the purposes of determining a premium deficiency, assessments should not be included in the calculation. However, assessments may be made as the result of a premium deficiency and should be recognized in accordance with paragraph 5 of Statement 30, as amended.

3.13.4. Q—If premiums are lowered to reduce accumulated pool net position, are there any specific disclosure requirements or accounting or financial reporting considerations? Likewise, if future premiums are raised as a *de facto* method of making assessments for a pool, is a specific disclosure required?

A—If premiums are lowered, the possibility that a premium deficiency exists should be considered. Premium deficiencies should be calculated and recognized in accordance with paragraph 34 of Statement 10 and paragraphs 4 and 5 of Statement 30, as amended. (See Question 3.13.2.)
However, Statement 10 does not require a specific disclosure for either situation. The results of both situations should be obvious from the statement of revenues, expenses, and changes in net position in the financial statements.

It is normal that premiums for future periods are adjusted to some extent based on the results of current and prior periods because the results are the basis for calculations of premium requirements. However, paragraph 7 of Statement 30 provides that, if changes in a pool’s loss, expense, reinsurance, excess insurance, or other transactions materially affect a pool’s financial statements and those changes are not fairly disclosed or presented in the 10-year revenue and claims development table, the pool should disclose or present additional details “to keep the [10-year revenue and claims development table] from being misleading or to keep trends from becoming obscured.” These additional details may be needed especially if only certain contract types are affected.

3.13.5. [Not used in GASBIG 2015-1]

3.14 Expense and Liability Recognition and Measurement

3.15 Acquisition costs

3.15.1. [Not used in GASBIG 2015-1]

3.16 Claim adjustment expenses

3.16.1. Q—If a pooling agreement specifies that, upon dissolution, all participants will assume the cost of overhead for servicing the remaining outstanding claims of the pool, does the pool still need to accrue these overhead costs, which include unallocated claim adjustment expenses?

A—Yes. Accounting requirements should be applied with the presumption that the pool is a going concern. Unallocated claim adjustment expenses are incurred by the pool when the claim itself is incurred and should be reported at the same time. The fact that these costs may be paid by pool participants in the event that the pool dissolves should not result in the liability’s not being reported by the pool, nor should it result in a receivable from participants being reported by the pool.

3.16.2. Q—How should unallocated claim adjustment expenses be calculated?

A—Unallocated claim adjustment expenses are “costs that cannot be associated with specific claims but are related to claims paid or in the process of settlement, such as salaries and other internal costs of the pool’s claims department” (Statement 10, paragraph 23). Along with allocated claim adjustment expenses, the unallocated expenses are to be accrued with related liabilities for unpaid claims. Guidance on determining the liability may be found in nonauthoritative commercial insurance accounting literature, such as the American Institute of Certified Public Accountants’ (AICPA) Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; publications of professional actuarial societies; and other industry publications. For pools using a third-party administrator, an additional source may be the service agreement, which should specify how these expenses are to be assigned to claims.
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3.16.3. If a public entity risk pool is required to pay a fee to the state based on its claims payments during the year, should that amount be included as part of the claim adjustment expenses related to the settlement of the claims?

A—Yes. The fee should be accrued as claim adjustment expenses; it is a cost of settling claims. Some would argue that the charge has a direct relationship with the payment of the claims, not with the process of settling the claims. However, paragraph 23 of Statement 10 requires all costs of settling claims to be accrued as claim adjustment expenses. That paragraph does not make distinctions about the nature of settlement costs except to classify them as allocated or unallocated.

3.17 Incurred but not reported claims

3.17.1. What are IBNR claims?

A—According to footnote 5 of Statement 10, IBNR claims include three components:

a. Known loss events that are expected to later be presented as claims—for example, a risk pool that is aware of an on-the-job injury for which no formal claim has been filed.

b. Unknown loss events that are expected to become claims—for example, a risk pool that is unaware of on-the-job injuries that have occurred and have not been filed but based on historical experience, has an expectation of claims to be filed.

c. Expected future development on claims already reported—for example, a risk pool that is unaware of the full extent of damages from a storm for a claim that has been filed.

IBNR is largely an estimate of loss and claim adjustment expenses associated with future likely activity on incurred claims based on historical actual results that establish a reliable pattern.

3.17.2. How are IBNR claims to be estimated and recognized?

A—IBNR claims generally are estimable. Initially, it may take time to accumulate a history of the proper data if those data are not currently available. If the historical results of an entity are not representative, supplementary analysis, including use of historical actual results of other entities with similar structure, risk assumptions, and risk exposure, should be considered. Other factors to be considered are changes in operations or operating environment, demographic changes, and statutes and regulations.

Other sources of data may also be used. For example, the AICPA Audit and Accounting Guide, Health Care Entities, Chapter 8, provides nonauthoritative guidance on the use of statistical and other data to estimate the amount and probability of medical malpractice IBNR claims for a hospital. The concepts in that guide can be applied to risks other than healthcare. In any case, the help of an actuary may be desirable, although the GASB does not require that an actuary’s services be used.

Paragraph 22 of Statement 10 requires recognition of claims costs, including future development on claims, and related liabilities if they are both probable and reasonably estimable. However, paragraph 27 requires disclosure of the nature of the contingency and a statement that an estimate cannot be made in situations in which a loss is probable but has not been accrued because it is not estimable. (Paragraph 27 also requires disclosure when a loss is reasonably possible but not probable. The disclosure of a reasonably possible loss should
include an estimate of possible loss or range of loss; otherwise, it should include a statement that an estimate cannot be made.)

3.17.3.  Q—Do claims-made policies have IBNR claims?

A—Yes. IBNR claims may arise from future development in the valuation of claims reported during the policy year. In addition, depending on the policy, IBNR claims may arise from claims reported after the policy year during a specified time period allowed in the policy or for claims reported under tail coverage in force on the policy.

3.18  Recoveries from subrogation

3.18.1.  Q—If a public entity risk pool has the right of subrogation on claims, what should be the accounting treatment of the recovered amounts when the related claims have already been paid?

A—Paragraph 22 of Statement 10 requires that estimated recoveries from subrogation on unpaid claims be deducted from the liability for unpaid claims costs. Estimated recoveries on settled claims also should be deducted from the liability for unpaid claims, unless amounts receivable from subrogation were not reasonably estimable and, therefore, were not recognized until received. In these cases, subrogated amounts should be reported as a reduction of current-period claims expense when received. (See the example in Illustration 1 of nonauthoritative Appendix B3-4.)

3.19  Reinsurance and excess insurance

3.19.1.  Q—Is all reinsurance or excess insurance purchased by a pool to be accounted for as provided in Statement 10, paragraph 37, irrespective of the preparer’s ability to determine the likelihood of collectibility of reinsurance or excess insurance by the pool?

A—No. Only the amounts of reinsurance or excess insurance recoveries that are collectible should be reported in the net receivable for paid claims and claim adjustment expenses. Likewise, only the collectible amounts of reinsurance or excess insurance recoveries should be used to offset liabilities for unpaid claims.

3.19.2.  Q—If, by participating in an excess pooling arrangement, a public entity risk pool assumes, either directly or indirectly, risk of loss from other participants in the excess pooling arrangement, how should such an assumption of risk by the pool be reported?

A—If the excess pooling arrangement provides for the excess pool to assume risk from a participating pool, then the arrangement should be reported as reinsurance in accordance with paragraphs 37 and 38 of Statement 10, as amended, and amounts recoverable should be reported as assets or reductions in unpaid claims liabilities, as appropriate. If there is no intended transfer of risk, the excess pooling arrangement should be reported in accordance with paragraph 39, and amounts paid by the participating pool to the excess pool should be reported as deposits.

Furthermore, it is essential that a participating pool determine if it has any liability for losses and claim adjustment expenses of the excess pooling arrangement, just as entities participating in a pool should ascertain whether liabilities should be accrued for assessments from a pool or for a pool’s inability to cover claims costs (paragraph 69, as amended, and paragraph 70). To the
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extent that amounts are probable and reasonably estimable, a pool should report a liability for claims costs (including IBNR and related claim adjustment expenses) of the excess pooling arrangement that will be assumed by the pool. If these costs are not estimable or are only reasonably possible, then disclosure of the contingency should be made in accordance with paragraph 27.

The disclosures on reinsurance transactions required by paragraph 6 of Statement 30 should include a full description of the excess pooling arrangement, including the pool’s rights and responsibilities and the type of coverage.

3.19.3. [Not used in GASBIG 2015-1]

3.19.4. [Not used in GASBIG 2015-1]

3.20 Deductibles and self-insured retentions

3.20.1. Q—What is a self-insured retention (SIR), and how should it be accounted for by a pool?

A—An SIR is that portion of a claim for which a pool participant is responsible and for which risk has not been pooled if there is no deductible arrangement. For example, a pooling agreement may stipulate that all participants are responsible in some manner for the first $100,000 of all claims submitted. If the participants are required to pay the first $100,000 before the pool is obligated to pay on claims or if the participants are required to deposit with the pool all or part of the $100,000 at the inception of the policy, there is an SIR arrangement. A pool generally is not responsible for claim adjustment on the claims covered by SIRs.

If the pooling agreement provides for SIRs, the pool needs only to consider, but not report, the amount of claims that are to be paid directly by the participants (or with participant deposits) in calculating claims liabilities in accordance with paragraphs 22–27 of Statement 10, as amended. (See the example in Illustration 2 of nonauthoritative Appendix B3-4.)

3.21 Annuity contracts

3.21.1. Q—When can a claim liability be removed from the statement of net position?

A—Paragraph 26 of Statement 10, as amended, provides that, if an annuity contract is purchased in the claimant’s name to satisfy a claim liability and the likelihood that the pool will be required to make future payments (for example, because an insurance company or institution may not fulfill its obligations on the annuity) is remote, then the pool should remove the annuity contract and the covered liability from the statement of net position. A pool usually pays a lump sum for an annuity contract. That lump sum plus the earnings on it is used to make periodic payments, fixed or variable in amount, to the claimant under the terms of a settlement with the claimant. However, the pool is generally not completely relieved of responsibility. It should evaluate whether the insurance company or institution from which the annuity contract was purchased can fulfill its obligations to pay out the required annuities.

Unless the claimant has provided the pool with a signed agreement releasing the pool from any and all further obligation, the pool should still include the liability amount in the disclosure of aggregate outstanding liabilities removed from the statement of net position, as required by paragraph 49h, as amended. The requirement for this off–statement of net position settlement
of claims liabilities is provided because the substance of these transactions is similar in nature to transactions involving in-substance defeasance of debt.

3.21.2. Q—Do annuity contracts that are held by the pool but that designate the claimant as the annuitant (payee) qualify as being “in the claimant’s name”?

A—Yes, provided that the pool cannot unilaterally change that designation. The intent of “in the claimant’s name” is to distinguish the contracts from those that are held for general investment or other purposes. When contracts are purchased only in the name of the pool or in a name that can be changed unilaterally by the pool, there is nothing that would distinguish the contracts from any other investment. It would be inappropriate to treat these types of investments as having defeased a specific claim liability, in accordance with Statement 10, paragraph 26, as amended.

3.22 Discounting

3.22.1. Q—Are all claims liabilities required to be discounted?

A—No. Paragraph 24 of Statement 10 provides that presenting claims liabilities at the discounted present value of estimated future payments is neither mandated nor prohibited. However, discounting is required for structured settlements if they “represent contractual obligations to pay specific amounts on fixed or determinable dates.” Implicit in these settlements is the time value of money.

Discounting for all claims liabilities is not required because of the “softness” of estimates and all the variables that need to be considered, such as interest rates, settlement dates, and amounts to be paid on future dates. Because payment dates and amounts are fixed or determinable for structured settlements, the time and payout rate variables have been removed, thereby making estimation of a present value more certain.

3.23 Investments

3.23.1. [Not used in GASB15-1]

3.23.2. [Not used in GASB15-1]

3.24 Real estate

3.24.1. [Not used in GASB15-1]

3.25 Disclosures and Required Supplementary Information

3.26 Note Disclosures

3.26.1. Q—What public entity risk pool disclosures are required to be presented in the financial statements of a financial reporting entity in which a public entity risk pool is included?

A—Paragraph 49 of Statement 10, as amended, which discusses disclosures, does not provide for this situation. The provisions of Statement 14, paragraphs 61–63, as amended, should be applied.
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3.27 Description of pool and responsibilities

3.27.1. Q—What types of disclosures should be provided in the description of the risk transfer or pooling agreement?

A—These disclosures should provide meaningful information to financial statement users, including the primary users identified in paragraph 5 of Statement 10:

a. Pool participants and those considering pool participation
b. Legislative and oversight bodies (such as state regulatory bodies)
c. Reinsurers and excess insurers
d. Investors and creditors.

The disclosures should provide a frame of reference for understanding the structure, operating results, loss experience, and financial stability of the pool. Disclosures that may be considered include composition of the participants (members) of the pool; how participants are admitted, including, for example, whether entry is limited by class of entity or by application of underwriting standards; what kinds of risks are being pooled (what coverage is being provided); statutes authorizing the pool or under which the pool is organized; how the pool is governed or administered; circumstances under which refunds or dividends are made to participants; whether the pool is subject to regulation by or reporting to any regulatory body; and whether the obligations of the pool are backed or guaranteed, in whole or in part, by any state or federal guaranty fund.

3.27.2. Q—What types of disclosures should be provided in the description of the rights and responsibilities of the pool?

A—These disclosures should provide financial statement users with a frame of reference for understanding the rights and responsibilities of the pool with respect to current and former participants. They also provide users with information that may assist in assessing the financial stability of the pool. Disclosures that may be considered include handling of claims; limitations on payment of claims; coordination of purchase of commercial insurance, if any; ability to make assessments against members (participants), including limitations on the amounts that can be assessed; and accessibility of the pool by other entities.

3.27.3. Q—What types of disclosures should be provided in the description of the rights and responsibilities of pool participants?

A—These disclosures should provide financial statement users with a frame of reference for understanding the rights and responsibilities of current and former pool participants both to the pool and to other current or former participants of the pool. Disclosures that may be considered include membership requirements, including any obligations to remain a member for specified time periods; withdrawal requirements, including any required period of advance notice to the pool before withdrawal and any obligations for unpaid claims; responsibilities for any deficiencies in pool equity; and requirements to pay any loss deductibles or SIRs and related claims administration costs on claims submitted.

3.27.4. Q—in describing risk transfer, should the description include risk transfer to the participant from the pool or other participants (for example, assessments) as well as transfer of risk from the participant to the pool?
A—Yes. This information allows financial statement users to assess the interdependence between the pool and its participants and among participants. Risk transfer to the participant from the pool is different from risk retention by the participant. Risk that is retained by a participant is generally a defined amount of risk related to the participant’s own claims costs and is not transferred to another party, such as a pool. Risk that is transferred from the pool to a participant may involve risk related to claims costs of other participants that, if they exceed a certain threshold or if they exceed related premiums earned by the pool, will be transferred back to all participants from the pool through assessments or similar mechanisms.

3.27.5. Q—Statement 34 requires a management’s discussion and analysis (MD&A). Should an MD&A be prepared for risk pool financial statements?

A—Risk pools that are separate legal entities should prepare an MD&A. Statement 34, paragraphs 134 and 138, provides relevant guidance.

3.28 Basis for estimating liabilities

3.28.1. Q—If the basis changes for estimating liabilities for unpaid claims and claim adjustment expenses, should this change be disclosed?

A—Although there is no specific requirement in paragraph 49b of Statement 10, disclosure is required by Statement 62, paragraph 85, to the extent that the effect of a change in the basis for estimating liabilities is significant or that failure to disclose such changes might be misleading or might obscure trends. This disclosure should include a description of the basis used for estimating liabilities before and after the change and an estimate of the effect of the change on the financial statements. For example, if the XYZ Workers’ Compensation Pool changes the basis for estimating workers’ compensation liabilities, it would disclose information similar to the following in the notes to the financial statements for the fiscal year: “For the current fiscal year, the pool estimated unpaid claims and claim adjustment expenses to be $250,000, based on the average aggregate number of employees on the payrolls of all participants during the fiscal year. In prior years, unpaid claims and claim adjustment expenses had been estimated based on aggregate payroll costs for all participants for the fiscal year. If these amounts had been estimated using the prior years’ basis for estimation, the unpaid claims and claim adjustment expenses reported in the financial statements would have been $225,000.”

3.28.2. [Not used in GASB 2015-1]

3.29 Acquisition costs

3.30 Face and carrying amount of liabilities

3.31 Anticipated investment income for premium deficiency

3.31.1. Q—When a pool considers anticipated investment income in determining if a premium deficiency exists, what information or assumptions should be disclosed?

A—Statement 10, paragraph 49e, requires only a disclosure of whether anticipated investment income is used in calculating a premium deficiency. There are no additional disclosure requirements.
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3.32 Reconciliation of unpaid claims

3.32.1. Q—Should the disclosure of the reconciliation of unpaid claims liabilities include IBNR claims as well as claims that have already been reported?

A—Yes. If IBNR claims are probable and reasonably estimable, they are required to be included in the total unpaid claims accrual. Therefore, they should be included in the reconciliation of unpaid claims liabilities as required in paragraph 49g of Statement 10. In addition, the expected future development on existing claims, which is another component of IBNR, should be included in the total unpaid claims accrual and, accordingly, in the reconciliation of unpaid claims liabilities. If, however, IBNR claims are disclosed only, in accordance with paragraph 27, because of an inability to estimate the amount or because claims are only reasonably possible and, thus, are not included as liabilities on the statement of net position, then this reconciliation would not include them either. However, IBNR claims generally are estimable.

3.32.2. Q—Does the reconciliation in Statement 10, paragraph 49g, include unallocated claim adjustment expenses?

A—Yes. These expenses should be an integral part of the total claim and claim adjustment expenses that are in the reconciliation. Paragraph 23 provides that both allocated and unallocated claim adjustment expenses should be included in the determination of the liability for unpaid claims and claim adjustment expenses.

Nonauthoritative Appendix B3-8 provides illustrations of the 2-year reconciliation of total claim liability by type of contract and the 10-year revenue and claims development table.

3.33 Annuity contracts

3.34 Loss contingencies

3.35 Required Supplementary Information

3.35.1. Q—What information is required to be presented in required supplementary information (RSI) in separately issued public entity risk pool reports?

A—As discussed in paragraph 7 of Statement 30, RSI consists of two tables:

a. A 10-year revenue and claims development table
b. A 2-year reconciliation of total claims liabilities by type of contract.

The 10-year revenue and claims development table shows trends in current claims and development in prior years’ claims. It also shows, over time, how well a pool is performing its underwriting function and its claims estimation (loss reserving) function.

The two-year reconciliation of total claims liabilities by type of contract provides additional information about the pool’s operations. For example, disaggregated claim liability information shows the extent to which changes in liabilities for claims costs and related expenses are due to current claims versus developments in prior years’ claims.
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3.35.2. Q—What information is required to be reported as RSI in the reports of a financial reporting entity in which a public entity risk pool is included?

A—Paragraph 7, footnote a, of Statement 30, as amended, provides that, if a pool is included as part of another financial reporting entity and the pool does not issue a separate report, the information required by that paragraph should be presented after the notes to the reporting entity’s financial statements. If the reporting entity issues a comprehensive annual financial report or presents a statistical section together with its basic financial statements, included pools may present the RSI as operating information in the statistical information.

Neither paragraph 7 of Statement 30, as amended, nor Statement 10, as amended, addresses the situation when a pool is included as part of another financial reporting entity, but the pool issues a separate report. However, paragraph 78 of Statement 10, as amended, requires the financial statements of the reporting entity to emphasize disclosures about the primary government’s participation in the pool and to include a reference to the separate report of the pool.

3.36 SEC requirements

3.36.1. [Not used in GASBIG 2015-1]

3.37 Reconciliation with financial statements

3.37.1. Q—If a pool’s data are maintained on a policy-year basis, should the two-year reconciliation of total claims liabilities (Statement 10, paragraph 49g) and two-year reconciliation of claims liabilities by type of contract (Statement 30, paragraph 7b) be presented on a policy-year basis?

A—No. The reconciliation should tie to the financial statements. To determine the year-end liability, the data should be re-sorted into a fiscal-year basis. The initial effort may be difficult, but this should facilitate preparation of financial statements, disclosures, and RSI in future years.

3.37.2. Q—If a pool’s accident year (for occurrence-based policies), report year (for claims-made policies), or policy year is different from its accounting or fiscal year, should all of the data in the 10-year revenue and claims development table tie to the financial statements?

A—No. Only the information required by paragraphs 7a(1) and 7a(2) of the 10-year revenue and claims development table are based on fiscal-year information and should tie to the financial statements. Those amounts should be presented on an accrual basis.

It was anticipated that the information required by paragraphs 7a(3)–7a(7) of the 10-year table would not necessarily tie into the financial statements if they are on an accident-, report-, or policy-year basis. (See Statement 30, paragraph 7, and paragraphs 36 and 37 in the Basis for Conclusions section of that Statement.)

3.38 Unallocated claim adjustment expenses

3.38.1. Q—What unallocated claim adjustment expenses are to be included in the 10-year revenue and claims development table?
A—Unallocated adjustment expenses are one of two components to line 2. They include costs related to settling claims that cannot be attributed to specific claims. This component may include, for example, salaries paid to claims department staff or costs related to a fixed-fee contract with a claims adjusting service (where payments made to the service company have no direct correlation with claims adjusted). The second component of line 2 consists of the “other costs” of the pool, as defined in paragraph 31 of Statement 10. Other costs are generally the administrative or overhead costs of the pool—costs not related to settling claims or to acquiring or renewing participation contracts.

3.39 Inclusion of IBNR claims

3.39.1. Q—Do estimated incurred claims and expenses and reestimated incurred claims and expenses in the 10-year revenue and claims development table include both known claims and IBNR claims?

A—Yes. IBNR claims should be included in the 10-year revenue and claims development table if those claims are eligible to be accrued as liabilities for financial statement purposes because the amounts are probable and estimable. That is, the claims should be included if they are eligible for accrual based on paragraph 22 of Statement 10. IBNR claims generally are estimable.

3.40 Discounted amounts

3.40.1. Q—Should discounted claim amounts be reported in the 10-year revenue and claims development table?

A—Paragraph 7 of Statement 30 neither requires nor prohibits discounting of liabilities in the 10-year revenue and claims development table. However, if discounted claims liabilities are presented in the financial statements (as allowed or required in Statement 10, paragraph 24), discounted claims amounts should be reported in the 10-year revenue and claims development table.

3.41 Policy-year basis

3.41.1. Q—Is it necessary to convert claims development triangles (used by a pool, for instance, in underwriting) that are prepared on another basis to a policy-year basis for the 10-year revenue and claims development table?

A—No. Paragraph 7 of Statement 30 amends Statement 10 to allow presentation of claim information on an accident-year basis (for occurrence-based policies) or report-year basis (for claims-made policies), as long as one basis is consistently applied. Incurred claims costs and allocated claim adjustment expenses (including IBNR) should be assigned to the accident, report, or policy year in which the event that triggered coverage under the pool’s contract occurred. The purpose of the table is to determine trends in the underwriting success of the pool.

Incurred claims costs and allocated claim adjustment expenses (including IBNR) for each policy or contract are assigned to the accident, report, or policy year in which the event that triggered coverage (for example, the incident giving rise to a claim in an occurrence-based policy, the reporting of a claim in a claims-made policy, or the payment of a claim in a claims-paid policy) under the policy or contract occurred.
Occurrence-based coverage

For occurrence-based coverage for which (a) all participants have a common insurance policy or participation contract renewal date and (b) all insurance policies or participation contracts have a coverage period that is the same as the pool’s fiscal year, the policy-year basis is the same as the fiscal-year basis.

For occurrence-based coverage for which (a) all participants have a common policy or contract renewal date and (b) any policy or contract issued by the pool has a coverage period that is not the same as the pool’s fiscal year, data should be converted to an accident- or policy-year basis by reassigning incurred claims costs and allocated claim adjustment expenses (including IBNR) to the policy year in which the event that triggered coverage under the policy or contract occurred.

For occurrence-based coverage for which participants have policy or contract renewal dates that fall at various times during the pool’s fiscal year, data should be converted to an accident- or policy-year basis by reassigning incurred claims costs and allocated claim adjustment expenses (including IBNR) to the policy year in which the event that triggered coverage under the policy or contract occurred.

Claims-made coverage

For claims-made coverage, the policy or contract to which incurred claims costs and allocated claim adjustment expenses (including IBNR) should be assigned is the reporting period in which the event that triggered coverage (generally the reporting of a claim) under the policy or contract occurred.

Claims-paid coverage

For policies or contracts with claims-paid or cash flow coverage provisions, the policy or contract to which incurred claims costs and allocated claim adjustment expenses (including IBNR) should be assigned is the reporting period in which the event that triggered coverage (generally the payment of a claim) under the policy or contract occurred. However, if claims-paid policies may become occurrence-based or claims-made policies, the following applies:

- If, under any circumstance, a policy or contract issued by the pool would provide coverage on an occurrence basis, the policy or contract should be accounted for as occurrence-based coverage.
- If a policy or contract issued by a pool would provide coverage on an occurrence basis and on a claims-made basis (such as in a claims-made policy that contains a policyholder right to convert to an occurrence-based coverage or in an occurrence-based policy that contains an insurer right to convert the policy to claims-made coverage), the policy or contract should be accounted for as occurrence-based coverage.
- If, under any circumstance, a policy or contract issued by the pool would provide coverage on a claims-made basis, the policy or contract should be accounted for as claims-made coverage.

Other types of coverage
For all other types of coverage, conversion is required, as necessary, so that incurred claims costs and allocated claim adjustment expenses (including IBNR) are assigned to the policy year in which the event that triggered coverage under the policy or contract occurred.

3.41.2. Q—If the policy year for a policy or participation contract is not the same as the fiscal year of the pool, what date within the policy or contract period should be used for purposes of assigning incurred claims costs and allocated claim adjustment expenses (including IBNR) to the policy year?

A—The annual inception date or renewal date of the policy or contract should be used. A standard policy year is not assumed for the 10-year revenue and claims development table. For example, during 20X2, the pool may have issued three different policies (contracts)—one started on January 1, another on March 1, and the third on June 1. Claims on all three policies will be included in the claims development for policy year 20X2, even though the one-year period in each contract is different and some of the covered events may physically occur in 20X3. If the claims for all three policies are consistently reported, the table will provide information on trends in loss development on claims.

3.42 Additional disclosures

3.42.1. Q—What are some examples of circumstances that should be evaluated for disclosure of changes in a pool’s loss, expense, reinsurance, or excess insurance, or other transactions that materially affect amounts presented in the 10-year revenue and claims development table, as required by Statement 30, paragraph 7?

A—The premiums charged by the pool are based on certain assumptions and are calculated so that revenues will be sufficient to cover expenses for each contract type. If those assumptions do not come to fruition, it is possible that premiums will not be adequate to meet claims obligations or that premiums are excessive. Examples include:

a. Change in limits, terms, or conditions of reinsurance or excess insurance
b. Inability or unwillingness of reinsurers or excess insurers to pay losses and related expenses
c. Change in the risk retention (net of reinsurance or excess insurance) of the pool
d. Change in commission (recovery of acquisition or other costs) paid by reinsurers or excess insurers (per paragraph 38 of Statement 10)
e. Change in rating systems—for example, how exposure is determined or premium charges are allocated among participants
f. Emergence or existence of dissimilar loss patterns between types of contracts issued
g. Change in the mix (as a percentage of total) of premium dollars by type of contract
h. Change in claims policy, underwriting policy, or claims reserving policy
i. Change in types, limits, or scope of coverages provided by the pool to participants
j. Dissimilarities in effect of loss reserve discounting by type of contract or by year
k. Dissimilarities in loss and claim adjustment expense payout patterns by type of contract or by year
l. Dissimilarities in percentage of unallocated claim adjustment expense by type of contract or changes from year to year
m. Emergence of dissimilar patterns of claims count by type of contract or by year
n. Imminent or pending litigation, other adjudication, or arbitration that has the potential of materially affecting assumptions regarding information reported in RSI.
These types of events, if significant, may signal a potential change in claims development and in the sufficiency of the pool’s resources to fulfill its obligations. The additional disclosures should help financial statement users understand the effects of these changes.

3.42.2. Q—Is there a preferred format for disclosing changes in a pool’s loss, expense, reinsurance, excess insurance, or other transactions that materially affect amounts presented in the 10-year revenue and claims development table, as required by Statement 30, paragraph 7?

A—No. These disclosures may be presented in narrative form or in tabular form, whichever format best conveys the information in a meaningful manner to likely users of public entity risk pool financial reports.

3.43 Presentation

3.43.1. [Not used in GASBIG 2015-1]

3.43.2. Q—Should prior years’ experience be restated in the 10-year revenue and claims development table if there have been changes in coverage or accounting practices during the 10-year period?

A—Generally, changes in coverage are prospective, but changes in accounting methods may affect prior years. Each year, a revised estimate of the net incurred claims and claim adjustment expenses should be presented for each policy year on line 6 of the table. Line 7 shows the cumulative change in the estimates. Prior-year information on lines 3–6 should not be retroactively restated; that information represents the best estimate at the time it was presented. However, lines 1 and 2 are based on fiscal-year information that ties to the financial statements. To the extent that prior-year financial statements are restated, the table should be modified on those two lines. The nature and effect of any of these changes should be disclosed.

3.43.3. Q—If a primary government includes more than one public entity risk pool, can the disclosures required by Statement 10 and Statement 30 be combined with RSI for the pools?

A—Most of the disclosures for the pools can be combined. However, the disclosure provisions in Statement 14, paragraphs 61–63, as amended, should be applied. (See Question 3.26.1.)

The 10-year revenue and claims development table required by Statement 30, paragraph 7a, and the reconciliation of total claims liabilities by type of contract required by paragraph 7b should be presented separately for each pool unless the underwriting for each pool is the same. The extent of any RSI presentation depends on the materiality of the pool, as discussed in Statement 14, paragraph 63, as amended.

3.44 Source of underlying loss data

3.44.1. Q—Does the source of underlying loss data need to be disclosed?

A—This information is not required by Statement 10, as amended, or Statement 30, as amended. It may be presented if the financial statement preparer believes that it enhances the disclosures required by Statement 10, paragraph 49, subparagraphs b and d, or if it explains trends in the 10-year revenue and claims development table required by Statement 30, paragraph 7, as amended.
3.45 Reinsurance recoveries

3.45.1. Q—How should reinsurance recoveries be treated in the 10-year revenue and claims development table?

A—Amounts in the 10-year table are shown gross (as defined by Statement 30, paragraph 7a(3)). This may necessitate a separate set of claims records for actuarial purposes, showing all claims with future development. This information could be combined with reinsurance information to derive the necessary amounts to meet the requirements of Statements 10 and 30, as amended.

3.46 Pools Not Involving Transfer or Pooling of Risk

3.47 Entities Other Than Pools

3.48 Definition and Scope

3.48.1. Q—What is an “entity other than a pool”?

A—For the purposes of Statement 10, an entity other than a pool is any state or local governmental entity financing risk that does not meet the definition of a public entity risk pool in paragraphs 10–13. (See Question 3.4.1.) The state or local governmental entity may be a general government (such as a state, county, or municipality), a public benefit corporation or authority, a public employee retirement system, a utility, a hospital, or a college or university.

3.49 Fund Classification

3.49.1. Q—Should all risk financing of an entity be reported either exclusively in the general fund (or a special revenue fund) or exclusively in an internal service fund?

A—if a single fund is used to account for an entity’s risk financing activities, that fund should be a governmental fund (for example, either the general fund or a qualifying special revenue fund), or an internal service fund. The intention of Statement 10 is to preclude the use of fiduciary funds, because it is believed that there is no fiduciary or trust relationship in risk financing activities. As a result, a fund that is used to provide risk management—and is used for no other function—should be an internal service fund, regardless of the number of separate funds performing that function (for example, one fund for workers’ compensation and another for general liability). Alternatively, if separate internal service funds have not been established, a governmental fund should be used to report all of these activities.

Statement 10, as amended, does not require that all of a government’s risk financing be classified in a single fund type. Therefore, a governmental entity can account for one form of risk financing in a governmental fund and another form in an internal service fund.

Furthermore, risk financing can still be accounted for in an enterprise fund or a special revenue fund for risk within the fund. However, risk financing cannot be provided to other funds of the entity without reporting the risk financing activity as an internal service fund or incorporating it into a governmental fund.

3.49.2. [Not used in GASBAG 2015-1]
3.49.3. **Q**—When should risk financing activities be reported in a governmental fund (for example, either the general fund or a qualifying special revenue fund) versus in an internal service fund?

**A**—Neither classification is preferred; however, there may be circumstances in which one is considered more appropriate. The use of an internal service fund may be appropriate when a governmental entity wants to segregate certain risk financing activities from its other activities, either for management and analysis or for financial statement presentation. Use of an internal service fund may also be appropriate when a government intends to recover the cost of its risk financing activities from other units of the government or when a government wants to allocate charges and possibly accumulate future catastrophe reserves. For some governments, however, risk financing activities are seen merely as a function of a government as a whole—not of the individual units of the government. In these cases, the use of a governmental fund may be desirable. Although the advantages of using an internal service fund were recognized, it is noted in paragraph 119 of the Basis for Conclusions that the use of an internal service fund is not required because “. . . consistent with the objective of minimizing the number of funds used by a governmental entity, [Statement 10, as amended] does not mandate use of internal service funds. . . .”

3.49.4. **Q**—A government retains risk for active employee health benefits—not for postemployment benefits—by establishing a fund for current claims using a formal trust agreement. Statutes require that the fund be reported as a trust fund. What type of fund should be used for financial statement purposes?

**A**—Although a trust fund may seem appropriate because of the trust agreement and legal requirement, Statement 10, as amended, requires that if a government uses a single fund to account for its risk financing activities, that fund could be the general fund, a special revenue fund, or an internal service fund for GAAP-basis financial statement purposes; the use of a trust fund is precluded. (See Question 3.49.1.) Therefore, the legal basis will be different from the GAAP basis. NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, under the heading “Conflicts between Legal Provisions and GAAP,” indicates that “conflicts between legal provisions and GAAP do not require maintaining two accounting systems. Rather, the accounting system may be maintained on a legal-compliance basis, but should include sufficient additional records to permit GAAP-based reporting” (paragraph 13 of NCGA Statement 1); and “the basic financial statements of governmental units should be prepared in conformity with GAAP” (paragraph 11 of that Statement).

An internal service fund can be used to segregate the health benefits fund from other general governmental activities, and it can be used effectively to charge premiums to other units of the government, if necessary, as discussed in paragraph 66 of Statement 10, as amended. Alternatively, the general fund or a qualifying special revenue fund can be used to account for this program.

3.49.5. [Not used in GASBIG 2015-1]

### 3.50 Employee Benefits

3.50.1. **Q**—Does Statement 10, as amended, apply to long-term disability benefits provided by employers to active and retired employees?
A—Determination of the applicable accounting and financial reporting requirements that an employer should follow for disability benefits depends on:

a. Whether the disability benefits are provided through a defined benefit pension plan or are provided separately, and

b. Whether the benefits are expected to be provided to disability-retired employees or to temporarily disabled employees pending their expected return to active status.

Long-term disability benefits that are provided through a defined benefit pension plan are classified as pension benefits. An employer should account for and report such benefits in conformity with the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as amended, or Statement No. 68, Accounting and Financial Reporting for Pensions, as applicable. Long-term disability benefits that are provided separately from a defined benefit pension plan and are expected to benefit disability retirees are classified as other postemployment benefits. An employer should account for and report those benefits in conformity with the requirements of Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended. Short-term disability benefits that are provided separately from a defined benefit pension plan and are expected to benefit temporarily disabled employees pending their expected return to service should be accounted for as risk financing activities in conformity with the requirements of Statement 10, as amended.

3.50.2. Q—Does Statement 10 apply to supplemental workers’ compensation benefits?

A—Yes. Paragraph 1e of Statement 10 designates “job-related illnesses or injuries to employees” as one of the types of risk included within the scope of the Statement. To the extent that an entity has claims, either reported or incurred but not reported, for which risk has not been transferred, it should accrue a liability or disclose a contingency in accordance with paragraphs 53−56 and paragraphs 58−61 of Statement 10, as amended, and paragraph 9 of Statement 30.

3.50.3. Q—Does Statement 10 apply to health, dental, or other medical benefits provided to active employees and retirees and their dependents and beneficiaries?

A—Statement 10, as amended, applies to health benefits provided to active employees and their dependents and beneficiaries. Health benefits provided to retirees and their dependents and beneficiaries are other postemployment benefits and should be accounted for in accordance with the requirements of Statement 45, as amended.

3.51 Environmental Liabilities

3.51.1. Q—Does the scope of Statement 10 include environmental liabilities?

A—The scope of Statement 10 includes environmental liabilities that are not within the scope of other GASB pronouncements or within the scope of other sources determined to be applicable using the GAAP hierarchy. Governments that retain risk for pollution remediation liability contingencies should apply the provisions of Statement 49, as amended, for recognition of such liabilities. The provisions of Statement No. 18, Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs, as amended, should be applied to entities covered by the scope of that Statement.
3.52 Stand-Alone Entities

3.52.1. Q—May a stand-alone entity that is engaged only in business-type activities use an internal service fund to report its own risk financing activities?

A—No. As amended, footnote 12 of Statement 10 provides that entities that are reported as proprietary funds, trust funds, or discretely presented component units of a primary government may participate in a risk financing internal service fund of that primary government. However, the footnote limits the classification of risk financing activities by stand-alone entities that are not reported as component units. Stand-alone entities that are engaged only in business-type or fiduciary activities and that are not considered to be a part of another financial reporting entity should not use an internal service fund to report their own risk financing activities. Instead, their risk financing activities should be reported as part of the stand-alone entities’ activities. Business-type or fiduciary component units should not use an internal service fund of their own to report their risk financing activities. However, those component units may use the risk financing internal service fund of the primary government.

3.53 Recognition and Measurement

3.54 General Fund

3.54.1. Q—If the general fund is used for an entity’s risk financing, is the government required to allocate its claims expenditures to other funds in the entity?

A—No. An allocation of these expenditures is not required to be made. Paragraph 53 of Statement 10, as amended, provides: “... This Statement is not intended to inhibit or restrict the method of allocation of those expenditures/expenses and liabilities among funds of the primary government in the fund financial statements.” In addition, paragraph 64, as amended, states: “... The entity may use any method it chooses to allocate loss expenditures to the other funds of the entity. ...” See Question 7.28.1 about allocating direct expenses to the programs/functions reported in the government-wide statement of activities.

3.55 Internal Service Fund

3.55.1. [Not used in GASB 2015-1]

3.55.2. Q—A county government operates an internal service fund for the costs of medical care. Every month $500 per employee is accumulated for future claims experience. Claims and costs are deducted from these resources. May net position be reported as designated for future claims experience?

A—No. Paragraph 98 of Statement 34, as amended, states that designated net position should not be reported on the face of proprietary fund financial statements. Net position should be displayed in three categories: net investment in capital assets, restricted, and unrestricted. The restricted classification of net position arises from constraints imposed by creditors, by others outside the government, or by law (Statement 34, paragraph 34, as amended). The resources set aside by the county government do not satisfy the definition of restricted.
Statement 10, paragraph 67, as amended, does, however, provide for disclosure of net position designated for future catastrophe losses. (See Question 7.47.21 about the government-wide reporting implications.)

3.56 Revenue

3.56.1. Q—Does Statement 10, as amended, provide requirements on how to finance rather than how to report deficits in risk financing internal service funds?

A—No. Statement 10, as amended, does not require the use of any specific claims financing method. Paragraph 67 of Statement 10, as amended, states that internal service fund deficits resulting from application of paragraphs 66b and 66c do not need to be charged back to other funds each year as long as fee or charge adjustments are made over a reasonable period of time. Conversely, paragraph 68, as amended, requires that deficits in an internal service fund should be charged back to other funds if the deficits are not recovered over a reasonable period of time.

The provisions of paragraph 66 are designed to generally permit a level charge to be assessed over a reasonable period of years from the internal service fund to the user funds. In years in which loss experience is unfavorable, a deficit in earnings and perhaps a deficit in net position will be shown in the internal service fund. Paragraph 67, as amended, recognizes this possibility and provides that if the government has a plan to recoup deficits over a reasonable period of time, then no current-period charge should be made in the user funds.

3.56.2. Q—What is meant or intended by the term actuarial method as introduced in paragraph 66b of Statement 10?

A—Statement 10 defines the term actuarial method as follows:

Any of several techniques that actuaries use to determine the amounts and timing of contributions needed to finance claims liabilities so that the total contributions plus compounded earnings on them will equal the amounts needed to satisfy claims liabilities. It may or may not include a provision for anticipated catastrophe losses.

The purpose of paragraph 66 of Statement 10 is to recognize that an internal service fund is a proprietary activity and that premiums should be able to be determined in a manner similar to insurance enterprises, with the intent of recovering the cost of paying claims. This method may be used for internal service funds. By allowing an actuarial method for determining charges to other funds, the amount recorded in other funds as expenditures/expenses can be level. Therefore, those funds are not affected in any one period because of a catastrophe or a payment of a large court settlement.

3.57 Colleges and Universities

3.57.1. [Not used in GASBIG 2015-1]

3.58 Liability Measurement
3.58.1. Q—Do the liability measurement provisions in paragraphs 53–56 of Statement 10, as amended, and paragraph 9 of Statement 30 apply for liability measurement to all governmental, proprietary, and fiduciary funds?

A—Yes. The liability measurement provisions in those paragraphs apply to all governmental, proprietary, and fiduciary funds; the requirements are not limited to just those governments that use a single fund (an internal service fund or a governmental fund) for risk financing. The requirements for liability recognition in governmental funds are set forth in paragraph 14 of Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements, as amended.

3.59 Contingencies

3.59.1. [Not used in GASB/GASB 2015-1]

3.60 Discounting

3.60.1. Q—Are all claims liabilities required to be discounted?

A—No. Paragraph 59 of Statement 10 provides that presenting claims liabilities at the discounted present value of estimated future cash payments is neither mandated nor prohibited. However, discounting is required for structured settlements only if they “represent contractual obligations to pay money on fixed or determinable dates.” Implicit in these settlements is the time value of money.

Discounting for all claims liabilities is not required because of the “softness” of estimates and all the variables that need to be considered, such as interest rates, settlement dates, and amounts to be paid on future dates. Because payment dates and amounts are fixed or determinable for structured settlements, the time and payout rate variables have been removed, thereby making estimation of a present value more certain.

3.61 IBNR claims

3.61.1. Q—What are IBNR claims?

A—According to footnote 5 of Statement 10, IBNR claims include three components:

a. Known loss events that are expected to later be presented as claims—for example, a government that retains risk for workers’ compensation claims is aware of an on-the-job injury for which no formal claim has been filed.

b. Unknown loss events that are expected to become claims—for example, a government that retains risk for workers’ compensation claims is unaware of an on-the-job injury that has occurred and has not been filed, but based on historical experience has an expectation of claims to be filed.

c. Expected future development on claims already reported—for example, a government that retains risk for property damage is unaware of the full extent of damages from a storm for a claim that has been filed.

IBNR is largely an estimate of loss associated with future likely activity on incurred claims based on historical actual results that establish a reliable pattern.
3.61.2. Q—How are IBNR claims to be estimated and recognized?

A—**IBNR claims generally are estimable.** Initially, it may take time to accumulate a history of the proper data if those data are not currently available. If the historical results of an entity are not representative, supplementary analysis, including use of historical actual results of other entities with similar structure, risk assumptions, and risk exposure, should be considered. Other factors to be considered are changes in operations or operating environment, demographic changes, and statutes and regulations.

Other sources of data may also be used. For example, the AICPA Audit and Accounting Guide, *Health Care Entities*, Chapter 8, provides nonauthoritative guidance on the use of statistical and other data to estimate the amount and probability of medical malpractice IBNR claims for a hospital. The concepts in that guide can be applied to risks other than healthcare. The help of an actuary may be desirable, although it is not required that an actuary’s services be used.

Paragraph 53 of Statement 10, as amended, requires recognition of claims and related liabilities if they are both probable and reasonably estimable. However, paragraph 58 requires disclosure of the nature of the contingency and a statement that an estimate cannot be made in situations in which a loss is probable or reasonably possible but has not been accrued because it is not estimable.

3.61.3. Q—Can another entity’s experience be used to calculate IBNR claims?

A—Statement 30 requires that accruals be made if IBNR claims are both probable and estimable, and it requires that such estimates should be made based on historical experience (paragraph 9). However, some entities may have a low frequency of losses and, therefore, may not be able to derive a reasonable IBNR estimate. If a reasonable estimate can be derived from another entity’s experience, it may serve as a basis for making a calculation, but there should be some level of confidence that the other entity’s experience is similar in amounts and types of past claims. Furthermore, it may be more appropriate to use aggregate data from several similar entities for the IBNR calculation.

Going forward, however, the entity should retain sufficient records to accumulate a history necessary to make such an estimation. Another entity’s experience should not be used on an ongoing basis.

3.61.4. [Not used in GASBIG 2015-1]

3.62 Use of third-party insurer

3.62.1. Q—If risk is transferred to a private insurer or a public entity risk pool, can it be removed from an entity’s claim liability?

A—To the extent that the government can reasonably expect that the insurance policy or participation contract will cover the risk in question, risk has been transferred; no liability, other than premiums or required contributions payable, needs to be accrued by the government, in accordance with Statement 10, paragraph 53, as amended. The government should look at such factors as the basis of coverage being provided by the insurer, the periods covered by the policy and when claims are required to be reported to be covered, any deductibles or SIRs on claims that are required to be paid by the government, and the financial capacity and stability of the insurer. If there is a deductible or an SIR, the government should accrue for its portion of
unpaid claims, both reported and IBNR. If there is a possibility that the insurer or pool may not be able to fulfill its obligations or that the risk may fall outside the coverage of the policy due to type or timing of claim or occurrence, risk may not effectively be transferred. The government should evaluate the likelihood that it will be required to pay its own claims. An accrual or disclosure of loss contingencies may be required, applying the provisions of paragraphs 53–56, 58, and 70 of Statement 10, as amended, and paragraph 9 of Statement 30.

Furthermore, for risks transferred to a public entity risk pool, the entity should consider the likelihood that the pool will assess the entity for its share of pool losses if the pool has the right to make these assessments according to the pooling agreement. If an assessment is probable and reasonably estimable, a liability should be accrued, as required by paragraph 69 of Statement 10, as amended. If the assessments are probable but not reasonably estimable or if the assessments are reasonably possible, disclosures about the possible assessments should be made, as required by paragraph 69, as amended. (See Question 3.58.1 about liability measurement and recognition.)

3.63 Claims-made policies

3.63.1. Q—Does the requirement in Statement 10, paragraph 72, to account for the estimated costs of unreported claims under a claims-made policy apply only if the policy period ends on or before the statement of net position/balance sheet date?

A—No. The relationship of the policy period ending date to the statement of net position/balance sheet is not relevant. Under a claims-made policy, risk is transferred to the insurer only to the extent that covered claims are reported during the claims reporting period described within the policy. For example, if a policy period ends on June 30, and an insurable incident occurs on June 29 but is not reported until July 1, it is outside the policy coverage. Unless it has purchased tail coverage or the policy has a period beyond the policy year when claims may be reported, the entity would be responsible for payment of the claim and should account for the claim in accordance with paragraphs 53–56 and paragraph 58 of Statement 10, as amended, and paragraph 9 of Statement 30. If the entity had a June 30 year-end, it should account for the claim and include any unpaid portion of the liability on the statement of net position/balance sheet. Likewise, if the entity had a December 31 year-end, it should account for the claim and include any unpaid portion of the liability on the statement of net position/balance sheet. (See Question 3.58.1 about liability measurement and recognition.)

3.64 Claims-paid policies

3.64.1. Q—When is risk transferred under an insurance policy with claims-paid provisions?

A—Risk is transferred only to the extent that claims are physically paid during the policy period. Therefore, an entity should evaluate the likelihood that the insurer will cover claims, regardless of when the event leading to the claim or the reporting of the claim occurred. If an entity determines that the insurer may not cover certain claims, an accrual or disclosure of loss contingencies may be required, applying the provisions of paragraphs 53–56 and 58 of Statement 10, as amended, and paragraph 9 of Statement 30.

3.65 Retrospectively rated policies and contracts

3.65.1. Q—Under a retrospectively rated policy, when should a liability for premiums be recognized?
A—With this type of policy, final premiums are determined after loss experience is known, and the initial payment under the policy is generally the minimum payment. For example, a government may make an up-front premium payment but may make additional premium payments at a later date based on loss experience. Under a policy where the entity’s premiums are based just on its own loss experience, there should be a minimum amount of known premium liability that should be recognized in accordance with paragraph 73 of Statement 10. Any amounts above the minimum that are probable and reasonably estimable should be accrued. Paragraph 58 requires disclosure of amounts that are reasonably possible or are probable and not reasonably estimable.

Similarly, under a policy where the entity’s premiums are based on the loss experience of a group of entities, at least the minimum premium liability should be recognized in accordance with paragraph 74, as amended. Any amount above the minimum premium, however, should be accrued if it is probable and reasonably estimable. Paragraph 58 requires disclosure of other amounts or conditions.

3.65.2. Q—A school district experiences above-the-ordinary medical claims. Should a liability and current expenditures/expenses be reported in anticipation of higher insurance premiums?

A—If the district’s policy is retrospectively rated, an accrual should be made for anticipated premium increases. On the other hand, if risk has been transferred to the insurer for predetermined premiums, the district’s liability is limited to those premiums. This guidance is appropriate even though excess claims experience may be expected to be factored into the determination of premiums for the following period. (See also Question 3.58.1 about liability measurement and recognition.)

3.66 Policyholder or pool dividends

3.67 Deductibles and self-insured retentions

3.67.1. Q—Should a liability be accrued for loss deductibles and SIRs?

A—Loss deductibles and SIRs are that portion of a claim for which an entity is responsible and for which risk has effectively not been pooled or transferred. Paragraph 53 of Statement 10, as amended, requires risks that have not been transferred to an unrelated third party to be evaluated for potential recognition as a liability.

For example, an insurance policy (or a participation contract) may stipulate that the policyholder (or participant) is responsible for the first $10,000 of each claim submitted. This portion of the risk has been retained by the policyholder. Thus, the policyholder should accrue a liability for the unpaid portion of claims, both reported and IBNR. In this example, the policyholder determines the following: There are five claims (on an occurrence-based policy) of $150,000 each for incidents that have occurred before the end of the fiscal year, whether reported or not reported; all the claims qualify for coverage under the insurance policy; and there is no uncertainty about the insurer’s ability to pay the claims. Based on this information, the policyholder should accrue a liability for $50,000 (5 × $10,000) for the loss deductibles or SIRs for which it will be responsible.

3.68 Costs related to claims
3.68.1. Q—Should the claims liabilities calculated in accordance with paragraphs 53−56 of Statement 10, as amended, and paragraph 9 of Statement 30 include costs related to the claims?

A—Yes. Paragraph 9 of Statement 30 requires that claims liabilities include specific, incremental claim adjustment expenses, reduced by estimated recoveries on unsettled claims. Incremental costs are incurred only because of a claim, such as adjustment fees for outside counsel engaged to settle a particular claim. Other allocated or unallocated claim adjustment expenditures/expenses, such as salaries, supplies, and utilities for the claims department, may be included, and, if so, this fact should be disclosed.

3.68.2. [Not used in GASBIG 2015-1]

3.69 Annuity contracts

3.69.1. Q—When can a claim liability be removed from the statement of net position/balance sheet?

A—Paragraph 61 of Statement 10, as amended, provides that if an annuity contract is purchased in the claimant’s name to satisfy a claim liability and the likelihood that the government will be required to make future payments (for example, because an insurance company or institution may not fulfill its obligations on the annuity) is remote, then the government should remove the annuity contract and the covered liability from the statement of net position/balance sheet. A government usually pays a lump sum for an annuity contract. That lump sum plus the earnings on it are used to make periodic payments, fixed or variable in amount, to the claimant under the terms of a settlement with the claimant. However, the government is not completely relieved of responsibility. It should evaluate whether the insurance company or institution from which the annuity contract was purchased can fulfill its obligations to pay out the required annuities.

Unless the claimant provides the entity with a signed agreement releasing the government from any further obligation, the government should include the liability in the disclosure of aggregate outstanding liabilities removed from the statement of net position/balance sheet, as required by paragraph 77d(3), as amended. The requirement for this off−financial statement settlement of claims liabilities is provided because the substance of these transactions is similar in nature to transactions involving in-substance defeasance of debt.

3.69.2. Q—Do annuity contracts that are held by the government but that designate the claimant as the annuitant (payee) qualify as being “in the claimant’s name”?

A—Yes, provided that the government cannot unilaterally change that designation. The intent of “in the claimant’s name” is to distinguish the contracts from those that are held for general investment or hedging purposes. When contracts are purchased only in the name of the government or in a name that can unilaterally be changed by the government, there is nothing that would distinguish the contracts from any other investment. It would be inappropriate to treat these types of investments as having defeased a specific claim liability, in accordance with paragraph 61 of Statement 10, as amended.

3.70 Investments

See paragraph 11.

3.71 Participation in Pool without Transfer of Risk
3.71.1. Q—Should payments to public entity risk pools without transfer of risk be reported as deposits or as reductions of claims liabilities?

A—Paragraph 71 of Statement 10 provides guidance for entities participating in public entity risk pools in which transfer of risk is not part of the relationship. To the extent that cumulative payments to the pool are less than cumulative paid and unpaid claims, payments should be treated as reductions of claims liabilities. The portion of cumulative payments to the pool that exceeds cumulative paid and unpaid claims should be reported as a deposit. (See the example in nonauthoritative Appendix B3-6.)

3.72 Participation in Risk-Sharing Pool

3.72.1. Q—Does a participant’s share of the surplus of a risk-sharing pool need to be disclosed?

A—No. Statement 10 contains no provisions for an entity participating in a pool to disclose that the pool has a surplus—that is, that the pool has taken in revenues sufficient to cover current and future claims. However, an entity may include a disclosure on pool surplus if the disclosure would meet the parameters of NCGA Interpretation 6, Notes to the Financial Statements Disclosure, paragraph 6:

The suggested areas to be considered for notes to the financial statements disclosures, as listed [in paragraph 5, as amended], are neither all-inclusive nor intended to replace professional judgment in determining disclosure necessary for fair presentation in the circumstances. The notes to financial statements should not be cluttered with unnecessary and immaterial disclosures. Attendant circumstances and materiality must be considered in assessing the propriety of the notes to the financial statements disclosures. Notes to the financial statements provide necessary disclosure of material items, the omission of which would cause the financial statements to be misleading.

Furthermore, paragraph 74 of Statement 10, as amended, provides that an entity insured under a retrospectively rated policy or contract with premiums or required contributions based primarily on the experience of a group of entities should accrue any refunds on the basis of the group’s experience to date. In determining if a refund should be recorded, the entity should consider the ultimate cost of reported and unreported claims as of the date of the financial statements.

3.72.2. Q—How should an entity account for a policyholder dividend from a pool or commercial insurer?

A—The entity should record a receivable (or a prepaid asset, if the dividend will be retained by the pool or insurer as payment of the entity’s premiums) and a reduction in premium expenditures/expenses at the time the dividend declaration is made. This treatment is in accordance with paragraph 75 of Statement 10. (See the example in nonauthoritative Appendix B3-7.)

3.72.3. Q—What is a participant’s responsibility for payment of claims that cannot be covered by a risk-sharing pool?
A—A participant’s responsibility depends on the pooling agreement. Pooling agreements usually specify whether any assessments other than premiums will be required of a participant to cover claims and related expenses if the pool experiences losses in excess of premiums. However, even if a pool has no recourse against a participant to make additional assessments for a higher than expected loss experience, the participant should still evaluate the pool’s ability to continue as a going concern. If the pool’s financial capacity or stability is in doubt, a participant may need to accrue or disclose loss contingencies for its own claims that the pool may not be able to cover.

3.73 Disclosures

3.74 Level of Disclosure

3.75 Liability Reconciliation

3.75.1. Q—Should the disclosure of the reconciliation of unpaid claims liabilities required in paragraph 77d(4) of Statement 10 include IBNR claims as well as claims that have already been reported?

A—Yes. If IBNR claims are probable and reasonably estimable, they are required to be included in the total unpaid claims accrual. Therefore, they should be included in the reconciliation of unpaid claims liabilities. In addition, the expected future development on existing claims, which is another component of IBNR, should be included in the total unpaid claims accrual and, accordingly, in the reconciliation of unpaid claims liabilities. If, however, IBNR claims are disclosed only, in accordance with paragraph 58, because of an inability to estimate the amount or because claims are only reasonably possible and, thus, are not included as liabilities on the statement of net position/balance sheet, this reconciliation would not include them either. However, *IBNR claims generally are estimable.*

3.75.2. Q—How is the removal of a liability because of an annuity contract reported in the reconciliation of the changes in aggregate liabilities?

A—The removal should be reported as an “other” item (paragraph 77d(4)(d) of Statement 10) with an explanation. It is not appropriate to report the removal as a payment, because the amount of the annuity contract will not necessarily correlate with the claim liability being removed.

3.76 Component Units

3.76.1. Q—A component unit participates in the risk financing internal service fund of its primary government. How should it report those activities in its separately issued financial statements?

A—Under the provisions of Statement 10, paragraph 79, as amended, the component unit should disclose its participation in the fund, the nature of that participation, and the rights and responsibilities of the component unit and the primary government. In addition, the disclosures should address the types of risk to which the component unit is exposed, how these are handled in the internal service fund, any reductions in the amount of risk covered by or through the internal service fund, and whether the amount of any settlements for the past three fiscal years exceeded coverage provided by or through the internal service fund.
Risk Financing and Related Insurance Issues

The purpose of these disclosures is to clearly identify the extent to which risk has or has not been transferred to the primary government’s internal service fund or through the internal service fund to a third-party insurer so that a reader can identify the component unit’s potential exposure to risk.

3.76.2. Q—A component unit handles its risk financing separately from the rest of the financial reporting entity. What disclosures should it make in its separately issued financial statements?

A—Component units should apply all of the provisions of paragraphs 77–80 of Statement 10, as amended, and paragraph 10 of Statement 30 to their separately issued financial statements as if they were primary governments.

3.77 Loss Contingencies

3.78 Subsequent Events

3.78.1. Q—When disclosing significant subsequent events, is pro forma financial information required?

A—No. Paragraph 80 of Statement 10, as amended, requires disclosure about events that occur after the statement of net position/balance sheet date where there is a reasonable possibility that an asset has been impaired or a liability incurred and where the financial statements may be misleading without this information. The required disclosures are (a) indications of the nature of the loss or loss contingency and an estimate of the amount or range of loss or possible loss or (b) a statement that an estimate cannot be made. Paragraph 80 only suggests that pro forma information may be the best way to make these disclosures, but it does not mandate that information.

3.79 Effective Date and Transition

3.79.1. [Not used in GASB No. 34]

3.79.2. [Not used in GASB No. 34]

3.79.3. [Not used in GASB No. 34]

Glossary

8. This paragraph contains definitions of terms as they are used in paragraph 7. The terms may have different meanings in other contexts.

Account pool
A public entity risk pool in which separate accounts are used to manage the risk financing activities of each pool member and from which the losses of only that member are paid. (The term claims-servicing pool is also used.)

Banking pool
A public entity risk pool through which resources are made available, on a loan basis, for pool members in the event of loss.
Claims-paid policy or contract
A type of policy or participation contract in which the obligation of the pool to pay the claim is not fixed until the pool has physically paid the claim. A claim that has not physically been paid—regardless of the date of the occurrence or event giving rise to the claim, the time at which the claim was reported, and the legal status of the claim—is not covered. The policy may impose additional requirements, such as time periods when the event giving rise to the claim is required to occur or be reported in order to be covered.

Claims-serving pool
A public entity risk pool in which separate accounts are used to manage the risk financing activities of each pool member and from which the losses of only that member are paid. (The term account pool is also used.)

Deductible
An amount on each claim or aggregation of claims for which risk is not transferred to a pool or insurer, as provided in a policy or participation contract. The pool or insurer generally assumes the responsibility for claim adjustment on the amount.

Excess pooling arrangement
An arrangement by which individual pools or insurers obligate themselves to share in each other’s losses, as opposed to a transfer of loss from a pool or insurer to an excess insurer or reinsurer through the purchase of an excess insurance or reinsurance policy.

Experience refund
Payments made or credits extended to the participant by a public entity risk pool that result in reducing the participant’s net participation contribution. These returns may be paid in cash to the participant or applied by the pool to reduce participation contributions due for the next participation contract year. Experience refunds are determined based on the actual experience of an individual pool participant.

Future development
Changes in expected loss and claim adjustment expenses associated with a claim (reported or unreported) between a point in time (for example, the statement of net position/balance sheet date) and the ultimate disposition of the claim. (In many situations, the term case reserve development is used in the commercial insurance industry.)

Insurance-purchasing pool
A public entity risk pool in which governments combine resources to purchase commercial insurance products. (The term risk-purchasing group is also used.)

Occurrence-based policy or contract
A type of policy or participation contract that covers losses that happen during the policy period, regardless of when the claims are asserted, reported, or paid.

Risk-purchasing group
A public entity risk pool in which governments combine resources to purchase commercial insurance products. (The term insurance-purchasing pool is also used.)

Risk-sharing pool
A public entity risk pool in which governments combine risks and resources and share in the cost of losses.
Self-insured retention (SIR)
An amount on each claim or aggregation of claims for which risk is not transferred to a pool or insurer, as provided in a policy or participation contract. The insured generally assumes the responsibility for claim adjustment on the amount.

The Financial Reporting Entity

9. Questions and answers in this paragraph address issues related to the financial reporting entity.

4.1 Introduction

4.2 Scope and Applicability of Statement 14, as Amended

4.2.1. Q—Is Statement 14, as amended, applicable to all governments, including those that do not meet the primary government criteria in paragraph 13?

A—Yes. Paragraph 9 of Statement 14, as amended, states:

The requirements of this Statement apply at all levels to all state and local governments. The Statement applies to financial reporting by primary governments, governmental joint ventures, jointly governed organizations, and other stand-alone governments; and it applies to the separately issued financial reports of governmental component units. This includes governmental enterprises, public benefit corporations and authorities, public employee retirement systems, governmental utilities, governmental hospitals and other healthcare providers, and governmental colleges and universities. . . . [Footnote reference omitted.]

Paragraph 12, as amended, reiterates this position, stating:

The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, a joint venture, a jointly governed organization, or another stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial reports. Although this Statement is written from the perspective of the primary government, its requirements apply to the separately issued basic financial statements of governmental component units, joint ventures, jointly governed organizations, and other stand-alone governments. . . .

An organization that is a component unit of a financial reporting entity may have component units of its own. For example, a school district may be a component unit of a county because the county appoints the governing board of the district, and the district imposes a financial burden on the county. The school district also could be financially accountable for an educational foundation and thus apply the provisions of Statement 14, as amended, to the foundation when the foundation is included in the school district’s separately issued basic financial statements.
4.2.2. Q—Should the reporting entity criteria be applied in determining whether nongovernmental organizations are component units?

A—Yes. Footnote 4 of Statement 14 provides that “a component unit may be a governmental organization (except those that meet the definition of a primary government in paragraph 13), a nonprofit corporation, or a for-profit corporation.” The financial accountability criteria in paragraph 21 of Statement 14, as amended, should be applied to all potential component units, including nongovernmental organizations. Requirements for governmental and nongovernmental organizations that do not meet the financial accountability criteria are provided in paragraph 39 of Statement 14, as amended; paragraph 40 of Statement 14; and paragraphs 5 and 6 of Statement 39. Paragraph 5 of Statement 39 provides criteria that, if met, require certain organizations to be included as part of the financial reporting entity because of the nature and significance of the organizations’ relationships with the primary government. Paragraph 6 of Statement 39 states that other organizations should be considered for inclusion as component units if they are closely related to, or financially integrated with, the primary government.

4.2.3. Q—Is every governmental organization required to be included in a reporting entity governed by elected officials?

A—No. Although most governmental organizations would be included in a reporting entity governed by elected officials, some will not. Those organizations that are not included generally are referred to as other stand-alone governments. Paragraph 66 of Statement 14 defines other stand-alone governments as those that (a) do not have a separately elected governing body and (b) do not meet the definition of a component unit. Other stand-alone governments are not directly governed by elected officials.

4.3 Financial Reporting Entity Concept

4.4 Defining the Financial Reporting Entity

4.5 Primary Governments

4.6 Defining a Primary Government

4.6.1. Q—Does a government have to meet all three criteria in paragraph 13 of Statement 14 to be considered a primary government?

A—No. Any state or general purpose local government (municipality or county) is a primary government. However, a special-purpose government can also be a primary government, but only if it meets all of the following criteria:

a. It has a separately elected governing body. (See Section 4.7.)

b. It is legally separate. (See Section 4.8.)

c. It is fiscally independent of other state and local governments. (See Section 4.9.)

4.6.2. Q—What is the importance of the primary government distinction?

A—The primary government distinction is significant because a government that meets the definition of a primary government may not be reported as a component unit of another primary government.
government. Footnote 4 of Statement 14 specifically states that an organization that meets the definition of a primary government cannot be a component unit. (See Questions 4.9.7, 4.10.2, and 4.26.3 for discussion of primary governments as potential component units and Question 4.14.2 for discussion of fiduciary relationships between primary governments.)

4.7 Separately Elected Governing Body

4.7.1. Q—A public employee retirement system has a governing board that is elected by the members of the system. Does this constitute a separately elected governing body in accordance with paragraph 13a of Statement 14?

A—No. Paragraph 13 stipulates that the election should be by the “citizens in a general, popular election.” Thus, an election by the members or participants in associations and organizations does not meet the criteria for defining a primary government.

4.7.2. Q—Officials are simultaneously elected to serve on the governing boards of two legally separate organizations. For example, county commissioners are elected to serve on the county board of commissioners and, as a result of that election, also serve as the county parks and recreation board. Would both governing boards be considered separately elected?

A—No. There would be no difference between a board that is serving in a dual capacity based on a single election and a board consisting of primary government officials serving “ex officio,” or as required by law. In this example, only the county board of commissioners would be considered separately elected.

Note: References to “primary government,” other than in the preceding questions pertaining to definitions, are equally applicable to other stand-alone governments and component units in their separately issued financial statements.

4.8 Separate Legal Standing

4.8.1. Q—What determines whether an organization is “legally separate”?

A—Paragraph 15 of Statement 14 states that an organization has separate legal standing:

- If it is created as a body corporate or a body corporate and politic, or
- If it otherwise possesses the corporate powers that would distinguish it as being legally separate from the primary government.

Most legally separate organizations are readily identifiable as such by a corporate charter that sets forth the powers that accompany incorporation. Generally, corporate powers give an organization:

- The capacity to have a name
- The right to sue and be sued in its own name without recourse to another state or local governmental unit
- The right to buy, sell, lease, and mortgage property in its own name.
Paragraph 109 of the Basis for Conclusions of Statement 14 states that the concept of legal separateness may be subject to interpretation and that professional judgment should be used to make this determination. In addition, there is no specific set of corporate powers that an organization is required to possess to be considered legally separate. An organization may be legally separate even without a corporate charter if it has been statutorily granted the typical corporate powers possessed by a chartered corporation.

4.8.2. Q—Is legal counsel necessary to determine separate legal standing?

A—No. Legal counsel is not required to support a determination of separate legal standing. It may be useful, however, to consult legal counsel in making the determination of separate legal standing if there is a question about the legal status of an organization.

4.8.3. Q—Are there any corporate powers that a potential component unit is required to possess to be considered legally separate?

A—No. There is no specific set of powers that an organization is required to possess to be considered legally separate. As explained in paragraph 109 in the Basis for Conclusions in Statement 14, it is not essential to possess all of a given set of corporate powers. Professional judgment should be used to decide whether a legally separate organization exists based on the corporate powers granted and all other relevant information.

4.8.4. Q—Similar organizations within a state were created under separate enabling legislation. All of the organizations have the same corporate powers. In some cases, the legislation specifically states that the organization is a “body corporate or a body corporate and politic,” but in other cases, the legislation does not include this language. Is “body corporate” or “body corporate and politic” language required for an organization to be considered legally separate?

A—No. Paragraph 15 of Statement 14 states that “an organization has separate legal standing . . . if it otherwise possesses the corporate powers that would distinguish it as being legally separate. . . .” Therefore, it would not be necessary for the legislation to explicitly state that the organization is a “body corporate and politic” for it to be considered legally separate.

4.8.5. Q—Is the authority for a potential component unit to issue bonds in its own name equivalent to having the right to mortgage property?

A—No. The power to issue bonds would not necessarily be equivalent to the right to mortgage property. However, the existence of authority to issue bonds should be considered in the determination of separate legal standing.

4.8.6. Q—Would a consistent pattern of legal action with recourse to the primary government indicate that a potential component unit is not legally separate?

A—Paragraph 15 of Statement 14 states, in part, that corporate powers generally give “the right to sue and be sued in its own name without recourse to a state or local governmental unit . . .” (emphasis added). A consistent pattern of legal action with recourse to the primary government would indicate that the potential component unit cannot be sued in its own name without recourse. However, that one fact would not necessarily mean that the potential component unit is not legally separate from the primary government. All other factors should be considered.
4.8.7. Q—If the law states that an organization is legally separate, without specific reference to “body corporate,” or “body corporate and politic,” but does not explicitly grant the organization any corporate powers, would it be considered legally separate?

A—There is no requirement that the law explicitly grant a set of corporate powers to an organization for it to be considered legally separate. However, if the law does not grant any of the corporate powers normally associated with a separate legal entity, use of professional judgment would be necessary to determine whether or not the potential component unit actually is legally separate. It may be helpful to consult legal counsel. (See Question 4.8.2 for further discussion on seeking legal counsel.)

4.8.8. Q—A potential component unit has the corporate powers listed in paragraph 15 (see Question 4.8.1), but the law specifically states that it is not legally separate. May the potential component unit be considered legally separate for purposes of applying Statement 14?

A—Paragraph 15 states that “an organization has separate legal standing if it is created as a body corporate or a body corporate and politic, or if it otherwise possesses the corporate powers that would distinguish it as being legally separate from the primary government . . .” (emphasis added). Professional judgment should be used to determine the significance of specifically being designated as not legally separate. Legal counsel may be consulted if the law appears to contradict the conclusion reached by applying the criteria of Statement 14. (See Question 4.8.2 for further discussion on seeking legal counsel.)

4.8.9. Q—How should an organization that is not legally separate be displayed in the reporting entity’s financial statements?

A—An organization that is not legally separate should not be considered a component unit. It should be reported as part of the primary government that holds the corporate powers. The organization would be reported in the same manner as departments or agencies of the primary government.

4.9 Fiscal Independence or Dependence

4.9.1. Q—What constitutes fiscal independence?

A—Paragraph 16 of Statement 14 states:

A special-purpose government is fiscally independent if it has the ability to complete certain essential fiscal events without substantive approval by a primary government. A special-purpose government is fiscally independent if it has the authority to do all three of the following:

a. Determine its budget without another government’s having the authority to approve and modify that budget.

b. Levy taxes or set rates or charges without approval by another government.

c. Issue bonded debt without approval by another government.

A special-purpose government that is not fiscally independent is fiscally dependent on the primary government that holds one or more of those powers.
For example, if a special-purpose government that has the ability to set its own rates and issue debt submits its operating budget to a primary government for approval for compliance purposes only and that budget is not subject to amendments imposed by the primary government, it would be considered fiscally independent of the primary government.

(See Questions 4.10.1—4.10.3 for further discussion of budgetary authority, Questions 4.11.1—4.11.5 regarding taxing and rate-setting authority, and Questions 4.12.1 and 4.12.2 pertaining to debt approval.)

4.9.2. Q—What is substantive approval?

A—A substantive approval provides the approving government with the ability to influence (for example, amend, modify, deny) the matter presented for approval, rather than to review the matter as a routine part of due process. It is authority having substance, rather than being based on a formality. Professional judgment should be used to determine whether the role of the primary government is substantive based on all of the relevant information available about the approval process.

4.9.3. Q—Is the concept of substantive approval a “two-way street;” that is, could a primary government’s de facto political or financial influence on a potential component unit, “in substance,” demonstrate that the potential component unit is fiscally dependent on the primary government?

A—No. The concept of substantive approval in Statement 14 does not extend to “in-substance” approvals that might result from political or financial influence. There is no presumption that substantive approval may exist in the absence of explicitly granted authority. (See Question 4.10.3 for further discussion of political influence.)

4.9.4. Q—Can fiscal dependence result solely from reliance on funding from another government?

A—No. Fiscal dependence, as the term is used in Statement 14, should not be confused with financial benefit or burden. Fiscal dependence is related to control or oversight relationships rather than day-to-day financing of operations. Paragraph 16 explains that “fiscal dependency does not necessarily imply that a financial benefit or burden relationship exists.” Similarly, reliance on funding does not necessarily imply that a fiscal dependency relationship exists. Therefore, despite a potential component unit’s reliance on the primary government’s appropriations, it is nevertheless fiscally independent if it meets the criteria in paragraph 16.

4.9.5. Q—Does fiscal dependency alone constitute financial accountability?

A—No. There also should be a financial benefit or burden relationship between the potential component unit and the primary government. The fiscal dependency criteria focus on capabilities that are essential to the fiscal autonomy of an organization. Therefore, the organization that has the capacity to carry out the fiscal responsibilities embodied within the criteria is financially accountable for that organization, if there also is a financial benefit or burden relationship with that organization.

4.9.6. Q—What is the difference between fiscal dependency and the ability to impose will?

A—The financial accountability of a primary government for another organization flows either from (a) the organization’s fiscal dependency on the primary government or (b) the primary
government’s appointment of a voting majority of the governing board of the organization. The fiscal dependency criteria in paragraph 16 relate to special-purpose governments with governing boards that are not appointed by the primary government. These criteria focus on the basic actions necessary for an organization to function as an autonomous government. If a special-purpose government is required to rely on another government to carry out any one of the responsibilities included in these criteria, it is not fiscally independent and is not able to function with autonomy. This would be true regardless of how the governing body of the organization is determined. In those cases, if there also is a financial benefit or burden relationship present, the special-purpose government would be included as a part of the reporting entity of the government that holds those powers.

The ability to impose will plays a different role in the determination of whether a primary government is financially accountable for an organization. Imposition of will was added as a means of determining whether the appointment authority granted to the primary government would result in financial accountability. Therefore, imposition of will creates financial accountability only when coupled with the authority to appoint a voting majority of the potential component unit’s governing board. (See Sections 4.17–4.22 for further discussion of financial accountability.)

4.9.7. Q—Would a primary government that is temporarily placed under the direct fiscal control of another entity lose its fiscal independence?

A—No. Footnote 3 of Statement 14 states that “a primary government that is temporarily under the fiscal control of another government continues to be fiscally independent for purposes of this Statement.” Therefore, a government in this situation would continue to apply the provisions of Statement 14, as amended, as a primary government. For example, some states have placed certain general purpose governments under the state’s direct control. In those situations, the state’s authority can include the authority to approve the budget and set tax rates for the local government, which would normally create a fiscal dependency relationship between the governments. However, because of the specific exclusion in footnote 3, the general purpose government would continue to report as a primary government.

4.10 Authority to determine budget

4.10.1. Q—A potential component unit of a county is legally separate and has a separately elected governing board. The organization determines its own operating budget, but the county is required to approve its capital budget. Is the potential component unit fiscally independent?

A—No. Fiscal independence requires that a government be able to “determine its budget without another government’s having the authority to approve and modify that budget” (paragraph 16a of Statement 14). If another government has substantive approval authority for a portion of an organization’s budget, the organization would not meet this criterion and should be evaluated as a potential component unit because it is fiscally dependent on the other government.

4.10.2. Q—A statute grants the state oversight control over the budgets of all counties and municipalities of the state. Given the various financial benefits and burdens that exist between a state and its local governments, should the counties and municipalities be evaluated as potential component units of the state under the fiscal dependency criteria in paragraph 16 of Statement 14?
A—No. Paragraph 20 of Statement 14 states that “component units are legally separate organizations for which the elected officials of the primary government are financially accountable.” Footnote 4 clarifies that provision and states that “a component unit may be a governmental organization (except those that meet the definition of a primary government in paragraph 13). . . .” Paragraph 13 defines a primary government as “any state government or general purpose local government.” Therefore, because counties and municipalities are general purpose governments, they should not be considered potential component units of the state.

4.10.3. Q—A potential component unit presents budgets to the primary government’s board for its approval because of the primary government’s political influence, even though there is no requirement that it do so. Any modifications suggested by the board might be made at the discretion of the potential component unit board. Is the potential component unit fiscally dependent on the primary government?

A—No. The voluntary actions of the potential component unit would not create fiscal dependency on the primary government. However, such actions indicate that it may be misleading to exclude the potential component unit from the reporting entity. (See Questions 4.26.1–4.26.3 for further discussion of “misleading to exclude” provisions.)

4.11 Authority to levy taxes or set rates

4.11.1. Q—Do state-legislated “ceilings” or rate limitations constitute approval of rates or charges (as set forth in paragraph 16b of Statement 14) for determining the existence of fiscal independence?

A—No. Paragraph 17 of Statement 14 emphasizes the need for distinguishing between substantive approvals and ministerial or compliance-oriented approvals. That paragraph also acknowledges that special-purpose governments typically are subject to the general oversight of their state governments. By establishing legislated ceilings or rate limitations (for example, on property tax rates), the state is adopting a routine oversight role as part of its duty to protect the interests of its constituents. This action does not create fiscal dependence, as the term is defined in Statement 14.

4.11.2. Q—A county provides grant funding to a legally separate local special district. The county requests annual budgets from the district to verify the amount of funding needed for the grants, and the county commissioners approve these grants as part of the county’s appropriations bill. Does this process create fiscal dependency?

A—No. Paragraph 17 states that “. . . a distinction should be made between substantive approvals and ministerial (or compliance) approvals. . . . Examples of approvals that are likely to be ministerial or compliance oriented in nature rather than substantive are . . . (b) a requirement for a state agency, such as a department of education, to review a local government’s budget in evaluating qualifications for state funding. . . .” The county commissioners are performing a “ministerial” function similar to that described in item b and, thus, the district would not be fiscally dependent.

4.11.3. Q—A local special district is created by statute as a separate legal entity but is not granted the authority to levy taxes directly. Instead, the district is required to submit its tax levy to the county board. The county board forwards the district’s levy, along with its own levy, to the county clerk for certification and extension. The county board does not have the authority to change the
district’s levy and is not required to review or approve that levy. Does the county’s participation in the tax levy process meet the criteria in paragraph 16b of Statement 14?

A—No. Although the county is required to submit the levy on behalf of the special district, it does not have substantive authority over the district’s levy.

4.11.4. Q—If a primary government is required by law, as a matter of due process, to pass a “waiver” resolution that cannot be “vetoed” when a potential component unit plans to levy a tax that exceeds the statutory rate limitation, is the potential component unit fiscally dependent on the primary government?

A—No. The authority of the primary government is not to approve or modify the tax levy request, or budget, of the potential component unit, but rather to authorize a “waiver” of the statutory rate limitation because the revenue needs of the potential component unit cannot be met within the existing rate limitation. Thus, the primary government’s authority is ministerial or compliance-oriented, and the potential component unit is not fiscally dependent on the primary government.

4.11.5. Q—A legally separate organization is required to present its capital budget to the city council, which may declare that it is necessary to levy a property tax to provide funding for projects included in that budget. The capital budget does not require action (for example, review or approval) by the city council. Does the city’s authority to levy taxes to finance the organization’s capital projects create fiscal dependency by the organization?

A—If the tax is levied by the city because the organization is not granted tax-levying powers by its enabling statutes, the action by the city is not an outright manifestation of fiscal dependency. However, if the organization cannot complete an essential fiscal event without substantive approval, the organization would be fiscally dependent on the city—for example, if the taxing power vested with the city is such as to enable the city council to amend, modify, or disapprove the tax levy request.

4.11.6. Q—A charter school does not have the constitutional or statutory authority to levy property taxes. Funding is provided by an enrollment-based formula similar to the formula used for public schools in the state. One component of the formula for charter schools is an allocation of the sponsoring school district’s property tax levy, based on a per-student metric. Is that tax levy allocation equivalent to the sponsoring district having the ability to approve the tax levy of the charter school for purposes of evaluating fiscal dependency?

A—No. Paragraph 16 in Statement 14 provides that the charter school would be fiscally dependent on the sponsoring school district if the charter school could not levy taxes without the approval of the sponsoring district. However, the charter school has no tax levy of its own that would be subject to the approval of the sponsoring district. Instead, the sponsoring district provides funding for the charter school from its own levy, which places a financial burden on the sponsoring district but is not an indication of fiscal dependency. (See also Question 4.12.1 about statutory prohibitions and fiscal dependency.)

4.12 Authority to issue debt

4.12.1. Q—State law prohibits certain types of special-purpose governments from incurring long-term debt. Are these special-purpose governments ineligible to be evaluated as primary governments because of the provision in paragraph 16c of Statement 14?
A—No. Paragraph 16c provides that a special-purpose government is not fiscally independent if it cannot issue bonded debt without the approval of another government. In this case, the special-purpose governments’ fiscal abilities are limited because they cannot issue debt, but they are not dependent upon another government. Paragraph 18 states that “a special-purpose government that is statutorily prohibited from incurring debt may be fiscally independent if it possesses the other two powers because the statutory prohibition does not subordinate the special-purpose government to another government for debt approval.” The fiscal dependency issue is not whether the governments can or cannot issue bonded debt, but whether they can do so only with the approval of another government.

4.12.2. Q—A potential component unit is prohibited by statute from issuing debt. If it becomes necessary to obtain financing for its operations, the potential component unit requests a primary government to issue debt on its behalf and is required to repay the primary government for the debt service payments. Is the potential component unit fiscally dependent on the primary government even though, technically, the primary government is not “approving” its debt?

A—Yes. The fiscal dependency criterion in paragraph 16c of Statement 14 states that a government is fiscally dependent if it is not able to issue bonded debt without the approval of another government. In this situation, the repayment arrangement makes the debt, in substance, the debt of the potential component unit, and the primary government’s willingness to issue the debt constitutes its approval. On the other hand, if the potential component unit was not required to repay the debt, the primary government’s actions would be equivalent to making a grant to the potential component unit and would constitute a financial burden, but would not be considered a manifestation of fiscal dependency.

4.13 Reporting the Primary Government

4.13.1. Q—Is a total column for the primary government required?

A—Yes. Paragraph 14 of Statement 34 states that a total column for the primary government is required in the government-wide financial statements. A total column for the reporting entity may be presented but is not required.

4.14 Reporting Primary Government Fiduciary Relationships

4.14.1. Q—Paragraph 19 of Statement 14, as amended, provides that a primary government should report activities associated with certain fiduciary funds, regardless of any reporting entity considerations, “if the primary government has a fiduciary responsibility for them.” The term fiduciary responsibility is not defined in the pronouncement. What is this term intended to encompass?

A—Paragraph 19 clarifies that Statement 14 does not modify the fund reporting requirements of the primary government. A primary government would continue to report its fiduciary funds regardless of whether the organization for which it is acting as an agent or trustee meets the criteria for inclusion as a component unit. Thus, as used in paragraph 19, the term fiduciary responsibility encompasses all transactions and balances that would be accounted for in fiduciary funds. Statement 34, paragraph 69, provides that fiduciary funds should be used to report “assets held in a trustee or agency capacity for others and therefore cannot be used to support the government’s own programs.” The fiduciary fund category includes pension (and
other employee benefit) trust funds, investment trust funds, private-purpose trust funds, and agency funds. The three types of trust funds should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations, or other governments.

4.14.2. Q—Does Statement 14 change the reporting requirements for fiduciary relationships in which the primary government has a fiduciary responsibility to another primary government, such as when a state performs treasury services for another primary government?

A—No. Paragraph 19, as amended, specifically states that the standard was not intended to modify the fund reporting requirements of the primary government, including those for fiduciary funds. Therefore, a primary government that provides such services would continue to report those balances in the appropriate fiduciary funds.

4.15 Component Units

4.16 Definition of Component Units

4.16.1. Q—What is a component unit?

A—Paragraph 20 of Statement 14, as amended, defines a component unit as an organization that is legally separate and for which the elected officials of the primary government are financially accountable, or for which the nature and significance of its relationship with a primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading. Footnote 4 further clarifies that a component unit may be any organization—governmental, nonprofit, or for-profit—that does not meet the definition of a primary government.

Examples of organizations that may meet the criteria to be included as component units include public benefit corporations or public authorities, such as port authorities; economic development corporations; mass transit systems; public colleges and universities; foundations; and financing entities that issue debt for major capital projects.

4.16.2. Q—Should an organization that is not legally separate be considered a potential component unit?

A—No. An organization that is not legally separate, as defined by Statement 14, should not be considered a potential component unit. It should be reported in the same manner as departments or agencies of the primary government that holds the organization’s corporate powers. (See Question 4.8.8.)

4.16.3. Q—Can professional judgment be used as a basis to exclude an organization that meets the criteria for inclusion as a component unit?

A—No. Exclusion of a component unit that meets the criteria for inclusion in the reporting entity would be a departure from Statement 14.

4.17 Financial Accountability

4.17.1. Q—What is financial accountability?
A—The underlying concept for the definition of the financial reporting entity, as embodied in Statement 14, is that elected officials are accountable for their actions, including the acts of those whom they appoint to govern other organizations, and that the financial statements should report this accountability. Although elected officials are accountable for the actions of all appointees, Statement 14, as amended, establishes financial accountability as the threshold for including an organization in the financial statements of the reporting entity. Generally, financial accountability results from one of the following determinations:

a. The primary government is financially accountable if it appoints a voting majority of the organization’s governing body and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government.

b. The primary government may be financially accountable if a special-purpose government is fiscally dependent on the primary government and there is a potential for the special-purpose government to provide specific financial benefits to, or impose specific financial burdens on, the primary government, regardless of whether the special-purpose government has (1) a separately elected governing board, (2) a governing board appointed by a higher level of government, or (3) a jointly appointed board. (See Sections 4.9–4.12 for the discussion of fiscal dependency.)

Paragraph 55, as amended, provides that a primary government is also financially accountable for an organization if it owns a majority of the equity interest in a legally separate organization, and the government’s intent in owning a majority equity interest is to directly enhance its ability to provide governmental services.

4.17.2. Q—Can a primary government be accountable for an organization because it appoints a voting majority of the board, but not be financially accountable for the organization because it does not have the ability to impose its will on the organization and there is not a potential financial benefit or burden relationship?

A—Yes. The organization would be classified as a related organization. (See Question 4.46.1 for further discussion of related organizations.)

For example, a port authority was established by the city for the purpose of stimulating commerce and promoting the shipment of goods and cargoes. Its governing board consists of five members appointed by the mayor of the city; however, the city does not appoint the port authority’s management. The board members may not be removed except for cause. The port authority determines its budget, issues bonded debt, levies taxes, and sets its rates without the approval of the city. The port authority does not provide a financial benefit, nor does it impose a financial burden on the city. Because the city is unable to impose its will on the authority and there is no financial burden or benefit relationship between the city and the authority, the port authority is not a component unit of the city. However, because the city appoints the voting majority of the authority’s board, the port authority should be disclosed as a related organization.

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5Note that appointment includes primary government officials serving as required by law and, thus, technically not “appointed” by the primary government. Note also that in the absence of continuing appointment authority, the ability of a primary government to unilaterally abolish an organization also provides the basis for ongoing accountability. Thus, a primary government that creates an organization (creation is tantamount to initial appointment of the governing body) is accountable for the organization if the primary government can unilaterally abolish it.
4.18 Appointment of a Voting Majority

4.18.1. Q—What constitutes appointment of a voting majority?

A—A primary government appoints a voting majority of the governing board of an organization if the action of its appointees alone can control decisions of the organization. (See Question 4.17.5, footnote 5, for discussion of appointments.)

4.18.2. Q—Are appointments made by appointed primary government officials the same as if the appointments were made by elected primary government officials?

A—Yes. Statement 14 does not require that appointments be made by elected officials. In fact, paragraph 23 refers to the “primary government’s officials or appointees.”

4.18.3. Q—Are appointments made by a single elected or appointed official, without concurrence of the entire governing body, considered to be primary government appointments?

A—Yes. The primary government is accountable for all appointments made by its elected or appointed officials in the course of their official duties.

4.18.4. Q—Is a primary government that creates an organization (or appoints the initial board) accountable for that organization?

A—Paragraph 24 of Statement 14 states that a primary government that creates an organization, or initially appoints the governing body of the organization (creation is tantamount to the initial appointment of the governing body), is accountable for the organization if (a) it has continuing appointment authority or (b) the primary government can unilaterally abolish the organization.

4.18.5. Q—A potential component unit’s articles of incorporation designate certain primary government officials to be potential component unit board members, and these members represent a voting majority of the potential component unit board. Does this constitute appointment of a voting majority?

A—Yes. Footnote 5 of Statement 14 states that appointment of a voting majority “includes situations in which a voting majority of an organization’s governing body consists of the primary government’s officials serving as required by law (and, thus, technically not appointed by the primary government).”

For example, a housing authority has five board members, three of which are designated by the articles of incorporation to be the mayor, the city manager, and the city’s economic development director. This would constitute appointment by the city of a voting majority of the housing authority’s board.

4.18.6. Q—A potential component unit’s charter requires that five of the seven members of its governing board be appointed by the city council from among the council members. Does this majority representation on the potential component unit’s governing board automatically constitute imposition of will by the city?
A—No. That fact alone does not unequivocally indicate that the primary government has the ability to impose its will on the potential component unit. Those individuals that make up the voting majority of the potential component unit’s governing board may not represent the voting majority of the primary government. The criteria in paragraph 26 of Statement 14 should be applied to determine whether the city has the ability to impose its will.

4.18.7. Q—If a potential component unit’s articles of incorporation require its board to appoint new board members from the primary government’s employees, would that be considered the same as if the board was appointed by the primary government?

A—In general, the requirement that the board be chosen from the employees of the primary government would not be the same as if the primary government made the appointment, as long as the employees are not serving on the board as representatives of the primary government. For example, if an organization is required to choose its governing body from its membership and employment by the primary government is a requirement for membership in the organization, this would not be the same as the primary government’s appointing the board of the organization. Although it would be true that the employee/board member could be terminated by the primary government, that ability relates to the employment relationship between the primary government and the board member, rather than the position of the employee on the potential component unit board. However, professional judgment should be exercised based on the specifics of each case. For instance, if the articles of incorporation indicate that employees in specific jobs are required to serve (ex officio) on the board of the potential component unit, those board positions would be considered appointments of the primary government.

4.18.8. Q—in order for the “voting majority” criterion (paragraph 21 of Statement 14) to be met, is the primary government required to directly appoint the voting majority?

A—No. It is not necessary for the primary government to directly appoint a voting majority. Paragraph 21 notes that “accountability flows from the notion that individuals are obliged to account for their acts, including the acts of the officials they appoint to operate governmental agencies. . . .” This accountability would include appointments made by the officials of component units, related organizations, and other primary government appointees. For example, the governing board of a legally separate authority consists of:

- The mayor of City A (the county seat).
- The mayor of City B (another municipality in the county).
- A member appointed by the county board.
- A member appointed by the parks and recreation board. (The parks and recreation board is a seven-member body appointed by the county board.)
- The chairman of the county board.
- Two members appointed by a majority vote of the other five.

The chairman of the county board and the member appointed by the county board are clearly direct appointees of the county. (Note that footnote 5 of Statement 14 states that “appointment” includes officials serving as required by law.) Because the parks and recreation board is appointed by the county board, its appointee is, in substance, also an appointee of the county. Further, because these three county appointees represent a voting majority of the five members who select the final two authority board members, those final two appointees also, in substance, result from county appointments. Only the two mayors are not directly or indirectly...
county appointees. Thus, for purposes of determining financial accountability, the county appoints five of the seven members of the authority’s board.

The conclusion is different, however, if the parks and recreation commission is included as a component unit of the county because it is both fiscally dependent on the county and there is a potential for it to provide specific financial benefits to, or impose specific financial burden on, the county and its board is not appointed by the county. Under those conditions, there is no unbroken line of appointment between the county board and the appointees of the parks and recreation board. Thus, only the county board chairman and the member directly appointed by the county board would qualify as county appointees.

4.18.9. Q—If the board of a primary government’s component unit appoints a voting majority of the members of another organization’s governing body and is able to impose its will on that organization, is that organization a component unit of the primary government?

A—No. The other organization is not a component unit of the primary government, per se; however, the effect on the reporting entity’s financial statements would be the same based on the “bottom-up” application in paragraph 43 of Statement 14.

4.18.10. Q—The authority to appoint the board members of a potential component unit formally rests with an elected official of the city (the primary government) but is delegated to an elected official of the state. Would the city be accountable for this organization?

A—Yes. Delegation of appointment authority would not relieve the elected official of responsibility for the appointments. The city official would be accountable for appointments to the board of the potential component unit whether that official makes the appointment directly or delegates the appointment authority to someone else.

4.18.11. Q—A housing authority is the general partner of a limited tax credit partnership (a legally separate entity). The limited partners have limited rights regarding the operation of the partnership, and the housing authority possesses essentially all authority over day-to-day operations. Should the housing authority be considered to have appointed a voting majority of the partnership’s board?

A—Yes. The board of the housing authority is acting as the general partner of the limited tax credit partnership, which is tantamount to the housing authority appointing a voting majority of the board of the partnership.

4.19 Substantive versus ministerial appointment authority

4.19.1. Q—What is a substantive appointment?

A—A substantive appointment is not based on ceremony or formality. Generally, a substantive appointment is a selection that is not significantly encumbered by a limited field of preselected candidates. Professional judgment should be used to determine whether the role of the primary government is substantive based on all of the relevant information available about the appointment process.
4.19.2. Q—A state official appoints board members for an organization from a list of nominees provided by various groups or entities. However, the official has the authority to reject the entire list, with no limit on the number of lists that can be rejected. Is this a substantive appointment?

A—Yes. Paragraph 23 of Statement 14 states that “a primary government’s appointment authority is not substantive if the number of candidates is severely limited by the nominating process, for example, if a primary government must select three appointees from a single slate of five candidates” (emphasis added). If the appointing official may reject all nominees, the process would not limit the primary government’s appointment authority and its authority would be considered substantive. Statement 14 does not specify the number of nominees that could be rejected before the appointment would be considered substantive.

4.20 Imposition of Will

4.20.1. Q—What conditions indicate that a primary government has the ability to impose its will on a potential component unit?

A—Imposition of will relates to a primary government’s ability to influence the day-to-day operations of a potential component unit. Paragraph 26 of Statement 14 states that:

A primary government has the ability to impose its will on an organization if it can significantly influence the programs, projects, activities, or level of services performed or provided by the organization. The existence of any one of the following conditions clearly indicates that a primary government has the ability to impose its will on an organization:

a. The ability to remove appointed members of the organization’s governing board at will
b. The ability to modify or approve the budget of the organization
c. The ability to modify or approve rate or fee changes affecting revenues, such as water usage rate increases
d. The ability to veto, overrule, or modify the decisions (other than those in b and c) of the organization’s governing body
e. The ability to appoint, hire, reassign, or dismiss those persons responsible for the day-to-day operations (management) of the organization.

Other conditions may also indicate that a primary government has the ability to impose its will on an organization. In determining whether imposition of will exists, a distinction should be made between substantive approvals and ministerial (or compliance) approvals. . . .

For example, if the primary government has the ability to impose budget amendments to the budget of a special-purpose government that submits its operating budget to the primary government for approval, the primary government would have the ability to impose its will on the special-purpose government. The ability to impose will is not contingent upon previous demonstration of that ability. Even though the primary government may not have imposed a budget amendment in the past, its ability to do so constitutes imposition of will.

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6The imposition-of-will criteria apply only if the primary government appoints a voting majority of a potential component unit’s governing body. (See Question 4.17.1.)
See Questions 4.9.2 and 4.9.3 for discussion of substantive approvals.

4.20.2. Q—What is meant by the authority to “abolish” an organization?

A—A primary government has the authority to abolish an organization if it can cause the organization to cease operations, as constituted. A primary government’s authority to abolish an organization would exist even if the legal structure or shell of the organization remained intact.

4.20.3. Q—Does the ability to abolish organizations provided to a state government through “sunset legislation” constitute the ability to impose will?

A—“Sunset legislation,” which requires the state, at scheduled intervals, to evaluate the viability of organizations to determine if those organizations should continue to remain in operation, generally does not give the state the ability to impose its will, as defined in Statement 14. In these situations, the state legislature’s ability to terminate agencies, programs, or organizations generally involves a formal system of due process. The ability to unilaterally abolish is comparable to the ability to remove an appointed board member at will, whereas the sunset review process can be compared to removal for cause. The former ability is a manifestation of the ability to impose will; the latter is not.

4.20.4. Q—Does the fact that a primary government appoints a voting majority of an organization’s governing board mean that the primary government is also able to impose its will on the organization through this voting majority?

A—Normally, the appointment of a voting majority is accompanied by conditions or circumstances that result in the appointing government’s having the ability to impose its will on an organization. However, as discussed in paragraph 25 of Statement 14, there are circumstances in which the primary government has little influence over the organization’s operations based on the provisions of law or contract. For that reason, it is necessary to determine whether the primary government has the ability to impose its will on the potential component unit using the criteria in paragraph 26 of Statement 14. For example, the state governor appoints the local board of civil service commissioners but has no other authority over the board. Therefore, the state does not have the ability to impose its will on the organization. (See Question 4.20.1 for further discussion of the criteria.)

4.20.5. Q—By statute, a primary government is required to approve any additions or changes to the potential component unit’s facilities. The potential component unit has been in the same facilities for many years and is expected to stay there indefinitely. Does this approval authority give the primary government the ability to impose its will on the potential component unit?

A—Paragraph 26 of Statement 14 states that “a primary government has the ability to impose its will on an organization if it can significantly influence the . . . level of services performed or provided by the organization . . .” (italics omitted). If the primary government has the authority to prohibit the organization from moving to another facility and the primary government controls all changes to the facilities, the primary government would have the ability to significantly influence the level of services provided. However, if the organization is free to move to another facility at will, the primary government’s influence is no different from that of a landlord and would not constitute the ability to impose its will on the organization.
4.20.6. Q—A primary government may remove members of the governing board of the potential component unit “for cause.” Does this right mean that the primary government may impose its will on the potential component unit?

A—No. Removal “for cause” does not mean “at will” because the need to establish “cause” implies that the primary government does not have the ability to impose its will. However, professional judgment should be used to determine whether the restriction is substantive. For example, removal for “inefficiency” could be considered imposing its will, whereas a requirement for due process (public hearings, listing of cause) would generally mitigate the notion that the appointing official has the ability to remove board members at will.

4.20.7. Q—A city council levies an excise tax on lodging that is required by statute to be spent solely to make contributions to a not-for-profit convention and visitors center operating within the city. Does the city’s tax levy authority represent imposition of will?

A—Using the criterion in paragraph 26c of Statement 14 (see Question 4.20.1), the answer would depend on whether the city has the authority to determine the rate of the excise tax or to “approve” the tax. If the city has the authority to do either, it has the ability to impose its will on the potential component unit.

4.20.8. Q—A primary government is the principal user of a potential component unit’s services. However, the transactions between the primary government and the potential component unit do not meet the financial benefit/burden criteria. Would this be equivalent to the primary government’s being able to impose its will on the potential component unit?

A—Dependence on the primary government’s continued purchase of services does not necessarily indicate that a primary government has the ability to impose its will. This situation may indicate that the potential component unit may be reliant on the primary government to purchase its services, but may not result in the primary government’s having the ability to impose its will, as defined by paragraph 26 of Statement 14. (See Question 4.20.1.) Essentially, this would be the same as the primary government’s being the main resource provider for an organization. (See Question 4.9.4 for additional discussion of reliance on financing.)

4.21 Financial Benefit to a Primary Government

4.21.1. Q—What constitutes financial benefit to a primary government?

A—An organization can provide financial benefit to a primary government in a number of different ways. Paragraph 27 of Statement 14 states that financial benefit “may result from legal entitlements or obligations, or it may be less formalized and exist because of decisions made by the primary government or agreements between the primary government and a component unit.” Specifically, that paragraph states that an organization has a financial benefit relationship with the primary government if “the primary government is legally entitled to or can otherwise access the organization’s resources.” Exchange transactions between organizations and the primary government do not indicate a financial benefit relationship. For example, a gaming enterprise that shares its revenues with the primary government would be considered to have a financial benefit relationship.

4.21.2. Q—What is an exchange transaction?
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A—Paragraph 27 of Statement 14 defines exchange transactions as transactions in which each participant directly receives and sacrifices value. For example, a purchase or sale of goods or services is an exchange transaction. The intent of paragraph 27 is to exclude from possible manifestations of financial benefit and burden transactions between a primary government and a component unit in the ordinary course of business—that is, purchases of goods and services. (See Questions 4.21.4, 4.21.5, 4.22.7, and 4.22.8 for further discussion of exchange transactions.)

4.21.3. Q—Are “exchange-like” transactions also not considered manifestations of a financial benefit or burden relationship? Paragraph 27 of Statement 14 discusses only exchange transactions.

A—Yes. As explained in footnote 1 of Statement 33, the exchange characteristics of an exchange-like transaction are equivalent to an exchange transaction for purposes of applying paragraph 27 of Statement 14.

4.21.4. Q—Legislation authorizes a city to impose a payment in lieu of taxes on various special-purpose governments “to recover the cost of providing governmental services to public entities that operate as private enterprises and are exempt from property taxes.” Would this legislation mean that the city has the ability to access the municipal corporations’ resources?

A—Paragraph 30 of Statement 14 discusses payments in lieu of taxes and states that they are evidence of a financial benefit:

Resources may flow from a component unit to a primary government for several reasons. Some organizations may operate activities, such as off-track betting or lotteries, for the principal purpose of generating net revenues that are accessible to the primary government. These organizations provide financial benefits to the primary government. Other organizations may operate activities (for example, public utilities) for the purpose of providing basic public services and charge rates sufficiently high to also provide a financial benefit to the primary government. These benefits may be characterized as “payments in lieu of taxes” or “contributions,” or they may simply be amounts remitted on request of the primary government. These organizations also provide financial benefits to the primary government.

These inflows are not “taxes.” They are generally subsidies and, in those cases, should be classified as a financial benefit. However, payments that are directly related to the cost of specific governmental services provided by the city may be viewed as exchange transactions. For example, if the city provides water to the potential component unit and requires that the potential component unit make payments “in lieu of taxes” approximately equal to the costs of providing water service, it would be an exchange transaction. Payments that cannot be directly attributed to service provided, however, would be deemed a financial benefit to the city.

4.21.5. Q—If a public power authority (a potential component unit) provides electricity to the city (the primary government) at no charge, or at rates that are substantially less than rates charged to other users, is the authority providing a financial benefit to the city?

A—Yes. As indicated in the previous question, if the charge to the city is approximately equal to the cost of providing electricity, it is an exchange transaction. If the value received or sacrificed is disproportionate, it should be considered evidence of a financial benefit/burden relationship.
4.22 Financial Burden on a Primary Government

4.22.1. Q—What constitutes financial burden on a primary government?

A—An organization can impose a financial burden on a primary government in a number of different ways. Paragraph 27 of Statement 14 states, in part, that financial burden “may result from legal entitlements or obligations, or it may be less formalized and exist because of decisions made by the primary government or agreements between the primary government and a component unit.” Specifically, that paragraph states that an organization has a financial burden relationship with the primary government if:

- The primary government is legally obligated or has otherwise assumed the obligation to finance the deficits of, or provide financial support to, the organization, or
- The primary government is obligated in some manner for the debt of the organization.

For example, in an effort to increase the availability and affordability of recreation facilities, a county government provides financial support to a park district, as user charges are insufficient to finance operations. If the county government provides the organization with financial support, such as periodic grants or annual appropriations, a financial burden relationship exists.

4.22.2. Q—Would a legally separate authority impose a financial burden on a primary government if the primary government makes recurring subsidies (for example, providing cash payments for operations or contributing capital assets) to the authority even though there is no requirement that the primary government continue to provide those subsidies?

A—If a primary government establishes a pattern of subsidies to the authority that could reasonably be interpreted as providing financial support, it would indicate the existence of a financial burden as described in paragraph 31a of Statement 14. Professional judgment would be necessary to determine whether such a pattern exists.

4.22.3. Q—What effect would a formal agreement that establishes a temporary financial burden relationship have on the definition of the reporting entity?

A—Statement 14 does not require a legally binding financial burden relationship for a potential component unit to meet the criteria for inclusion in the reporting entity, but only the potential for an organization to impose financial burdens on the primary government. For example, in the discussion of financial burden as a result of a primary government’s obligation in some manner for the debt of an organization, paragraph 33g states that financial burden exists when “previous actions by the primary government related to actual or potential defaults on another organization’s debt make it probable that the primary government will assume responsibility for the debt in the event of default.” The fact that the primary government has entered into an agreement that creates a financial burden may indicate that it would do so again in the future, which would create the potential for financial burden and meet the criteria for inclusion. Professional judgment should be used to determine whether the facts in a given situation manifest financial accountability.

4.22.4. Q—What determines whether a primary government is “obligated in some manner for the debt of an organization”? 
A—Paragraph 33 of Statement 14 states that “. . . a primary government is obligated in some manner for the debt of an organization if (a) it is legally obligated to assume all or part of the debt in the event of default or (b) it may take certain actions to assume secondary liability for all or part of the debt, and the government takes, or has given indications that it will take, those actions . . .” (emphasis added). A list of conditions that would indicate that a primary government is obligated in some manner is included in that paragraph.

a. The primary government is legally obligated to honor deficiencies to the extent that proceeds from other default remedies are insufficient.

b. The primary government is required to temporarily cover deficiencies with its own resources until funds from the primary repayment source or other default remedies are available.

c. The primary government is required to provide funding for reserves maintained by the debtor organization or to establish its own reserve or guarantee fund for the debt.

d. The primary government is authorized to provide funding for reserves maintained by the debtor organization or to establish its own reserve or guarantee fund and the primary government establishes such a fund. (If a fund is not established, the considerations in subparagraphs f and g may nevertheless provide evidence that the primary government is obligated in some manner.)

e. The primary government is authorized to provide financing for a fund maintained by the debtor organization for the purpose of purchasing or redeeming the organization’s debt, or to establish a similar fund of its own, and the primary government establishes such a fund. (If a fund is not established, the considerations in subparagraphs f and g may nevertheless provide evidence that the primary government is obligated in some manner.)

f. The debtor government explicitly indicates by contract, such as the bond agreement or offering statement, that in the event of default the primary government may cover deficiencies although it has no legal obligation to do so. That is, the bond offering statement may specifically refer to a law that authorizes the primary government to include an appropriation in its budget to provide funds, if necessary, to honor the debt of the organization.

g. Legal decisions within the state or previous actions by the primary government related to actual or potential defaults on another organization’s debt make it probable that the primary government will assume responsibility for the debt in the event of default.

For example, a county is obligated for the debt of a finance authority when the finance authority’s bond agreement or offering statement indicates that, in addition to the finance authority’s primary revenue stream, a revenue stream of the county is secondarily pledged to retire the debt.

4.22.5. Q—Would a primary government’s guarantee (legal obligation) of a potential component unit’s debt create a financial burden on the primary government even if it is highly improbable that the potential component unit will default on the debt?

A—Yes. The financial burden relationship is based on the potential for an organization to impose specific financial burdens on the primary government. If the primary government is legally obligated to assume responsibility for the debt of the potential component unit in the event of a default, a financial burden relationship exists between the primary government and the potential component unit.

4.22.6. Q—A potential component unit is authorized to issue debt in its own name. However, to obtain better interest rates, the primary government issues its own general obligation bonds for the
potential component unit. Amounts equal to the debt service requirements will be paid to the primary government by the potential component unit. Does the debt create a financial benefit/burden relationship between the primary government and the potential component unit?

A—Yes. The primary government would be legally obligated for the debt, regardless of any repayment arrangements between the primary government and the potential component unit. Therefore, there would be a financial benefit/burden relationship between the primary government and the potential component unit.

4.22.7. Q—If a city (the primary government) purchases water from a water utility (a potential component unit) at rates that are several times higher than the normal usage charge, is this an exchange transaction?

A—No. Exchange transactions do not result in a benefit or burden to either party—thus, there is a presumption of “arm’s length.” If the value received or sacrificed is disproportionate, it should be considered evidence of a financial benefit/burden relationship and should not be treated as an exchange transaction.

4.22.8. Q—are nonexchange transactions (for example, a city provides free services to a public housing authority) evidence of financial burden relationships?

A—Yes. A nonexchange transaction indicates that one party to the transaction is sacrificing something of value and is not receiving equivalent benefits in return. Therefore, if a primary government sacrifices some type of benefit without an equal exchange by the other party to the transaction, it would constitute a financial burden.

4.22.9. Q—A city appoints the voting majority of the governing boards of component unit A and potential component unit B. B imposes a financial burden on A, but not on the city. Is B a component unit of the city even though its financial benefit/burden relationship is with A?

A—Yes. Paragraph 28 of Statement 14 states:

The effect of the financial benefits or burdens on the primary government can be either direct or indirect. . . . An indirect benefit or burden exists if one or more of the primary government’s component units is entitled to the resources or is obligated for the deficits or debts of the organization. For purposes of this Statement, a financial benefit or burden relationship exists if the primary government is either directly or indirectly entitled to the resources or is either directly or indirectly obligated for the deficits or debts of an organization.

4.23 Fiscal Dependency

4.24 Potential for Dual Inclusion

4.24.1. Q—If an organization meets the criteria to be considered a component unit in more than one reporting entity, should the organization be included “at the lowest level” of legislative authority?

A—Paragraph 38, as amended (and paragraph 102 in the Basis for Conclusions), of Statement 14 discusses the potential for dual inclusion. A component unit should be included in only one reporting entity; however, Statement 14 does not suggest that the level of government should
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be the deciding factor. The potential for dual inclusion arises when a potential component unit is fiscally dependent on, and has a financial benefit or burden relationship with, a government that does not appoint a voting majority of its governing board and the potential component unit otherwise meets the criteria for inclusion in another government’s reporting entity. In this situation, professional judgment is required to determine whether the significance of the combined fiscal dependency and financial benefit or burden relationship outweighs the financial accountability that results from the board appointment. For example, if the question was whether to include a component unit in a city’s or state’s financial reporting entity, it may be useful to include the “lowest level” criterion among the factors being considered in making the final decision.

4.25 Organizations Included in the Reporting Entity Although the Primary Government Is Not Financially Accountable

4.26 Misleading to Exclude

4.26.1. Q—An organization concludes that it qualifies as a component unit of a primary government based on the “misleading to exclude” criterion in paragraph 12 of Statement 14, as amended, but the primary government does not reach the same conclusion. Should the organization identify itself as a component unit of the primary government?

A—Paragraph 20 of Statement 14, as amended, states that organizations qualify as component units if “the nature and significance of their relationship with a primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading. . . .” The ultimate responsibility to decide whether an organization is a component unit rests with the primary government, not with the potential component unit. So in this case, the decision by the primary government that the organization is not a component unit overrides the opinion of the potential component unit regarding the “misleading to exclude” criterion. The organization should describe the relationship with the primary government in the notes to its financial statements.

4.26.2. Q—In evaluating whether it would be misleading to exclude an organization from a reporting entity, pursuant to the provisions of paragraph 41 of Statement 14, as amended, should the method of display (blending or discrete presentation) be considered?

A—Paragraph 41 of Statement 14, as amended, states that determining whether it would be misleading to exclude an organization is a matter of professional judgment, taking into consideration all relevant factors, with the focus generally being on financial relationships. The decision to include or exclude should be based on all pertinent considerations, including the organization’s significance in relation to the primary government and the extent to which the organization is financially integrated with the primary government. Because of the differences in the relationships that a primary government has with blended component units versus discretely presented component units, it is more likely that it would be misleading to exclude an organization that would be blended than it would be to exclude one that would be discretely presented.

4.26.3. Q—Can a primary government include another primary government as a component unit on the basis that its financial statements would be misleading if the other primary government was not included in the reporting entity?
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A—No. Footnote 4 of Statement 14 specifically states that an organization that meets the definition of a primary government cannot be a component unit. (See Question 4.6.2 about the importance of the primary government distinction.)

4.27 Reporting Component Units

4.27.1. Q—How are component units reported?

A—Component units are either blended, discretely presented, or included in the fiduciary funds financial statements. The relationship of some component units to the primary government is so close that the component units are reported as though they are part of the primary government, or blended. (See Sections 4.30–4.32 for further discussion of blending.) Most component units should be discretely presented, which allows readers to distinguish between the financial data of the component unit and that of the primary government. (See Sections 4.28 and 4.33 for more discussion of discrete presentation.) Component units that are fiduciary in nature should be included only in the fund financial statements with the primary government’s fiduciary funds.

4.27.2. Q—Can component units be reported through note disclosure only?

A—No. If an organization meets the criteria to be included as a component unit, it should be presented discretely, blended, or included in the fiduciary funds financial statements. (See Question 4.27.1.) If the primary government appoints a voting majority of the board of an organization that does not meet the financial accountability criteria, the primary government’s accountability for that related organization would be reported in the notes to the financial statements in accordance with the applicable provisions of Statement 14. (See Question 4.46.1 for further discussion of related organizations.)

4.28 Discrete Presentation of Component Units

4.28.1. Q—What criteria should be used to determine whether a component unit is discretely presented or blended?

A—Component units that meet the criteria in paragraph 53 of Statement 14, as amended, should be blended. However, excluding component units that are fiduciary in nature, most component units, including those that meet the criteria of paragraph 5 of Statement 39, should be discretely presented. (See Question 4.30.1 for a discussion of the blending criteria.)

4.28.2. Q—What does it mean to discretely present a component unit?

A—Discrete presentation refers to the use of columns and rows in the government-wide statements separate from the financial data of the primary government to provide an overview of component unit financial data. The discrete column(s) should be located to the right of the financial data of the primary government, with descriptive headings to allow readers to distinguish between the financial data of the primary government (including its blended component units) and those of the discretely presented component units. In addition to the columns in the statement of activities, discrete row(s) should be located below the function/program details of the primary government to provide for that distinction. (See also Question 4.33.1 about component units that use a different GAAP reporting model and Question 4.28.10 about discrete presentation in the BTA model.)
4.28.3. [Not used in GASBIG 2015-1]

4.28.4. Q—Paragraph 44 of Statement 14, as amended, allows governments to use one or more columns to display their component unit financial data. What distinctions can be used to segregate component units in more than one column?

A—A government that presents its component units in more than one column may segregate the component units using any method that it chooses. The provisions in paragraphs 44, 50, and 51 of Statement 14, as amended, regarding the mechanics of discrete presentation, are intended to provide flexible guidance. Paragraph 51, as amended, permits governments to present major component units in separate columns (and rows) in the government-wide statements. In addition, component units could be presented based on functional groupings, whether component units are governmental or business type, or whether the primary government is financially accountable based on fiscal dependency and a financial benefit or burden relationship. However, segregating component units into functional groupings in the government-wide statements does not relieve the government of the major component unit reporting responsibility—either in combining statements or in condensed financial statements in the notes.

4.28.5. [Not used in GASBIG 2015-1]

4.28.6. Q—Is a reporting entity with no component units required to identify the columns on the financial statements as being those of a primary government?

A—No. Paragraph 42 of Statement 14 requires that the financial statements of the reporting entity distinguish between the primary government and its component units. There would be no need for identification of the columns as being those of the primary government if there are no component unit columns.

4.28.7. Q—If there is only one discretely presented component unit, is the primary government required to present the fund financial statements of the component unit in the combining statements?

A—Paragraph 50 of Statement 14, as amended, states that presentation of the fund financial statements of the individual component units is not required unless such information is not available in the separately issued financial reports of the component units. If not otherwise available, these fund financial statements would be presented as supplementary information.

4.28.8. [Not used in GASBIG 2015-1]

4.28.9. Q—What are the display/disclosure options when there is only one discretely presented component unit?

A—Paragraph 125 of Statement 34, as amended, requires component unit information to be displayed in the reporting entity’s government-wide statements. Therefore, when there is only one component unit, the options discussed in paragraph 126, as amended, of that Statement—to present major component unit information in combining statements or in the notes—are inapplicable because the major component unit reporting requirements are met by discrete presentation in the government-wide statements.
4.28.10. Q—An authority that is engaged only in business-type activities reports its three major enterprise funds in accordance with the guidance in paragraph 138 of Statement 34, as amended. The authority also has a business-type component unit that meets the criteria for discrete presentation. Statement 34, paragraph 125, as amended, states that the requirements for discrete presentation should be met by displaying the component unit financial data in the government-wide statements of net position and activities. How should the authority’s component unit be reported?

A—The component unit financial data can be reported in one of two ways. Because the authority follows the guidance in paragraph 138, as amended, there are no government-wide statements to use for reporting component unit information. The authority could insert the component unit column to the right of the required total column on the enterprise fund financial statements. Only the statement of net position and change statement for the component unit would be presented. Cash flow information for the component unit is not required. (See Questions 2.4.2 and 2.4.3.) Alternatively, the authority could present the enterprise fund total columns for the statement of net position and the statement of revenues, expenses, and changes in net position on separate pages and include the component unit data to the right of the total columns on those separate pages—in effect, a “government-wide” style presentation.

4.28.11. Q—If a discretely presented component unit is not fiduciary in nature, but has fiduciary funds, are those fiduciary funds reported in the reporting entity’s financial statements?

A—No. Fiduciary funds of a discretely presented component unit are not included in the reporting entity’s financial statements. As explained in paragraph 126 of Statement 34, as amended, the “aggregated total” financial information of a discretely presented component unit is taken from its statement of net position and statement of activities. (See Question 4.28.14.) Statement 34, paragraph 13, as amended, defines the scope of those statements to exclude fiduciary funds. (However, fiduciary fund financial statements of a component unit that does not issue separate financial statements should be included in the reporting entity’s comprehensive annual financial report, as required by paragraph 50 of Statement 14.)

4.28.12. [Not used in GASBIG 2015-1]

4.28.13. Q—Certain activities of a component unit are financed by payments from the primary government’s general fund. If the component unit does not meet the criteria for blending, how should the transactions and balances related to the component unit be reported in the reporting entity’s financial statements?

A—Paragraph 61 of Statement 34 states that the payments should be reported in the reporting entity’s statement of activities as if they were external transactions—as expenses of the primary government and revenues of the component unit. Amounts payable and receivable between the primary government and the component unit should be reported separately from other payables and receivables. In addition, paragraph 128 of Statement 34 requires disclosure of the nature and amounts of significant transactions between the primary government and the component unit.

4.28.14. Q—If a discretely presented component unit has component units of its own, but does not present a reporting entity total column, what information should be “rolled up” to the primary government’s reporting entity financial statements?
A—Paragraph 126 of Statement 34, as amended, states that the “aggregated total” component unit information, as discussed in Statement 14, should be taken from the entity totals derived from the component unit’s statements of net position and activities. Statement 34 does not amend the requirement in paragraph 43 of Statement 14. That paragraph states that the component unit financial data that are incorporated into a reporting entity’s financial statements should include the data from all of its component units. Therefore, the data that should be taken from the discretely presented component unit’s financial statements are the amounts that would be in its entity total column if one had been presented.

4.28.15. Q—A state university is a discretely presented component unit of the state. In its separate financial statements, the university presents its fund-raising foundation as a discretely presented component unit, based on the criteria in Statement 39. When the aggregated totals of the university’s reporting entity are “rolled up” for inclusion as a component unit of the state, should significant transactions and balances between the university and the foundation be eliminated from the aggregated totals?

A—Yes. Paragraph 14 of Statement 34 states that a total column for the reporting entity may be presented but is not required. Paragraph 43 in the Basis for Conclusions of Statement 39 indicates that eliminations should be made when a component unit’s reporting entity totals are “rolled up” for inclusion in a primary government’s financial reporting entity. Therefore, significant transactions and receivable/payable balances between the university and the foundation should be eliminated from the aggregated totals that would be carried forward for discrete presentation in the state’s financial statements. Paragraph 128 of Statement 34 requires disclosure of the nature and amount of significant transactions between a primary government and its component units. (See Question 7.47.23 about transactions between a university and its auxiliary enterprises.)

4.28.16. Q—If a reporting entity that has few component units presents each one in a separate discrete column in the government-wide statements, is it necessary to include condensed financial statements in the notes, or combining statements in the reporting entity’s basic financial statements?

A—No. The requirement in paragraph 51 of Statement 14, as amended, is that information about each major component unit should be presented in some manner in the basic statements of the reporting entity. There are three ways to satisfy the requirements of paragraph 51, as amended. Financial information for each major component unit can be presented in:

a. A separate column in the reporting entity’s statement of net position and a separate column and row in the statement of activities
b. Combining statements in the reporting entity’s basic statements, after the fund financial statements
c. Condensed financial statements in the notes to the reporting entity’s financial statements.

4.28.17. Q—What criteria should be used to determine which component units are “major”?

A—Paragraph 51 of Statement 14, as amended, states that “‘major’ should be based on the nature and significance of its relationship to the primary government.” This determination generally would be based on any of the following factors: (a) the services provided by the component unit to the citizenry are such that separate reporting as a major component unit is
considered to be essential to financial statement users, (b) there are significant transactions with the primary government, or (c) there is a significant financial benefit or burden relationship with the primary government. However, what is considered significant in one relationship might be insignificant in another. For example, a component unit that has significant cash balances or other resources might not be considered “major” if it is included because of imposition of will, while another component unit with significant cash balances or other resources might be considered “major” if it is included because the primary government has the ability to access its resources.

4.28.18. [Not used in GASB 2015-1]

4.28.19. [Not used in GASB 2015-1]

4.28.20. Q—A government uses the combining statement method to present its major component unit information in accordance with paragraph 126 of Statement 34, as amended. In the combining statements, should the government “recast” the financial statement data of business-type component units into a statement of activities format, or can it present a combining statement of revenues, expenses, and changes in net position?

A—The answer depends on the level of detail presented in the reporting entity’s government-wide statement. (See also Question 7.26.6 about reporting business-type component units in the statement of activities.)

If the business-type component units are combined with component units engaged in governmental activities, the combining statement should follow the statement of activities format. (However, the government could display a single business-type activity line on the combining statement of activities, with a supporting combining statement of revenues, expenses, and changes in net position.)

If business-type component units are reported separately in the reporting entity’s statement of activities, the combining statement may be presented in the statement of revenues, expenses, and changes in net position format with the combined totals recast into the reporting entity’s statement of activities.

4.28.21. Q—Paragraph 127 of Statement 34, as amended, establishes the minimum level of detail required for condensed financial information of major component units presented in the notes. Does that guidance also apply to major component units presented in combining statements?

A—No. Paragraph 126 of Statement 34, as amended, states that the major component unit information should be the entity totals derived from the component units’ statements of net position and activities. There is no additional provision allowing governments to condense that information to the levels indicated in some parts of paragraph 127, as amended. However, some governments may need to combine or retitle certain accounts for consistency and comparability across component units in the combining statements.

4.28.22. Q—If some, but not all, major component unit information is displayed separately in the government-wide statements, what is required to be presented in the combining statements or disclosed in the notes? For example, the reporting entity’s statement of activities uses a separate line for each major component unit, but reports the net expense/revenue totals and changes in net position in a single “component units” column.
A—Paragraph 127 of Statement 34, as amended, requires presentation of a condensed statement of activities in the notes. Therefore, presentation of only a portion of the statement of activities would not satisfy that disclosure requirement, even though some of the required data from within the statement is displayed on the face of the basic financial statements.

4.28.23. Q—What is required if the condensed financial statements of major component units are presented in the notes to the reporting entity’s financial statements?

A—If the condensed financial statements approach is used, paragraph 127 of Statement 34, as amended, provides that the following information should be presented for each major component unit. Information for all nonmajor component units should be presented in the aggregate.

a. Condensed statement of net position:
   (1) Total assets—distinguishing between current assets, capital assets, and other assets. Amounts receivable from other funds or component units should be reported separately.
   (2) Total deferred outflows of resources.
   (3) Total liabilities—distinguishing between current liabilities and long-term liabilities. Amounts payable to other funds or component units should be reported separately.
   (4) Total deferred inflows of resources.
   (5) Total net position—distinguishing among net investment in capital assets, restricted (separately reporting expendable and nonexpendable components), and unrestricted.

b. Condensed statement of activities:
   (1) Expenses (by major functions and for depreciation expense, if separately reported).
   (2) Program revenues (by type).
   (3) Net program (expense) revenue.
   (4) Tax revenues.
   (5) Other nontax general revenues.
   (6) Contributions to endowments and permanent fund principal.
   (7) Special and extraordinary items.
   (8) Change in net position.
   (9) Beginning net position.
   (10) Ending net position.

Because component units that are engaged only in business-type activities are not required to prepare a statement of activities, the disclosures for the condensed statement of activities should be taken from equivalent information provided in the component unit’s statement of revenues, expenses, and changes in net position.

4.28.24. [Not used in GASBIG 2015-1]

4.28.25. Q—Paragraphs 124–128 of Statement 34, as amended, provide guidance for including component units in a primary government’s financial reporting entity. Paragraph 127, as amended, discusses disclosing condensed financial information of the component units in the notes to the financial statements. If the note disclosure approach is used, is a government relieved of any display requirements in the basic statements?
A—No. The guidance in paragraphs 124–128, as amended, refers to “major” component units as described in paragraph 51 of Statement 14, as amended. Discretely presented component units may be aggregated into a single-column presentation on the face of the financial statements; however, details of major component units included in this aggregation should be presented either in combining statements or in notes to the financial statements. Disclosure (and the combining statement approach) supplements, but does not replace, the display of component unit information on the face of the financial statements. (See Question 4.28.22 relating to the condensed financial statements required in combining statements or notes to the financial statements.)

4.29 Individual component unit disclosures

4.30 Blending Component Units

4.30.1. Q—What are the criteria for a component unit to be blended with the primary government?

A—Paragraph 53 of Statement 14, as amended, states, in part:

A component unit should be included in the reporting entity financial statements using the blending method in any of these circumstances:

a. The component unit’s governing body is substantively the same as the governing body of the primary government and (1) there is a financial benefit or burden relationship between the primary government and the component unit, . . . or (2) management of the primary government has operational responsibility for the component unit (footnote omitted). . . .

b. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it. . . .

c. The component unit’s total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the primary government. . . .

However, organizations that meet the criteria in paragraph 5 of Statement 39 should be discretely presented, even if they also meet the criterion in paragraph 53b or paragraph 53c of Statement 14, as amended.

4.30.2. Q—Can professional judgment be used as a basis for blending a component unit that does not meet the criteria for blending?

A—No. Only those component units that meet the criteria in paragraph 53 of Statement 14, as amended, should be reported using the blending method. However, organizations that meet the criteria in paragraph 5 of Statement 39 should be discretely presented, even if they also meet the criterion in paragraph 53b or paragraph 53c of Statement 14, as amended.

4.30.3. Q—How is a component unit blended with the primary government?

A—Component units that meet the criteria for blending in paragraph 53 of Statement 14, as amended, should be included in the reporting entity’s fund financial statements in accordance with paragraphs 52–54 of that Statement, as amended.
For financial reporting purposes, funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. As such, the primary government can choose to present a blended component unit fund separately or aggregate it with other funds of a similar fund type with the exception of the primary government’s general fund. The combined presentation of the primary government is still subject to major fund considerations and, thus, for example, a blended component unit presented separately as a special revenue fund could represent a major fund for the primary government. (See Question 7.56.1 about major fund reporting.)

4.30.4. Q—How should a blended component unit (A) that has a discretely presented component unit of its own (B) be included in the primary government’s financial reporting entity?

A—Because A meets the criteria for blending, it is presented as if it were part of the primary government, as described in paragraph 52 of Statement 14, as amended. Consistent with that notion, B would then be treated as a component unit of the primary government and would be discretely presented. (See Question 4.28.14 about including discretely presented component units that have component units of their own.)

4.30.5. Q—A city has a long-term loan receivable from the local redevelopment agency (RDA). Repayment of the loan will commence in three years. The RDA is a component unit of the city and meets the criteria for blending. When the RDA is included in the city’s financial reporting entity, the loan will be reported as an interfund receivable/payable. The RDA uses the governmental fund structure in its separately issued financial statements. In those statements, should the loan from the city be reported as a governmental fund liability to parallel the reporting of the RDA as a blended component unit?

A—No. Within the context of the separately issued financial statements of the RDA, the debt is not fund debt and should not be included in the fund financial statements because it is long-term external debt. It would, however, be reported as a liability in the RDA’s government-wide statement of net assets. When the financial data of the RDA are blended into the funds of the city, the amount due to the city becomes an internal advance and should be reported as a fund liability. In one setting (as a blended component unit) the debt is internal, but in the other (the RDA’s separate financial statements) it is not. In the blending process, the fund balance of the RDA should be adjusted (reduced) to reflect the long-term internal payable to the city’s general fund.

4.30.6. Q—Paragraph 54 of Statement 14, as amended, requires that “the general fund of a blended component unit should be reported as a special revenue fund” of the primary government. However, Statement 54 limits the use of special revenue funds to account for specific revenue sources that are restricted or committed for specified purposes as set forth in paragraphs 30 and 31. Does Statement 54 affect the reporting of a blended component unit as a special revenue fund?

A—No. Statement 54 does not amend the requirement that a general fund of a blended component unit be reported as a special revenue fund of the primary government. Satisfying the criteria in paragraphs 30 and 31 of Statement 54 is not required in this specific instance.

4.30.7. Q—When a component unit is blended into the same column as a BTA in accordance with paragraph 54a of Statement 14, as amended, do internal activities and balances, such as loans between the BTA and the component unit, need to be eliminated?
A—Yes. Elimination of internal balances and transactions is required by Statement 34. An eliminations column should be included in the required disclosure of condensed combining financial statements.

4.30.8. Q—For governments that report in a single column for financial statement presentation as discussed in Question 4.30.7, paragraph 54a of Statement 14, as amended, states that “condensed combining information” should be presented in the notes to the financial statements. Is a total column for the primary government required in that disclosure?

A—No. The purpose of the condensed combining financial information is to allow financial statement users to disaggregate the blended component unit information from the single-column presentation.

4.30.9. Q—A state government established a financing authority to issue debt for transportation, public safety, and corrections facilities for the state, and educational facilities for local school districts (approximately one fourth of the total debt outstanding). The state appoints all the members of the authority’s board and has pledged portions of its sales and motor fuel taxes to repay all of the outstanding debt of the authority. How should the financing authority be included in the state’s financial reporting entity?

A—The financing authority should be included as a blended component unit. Even though the authority provides financing services to entities other than the state, the fact that the authority’s debt is to be repaid entirely with resources of the state meets the criteria for blending in paragraph 53c of Statement 14, as amended.

4.30.10. Q—in the example in Question 4.30.9, does the answer change if the debt attributable to the local school districts will be repaid with local property taxes?

A—Yes. The debt attributable to the local school districts represents a substantial portion of the authority’s outstanding debt. Therefore, the state’s resources will not be expected to entirely or almost entirely repay the authority’s debt. If all other facts in the example remain the same, the authority would be reported as a discretely presented component unit.

4.31 Determining whether the boards are substantively the same

4.31.1. Q—A component unit has a seven-member governing board. Five of the seven members also are city council members (of the municipality that appoints the board). Is the board of the component unit substantively the same as the city council?

A—The two boards are considered “substantively the same” if the five council members also make up a voting majority of the city council and, thus, sufficiently represent the primary government’s entire governing body. On the other hand, if the city council comprises 15 members, the 5 members that also serve on the component unit’s board could not sufficiently represent the entire governing board of the primary government and the 2 boards would not be considered “substantively the same.” (See also Question 4.18.6.)

4.31.2. Q—The five-member governing board of a legally separate organization consists entirely of elected state officials, including the governor. Would this organization qualify to be blended using the criteria in paragraph 53a of Statement 14, as amended?
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A—Footnote 7, as amended, states:

“Substantively the same” means sufficient representation of the primary government’s entire governing body on the component units’ governing body so that decisions of the primary government cannot be overridden by the component unit. . . . This criterion will rarely, if ever, apply to a state government because of the impracticality of providing sufficient representation of the state’s entire governing body.

Even if an organization’s board consists entirely of elected state officials, it is unlikely that five elected officials would provide sufficient representation of the state’s entire governing body for the boards to be considered substantively the same. Therefore, the component unit would not be blended.

4.32 Provision of services

4.32.1. Q—A component unit provides services entirely to the primary government and therefore would be blended under the provisions of Statement 14, as amended. However, the primary government has no liability for the debt of the component unit. Is it permissible to discretely present the component unit?

A—No. If a component unit meets the criterion for blending in paragraph 53b of Statement 14, as amended, it would be reported as if it were part of the primary government. However, organizations that meet the criteria in paragraph 5 of Statement 39 should be discretely presented, even if they meet the criterion in paragraph 53b, as amended. This situation is the same as an enterprise fund with a separate board that issues revenue bonds “payable solely from the revenues” of the enterprise fund and are not a general obligation of the city. A government could describe the extent of its obligation on the face of the financial statements or in the notes to the financial statements.

4.32.2. Q—Does the “sole/exclusive benefit” criteria in paragraph 53b of Statement 14 refer to the reporting entity or its residents?

A—The primary government referred to in paragraph 53b of Statement 14 is the “institution” rather than the “populace.” Paragraph 53b clarifies the criterion by explaining that the “essence of this type of arrangement is much the same as an internal service fund—the goods or services are provided to the government itself rather than to the citizenry.”

4.32.3. Q—Would an organization that provides services to a primary government’s employees meet the criteria to be blended with the primary government?

A—Yes. Paragraph 53b of Statement 14, as amended, specifically states that the blending criteria may be met by a component unit providing services to a primary government indirectly. For example, a component unit that administers employee benefits is providing services indirectly to the primary government, as it provides services directly to the primary government’s employees.

4.32.4. Q—A component unit would be discretely presented under the provisions of Statement 14, as amended; however, in its day-to-day operations, the component unit does not act as a separate legal entity and operates in the same manner as departments or agencies of the primary
government. Can the component unit be reported as part of the primary government or as a blended component unit?

A—Even though a primary government may have the ability to impose its will on an organization to the extent that it gives the appearance that the potential component unit is no longer a separate entity, the separate legal standing of the organization would not be compromised. Therefore, the component unit would not be considered an agency or department of the primary government for reporting purposes. If the component unit does not meet the criteria for blending in paragraph 53 of Statement 14, as amended, it would be discretely presented.

4.32.5. Q—Paragraph 53b of Statement 14 states that a component unit should be blended if it “provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it.” In this example, the state lottery qualifies as a component unit. Does the state lottery meet this criterion for blending?

A—No. Even though state lotteries are created primarily to generate revenue for those states, the service provided by a lottery—the opportunity for financial gain—is provided to anyone who chooses to participate. When prizes are awarded to winners and financial gain is achieved, the lottery operation does not exclusively, or almost exclusively, benefit the primary government as an institution.

4.33 Nongovernmental Component Units

4.33.1. Q—How would a reporting entity display the financial statements of a component unit that uses a GAAP reporting model other than the governmental model?

A—Component units that use other GAAP reporting models would be incorporated into the reporting entity’s financial statements generally in the same manner as governmental component units. As described in paragraph 43 of Statement 14, all component units are required to apply the definition and display provisions of Statement 14, as amended, before they are combined with the primary government. In the reporting entity’s statement of net position, a discretely presented component unit’s financial data may be presented in a separate discrete column or combined with the financial data of other discretely presented component units as described in paragraph 44, as amended. Similarly, in the reporting entity’s statement of activities, a nongovernmental component unit’s financial data may be presented on a separate line or combined with the financial data of other component units. The financial data of a nongovernmental component unit would be arrayed based on the same display considerations as those discussed for component units engaged only in business-type activities in Question 7.26.6. If the reporting entity’s financial statements do not include a statement of activities, the nongovernmental component unit’s financial statement data should be reconfigured into a display that is compatible with the reporting entity’s change statement format and be presented in a discrete column to the right of the financial statement data of the primary government. However, if it is impractical to reformat the nongovernmental component unit’s change statement data, they need not be reported on the same page as that of the primary government, but may be reported on a separate following page. (See Questions 4.33.3 and 4.33.4 about including financial data of nongovernmental component units.)
4.33.2. Q—Does Statement 14, as amended, apply to nongovernmental component units when they are included in a governmental reporting entity?

A—Yes. Paragraph 9 of Statement 14 states that “this Statement should be applied to all governmental and nongovernmental component units when they are included in a governmental financial reporting entity” (emphasis added).

For example, for the purposes of preparing the financial statements for the governmental reporting entity, a nongovernment component unit of the governmental reporting entity would need to apply Statement 14, as amended, and Statement 39 to its potential component units to determine whether or not they meet the criteria to be included as component units.

(See Question 4.43.3 about separately issued financial statements of a nongovernmental component unit.)

4.33.3. Q—Many organizations that Statement 39 requires be included in a government’s reporting entity as discretely presented component units are nongovernmental and follow Financial Accounting Standards Board (FASB) standards in their separately issued financial statements. To what extent should the financial statements of a nongovernmental component unit be converted to comply with GASB standards?

A—There are no requirements to change the recognition, measurement, or disclosure standards applied in a nongovernmental component unit’s separate financial statements. However, as discussed in Question 4.33.2, the provisions of Statement 14 should be applied to the financial statements of a nongovernmental component unit when those statements are incorporated into a governmental financial reporting entity. That is, a nongovernmental component unit should include component units of its own based on the criteria in Statement 14, as amended. In addition, the financial statements of a nongovernmental component unit may need to be reformatted to comply with the classification and display requirements in Statement 34, as amended. (See Question 4.33.1 about presenting the financial data of nongovernmental component units on separate pages, and Question 4.33.4 about reformatting. Also see the illustrations in nonauthoritative Appendix B4-5.)

4.33.4. Q—A state university is affiliated with a nongovernmental fund-raising organization that meets the criteria in Statement 39 for discrete presentation in the university’s financial reporting entity. In its separate financial statements, the university (legally separate from the state) reports as a BTA, pursuant to the provisions of paragraph 138 in Statement 34, as amended. If the university chooses to present the foundation’s financial statements in a separate column adjacent to its own total columns, what display and classification modifications to the foundation’s financial statements may be necessary?

A—If the foundation’s statement of net assets is not presented in a classified format, its assets and liabilities should be reclassified into their current and noncurrent components, based generally on the guidance in Statement 62, paragraphs 29–44, as amended. Also, the foundation’s net assets should be redistributed among the three net position components required in Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position—net investment in capital assets, restricted (distinguishing between expendable and nonexpendable and between major categories of restrictions), and unrestricted. The data in the foundation’s statement of activities may need to be realigned to distinguish between operating and nonoperating revenues and expenses and
generally relocated to their appropriate positions in the GASB’s required format. Also, because the university can present its operating expenses by either natural classification or functional categories, the foundation’s expenses may need to be reconfigured to conform to the approach used by the university. In addition, the foundation’s revenues may need to be reduced by related discounts and allowances, if reported separately as expenses, to be consistent with the university’s presentation. (See also Questions 4.33.1 and 4.33.3, and the illustrations in nonauthoritative Appendix B4-5.)

4.34 Component Unit Financial Statements Prepared Using an Other Comprehensive Basis of Accounting

4.34.1. [Not used in GASBIG 2015-1]

4.35 Investments in Legally Separate Organizations

4.35.1. [Not used in GASBIG 2015-1]

4.36 Budgetary Presentations

4.36.1. Q—Can budgetary data for a discretely presented component unit be presented in the reporting entity’s budget-to-actual comparison as RSI or in the basic financial statements?

A—No. Paragraph 130 of Statement 34, as amended, clearly limits the comparison to the primary government’s general fund and major special revenue funds with legally adopted annual budgets. Including data for discretely presented component units in the budgetary comparison schedule would be in conflict with the limitations of that requirement. Budgetary comparisons for discretely presented component units, however, can be presented as supplementary information.

4.36.2. Q—Activities of a legally separate component unit are included in the budget for the primary government’s general fund. What effect should this have on the budgetary comparison?

A—The budgetary comparison should be consistent with the budget. Thus, the activities of a component unit in the primary government’s budget should not be excluded from the budgetary comparison. Entity differences should be reconciled to actual amounts on a GAAP basis, based on the requirements included in NCGA Interpretation 10, State and Local Government Budgetary Reporting, as amended.

4.37 Intra-Entity Transactions and Balances

4.37.1. [Not used in GASBIG 2015-1]

4.37.2. [Not used in GASBIG 2015-1]

4.37.3. [Not used in GASBIG 2015-1]

4.38 Reporting Periods

4.38.1. Q—How should the financial statements be presented when a component unit has a different year-end than the primary government?
A—Paragraph 59 of Statement 14 states that the reporting entity (which reports using the primary government’s fiscal year) should incorporate the financial statements for the component unit’s fiscal year that ends during the reporting entity’s fiscal year. However, if the component unit’s fiscal year ends within the first quarter of the reporting entity’s subsequent fiscal year, the reporting entity can incorporate that fiscal year of the component unit, rather than the fiscal year ending during the reporting entity’s fiscal period. For example, a primary government that has a fiscal year ending December 31, 20X4, can include the data of component units that have fiscal years ending from January 1, 20X4, through March 31, 20X5.

Paragraph 60 of Statement 14, as amended, states that if transactions with component units that have different fiscal years result in inconsistencies in amounts reported as receivable or payable, or disclosed in the notes (as required by paragraph 128 of Statement 34), the nature and amount of those transactions should be disclosed in the notes to the financial statements. The fiscal year of the component units included in the reporting entity should be consistent from year to year, and changes in fiscal years should be disclosed.

4.38.2. Q—Under the provisions of paragraph 59 of Statement 14, the financial statements of the primary government for the year ending June 30, 20X4, incorporate the financial statements of component unit A for the year ending December 31, 20X3. The financial statements of component unit A include financial data for its component unit B for the fiscal year ending June 30, 20X3. Therefore, component unit B’s data will be one year old when they are “rolled up” into the reporting entity financial statements. How should this information be reported in the reporting entity financial statements?

A—The reporting entity should incorporate the financial statements of component unit A as described in paragraph 59. Statement 14 is applicable to the separately issued financial statements of a component unit. Paragraph 43 states that the financial reporting entity definition should be applied “from the bottom up.” This means that the primary government’s component unit would include the financial data of its component units that have different year-ends based on the guidance provided in paragraph 59, and the primary government would do the same. Therefore, it would be appropriate for component unit A to include the June 30, 20X3, financial information of component unit B in its December 31, 20X3, financial statements. Likewise, it would be appropriate for the reporting entity to include this information in its June 30, 20X4, financial statements through the incorporation of the December 31, 20X3, financial statements of component unit A.

4.38.3. Q—An organization that was reported as a component unit of a state no longer qualifies as a component unit. How should the state report that change in the reporting entity?

A—The state should restate its beginning net position as if the organization was not in the reporting entity in the preceding year, as discussed in paragraph 86 of Statement 62. In addition, the state should make the disclosures required by paragraph 87 of that Statement. The financial statements would report “net position, beginning of the year (as restated),” and the restatement would be explained in the notes.

4.38.4. Q—A blended component unit that was reported as a special revenue fund of a primary government ceases to be legally separate and becomes a department of the primary government. It continues to meet the requirements for reporting as a special revenue fund. Does this constitute a change in reporting entity as discussed in paragraph 86 of Statement 62?
A—Yes. However, restatement of the financial statements is not necessary if the accounts reported by the primary government have not changed. The primary government should disclose the nature of the change and the reasons for it, as discussed in paragraph 87 of Statement 62.

4.39 Note Disclosures

4.39.1. Q—Are extensive note disclosures required for component units?

A—The financial statements of the reporting entity should include those discretely presented component unit disclosures that are essential to the fair presentation of the financial reporting entity’s basic financial statements. Therefore, to the extent that the disclosures are essential to the fair presentation, they are required. As noted in paragraph 63 of Statement 14, as amended, “determining which discretely presented component unit disclosures are essential to fair presentation is a matter of professional judgment and should be done on a component unit-by-component unit basis.” Paragraph 126, in the Basis for Conclusions of Statement 14, uses the long-term debt disclosure requirements to illustrate how one might decide which component unit disclosures are “necessary for a fair presentation.” For example, paragraph 63, as amended, states that “if a primary government is obligated in some manner for the debt of a particular component unit, it is likely that the debt service requirements to maturity should be disclosed for that component unit.”

4.39.2. Q—Are individual component unit disclosures required for all discretely presented components?

A—No. Paragraph 51 of Statement 14, as amended, requires, in certain instances, disclosure of information about each “major” component unit included in the component units column(s). The nature and significance of its relationship to the primary government should be considered to determine which component units are “major.” (See Question 4.28.17 for further discussion of major component units and Question 4.39.4 for disclosure of how component units are reported.)

4.39.3. Q—What disclosures are required for organizations that were considered for inclusion as component units but did not meet the criteria for inclusion?

A—Except for the disclosures required for related organizations in paragraph 68, there is no requirement for disclosures about organizations that are not part of the reporting entity. Paragraph 61 of Statement 14, as amended, requires disclosure of the rationale for including the component units, but there is no requirement to explain why an organization is excluded—the implication is that, if the criteria for inclusion are met, the organization is included. (See Question 4.46.1 for further discussion of related organizations.)

4.39.4. Q—What is the intent of the requirement in paragraph 61 of Statement 14, as amended, to disclose how the component units are reported?

A—The purpose of the disclosure is to describe to the reader how the financial data of the component unit are displayed. For example, if a component unit of a city was blended because its governing board is substantively the same as the primary government’s board and there is operational responsibility, the disclosure requirements would be satisfied by stating that “even though it is legally separate, it is reported as if it were part of the city because the city council
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also serves as the governing board of the component unit and management of the primary government has operational responsibility for the component unit.” If a component unit was *discretely presented*, it is sufficient to state that it is “reported in a separate column(s) to emphasize that it is legally separate from the primary government and is governed by a separate board.” If there are no discretely presented component units, the notes should not include a discussion of discrete presentation as a method of displaying component unit data. Paragraph 61, as amended, provides that “component units may be disclosed together if they have common characteristics as long as each component unit is separately identified.”

4.39.5. [Not used in GASBIG 2015-1]

4.39.6. Q—Should disclosures related to discretely presented component units be segregated from disclosures relating to the primary government?

A—Yes. Paragraph 62 of Statement 14 states, in part, that the notes “should distinguish between information pertaining to the primary government (including its blended component units) and that of its discretely presented component units.” This can be accomplished by presenting component unit information after the primary government information for each relevant disclosure or by presenting all component unit disclosures after the primary government disclosures.

4.40 Focus of the Reporting Entity’s Note Disclosures and Required Supplementary Information

4.41 Separately Issued Financial Statements

4.42 Primary Government Financial Statements

4.42.1. Q—Can a government choose to issue financial statements that purport to be in conformity with GAAP without any component unit financial data?

A—Paragraph 64 of Statement 14 provides:

A primary government may find it useful or necessary (for example, to satisfy specific legal requirements) to issue financial statements that do not include the financial data of its component units. Paragraph 9 states that the provisions of this Statement apply to financial reporting by primary governments; thus, financial statements that present only the data of the primary government should acknowledge that the financial statements do not include the data of the component units necessary for reporting in conformity with generally accepted accounting principles.

The intent of paragraph 64 is to clarify that governments may issue “primary government only” financial statements that do not include component unit data to meet certain general purpose needs (for example, a bond issuance); however, those financial statements do not present the *reporting entity* in accordance with GAAP and are intended to supplement, not supplant, the financial statements of the reporting entity.

4.42.2. Q—Would it be permissible for financial statements of only the primary government to include a disclosure of the existence of the excluded component units and their relationship to the primary government?
A—Paragraph 64 of Statement 14 states that “. . . the primary government should acknowledge that the financial statements do not include the data of the component units necessary for reporting in conformity with generally accepted accounting principles.” Therefore, it would be permissible, but not required, to disclose in the notes the existence of component units and their relationship to the primary government. These additional disclosures, however, are not a substitute for inclusion of the financial data of the component units and do not fulfill the requirements for reporting in accordance with GAAP.

4.43 Component Unit Financial Statements

4.43.1. Q—Paragraph 65 of Statement 14, as amended, states that a component unit should apply the provisions of the Statement “as if it were a primary government.” In its separately issued financial statements, can a component unit that has component units of its own refer to itself as the “primary government,” in distinguishing between its data and those of its component units?

A—No. Only those governments that meet the criteria in paragraph 13 of Statement 14 should be referred to as primary governments. Separately issued financial statements for component units and other stand-alone governments can use the specific name of the reporting government rather than the “primary government” label to refer to the data that do not include the component units. For example, the statement of net position for the Sample County Airport (a component unit of Sample County) might resemble the following:

Sample County Airport  
(A Component Unit of Sample County)  
Statement of Net Position  
December 31, 20X4

<table>
<thead>
<tr>
<th>Sample County Airport</th>
<th>Governmental Activities</th>
<th>Business-Type Activities</th>
<th>Total</th>
<th>Component Units</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

A total column for the reporting entity may be presented, but is not required.

4.43.2. Q—Should a component unit title its financial statements as “component unit financial statements” and “component unit financial report”?

A—No. Applying the “bottom-up” provision in paragraph 65 of Statement 14, as amended, establishes the nature of component unit reporting so that the component unit financial statements do purport to present the component unit’s reporting entity. As a result, a component unit’s financial statements are its “basic financial statements,” and the component unit may issue a “comprehensive annual financial report.” The reporting component unit should apply the provisions of Statement 14, as amended, as if it were a primary government; however, the financial statements should clearly indicate that it is a component unit of another government.
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4.43.3. Q—Do the provisions of Statement 14, as amended, apply to the separately issued financial statements of a nongovernmental organization that is a component unit?

A—No. A nongovernmental component unit would not apply the provisions of Statement 14, as amended, to its separately issued financial statements; however, Statement 14, as amended, would be applied to the nongovernmental component unit when it is included in the financial statements of the governmental reporting entity. (See Question 4.33.3.)

4.44 Other Stand-Alone Government Financial Statements

4.44.1. Q—Paragraph 66 of Statement 14, as amended, provides that other stand-alone governments, such as joint ventures, jointly governed organizations, pools, and some special-purpose governments, should apply the provisions of Statement 14, as amended, “as if they were primary governments” when they issue separate financial statements. Does this mean that these governments are primary governments for financial reporting purposes?

A—No. Only those governments that meet the criteria in paragraph 13 are primary governments. However, a stand-alone government that does not meet the financial accountability criteria to be included as a component unit in the financial statements of a primary government should apply the provisions of Statement 14, as amended, “as if it were a primary government” for its financial reporting. For a stand-alone government, the financial reporting entity consists of the stand-alone government and any component units for which it is financially accountable.

4.45 Reporting Relationships with Organizations Other Than Component Units

4.46 Related Organizations

4.46.1. Q—What is a related organization?

A—A related organization is one for which a primary government is accountable because it appoints a voting majority of the organization’s governing board. (See Question 4.17.1 for further discussion of appointments.) However, the primary government is not financially accountable because it cannot impose its will on the organization and a financial benefit/burden relationship does not exist.

For example, a port authority was established by the city for the purpose of stimulating commerce and promoting the shipment of goods and cargoes. Its governing board consists of five members appointed by the mayor of the city; however, the city does not appoint the port authority’s management. The board members may not be removed except for cause. The port authority determines the budget, issues bonded debt, levies taxes, and sets its rates without the approval of the city. The port authority does not provide a financial benefit, nor does it impose a financial burden on the city. Because the city is unable to impose its will on the authority and there is no financial burden or benefit relationship between the city and the authority, the port authority is not a component unit of the city. However, because the city appoints the voting majority of the authority’s board, the port authority should be disclosed as a related organization.

4.46.2. [Not used in GASB 2015-1]
4.46.3. [Not used in GASBIG 2015-1]

4.47 Joint Ventures

4.47.1. Q—What is a joint venture?

A—A joint venture has the following characteristics, as stated in paragraph 69 of Statement 14:

• It is a legal entity or other organization that results from a contractual arrangement.
• It is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control.
• Participants retain an ongoing financial interest or an ongoing financial responsibility.

For example, two nearby municipalities contribute resources and land to create a water district that represents a separate legal entity governed equally by both municipalities. While the water district’s operations may be considered self-sufficient, the municipalities agree to share responsibility for financing the water district’s future deficits or capital needs, if any. The water district would represent a joint venture of the two municipalities.

4.47.2. Q—What is joint control?

A—Paragraph 69 of Statement 14 defines joint control to mean that no single participant has the ability to unilaterally control the financial or operating policies of the joint venture. For example, if a joint venture with three participants has a six-member governing board, it would be subject to joint control if each of the participants appoints two members and all members have equivalent voting power. However, if one of the participants appoints a voting majority of the governing board, the organization would not be jointly controlled.

4.48 Ongoing Financial Interest

4.48.1. Q—What is an ongoing financial interest?

A—Paragraph 70 of Statement 14 states that an ongoing financial interest includes the ability to access the joint venture’s resources by the participating government, either directly or indirectly, or from an equity interest in the joint venture. The ability to directly access a joint venture’s resources means that the joint venture can be compelled to remit its resources to the participants. The ability to indirectly access a joint venture’s resources occurs when the joint venture can be influenced to undertake projects of interest to the participants. For example, if an organization could be influenced to undertake a specific construction project at the request of a participating entity, this ability would constitute indirect access. Equity interest is evidenced either by ownership in the joint venture’s stock or by an explicit and measurable right to the joint venture’s net resources. For example, if an agreement specifically spells out the participant’s rights to the organization’s net resources based on the original contributions, this would represent an equity interest.

4.49 Ongoing Financial Responsibility

4.49.1. Q—What is ongoing financial responsibility?
A—Paragraph 71 states that a participating government has an ongoing financial responsibility for a joint venture if it is obligated in some manner for the debts of the joint venture (see Question 4.22.4), or if the joint venture’s continued existence depends on continued funding by the government. For example, if a mass-transit authority is dependent on appropriations from a city to subsidize recurring operating deficits caused by insufficient user fee revenues, the city would have an ongoing financial responsibility.

4.49.2. Q—Does a joint venture’s reliance on continued funding have to be reliance on funding in the form of cash contributions, or can it be reliance on other forms of support from the participating government?

A—The form of the funding would not matter; the dependence of the joint venture’s continued existence on the funding, whether in the form of cash subsidies, purchases of the joint venture’s goods or services, or some other form, would be the relevant factor.

4.50 Equity Interest

4.51 Reporting Participation in Joint Ventures in Which There Is an Equity Interest

4.51.1. Q—What was intended in paragraph 73 of Statement 14, as amended, with regard to the elimination of profit on transactions between a participant and a joint venture? Is the transaction itself eliminated, or only the effect of profit on the transaction?

A—The intent was to prevent a participant from reporting net income on “transactions with itself.” The participant’s share of the net income on transactions with the joint venture would be treated as an additional equity interest in the joint venture rather than earnings from the joint venture. The total change in the equity interest in the joint venture would be unaffected, but the net increase in the equity interest would result from two factors rather than one. (See the example in nonauthoritative Appendix B4-3.)

4.51.2. [Not used in GASBIG 2015-1]

4.52 Disclosure Requirements for Joint Venture Participants

4.52.1. Q—What disclosures are required for joint venture participants?

A—Paragraph 75 of Statement 14 requires the following disclosures for all joint venture participants:

A general description of each joint venture, including:

(1) Description of the participating government’s ongoing financial interest (including its equity interest, if applicable) or ongoing financial responsibility. This disclosure should also include information to allow the reader to evaluate whether the joint venture is accumulating significant financial resources or is experiencing fiscal stress that may cause an additional financial benefit to or burden on the participating government in the future.

(2) Information about the availability of separate financial statements of the joint venture.
In addition, the participating government should include any other information required by Statement 62, paragraph 55, as amended, and paragraph 56—for example, related-party transactions.

4.53 Joint Building or Finance Authorities

4.54 Jointly Governed Organizations

4.54.1. Q—What are jointly governed organizations?

A—Jointly governed organizations are organizations that provide goods or services to the citizenry of two or more governments, but that do not meet the definition of a joint venture because there is no ongoing financial interest or responsibility by the participating governments. For example, a regional utility authority created by a large number of local governments to operate electric power utilities for a multicounty area would be a jointly governed organization.

4.54.2. Q—How is a jointly governed organization reported?

A—The only reporting requirement for jointly governed organizations is to disclose related-party transactions, as required by Statement 62, paragraph 55, as amended, and paragraph 56.

4.55 Component Units and Related Organizations with Joint Venture Characteristics

4.55.1. Q—Is it possible for an organization with characteristics of a joint venture to be a component unit in a reporting entity’s financial statements?

A—Yes. The organization may be fiscally dependent on one of the participating governments and have a financial benefit or burden relationship with that participant, thus making it a component unit of that participant. For example, the joint venture agreement may stipulate that debt cannot be issued by the joint venture without the express approval of a specific participating government. (See Sections 4.9–4.12 for further discussion of fiscal dependence.)

4.56 Pools

4.56.1. Q—What is a pool?

A—Paragraph 79 of Statement 14 defines a pool as a “multijurisdictional arrangement that has the characteristics of a joint venture but has additional features that distinguish it, for financial reporting purposes, from the traditional joint venture defined in paragraph 69. For example, an investment pool generally has ‘open’ membership; that is, governments are free to join, resign, and increase or decrease their participation in the pool without the knowledge or consent of the other participants. Furthermore, a participant’s equity interest in the pool (for example, its share of investments in an investment pool) should already be recognized in its financial statements; thus, calculating and reporting an equity interest as defined in paragraph 72 would be redundant. . . .”

For example, a state may sponsor an investment pool for all local governments within the state. Each local government is able to manage their level of participation without consent of
other participating governments, and therefore, this arrangement would meet the definition of a pool.

### 4.57 Undivided Interests

4.57.1. Q—What is an undivided interest?

A—Paragraph 80 of Statement 14 states, in part, that an undivided interest is “an arrangement that resembles a joint venture but no entity or organization is created by the participants.” The characteristics of an undivided interest are:

- Two or more parties own property in which title is held individually to the extent of each party’s interest.
- Each participant is also liable for specific, identifiable obligations (if any) of the operation.
- Borrowing to finance its operations often is done individually by each participant. There is no entity with assets, liabilities, expenditures/expenses, and revenues—and thus, equity—to allocate to participants.

For example, if a county owns a convention center and the city operates the center and owns all of the catering equipment, this would be considered an undivided interest.

4.57.2. Q—How is an undivided interest reported?

A—A government participating in an undivided interest of this type should report its assets, liabilities, expenditures/expenses, and revenues that are associated with the joint operation. Statement 14 does not require specific disclosures for undivided interests.

4.57.3. Q—Can an undivided interest be part of a joint venture?

A—Yes. Paragraph 80 of Statement 14 provides that a hybrid arrangement may result if a joint venture agreement creates a separate organization but provides for undivided interests in specific assets and liabilities and equity interests in the other net resources of the organization. The participants in these arrangements should report their undivided interests in accordance with the provisions of paragraph 80 and their equity interests in accordance with paragraphs 73 and 74, as amended.

### 4.58 Cost-Sharing Arrangements

4.58.1. Q—Are cost-sharing arrangements joint ventures?

A—Most cost-sharing projects (such as road construction funded by federal, state, and local governments) and joint purchasing agreements do not meet the joint venture criteria because there is no legal entity or other organization that is owned, operated, or governed by the participating governments. In addition, paragraph 81 of Statement 14, as amended, specifically states that multiple-employer pension and other postemployment benefit plans are not considered joint ventures for the purposes of that Statement.

### 4.59 Other Issues

### 4.60 Statement of Cash Flows
4.60.1. [Not used in GASBIG 2015-1]

4.60.2. [Not used in GASBIG 2015-1]

4.60.3. [Not used in GASBIG 2015-1]

4.61 Colleges and Universities

4.61.1. [Not used in GASBIG 2015-1]

4.61.2. [Not used in GASBIG 2015-1]

4.62 Pension Plans

4.62.1. [Not used in GASBIG 2015-1]

4.62.2. Q—Under what circumstances should a pension plan be evaluated as a component unit of a primary government?

A—If the primary government is not acting in a trustee capacity for the assets of the pension plan, the pension plan should be evaluated using the financial accountability criteria of Statement 14. In addition, paragraph 41, as amended, notes that other organizations should be evaluated as potential component units if they are closely related to the primary government to determine whether the nature and the significance of a potential component unit’s relationship with the primary government warrant inclusion.

Pensions—Plan and Employer Accounting and Reporting

10. Questions and answers in this paragraph address issues related to plan and employer accounting and reporting for pensions.

5.1−5.58

[Not used in GASBIG 2015-1]

5.59 Statement 67

5.60 Scope and Applicability of Statement 67

5.60.1. Q—Does Statement No. 67, Financial Reporting for Pension Plans, require that stand-alone financial reports be issued for defined benefit pension plans?

A—No. Statement 67 establishes standards that apply to financial reporting for defined benefit plans, including stand-alone financial reports, when such reports, prepared in conformity with GAAP, are issued.
5.60.2. **Q**—A city reports a single-employer defined benefit pension plan as a pension trust fund in its basic financial statements. The plan issues a stand-alone financial report prepared in conformity with the requirements of Statement 67. Does the city have to apply all the requirements of Statement 67 for the pension trust fund?

**A**—No. Although, in general, Statement 67 applies to financial reporting of the plan in stand-alone financial statements and in circumstances in which the plan is included as a pension trust fund of another government, for purposes of including the pension plan as a pension trust fund in the city’s financial report, footnotes 9 and 11 of Statement 67 limit the applicability of the note disclosure and RSI requirements of that Statement to circumstances in which defined benefit pension plan financial statements are presented solely in the financial report of the city. Therefore, because a stand-alone plan financial report is prepared in conformity with the requirements of Statement 67, that Statement does not require that the city include the information identified in the detailed disclosure and RSI requirements of Statement 67 as part of its presentation of the pension plan as a pension trust fund in its financial report. Paragraph 106 of Statement 34, as amended, requires that, in this circumstance, the notes to the financial statements of the city include information about how to obtain the stand-alone plan financial report. However, additional information can be presented in the city’s note disclosures if the information is determined to be essential to the fair presentation of the city’s basic financial statements.

5.60.3. **Q**—A city offers an unfunded (“pay-as-you-go”) plan (that is, the city’s annual contributions are approximately equal to that year’s benefit payments) that provides supplemental defined benefit pensions to certain employee classes. The plan is administered through a trust that has the characteristics identified in paragraph 3 of Statement 67. Does Statement 67 apply to an unfunded plan?

**A**—Yes. Regardless of the method or timing of funding the benefits, if the supplemental pensions are provided through a plan that is administered through a trust (or equivalent arrangement) that has the characteristics identified in paragraph 3 of Statement 67, the Statement applies.

5.60.4. **Q**—Would the answer to Question 5.60.3 be different if the plan were closed to new entrants?

**A**—No. All provisions of Statement 67 apply to closed plans, as well as to open plans, administered through a trust (or equivalent arrangement) that has the characteristics identified in paragraph 3 of that Statement.

5.60.5. [Not used in GASBIG 2015-1]

### 5.61 Trusts or Equivalent Arrangements

5.61.1. **Q**—A pension plan’s trust agreement includes a provision for return of amounts remaining in the trust to an employer if all obligations associated with a plan that is administered through the trust have been fulfilled. Is this provision consistent with the criterion in paragraph 3a of Statement 67 regarding the irrevocability of contributions?

**A**—Yes. As used in paragraph 3a of Statement 67, irrevocability is understood to mean that an employer no longer has ownership or control of the assets, except for any reversionary right once all benefits have been paid. That is, for purposes of the Statement, the trust should be so
constituted that assets may flow from an employer to the plan, but not from the plan to an employer—unless and until all obligations to pay benefits in accordance with the plan terms have been satisfied by payment or by defeasance with no remaining risk regarding the amounts to be paid or the value of plan assets.

5.61.2. [Not used in GASBIG 2015-1]

5.62 Classifying Pensions as Defined Benefit or Defined Contribution

5.62.1. Q—The terms of a pension specify that an employer is required to contribute 7.5 percent of each plan member’s annual salary to an individual plan member account. Individual plan member accounts are credited with interest at a rate of 5 percent per year, as specified in the benefit terms, and are assessed an administrative fee based on the average balance of assets in the account for the year. During retirement, a plan member draws down the balance of the account, with interest continuing to accrue at the specified interest rate. Should this pension be classified as defined benefit or as defined contribution for purposes of applying Statement 67?

A—This pension is defined benefit for purposes of applying Statement 67. To be classified as a defined contribution pension, paragraph 7 of Statement 67 specifies that all three of the following criteria are required to be met:

a. An individual account is provided for each plan member.
b. The plan terms define the amount of contributions that the employer is required to make (or credits that it is required to provide) to an active plan member’s account for periods in which the plan member renders service.
c. The pension that a plan member will receive will depend only on the contributions (or credits) to the plan member’s account, actual earnings on investments of those contributions (or credits), and the effects of forfeitures of contributions (or credits) made for other plan members, as well as pension plan administrative costs, that are allocated to the plan member’s account.

Although the pension provided in this question meets the first two of these criteria, it does not meet the third criterion because the interest credited to a plan member’s account is based on a specified rate regardless of the actual earnings on the underlying investments made with the assets in the account. Because the pension does not meet all three of the criteria identified in paragraph 7 of Statement 67 to be classified as defined contribution, it should be classified as defined benefit for purposes of applying Statement 67.

5.62.2. Q—If, instead of crediting interest to the plan members’ accounts at a specified rate of return, the benefit terms described in Question 5.62.1 provide that interest on plan members’ account balances is determined based on an outside index, how should the pension be classified for accounting and financial reporting purposes?

A—Unless the investments of each plan member’s account mirror the investments that comprise the outside index, the crediting of interest earnings based on a rate that is tied to the performance of an outside index does not represent actual earnings on investments in the plan members’ accounts, and the pension should be classified as defined benefit for purposes of applying Statement 67.
5.62.3. Q—The terms of a pension meet the criteria in paragraphs 7a and 7b of Statement 67 to be classified as defined contribution but provide that, upon retirement, the balance in a plan member’s individual account is converted to an immediate life annuity paid by the pension plan. Annuity payments are calculated at the plan member’s retirement date based on mortality tables and an interest rate established by the pension plan’s administrative board. The total amount of payments received is not otherwise limited by the amounts in the plan member’s account—that is, if the plan member lives longer than projected at retirement, benefit payments continue at the amount calculated at retirement until the plan member’s death. Is the pension defined contribution or defined benefit for financial reporting purposes?

A—The pension is defined benefit. Although the amount of a plan member’s annuity payment is based on the individual account balance at retirement, the total amount of benefits received by the plan member does not depend only on “the contributions (or credits) to the plan member’s account, actual earnings on investments of those contributions (or credits), and the effects of forfeitures of contributions (or credits) made for other plan members, as well as pension plan administrative costs, that are allocated to the plan member’s account.” The total amount of benefits also depends on the number of years the plan member lives to receive benefit payments. Further, the amount of the benefit payments depends upon the interest rate established by the plan’s administrative board, rather than on actual earnings on the investment of assets in the account. Therefore, the annuitization of the plan member’s account balance under the benefit terms results in a pension that does not depend solely on the factors identified in paragraph 7c of Statement 67.

5.62.4. Q—The terms of a pension otherwise meet the criteria in paragraph 7 of Statement 67 to be classified as defined contribution but provide that after a plan member retires, the plan member has the option to annuitize some or all of their account balance through the purchase of an individual annuity contract with a third party. Is this plan defined contribution for financial reporting purposes?

A—Yes. In the circumstance described in this question, the purchase of the annuity is a separate transaction between the plan member and the third party. Because there is no potential for a change in the obligation of the employer related to the amounts that will be provided to the plan member as a result of the annuity purchase option, in this case, the annuitization of the plan member’s account balance does not impact the classification of the pension as defined contribution.

5.63  Types of Defined Benefit Pension Plans

5.63.1. Q—A PERS administers the assets, the payment of benefits, and the general recordkeeping and support services for pensions provided to the employees of three employer governments. A separate actuarial valuation is performed for separate classes of plan members (for example, general government employees versus public safety employees), and employers make contributions for each class at the rate for the class applied to the employer’s active-employee covered payroll for the class. Plan assets legally are available to pay benefits to any plan member. What type of plan(s) is the PERS administering?

A—The classification of the plan depends on whether there is a legal segregation of assets for purposes of providing benefits to the different classes of plan members. In this situation, although different rates are calculated for different classes of plan members, all plan assets legally are available to pay benefits of any plan member, regardless of their employment class.
Therefore, this plan is a cost-sharing multiple-employer plan for purposes of applying Statement 67.

5.63.2. Q—If the facts regarding the plan in Question 5.63.1 were changed, to the extent that separate actuarial valuations were performed for separate employers based on their employees and an allocation of assets to each employer, rather than for separate classes of plan members, would the separate valuations change the classification of the plan from a cost-sharing multiple-employer plan to an agent multiple-employer plan?

A—No. The classification of the plan depends on whether assets held by the pension plan legally can be used to pay the benefits of the employees of any of the employers. In this situation, although different contribution rates are established for different employers, all plan assets legally are available to pay benefits pertaining to the employees of any employer. Therefore, this plan is classified as a cost-sharing multiple-employer plan for purposes of applying Statement 67.

5.63.3. Q—A defined benefit pension plan is used to provide pensions to the employees of a state government and several governments that are component units of the state. There are no other entities whose employees are provided with pensions through the plan. The assets in the plan legally can be used to pay benefits to the employees of the state or any of the component units. Is this plan a single-employer, agent multiple-employer, or cost-sharing multiple-employer plan?

A—This plan is a single-employer plan for financial reporting purposes. Defined benefit pension plans are classified according to the number of employers whose employees are provided with benefits through the plan and whether pension obligations and pension plan assets are shared. Paragraph 8 of Statement 67 specifies that a primary government and its component units should be considered to be one employer for purposes of classifying a defined benefit pension plan as single employer or multiple employer. (See Questions 5.125.1–5.125.3 for a discussion of issues related to employer reporting in this circumstance.)

5.63.4. Q—A defined benefit pension plan is used to provide pensions to the employees of a state government, several governments that are component units of the state, and governments other than the state and the component units. Is this plan a single-employer, agent multiple-employer, or cost-sharing multiple-employer plan?

A—The plan is a multiple-employer plan for financial reporting purposes. If (a) a separate account is maintained for each of the governments or (b) a separate account is maintained for the state and its component units together and separate accounts are maintained for each of the other governments, such that the assets in each of the separate accounts legally are available to pay the benefits of only the employees of the government or governments whose assets are maintained in the separate account, the plan would be classified as an agent multiple-employer plan. If, instead, the pension plan assets legally can be used to pay the benefits of the employees of any of the governments, the plan would be classified as a cost-sharing multiple-employer plan.

5.63.5. Q—A PERS administers a single trust fund through which pensions are provided to employees of local governments in a state. For certain employers ("nonpool employers"), the PERS maintains separate asset accounts. The assets and obligations of other employers ("pool employers") are pooled. How should this arrangement be classified for purposes of applying Statement 67?
A—If the assets of each of the nonpool employers cannot legally be used to pay benefits to the employees of any other employer, the portion of the trust that is being used to administer benefits to the employees of the nonpool employers is a separate (agent multiple-employer) plan. In this circumstance, the portion of the trust that is being used to administer the benefits of the employees of pool employers is a cost-sharing multiple-employer plan. If, however, the assets in the trust may legally be used to pay benefits to the employees of any of the employers (pooled or nonpooled), the trust should be reported as one cost-sharing multiple-employer plan.

5.64 Other Postemployment Benefit Plans

5.64.1. Q—Does Statement 67 apply to postemployment healthcare benefits that are provided through a trust that also is used to provide defined benefit pensions?

A—No. Consistent with prior pension and other postemployment benefit (OPEB) Statements, paragraph 6 of Statement 67 distinguishes between pensions and OPEB. This includes the classification of postemployment healthcare benefits as OPEB, regardless of the manner in which those benefits are provided. As a result, a trust that is used to administer both pensions and postemployment healthcare benefits is subject to the requirements of both Statement 67 and Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended, including the requirement for separate reporting of each pension and OPEB plan. Therefore, in the context of this question, the postemployment healthcare plan should be reported separately from the pension plan.

5.64.2. Q—Is separate financial reporting required for (a) a defined benefit pension plan and (b) a postemployment healthcare plan administered by the pension plan?

A—Yes. The pension and postemployment healthcare plans are required to be reported as two plans, not one, and separate reporting of those plans is required. Paragraph 6 of Statement 67 and paragraph 6a of Statement 43 are consistent in classifying as pension benefits retirement income and all other benefits provided through a defined benefit pension plan, except postemployment healthcare benefits, which are classified as OPEB for financial reporting purposes. Paragraph 6 of Statement 67 states, “For financial reporting purposes, assets accumulated and managed for the payment of postemployment healthcare benefits should be accounted for and reported as part of an OPEB plan.”

The complement to that paragraph is paragraph 6a of Statement 43, which includes as OPEB plans—to which the requirements of that Statement are applicable—plans that provide “[p]ostemployment healthcare benefits, either separately or through a defined benefit pension plan.” In regard to the latter arrangement, Statements 43 and 67 are consistent in viewing the postemployment healthcare benefits and related assets as an OPEB plan administered by, but separate from, the pension plan.

5.64.3. Q—How should a postemployment healthcare plan administered by a defined benefit pension plan be reported?

A—A postemployment healthcare plan administered by a defined benefit pension plan should be accounted for as a separate OPEB plan in accordance with the requirements of Statement 43. Statement 34, as amended, provides additional guidance regarding financial reporting of the defined benefit pension plan and the postemployment healthcare plan (a) in stand-alone
plan reports (for example, when the plans are included in the report of a PERS that administers them; paragraphs 139–141, as amended) and (b) when the plans are included as pension and other employee benefit trust funds in the report of the employer or sponsor of the plans (paragraph 106, as amended).

Stand-alone reports. A PERS that issues a financial report of the plans that it administers, including the pension plan and the postemployment healthcare plan, should present combining fiduciary fund financial statements (including notes) for all plans administered, accompanied by required schedules for each plan as applicable. The requirement to present combining financial statements should be met by one of the following methods:

a. Presenting a separate column for each plan on the statement of fiduciary net position and the statement of changes in fiduciary net position
b. Presenting additional combining statements for those plans as part of the basic financial statements, in order to break out information aggregated on the original statements.

Plans reported as trust funds by the employer or sponsor. Fiduciary fund financial statements are required to include a separate column for each fiduciary fund type, including pension and other employee benefit trust funds as one of those fund types. If separate financial reports of the individual pension and postemployment healthcare plans prepared in conformity with GAAP have been issued, the notes to the financial statements should include information about how to obtain those reports. In that case, separate plan financial statements (including notes) for those plans are not required to be presented in the employer’s or sponsor’s report. (However, additional information can be presented in the employer’s or sponsor’s note disclosures if the information is determined to be essential to the fair presentation of the employer’s or sponsor’s basic financial statements.) If separate GAAP-basis plan reports have not been issued, separate financial statements (including notes) for individual pension and postemployment healthcare plans should be presented in the notes to the financial statements and should be accompanied by required schedules of each plan, as applicable. (See paragraph 106 of Statement 34, as amended.)

5.64.4. Q—A state-administered cost-sharing defined benefit pension plan collects from employers and remits to a separate state agency contributions of $75 per plan member per month for postemployment healthcare benefits, which the other state agency administers. The cash collected for postemployment healthcare benefits is credited to a liability account in the pension trust fund, which is liquidated when money is remitted to the state agency that administers the postemployment healthcare plan. Should the pension plan instead follow the requirements of Statement 43, as amended, for an OPEB plan that is administered as a trust?

A—No. In collecting and remitting contributions to the agency administering the postemployment healthcare plan, the pension plan’s role in this case is that of an agent (cash conduit). Reporting the cash flow through a liability account in the pension trust fund is an appropriate way of reporting the plan’s involvement. (Agency fund reporting also would fit the circumstances.) The plan reporting requirements of Statement 43, as amended, would apply to reporting by the state agency that administers the postemployment healthcare plan.

5.65 Defined Benefit Pension Plans

5.66 Number of Pension Plans
5.66.1. **Q**—A defined benefit plan is used to provide pensions to two classes of plan members—those in elected positions and those in nonelected positions. Does Statement 67 require separate financial statements (including notes) and RSI for each class of plan members?

**A**—If, on an ongoing basis, all assets are available for the payment of pension benefits to either class of plan members, even if the benefits differ by class, there is only one plan for financial reporting purposes, and Statement 67 requires only one set of financial statements (including notes) and RSI. If, on an ongoing basis, a portion of the assets is legally restricted for the payment of benefits to one of the two membership classes, there are two separate plans for financial reporting purposes and Statement 67 requires separate financial statements (including notes) and RSI for each plan—even if the assets are pooled for investment purposes.

5.66.2. **Q**—If, within a single trust, a portion of the assets are legally segregated to pay the defined benefit pensions of a particular class of the employees of all local governments within a state (for example, elected officials) and a portion is legally segregated to pay the defined benefit pensions of another class of employees of the local governments, should the portion of the assets associated with each class be considered assets of a separate plan?

**A**—Yes, if, on an ongoing basis, each portion of assets held in the trust may not legally be used to pay benefits to other classes of plan members. Paragraph 13 of Statement 67 requires, in that circumstance, that the portion of trust assets segregated to pay benefits to each class of plan members be considered assets of a separate defined benefit pension plan for financial reporting purposes. In this case, because each plan is used to provide benefits to more than one employer, each plan would be reported as a separate multiple-employer plan.

5.66.3. **Q**—Within a trust used to administer defined benefit pensions, a certain portion of employer contributions and earnings on those contributions are accumulated in a separate account to be used as the basis for determining ad hoc cost-of-living adjustments (COLAs) that, if granted, will adjust the benefits of all retirees. Should the assets in the separate account be reported as a separate pension plan?

**A**—No. Paragraph 13 of Statement 67 requires that “if, on an ongoing basis, all assets accumulated in a defined benefit pension plan for the payment of benefits may legally be used to pay benefits . . . to any of the plan members, the total assets should be reported as assets of one defined benefit pension plan even if administrative policy requires that separate reserves, funds, or accounts for specific groups of plan members, employers, or types of benefits be maintained. . . .” That paragraph further differentiates between a separate account used as described in this question—that is, to provide an additional benefit to all retirees—and an account legally restricted for the benefits to only certain classes or groups of plan members or to plan members who are employees of certain entities. Although the assets in the separate account should not be reported as a separate plan, information should be included in notes to the plan’s financial statements to meet the requirements of paragraph 30e related to setting aside a portion of the pension plan’s fiduciary net position that otherwise would be available for existing pensions or for pension plan administration.

### 5.67 Financial Statements

### 5.68 Statement of fiduciary net position
5.68.1. Q—In paragraph 14 of Statement 67, deferred outflows of resources and deferred inflows of resources are identified in the list of elements that should be included, as applicable, in a statement of fiduciary net position for a defined benefit pension plan. However, paragraphs 15–21 of that Statement, which discuss recognition of specific items in a defined benefit pension plan’s statement of fiduciary net position, do not include any specific items to be recognized as deferred outflows of resources or deferred inflows of resources. Does this mean that there are no transactions for which a defined benefit pension plan would be required to report a deferred outflow of resources or a deferred inflow of resources in its statement of fiduciary net position?

A—No. A pension plan should report deferred outflows of resources or deferred inflows of resources if that recognition is required by other accounting and financial reporting requirements applicable to the transactions and other events reported in its basic financial statements (for example, Statement 53, as amended). Statement 67 does not include requirements for the recognition of deferred outflows of resources or deferred inflows of resources by defined benefit pension plans because the approach used in that Statement is to establish requirements for transactions for which the accounting or financial reporting is specific to pension plans. No pension-plan specific transactions or other events were identified during the development of Statement 67 for which reporting deferred outflows of resources or deferred inflows of resources would be required.

5.69 Assets

5.70 Receivables

5.70.1. Q—If, at the end of a pension plan’s fiscal year, a contractually required contribution due from a cost-sharing employer for the last month of the year is unpaid, should the amount of the contribution be recognized as a receivable under the requirements of paragraph 16 of Statement 67? That is, is a contractually required contribution considered to be “due pursuant to legal requirements”?

A—Yes. The reference to legal requirements in paragraph 16 is intended to broadly describe circumstances in which the pension plan has a legally enforceable right to the resources that are due to it. Concepts Statement No. 4, Elements of Financial Statements, defines assets as “resources with present service capacity that the government presently controls.” One embodiment of control over the present service capacity of resources is a legally enforceable right to the resources. Contractual provisions or statutory requirements for employer contributions create a legally enforceable right of the pension plan to the resources due. Therefore, the plan should recognize a receivable for unpaid contractually required contributions at its fiscal year-end.

5.70.2. Q—An agent employer that has no statutory or contractual requirement as to the amount of contributions that it makes to the pension plan each year has a policy of making contributions to the pension plan based on actuarially determined contribution rates. The employer has consistently contributed those amounts in the past and, although it has not yet made a contribution for the last month of the plan’s fiscal year, has appropriated for that purpose an amount equal to the actuarially determined contribution for that period. Should the pension plan recognize a receivable for the appropriated but unpaid contribution amount as of its fiscal year-end?

A—No. Paragraph 16 of Statement 67 limits receivables recognition to circumstances in which amounts are due pursuant to legal requirements. As discussed in Question 5.70.1, paragraph
16 was intended to require recognition of a receivable in circumstances in which the pension plan has a legally enforceable right to the resources. In this circumstance, the appropriation of an amount by the employer does not create a legally enforceable right to the resources as of the pension plan’s fiscal year-end. Therefore, the plan should not recognize a receivable for the appropriated but unpaid contributions.

5.70.3. Q—In a cost-sharing plan, employers’ contractually required contributions are based on an actuarially determined contribution rate, but they have the option to pay the required amount in installments over a 10-year period. How should this arrangement be reported by the pension plan?

A—The pension plan should recognize an employer contribution equal to the employers’ contractually required actuarially determined contributions for the plan’s fiscal year. At the end of the pension plan’s fiscal year, the unpaid portion of the amount should be reported as a receivable. The pension plan also should disclose information required by paragraph 30c of Statement 67 about the terms of and outstanding balance on the installment arrangement at the end of its reporting period.

5.70.4. Q—A pension plan has a noninterest-bearing long-term receivable. Can the plan report the receivable at its full contract value, or is the plan required to report the receivable at its discounted present value?

A—Neither Statement 67 nor other pronouncements applicable to pension plans for purposes of preparing financial statements in conformity with GAAP require that a receivable be valued at its discounted present value. (Guidance in Statement 62, as amended, addresses this issue but is not applicable to fiduciary activities.) Therefore, the pension plan can report the receivable at its full contract value. If, however, the receivable is reported at its discounted present value, paragraph 17 of Statement 67 requires that interest be accrued using the effective interest method, unless use of the straight-line method would not produce significantly different results.

5.70.5. Q—May receivables and payables arising from trade-date accounting be reported net?

A—No. Receivables and payables should be reported net only if there is a right of offset and offsetting is not prohibited by another financial reporting standard.

5.70.6. Q—A state has created a “window of opportunity” during which enhanced retirement benefits through the state’s cost-sharing multiple-employer pension plan may be offered by individual employers to encourage their employees to take early retirement. Employers are not required to participate in this initiative. Because of this, the cost of the additional benefits will be determined for each participating employer and will not affect the required contributions of employers that do not participate in the initiative. Each participating employer will make contributions—in addition to its regular contractually required contributions—with interest, in equal amounts over the next five plan years, with respect to its employees who elect to retire under the offer. Should the plan treat the additional contribution requirements as a contribution receivable pursuant to an installment contract? If so, should the entire estimated cost of the additional benefits be recognized as a receivable in the year that the employees accept the offer (and as a contribution for that year in the statement of changes in fiduciary net position)?

A—Yes. The pension plan should account for the additional contribution requirements as contributions receivable pursuant to an installment agreement (see paragraph 17 of Statement...
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67) and as additions (employer contributions) in full in the year in which the installment agreements with the employers become effective. Also, the plan should disclose the terms and outstanding balances of installment contracts. (See paragraph 30c of Statement 67.)

5.70.7. Q—A plan’s terms permit any active plan member to enter into an installment agreement with the plan for the purchase of certain service credits. If the member dies or otherwise terminates employment before all payments have been made under the installment agreement, the agreement is canceled and only the years actually paid for are credited. How should such installment agreements be reported?

A—Contributions receivable and additions to the plan’s fiduciary net position pursuant to an installment contract should be recognized in full in the year in which the contract is made. As with receivables in general, a plan may consider its past and projected experience with respect to contracts not completed as a basis for creating an allowance for cancellations, which would adjust the net book value of the receivable to its expected realizable value.

5.70.8. Q—Would the answer to Question 5.70.7 be different if no service credit is granted unless and until the member has paid for the entire service contract?

A—No. Accrual accounting would require the same treatment.

5.71 Investments

5.71.1. [Not used in GASBIG 2015-1]

5.71.2. [Not used in GASBIG 2015-1]

5.71.3. Q—How should the principal components of defined benefit pension plan investments be reported when almost all of the plan’s investments are in mutual funds or external investment pools, each of which invests in a cross section of investments? For example, should the plan report its share of each category of assets held by the various funds or pools—in effect “looking through” the funds or pools to the securities they hold?

A—The mutual funds or investment pools in which the plan invests should be categorized and displayed by type (for example, “Mutual Funds—Equities” and “State Treasury Investment Pool”). (See Question 1.3.2 in Chapter 1 for additional discussion of investment types.) There is no basis for “looking through” a mutual fund or investment pool to report the plan’s share of each category of assets held by the fund or pool. Moreover, the latter method of presentation could be misleading. For example, presenting a pro rata share of a pool’s bonds as an investment of a pension plan in bonds would imply that such investments have fixed maturities when, typically, the plan’s investment in the investment pool would have no maturity.

5.72 Liabilities

5.72.1. Q—Because benefit payments not yet due and payable are not recognized as plan liabilities, should plan liabilities, as reported in the financial statements, be limited to current liabilities?

A—No. Plan liabilities should include noncurrent liabilities other than those related to benefits. For example, a plan might have a mortgage loan or a liability under a long-term capital lease on the office building used for plan administration.
5.72.2. Q—Should amounts held pursuant to a deferred retirement option program (DROP) be reported by a defined benefit pension plan as a liability for benefits in the plan’s statement of fiduciary net position?

A—Paragraph 20 of Statement 67 requires that a defined benefit pension plan recognize a liability for benefits when the benefits currently are due and payable to a plan member. Therefore, only those amounts in the DROP accounts that are due and payable to the plan member at the plan’s reporting date should be reported as a liability in the pension plan’s statement of fiduciary net position. Within the context of a DROP, benefits generally would be due and payable only when they are required to be distributed to the plan member from the DROP account. Paragraph 30f of Statement 67 requires that the pension plan disclose the balance of amounts held pursuant to the DROP, as well as information describing the DROP terms, in notes to its financial statements.

5.73 Fiduciary net position

5.73.1. Q—Should assets credited to individual member accounts pursuant to a DROP be included in the fiduciary net position reported by the defined benefit plan?

A—Yes. One feature of a program that meets the definition of a DROP in paragraph 51 of Statement 67 is that individual member accounts pursuant to the program are held within the defined benefit pension plan, rather than in a separate plan. Therefore, assets associated with the DROP should be included in the fiduciary net position reported by the defined benefit pension plan. Paragraph 30f of Statement 67 requires that information about the DROP, including amounts held by the pension plan pursuant to the DROP, be disclosed in notes to the pension plan’s financial statements.

5.74 Statement of changes in fiduciary net position

5.74.1. Q—A PERS administers numerous defined benefit pension plans for state employees. These plans remit money to an investment pool for operating expenses of the pool. Also, movements of member account asset balances occur between plans when members change employment from one state department or agency to another and, thereby, from one plan to another. In the plan’s statement of changes in fiduciary net position, should an additional section, below the additions and deductions sections, be added for transfers? If not, how should these types of transactions be reported?

A—All changes in fiduciary net position should be reported either in the additions section or in the deductions section of the statement of changes in fiduciary net position. The term transfer implies activity internal to an entity, whereas, from the standpoint of Statement 67, each defined benefit pension plan is effectively a separate entity. Thus, for purposes of financial reporting under Statement 67, movements of resources between a defined benefit pension plan and any other plan, fund, government, company, or individual are external transactions, rather than transfers. With regard to the particular types of resource movements in question:

a. Those to an investment pool for operating expenses of the pool should be reported by the plan as investment expense.

b. Those that move member account asset balances from one pension plan to another may be reported as separate line items within the deductions and additions sections, respectively, of each plan’s statement of changes in fiduciary net position.
5.75 Additions

5.75.1. Q—Plan members have an arrangement with their employer that each pay period, the employer makes contributions to the pension plan to satisfy plan member contribution requirements. Should the pension plan classify the contributions received from the employer under this arrangement as employer contributions or plan member contributions?

A—If the contributions are recognized by the employer as salary expense, the pension plan should classify the contributions as plan member contributions. (Because the amounts are treated as plan member salaries by the employer, contributions paid from those salaries, whether transmitted by the plan member or by the employer, are plan member contributions.) If, instead, the employer does not include the amount of the contributions in salary expense, Statement 67 requires that the contribution be classified as an employer contribution to the pension plan. In both circumstances, the net effect on the employer’s compensation expense (salaries plus pensions) would be the same, and the employer’s net pension liability would be reduced by the amount of the contributions.

5.76 Investment Income

5.76.1. Q—May a defined benefit pension plan separately display (a) realized gains and losses on sales of investments during the reporting period and (b) unrealized gains and losses on investments?

A—No. The net increase (decrease) in the fair value of investments during the reporting period should be displayed as a single line item in the statement of changes in fiduciary net position. In fair value reporting, the increase (decrease) in an investment’s fair value is recognized as an addition to (deduction from) the plan’s fiduciary net position each reporting period. However, a realized gain or loss on an investment sold during a reporting period is the difference between the proceeds of the sale and the original cost of the investment. Thus, when an investment that has been held for more than one year is sold, the realized gain (loss) may include amounts that were recognized as increases (decreases) in prior periods.

The net increase (decrease) for any year may not be the sum of realized and unrealized gains (losses). Therefore, attempts to identify unrealized gains (losses) by calculating realized gains (losses) for a particular year and subtracting them from the net increase (decrease) for that year could produce an incorrect result.

Although realized gains and losses should not be displayed separately in the financial statement, disclosure of realized gains and losses is permitted in the notes to the financial statements, if disclosure also is made of both of the following, as required by Statement 67, paragraph 24:

a. That the calculation of the realized gains and losses disclosed is independent of the calculation of the net change in the fair value of pension plan investments reported in the financial statements
b. Realized gains and losses on investments sold in the current year that had been held for more than one year were included in investment income reported for a previous year or years (as part of the reported net increase or decrease for those years).

5.76.2. Q—is the net increase (decrease) in fair value required to be reported separately for each principal component of investments?
A—No. Plans may choose to compute the net increase (decrease) separately for each category of investments, but a single line item is all that is required for financial reporting.

5.76.3. Q—A pension plan chooses to separately display investment income in its statement of changes in fiduciary net position. Should the amortization of premium (discount) on bonds be included in the amount reported as interest income?

A—No. Interest income should be reported at the stated (or coupon) interest rate. If the stated rate is zero, no interest income should be reported for that bond. (Effectively, interest on a zero-coupon bond is reflected in the reported fair value and, therefore, in the reported net increase [decrease] in fair value.)

5.76.4. Q—In its reports to its investors, an investment company that offers pooled investment vehicles for pension plans reports all investment income as an increase (decrease) in investors’ accounts. Is this form of reporting acceptable for use by the pension plan in its financial statements?

A—Yes. Statement 67, paragraph 23, provides that a net increase (decrease) may be combined for financial reporting purposes with interest, dividends, and other investment income. In addition, paragraph 26 provides that investment-related costs should be reported as investment expense if they are separable from (a) investment income and (b) the administrative expense of the pension plan. Based on those provisions, because the income is reported to the plan net of related expense and, therefore, is not readily separable from investment income, a plan could comply with the requirements of Statement 67 with regard to reporting investment income using the form of reporting provided by the investment company.

5.77 Investment Expense

5.77.1. Q—What determines whether investment-related expenses that are included in general administrative expenses are readily separable and, thus, should be reported in the additions section of a plan’s statement of changes in fiduciary net position as part of investment expense in conformity with paragraph 26 of Statement 67? For example, should chief investment officer and investment staff salaries, payroll taxes for these, hardware and software purchases for those employees, and costs of subscriptions, data services, and supplies for them be reported as investment expense?

A—Statement 67 requires separate display of investment expense, including investment management and custodial fees and all other significant investment-related costs (paragraph 22d(2)). The purpose of this requirement is to help users of the pension plan’s financial statements assess both gross and net investment income. Paragraph 26 provides that investment-related costs should be reported as investment expense if they are separable from (a) investment income and (b) the administrative expense of the pension plan. For purposes of applying these paragraphs, each investment-related cost should be evaluated on its own merits. The cost associated with each of the examples given in the question (that is, salaries of the chief investment officer and of the investment staff, related payroll taxes, depreciation of software and hardware used by the investment staff, and subscriptions, data services, and supplies for the investment staff) is readily identifiable as an investment-related cost and should be reported as an investment expense.
5.77.2.  Q—Should the salary and fringe benefits of a plan employee whose time is allocated 50 percent to investments and 50 percent to general plan administrative duties be allocated between investment expense and administrative expense?

A—if the employee spends a significant portion of time on tasks related to investments, allocation to investment expense of a portion of salary and related costs for a plan employee is appropriate. In contrast, if a plan employee whose responsibilities are basically administrative spends only an insignificant or highly variable percentage of time on tasks that are investment related, so that the investment-related costs are not readily separable from general administrative expense, professional judgment should be used to determine whether to separately measure the cost of that person’s investment-related activities.

5.78  Deductions

5.79  Net increase (decrease) in fiduciary net position

5.80  Notes to Financial Statements

5.80.1.  Q—Does Statement 67 establish specific requirements for a defined benefit pension plan that is closed to new entrants?

A—The only requirement of Statement 67 that is specific to a closed plan is the requirement in paragraph 30a(4) that, if a pension plan is closed to new entrants, that fact should be disclosed. Apart from that provision, a defined benefit pension plan that is closed to new entrants is required to follow the same requirements as plans that are not closed.

5.81  Disclosures applicable to all defined benefit pension plans

5.82  Paragraph 30a

5.83  Paragraph 30b

5.84  Investment Policies

5.85  Fair Value of Investments

5.86  Investment Concentrations

5.86.1.  Q—Paragraph 30b(3) of Statement 67 requires pension plans to identify investments in any one organization that represent 5 percent or more of the pension plan’s fiduciary net position. Do the requirements of paragraph 11 of Statement 40 for governments to provide information about the concentration of credit risk associated with their investments by disclosing, by amount and issuer, investments in any one issuer that represent 5 percent or more of total investments also apply to pension plans?

A—Yes. The focus of the two disclosures is different, and a pension plan should include both, if applicable. The disclosure requirement of Statement 40 is limited to concentrations of credit risk—a notion associated with the risk of loss on fixed-income investments if a creditor or other counterparty fails to meet its obligations to repay. The requirement in paragraph 30b(3) of Statement 67 is broader—that is, concentrations of investments.

5.86.2.  Q—How should investments in mutual funds be viewed in relation to the requirement in Statement 67, paragraph 30b(3), to disclose investments in any one organization that represent
5 percent or more of the pension plan’s fiduciary net position? For example, is a mutual fund, or a bank that sponsors mutual funds, an organization, as the term is used in that paragraph, to which the 5 percent criterion applies?

A—Mutual funds diversify investments among organizations. Therefore, for purposes of the requirements of Statement 67, paragraph 30b(3), the 5 percent test need not be applied to a mutual fund.

5.87 Money-Weighted Rate of Return on Pension Plan Investments

5.87.1. Q—For purposes of determining the money-weighted rate of return on pension plan investments, should the beginning and ending values of investments that are used as the basis for the calculation equal the amounts reported in the investments line item in the pension plan’s statements of fiduciary net position?

A—Generally, no. For purposes of determining the money-weighted rate of return on pension plan investments, investments should include cash, investments, and other investment-related balances, such as receivables for investment income, receivables to/payables from brokers for unsettled trades, and assets/liabilities associated with securities lending cash collateral. (See nonauthoritative Appendix B5-2, Illustration 3, for an example of the determination of beginning and ending pension plan investment balances using amounts reported in a pension plan’s financial statements for purposes of calculating the money-weighted rate of return.)

5.87.2. Q—What should be considered an investment expense for purposes of the calculation of the annual money-weighted rate of return?

A—Similar to the manner in which investment expense is defined for financial statement recognition purposes, for purposes of calculating the money-weighted rate of return on pension plan investments, investment expense should include, to the extent separable from investment income and the administrative expense of the pension plan, investment management fees, custodial fees, and other significant investment-related costs. Within the context of calculating the money-weighted rate of return, investment expense should include such fees and costs that are associated with the types of assets and liabilities that are discussed in Question 5.87.1, whether or not those items are reported as investments in the pension plan’s statement of fiduciary net position.

5.87.3. Q—Should cash flows associated with investment expense be included in the calculation of the money-weighted rate of return on pension plan investments?

A—No. In the calculation of the money-weighted rate of return on pension plan investments, the beginning and ending values of investments reflect the effects of net investment income, which includes the effect of investment expense. (See Illustration 3 in nonauthoritative Appendix B5-2.) Accordingly, cash flows for transactions associated with investment expense should not be included in the measures of the periodic external cash flows used to determine the money-weighted rate of return.

5.87.4. Q—Should the money-weighted rate of return be calculated net of pension plan administrative expense?

A—No. Consistent with the measure of the long-term expected rate of return required by paragraph 44 of Statement 67, the money-weighted rate of return for purposes of that
Statement should be determined net of investment expense but not net of pension plan administrative expense. Therefore, cash flows associated with transactions included in pension plan administrative expense, along with all other noninvestment-related cash flows, should be included in the measures of the periodic external cash flows used to determine the money-weighted rate of return.

5.87.5. Q—For purposes of determining the money-weighted rate of return on pension plan investments, if external cash flows are determined monthly, how should those cash flows be weighted?

A—The plan should use a cash flow weighting methodology that is representative of the pattern of the plan’s external cash flows. Depending on the timing of the cash flows throughout the month, weighting methodologies could include, for example, beginning of the month (1.0 weight), middle of the month (0.5 weight), and end of the month (zero weight).

5.92 Disclosures specific to single-employer and cost-sharing multiple-employer pension plans

5.92.1. Q—In a defined benefit pension plan’s financial statements for the fiscal year ended June 30, 20X4, is the plan’s most recent fiscal year-end, as referred to in paragraph 31 of Statement 67, the fiscal year ended June 30, 20X4, or the fiscal year ended June 30, 20X3?

A—For purposes of application of Statement 67 to the plan in this question, the plan’s most recent fiscal year-end is June 30, 20X4. Therefore, for example, the information required by paragraph 31 about the net pension liability should relate to the net pension liability measured as of June 30, 20X4.

5.97 Single-employer and cost-sharing multiple-employer pension plans

5.97.1. Q—Within a single-employer plan, multiple tiers of benefits have been created such that each tier provides different benefits (for example, through different salary multipliers or different vesting schedules) to plan members hired between certain dates. Separate actuarial valuations are performed to establish the employer’s annual contributions for plan members in each tier. Is the pension plan required to present separate schedules of RSI with information about the employer’s obligations relative to plan members in each tier?
A—No. The pension plan is required to present schedules of RSI for the plan as a whole. RSI is limited to information specifically required. Therefore, the plan should not present the schedules of RSI by tier.

5.97.2. Q—A cost-sharing multiple-employer pension plan covers only volunteer firemen. The volunteers are not paid a salary. Therefore, there is no covered-employee payroll. How does this affect requirements for presentation of information in schedules of RSI about measures of the net pension liability and contributions in relation to covered-employee payroll?

A—The requirements of Statement 67, paragraphs 32b and 32c, for ratios that present the net pension liability and contributions, respectively, as a percentage of covered-employee payroll would not be applicable for this plan. Therefore, those ratios should not be presented in the RSI schedules.

5.97.3. [Not used in GASBIG 2015-1]

5.98 Paragraph 32a

5.98.1. Q—If part of the total service cost for pensions provided through a single-employer defined benefit plan is identified as being paid by the plan members through their annual contribution requirement, should the amount presented in the schedule of changes in the net pension liability be only the portion of the total service cost that is required to be paid by the employer?

A—No. Paragraph 51 of Statement 67 defines service cost as “the portion of the actuarial present value of projected benefit payments that is attributed to a valuation year.” The actuarial present value of projected benefit payments generally would not include a reduction for expected plan member contributions. Therefore, the amount presented as service cost in each year in the schedule of changes in the net pension liability should be the total service cost of the period.

5.98.2. Q—For a plan’s fiscal year ended June 30, 20X5, can the portion of the change in the net pension liability attributable to service cost be calculated based on the results of the actuarial valuation used to determine the net pension liability reported at June 30, 20X4?

A—Yes. Use of a service cost measure based on the results of the actuarial valuation that determined the beginning net pension liability for the reporting period is consistent with the requirement to calculate interest on the total pension liability over the period. Interest on service cost should be included in the amount reported as interest on the total pension liability. (See Question 5.98.3.)

5.98.3. Q—If the approach described in Question 5.98.2 is used to determine the service cost reported in the schedule of changes in the net pension liability for the pension plan’s fiscal year ended June 30, 20X5, should the amounts identified as interest on the total pension liability be calculated on the beginning total pension liability, adjusted for service cost and actual benefit payments (including refunds of plan member contributions), or should projected benefit payments from the actuarial valuation that is used to determine the service cost be used for purposes of the adjustment?

A—Interest on the total pension liability should be determined based on the beginning total pension liability, adjusted for service cost and actual benefit payments. Because the actual amounts of benefit payments and contributions are components of the total change in the
plan’s fiduciary net position, it would be consistent to use actual amounts to determine other components of the change in the net pension liability, including the changes in the total pension liability resulting from benefit payments and interest on the total pension liability.

5.98.4. **Q**—How should the effects of an ad hoc COLA granted to retirees be classified in the schedule of changes in the net pension liability if the effects of the COLA were not included in the present value of projected benefit payments as of the pension plan’s prior fiscal year-end because the COLA was not determined to be substantively automatic?

**A**—An ad hoc COLA that is determined not to be substantively automatic is a form of postemployment benefit change. Therefore, the effects of such an ad hoc COLA should be classified as a change of benefits in the schedule of changes in the net pension liability.

5.98.5. **Q**—The effects of a COLA that was determined to be substantively automatic were included in the present value of projected benefit payments in the total pension liability as of the pension plan’s prior fiscal year-end. The COLA was not provided in the current fiscal year. At the plan’s current fiscal year-end, the COLA still is determined to be substantively automatic. In this circumstance, how should the effects on the total pension liability that result from not providing the COLA be classified in the schedule of changes in the net pension liability of the employers and nonemployer contributing entities?

**A**—The effects on the total pension liability that result from not providing the COLA should be classified as a difference between expected and actual experience.

5.98.6. **Q**—Would the answer to Question 5.98.5 be different if, at the current fiscal year-end, the COLA is no longer considered to be substantively automatic?

**A**—No. The effects on the total pension liability that result from the COLA not being provided in the current period should be classified as a difference between expected and actual experience, even if the COLA is determined to no longer be substantively automatic at the plan’s current fiscal year-end. The reclassification of the COLA as ad hoc rather than as substantively automatic is a separate event, and the effects of that reclassification on the total pension liability should be classified as a change of benefit terms.

5.98.7. **Q**—If the terms of a defined benefit pension plan are amended and a change of assumption is made as a direct result of the amendment, should the effect of the change of assumption on the total pension liability be included with the effect of the change of benefit terms in the schedule of changes in the net pension liability?

**A**—Yes. Although, generally, the effect of a change of assumption on the total pension liability should be separated from the effect of a change of benefit terms, in circumstances in which the change of assumption is adopted as a direct result of the change of benefit terms, the effect of the change of assumption should be classified as a component of the change of benefit terms for purposes of presentation of changes in the net pension liability by source. For example, if the mandatory retirement age in a plan is modified, changes of assumptions about the retirement ages of active plan members that are made to adjust for the change of benefit terms would be directly related to the benefit change. Although mathematically separable, if the change of assumptions would not have occurred in the absence of the change of benefit terms, the change of assumptions is, in substance, a component of the change of benefit terms, and the effects of the change should be classified in the schedule of changes in the net pension liability as a change of benefit terms. In contrast, if, at the same actuarial valuation date, a
change is made to mortality assumptions based on the results of a recent experience study and mortality rates are not associated with retirement age, the effect of the change of mortality assumption would not be directly related to the change of benefit terms and should be classified as a change of assumption in the schedule of changes in the net pension liability.

5.98.8. Q—If a pension plan purchases an allocated insurance contract that meets the criteria in paragraph 19 of Statement 67, how should the effects on the components of the net pension be classified in the schedule of changes in the net pension liability?

A—The amount paid for the purchase of an allocated insurance contract should be classified as a reduction of the pension plan’s fiduciary net position, as well as a reduction of the total pension liability, due to benefit payments. In addition, if there is a difference between the amount recognized as a benefit payment by the pension plan and the amount of the actuarial present value of projected benefit payments that is removed from the total pension liability as a result of the purchase, that amount should be classified as a difference between expected and actual experience in the schedule of changes in the net pension liability.

5.99 Paragraph 32b

5.100 Paragraph 32c

5.100.1. Q—If a contribution rate for the period from July 1, 20X2, to June 30, 20X3, is adopted at October 31, 20X1, based on the results of an actuarial valuation as of June 30, 20X1, should the resulting actuarially determined contribution be reported in the schedule of contributions for the plan’s fiscal year ended June 30, 20X2, or June 30, 20X3?

A—The actuarially determined contribution is an amount determined based on the most recent measurement available when the contribution for the reporting period was adopted. Therefore, in this example, assuming that the results of the June 30, 20X1 actuarial valuation are the most recent results available as of October 31, 20X1, amounts based on those results should first be presented in the contribution schedule required by paragraph 32c for the plan’s fiscal year ended June 30, 20X3.

5.100.2. Q—If an actuarially determined contribution is calculated for an employer’s fiscal year and the plan’s fiscal year does not coincide with the fiscal year of the employer, what amount should be reported in the contribution-related schedule required by Statement 67, paragraph 32c?

A—The amount reported in the contribution schedule required by paragraph 32c should be the amount that is applicable to the plan’s fiscal year for which the information is being reported. Therefore, if the actuarial determined contribution is not calculated for the plan’s fiscal year, it would be determined as the aggregate of the employer’s actuarially determined contributions for the portions of the employer’s fiscal years that overlap the plan’s fiscal year. For example, a plan’s fiscal year is from July 1 to June 30, and the employer’s fiscal year is from January 1 to December 31. The actuarially determined contribution applicable to the plan’s fiscal year ended June 30, 20X7, would be the actuarially determined contribution for the last six months of the employer’s fiscal year 20X6 (because that fiscal year overlapped the first six months of the plan’s fiscal year), plus the actuarially determined contribution for the first six months of the employer’s fiscal year 20X7 (because that fiscal year overlapped the last six months of the plan’s fiscal year).
5.100.3. Q—Should the schedule of contribution-related information required by paragraph 32c of Statement 67 include information for the year between actuarial valuations if actuarially determined contributions are calculated biennially?

A—Yes. The actuarially determined contribution for the period between actuarial valuations should be reported, using the results of the actuarial valuation that established the contribution applicable to that period.

5.100.4. Q—What actuarial methods and assumptions should be used to calculate the actuarially determined contribution reported in conformity with the requirements of paragraph 32c?

A—For purposes of applying the requirements of paragraph 32c, an actuarially determined contribution is defined, in part, as a contribution calculated in conformity with Actuarial Standards of Practice. That is, a calculation that applies relevant guidance from Actuarial Standards of Practice, for example, standards related to the selection of economic or demographic assumptions. Statement 67 does not establish requirements for the specific methods and assumptions used to calculate an actuarially determined contribution.

5.100.5. Q—If a pension plan uses an actuarial value of assets that incorporates differences between projected and actual earnings on pension plan investments over a three-year period for purposes of determining contribution requirements of employers that provide pensions through the plan, can the plan continue to use that method after implementation of Statement 67?

A—Yes. Statement 67 does not establish requirements for the specific methods and assumptions, if any, used for funding purposes. Therefore, an actuarial value of assets can continue to be used for funding purposes. However, for purposes of complying with Statement 67, all changes in plan net position, including the full amount of the actual earnings on pension plan investments, should be included in the calculation of the net pension liability and changes in the net pension liability in the reporting period in which they occur.

5.100.6. Q—Paragraph 50 of Statement 67 states that schedules of RSI “should not include information that is not measured in accordance with the requirements of this Statement.” Does that mean that information about actuarially determined contributions should be presented only if it is calculated using the same methods and assumptions as are required to be applied for purposes of measuring the net pension liability?

A—No. As noted in Question 5.100.4, an actuarially determined contribution is defined, in part, as a contribution calculated in conformity with Actuarial Standards of Practice; however, Statement 67 does not establish requirements for the specific methods and assumptions that are used to calculate an actuarially determined contribution. Therefore, if calculated, the pension plan should present measures of actuarially determined contributions, regardless of the methods and assumptions used to calculate them.

5.100.7. Q—Should contributions recognized by a cost-sharing pension plan for amounts payable to the plan by an employer pursuant to an installment contract for the amount of an employer’s unfunded past service liability when it entered the plan be included in the amount reported by the plan as contributions in relation to the actuarially determined contribution?

A—No. The installment contract is an example of an individual employer’s separately financed liability to the pension plan. The measure of the actuarially determined contribution that is required by paragraph 32c(1) of Statement 67 excludes amounts, if any, to separately finance
specific liabilities of an individual employer or nonemployer contributing entity to the pension plan. Similarly, the amount of contributions recognized during the fiscal year by the pension plan in relation to the actuarially determined contribution should exclude amounts recognized as additions to the pension plan for separately financed specific liabilities of an individual employer or nonemployer contributing entity to the pension plan.

5.100.8. Q—When actuarially determined contribution rates are calculated for the employer in a single-employer pension plan and a nonemployer contributing entity, should the schedule of RSI that presents actual contributions as compared to actuarially determined contributions (paragraph 32c of Statement 67) include amounts for the nonemployer contributing entity?

A—Yes. If an actuarially determined contribution is calculated for both the employer and a nonemployer contributing entity, the contribution-related information in the schedule should present the aggregated totals for the employer and nonemployer contributing entity. In that case, Statement 67, paragraph 32c, indicates that the schedule should identify that the information includes amounts related to both the employer and the nonemployer contributing entity.

5.100.9. Q—May plan member contributions be added to the RSI schedule that presents contributions made as compared to actuarially determined contributions (paragraph 32c of Statement 67)?

A—No. Including plan member contributions in the schedule could obscure information about employer or nonemployer contributing entity contribution decisions. Instead, plan member contribution rates (in dollars or as a percentage of covered payroll) should be disclosed in the notes to the financial statements of all types of defined benefit pension plans—single-employer, agent multiple-employer, and cost-sharing multiple-employer—as required by Statement 67, paragraph 30a(6).

5.100.10. Q—The dollar amount of an employer’s actuarially determined contribution is calculated based on the projected covered payroll for the year to which the contribution will apply. An actuarially determined contribution rate, expressed as a percentage of the projected covered payroll also is calculated. The employer contributes based on that actuarially determined contribution rate, applied to its actual covered payroll, which frequently is not the same as the projected covered payroll. Thus, the dollar amount of employer contributions may differ from the dollar amount of the actuarially determined contribution that is calculated because of the difference between projected and actual covered payrolls. Which amount should be reported as the actuarially determined contribution in the plan’s schedule of contribution-related information required by paragraph 32c?

A—The intent of the schedule required by paragraph 32c is to provide information to allow a reader to evaluate the degree to which employers and nonemployer contributing entities are meeting actuarially determined financing requirements. Therefore, the actuarially determined contribution and the amount of contributions recognized by the plan in relation to that contribution should be presented on a comparable basis. Thus, for this schedule, the dollar amount of the actuarially determined contribution should be adjusted, if necessary, so that the amount reported is based on the same measure of payroll as the contributions recognized as additions in the pension plan’s statement of changes in fiduciary net position. (See Illustration 4 in nonauthoritative Appendix B5-2 for an example.)
5.106.1. Q—In a single-employer pension plan with a June 30 fiscal year-end, actuarial valuations are obtained annually as of December 31. To meet the requirement of paragraph 35 of Statement 67 that the net pension liability reported in the pension plan’s notes to financial statements and schedules of RSI be measured as of the pension plan’s most recent fiscal year-end, each reporting period, the results from the mid-year actuarial valuation are updated to June 30. Are there specific procedures that are required for an update for financial reporting purposes?

A—No. Statement 67 does not establish specific procedures for this purpose. Therefore, professional judgment should be applied to determine the extent of procedures necessary to faithfully represent the total pension liability as of the pension plan’s fiscal year-end. In all circumstances, the total pension liability should include all significant effects of transactions and other events between the actuarial valuation date and the pension plan’s fiscal year-end. In some circumstances, for example, if there are few differences between expected and actual experience, no changes in benefit terms, and no circumstances suggesting that a significant change of assumption is needed, it might be reasonable to roll forward the results of the mid-year actuarial valuation to the plan’s fiscal year-end with few adjustments. However, in other circumstances, more significant adjustments might be necessary to update the results of the mid-year actuarial valuation to the plan’s fiscal year-end. (See Question 5.106.2 for examples of events that might result in a significant change.) The Statement also requires that in evaluating the extent of procedures necessary to update the measure to the pension plan’s fiscal year-end, among the factors that should be considered is whether a new actuarial valuation is needed for this purpose.

5.106.2. Q—What are some examples of transactions or other events that can occur between the actuarial valuation date and the pension plan’s fiscal year-end that might have a significant effect on the total pension liability?

A—A change in the total pension liability can arise from a single factor or a combination of factors. Some examples of circumstances that might have a significant effect on the total pension liability include a change of benefit terms, a change in the size or composition of the covered group, a change in the municipal bond yield or index rate component of the discount rate, and a change in the pension plan’s fiduciary net position such that the discount rate used in the calculation of the total pension liability is impacted.

5.106.3. Q—When a single-employer or cost-sharing multiple-employer pension plan has biennial actuarial valuations, does Statement 67 require an update in the intervening year for financial reporting purposes?

A—Yes. Statement 67 requires that information presented in notes and in schedules of RSI about the net pension liability for benefits provided through a single-employer or cost-sharing
multiple-employer pension plan be measured as of the end of the pension plan’s fiscal year. That requirement can be met through the use of the results of an actuarial valuation as of the plan’s fiscal year-end or through the use of update procedures to roll forward the results of an actuarial valuation performed as of a date no earlier than 24 months prior to the fiscal year-end of the pension plan. For plans, if update procedures are used and significant changes in, for example, benefits, the covered population, or other factors affecting the valuation results have occurred between the actuarial valuation date and the pension plan’s fiscal year-end, professional judgment should be used to determine the extent of the procedures needed to roll forward the measurement of the total pension liability, and consideration should be given to whether a new actuarial valuation is needed.

5.107 Projection of benefit payments

5.107.1. Q—The amount of a defined benefit pension is determined based on a plan member’s years of service and final three-year average pay. The calculation of pay for this purpose includes the plan member’s base salary and overtime pay. Should the projection of benefit payments include an assumption about overtime pay?

A—Yes. In this circumstance, overtime pay should be considered in the projection of benefit payments. Paragraph 39 of Statement 67 requires that the projection of benefit payments include all benefits to be provided to the plan member in accordance with the benefit terms. That paragraph further specifically requires that the effects of projected salary changes be included in the projection of benefit payments in circumstances in which the pension formula incorporates future compensation levels. Although not part of the plan member’s base salary, the pension formula establishes overtime compensation as a relevant factor in determining the amount of a plan member’s pension. Therefore, consistent with the requirements of paragraph 39, the projected impact of future overtime compensation on the benefit payments that will be made to the plan member should be included in the measure.

5.107.2. Q—A defined benefit pension plan’s enabling statute provides for a COLA if the investment earnings rate for the plan’s fiscal year exceeds the actuarially assumed rate. Should this COLA be treated as an automatic COLA?

A—Yes. Paragraph 39 of Statement 67 requires that the effects of any COLAs that are embedded in the benefit terms and for which there is no discretion as to timing or amount be included in the projection of future benefit payments. In this example, although a certain economic condition is required to be met for the COLA to be effective, if that condition is met, there is no discretion regarding whether the COLA will be granted.

5.107.3. Q—A defined benefit pension plan’s enabling statute provides that the board of trustees can annually authorize a COLA not to exceed a specified percentage increase or the change in the price index, whichever is lower. The maximum allowable COLA has always been authorized. Should the effects of this COLA provision be included in the projection of future benefit payments?

A—This COLA is not automatic because approval of the board of trustees is required to authorize the benefit increase. Therefore, the effects of the COLA provision should be included in the projection of future benefit payments only if the provision is evaluated to be substantively automatic. Footnote 14 of Statement 67 identifies some of the factors that might be relevant in making this determination—the historical pattern of granting the changes, the consistency in
the amounts of the changes or in the amounts of the changes relative to a defined cost-of-living
or inflation index, and whether there is evidence to conclude that changes might not continue to
be granted in the future despite what might otherwise be a pattern that would indicate such
changes are substantively automatic. If, after evaluation, the COLA is determined not to be
*substantively automatic*, the projected effects of future COLAs should not be included in the
measurement. In the latter case, the increased benefits should be included in the measurement
of the total pension liability as of the first plan fiscal year-end at which the COLA has been
granted and the amount is known or reasonably estimable.

5.107.4. Q—A collective-bargaining agreement that includes a provision for a postemployment benefit
increase has been made prior to the pension plan’s fiscal year-end. However, the increase
does not go into effect until the next fiscal year. Should the increase in projected benefit
payments as a result of this agreement be included in the measurement of the total pension
liability?

A—Yes. The actuarial present value of projected benefit payments should include benefits to
be provided pursuant to a contractual agreement, including a collective-bargaining agreement,
that is in effect at the plan’s fiscal year-end. In other words, the issue is whether the agreement
is in effect at that date, not whether the benefits included in the agreement will begin to accrue
or begin to be paid by that date.

5.107.5. Q—A collective-bargaining agreement that includes an agreement for a postemployment
benefit increase has been made after the plan’s June 30, 20X5 fiscal year-end (the
measurement date of the net pension liability) but before the completion of the June 30, 20X5
actuarial valuation. Should the increase in projected benefits as a result of this agreement be
included in the measurement of the total pension liability presented in the plan’s June 30, 20X5
financial report?

A—No. Paragraph 39 of Statement 67 requires that projected benefit payments include “all
benefits to be provided to current active and inactive plan members through the pension plan in
accordance with the benefit terms and any additional legal agreements to provide benefits that
are in force at the pension plan’s fiscal year-end.” Because the agreement was not in effect at
the plan’s June 30, 20X5 fiscal year-end, the effect of the increased benefits should not be
included in the total pension liability reported by the plan at that date.

5.108 Discount rate

5.108.1. Q—If the actuarial valuation date is earlier than the plan’s fiscal year-end and the long-term
expected rate of return assumption remains the same at the pension plan’s fiscal year-end as it
was at the actuarial valuation date, does the discount rate have to be evaluated for significant
changes between the actuarial valuation date and the plan’s fiscal year-end?

A—Yes. A change in the discount rate can occur due to factors other than a change in the long-
term expected rate of return. For example, a change in the municipal bond yield or index rate (if
used in the determination of the discount rate) or a change in the projected fiduciary net
position of the pension plan that affects the relative weighting of the long-term expected rate of
return and the municipal bond yield or index rate can affect the discount rate. Therefore, these
and other factors, if applicable, should be considered when evaluating whether changes have
occurred that should be reflected in the total pension liability at the pension plan’s fiscal year-
end, either through update procedures or through a new actuarial valuation. (See Question
5.106.1 for a discussion of update procedures.)
5.109 Comparing Projections of the Pension Plan’s Fiduciary Net Position to Projected Benefit Payments

5.109.1. Q—An employer has an actuarially determined contribution rate and has a written policy of contributing the actuarially determined rate each period. The employer has consistently adhered to its policy for the past 10 years, and there are no known events or conditions that indicate that the employer will not continue to adhere to its policy in the future. In this circumstance, for purposes of determining the discount rate, how would the amount of projected employer contributions that should be included in the projection of the pension plan’s fiduciary net position be determined?

A—In this circumstance, the actuarially determined contribution rate of the employer would be used as the basis for the projection of future employer contributions. Future employer contributions based on the actuarially based funding method should be evaluated to determine the extent to which they are associated with the service costs of future plan members. The portion of future contributions that is associated with the service costs of future plan members would be excluded from the projection of the pension plan’s fiduciary net position, which would be compared to projected future benefit payments for current active and inactive plan members to determine whether and, if so, to what extent the municipal bond yield or index rate should be reflected in the discount rate.

5.109.2. Q—If the benefit payments in a period are projected to be partially covered by the pension plan’s projected fiduciary net position, should the covered portion be discounted using the long-term expected rate of return on pension plan investments, with only the remainder discounted at the required municipal bond yield or index rate?

A—Paragraphs 41 and 44 of Statement 67 require that projected benefit payments for a period be compared to the pension plan’s projected fiduciary net position in the period for purposes of determining whether the long-term expected rate of return or the municipal bond yield or index rate should be used to discount the benefit payments of the period when determining the discount rate. The Statement does not require that a specific approach be used to assign the total of the projected benefit payments in each period to the projected “funded” and “unfunded” categories. Therefore, the total of the benefit payments that are projected to occur in a period during which the pension plan’s fiduciary net position is projected to not be sufficient to make those benefit payments may be divided into projected “funded” and “unfunded” portions or the entire total may be classified as “unfunded.”

5.109.3. Q—Paragraph 43 of Statement 67 indicates that, if the results are sufficiently reliable, any approach to evaluating the sufficiency of the pension plan’s projected fiduciary net position to make projected benefit payments can be used in place of the projections of cash flows that are described in paragraphs 41 and 42 of the Statement. Is a specific method contemplated?

A—No. The determination of whether the results of an alternative approach to making the evaluation required in paragraph 41 are sufficiently reliable for this purpose is subject to professional judgment.

5.110 Calculating the Discount Rate

5.110.1. Q—As of what date should the long-term expected rate of return and the municipal bond yield or index rate that are used to establish the discount rate be determined—the valuation date or the pension plan’s fiscal year-end?
A—The long-term expected rate of return on pension plan investments is an assumption, and assumptions generally are not required to be updated between actuarial valuation dates unless there is an indication that the assumption is no longer valid. Therefore, the expectation developed as of the actuarial valuation date can be used at the pension plan’s fiscal year-end unless it is determined to no longer be appropriate. In contrast, the municipal bond yield or index rate is not an assumption and should be determined as of the pension plan’s fiscal year-end. If the actuarial valuation to determine the total pension liability is performed earlier than the pension plan’s fiscal year-end, consideration should be given to changes in the municipal bond yield or index rate, along with other factors that potentially affect the discount rate, such as the pension plan’s fiduciary net position, to evaluate whether those factors would result in changes that should be reflected in the total pension liability at the pension plan’s fiscal year-end, either through update procedures or through a new actuarial valuation. (See Question 5.106.1 for a discussion of update procedures.)

5.111 Attribution of the actuarial present value of projected benefit payments to periods

5.111.1. Q—In what way are multiple exit ages considered in the attribution of the actuarial present value of projected benefit payments to periods for financial reporting purposes?

A—Generally, the end point of the attribution period would not be a single age or single date. Rather, assumptions are made as to when plan members will exit from active service. Examples of events that might result in a plan member’s exit from active service are the termination of employment, incurrence of a disability, retirement, and death. Assumptions about events that result in exit from active employment are expressed as the probability of the occurrence of the triggering event based on, for example, the plan member’s age or number of years of service. These probabilities are applied to all projected ages/years of service of a plan member, resulting in multiple exit ages for each plan member.

5.111.2. Q—If a plan member in a single-employer plan is inactive but is expected to return to work for the employer, should the attribution period for the plan member extend over expected future years of service?

A—Yes, generally an inactive plan member that is expected to return to service would be assumed to have exit ages that extend through future periods. Therefore, to meet the requirement of paragraph 46d of Statement 67, the attribution period generally should extend through the plan member’s assumed retirement age. If, however, the plan member is classified as inactive because of the plan member’s participation in a program that meets the Statement 67 definition of a DROP, paragraph 46d requires that the date of entry into the DROP be considered the plan member’s retirement date (and hence, the end of the attribution period).

5.111.3. Q—If benefit terms include a cap on plan members’ service credit that is not part of a DROP, should a portion of the actuarial present value of projected benefit payments be attributed to only those periods in which a plan member is expected to earn service credit, or should the attribution period include all periods within a plan member’s projected working lifetime?

A—The exchange of benefits for services generally is viewed as related to a plan member’s entire career. Therefore, the attribution period should include all periods of a plan member’s projected service for an employer that provides benefits through the pension plan, regardless of whether additional service credit is expected to be earned.
5.112 Statistical Section Information

For additional information about the presentation of statistical section information, see paragraph 15.

5.112.1. Q—For purposes of presenting supplementary information about principal participating employers as required by paragraph 39c of Statement No. 44, Economic Condition Reporting: The Statistical Section, should a primary government and its component units be listed as separate employers?

A—No. Information about principal participating employers in a pension plan’s statistical section should present a primary government and its component units as one employer, consistent with the requirement of paragraph 8 of Statement 67.

5.113 Defined Contribution Pension Plans

5.113.1. Q—Statement 67 addresses financial statement display as well as disclosures for defined benefit pension plans, but only disclosures for defined contribution pension plans. Does this mean that financial statements for defined contribution pension plans are not required?

A—No. Defined contribution pension plans should follow the disclosure requirements of Statement 67, as well as all other accounting and financial reporting requirements applicable to transactions and other events reported in their basic financial statements, including notes to those statements, and RSI. Those requirements include the provisions of paragraphs 106–109 of Statement 34, as amended, which discuss the required financial statements for fiduciary funds—a statement of fiduciary net position and a statement of changes in fiduciary net position.

5.114 Effective Date and Transition

5.114.1. Q—if comparative financial statements are presented, should the financial statements for the prior year be restated?

A—Yes, if it is practical to do so. If it is not practical to restate the financial statements for the prior year, the reason for not restating prior periods should be explained in notes.

5.114.2. Q—at the beginning of the initial period of implementation of Statement 67, a defined benefit pension plan has a balance of $750,000 of receivables for employer contributions due pursuant to formal commitments. Because Statement 67 does not permit the recognition of receivables based solely on formal commitments, the plan “derecognizes” those receivables. The plan makes no other changes to amounts recognized in its financial statements to comply with the requirements of Statement 67. The plan does not present comparative financial statements. How should the change be reported in the pension plan’s financial statements?

A—Paragraph 49 of Statement 67 requires that changes made to comply with Statement 67 be treated as an adjustment of prior periods. Therefore, the pension plan in this question should reduce its beginning fiduciary net position by $750,000—the cumulative effect of applying the Statement. The plan also should disclose the nature of the restatement and its effect.

5.114.3. Q—in the initial year of implementation, is a single-employer or cost-sharing multiple-employer pension plan required to present a schedule of changes in the net pension liability?
A—Yes. The schedule is required and should present at least one year of information, including information about the net pension liability as of the beginning of the fiscal year, in order to present changes in the net pension liability during the initial year of implementation. If information is not available to present the additional nine years of historical information calculated in conformity with the requirements of Statement 67 at transition, the plan should present information in the schedule for as many years as are available. If this approach is used, additional years should be added prospectively, until 10 years of information is available.

5.114.4. Q—A single employer pension plan intends to have annual actuarial valuations for purposes of determining the net pension liability information required to be presented in its financial statements. On an ongoing basis, the plan intends to base the measurement of the net pension liability on an actuarial valuation performed as of the end of the prior fiscal year, updated to the end of the current fiscal year. In the initial year of implementation (the pension plan’s fiscal year ended June 30, 2014), can the results of the June 30, 2013 actuarial valuation be used as the basis for determining the total pension liability at both July 1, 2013, and June 30, 2014?

A—Yes. Use of the results of an actuarial valuation as of June 30, 2013, for purposes of determining the total pension liability as of the pension plan’s June 30, 2014 fiscal year-end would be consistent with the timing requirements of paragraph 37 of Statement 67. That is, the actuarial valuation date would be within 24 months of the pension plan’s fiscal year-end. Therefore, the same actuarial valuation can be used to determine the total pension liability as of the beginning and as of the end of the initial year of implementation, provided that amounts reported as of the end of the plan’s fiscal year are updated to June 30, 2014, to include the significant effects of transactions and other events that occur during the year.

5.114.5. Q—A single-employer pension plan intends to have annual actuarial valuations for purposes of determining the net pension liability information required by Statement 67 to be presented in its financial report. On an ongoing basis, the plan intends to base the measurement of the net pension liability on an actuarial valuation performed as of the end of its fiscal year. In the initial year of implementation (the pension plan’s fiscal year ended June 30, 2014), can the results of the June 30, 2014 actuarial valuation be used as the basis for determining the total pension liability at both July 1, 2013, and June 30, 2014?

A—Yes. Use of the results of an actuarial valuation as of the plan’s fiscal year-end would be consistent with the timing requirements of paragraph 37 of Statement 67. Therefore, the same actuarial valuation can be used to determine the total pension liability as of the beginning and as of the end of the initial year of implementation, provided that the rollback of the amounts to the beginning of the plan’s fiscal year reflect the significant effects of only transactions and other events that occurred to that date.

5.115 Statement 68

5.116 Scope and Applicability of Statement 68

5.116.1. Q—A single or agent employer provides pensions to its employees through a defined benefit pension plan that is administered through a trust that has the characteristics identified in paragraph 4 of Statement 68. The employer does not have a special funding situation (as defined by paragraph 15 of Statement 68) and does not have a payable to the pension plan. If there is no requirement that the employer make contributions to the plan, does Statement 68 apply to the employer?
A—Yes. If the single or agent employer provides benefits to its employees through a defined benefit pension plan that is administered through a trust (or equivalent arrangement) in which contributions to the pension plan from employers and nonemployer contributing entities and earnings on those contributions are irrevocable; pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms; and pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, the pension plan administrator, and plan members, an employer that does not have a special funding situation should follow the provisions of paragraphs 18–47 of Statement 68 for pension liabilities to employees.

5.116.2. Q—If the single or agent employer in Question 5.116.1 has a special funding situation, does Statement 68 apply to the employer?

A—Yes. Regardless of whether the single or agent employer in Question 5.116.1 has a special funding situation, if the employer provides pensions through a defined benefit pension plan that is administered through a trust (or equivalent arrangement) that has the characteristics identified in paragraph 4 of Statement 68, Statement 68 applies. A single or agent employer that has a special funding situation should follow the provisions of paragraphs 18, 19, and 83–91 of Statement 68 for pension liabilities to employees.

5.116.3. Q—An employer provides pensions to its employees through a cost-sharing defined benefit pension plan that is administered through a trust that has the characteristics identified in paragraph 4 of Statement 68. There is no requirement that the employer make annual contributions to the plan because the employer has a special funding situation (as defined by paragraph 15 of Statement 68) in which the nonemployer contributing entity is the only entity with a legal requirement to make contributions. The employer has no payables to the pension plan, and contributions to the plan are not made by any other nonemployer entities. Does Statement 68 apply to the employer?

A—Yes. Because the employer has a special funding situation for benefits provided through a pension plan that is administered through a trust that has the characteristics identified in paragraph 4 of Statement 68, Statement 68 applies. In this circumstance, the cost-sharing employer should apply the requirements of paragraphs 18, 19, and 94–96 of Statement 68 to recognize pension expense/expenditure and revenue for the support of the nonemployer contributing entity, as well as the requirements for note disclosures and RSI in paragraphs 74–82 of Statement 68.

5.116.4. Q—In the past, an employer provided pensions to its employees through a cost-sharing defined benefit pension plan that is administered through a trust that has the characteristics identified in paragraph 4 of Statement 68. The employer no longer provides benefits to active employees through the plan. Does Statement 68 apply?

A—If the cost-sharing employer has no requirement to make contributions to the plan, does not have a payable to the pension plan, and does not receive support from a nonemployer contributing entity through contributions made directly to the pension plan (whether as a result of a special funding situation or not), the requirements of Statement 68 do not apply to the financial reporting by the employer.
5.116.5. Q—A state makes contributions to an IRC Section 457 deferred compensation plan for its employees. Does Statement 68 apply to the employer’s involvement in the Section 457 plan?

A—No. Despite similarities between Section 457 plans and certain plans that are reported by governments as pension plans (for example, Section 403(b) plans), paragraph 20 in the Basis for Conclusions of Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans, indicates that for purposes of financial reporting, a Section 457 plan is not classified as a pension plan. This distinction was not modified by Statement 68. Therefore, Statement 68 does not apply to employer reporting for benefits provided through a Section 457 plan.

5.116.6. Q—An employer offers an unfunded (“pay-as-you-go”) plan (that is, the employer’s annual contributions are approximately equal to that year’s benefit payments) that provides supplemental defined benefit pensions to certain employee classes. The plan is administered through a trust that has the characteristics identified in paragraph 4 of Statement 68. Does Statement 68 apply to pensions provided through an unfunded plan?

A—Yes. Regardless of the method or timing of funding the benefits, if the supplemental pensions are provided through a plan that is administered through a trust (or equivalent arrangement) that has the characteristics identified in paragraph 4 of Statement 68, the Statement applies.

5.116.7. Q—Would the answer to Question 5.116.6 be different if the plan were closed to new entrants?

A—No. All provisions of Statement 68 apply to pensions provided through closed plans, as well as to those provided through open plans, that are administered through a trust (or equivalent arrangement) that has the characteristics identified in paragraph 4 of that Statement.

5.116.8. Q—Does Statement 68 apply to a governmental employer that provides pensions through a single-employer plan that is administered by the employees’ union if benefits are negotiated periodically (for example, every three to five years)?

A—If the pension plan is administered through a trust (or equivalent arrangement) that meets the criteria of paragraph 4 of Statement 68, Statement 68 is applicable to the state or local government whose employees are provided with pensions through the plan. This is the case regardless of the nature of the entity administering the plan or whether the benefits provided through the plan are subject to periodic negotiation.

5.116.9. Q—If an employer provides pensions through a pension plan that is administered through a trust that meets the criteria of paragraph 4 of Statement 68, do any of the requirements of Statement 27, as amended, or Statement 50, as amended, apply?

A—No. For pensions within its scope, Statement 68 replaces the requirements of Statements 27 and 50, as amended.

5.117 Trusts or Equivalent Arrangements

5.117.1. Q—A pension plan’s trust agreement includes a provision for return of amounts remaining in the trust to an employer if all obligations associated with a plan that is administered through the trust have been fulfilled. Is this provision consistent with the criterion in paragraph 4a of Statement 68 regarding the irrevocability of contributions?
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A—Yes. As used in paragraph 4a of Statement 68, irrevocability is understood to mean that an employer no longer has ownership or control of the assets, except for any reversionary right once all benefits have been paid. That is, for purposes of the Statement, the trust should be so constituted that assets may flow from an employer to the plan, but not from the plan to an employer—unless and until all obligations to pay benefits in accordance with the plan terms have been satisfied by payment or by defeasance with no remaining risk regarding the amounts to be paid or the value of plan assets.

5.117.2. Q—A pension plan’s trust agreement includes a provision for the return of plan assets to an employer if the funded status of the plan reaches a specified level, regardless of whether all obligations associated with the plan that is administered through the trust have been fulfilled. Is this provision consistent with the criterion in paragraph 4a of Statement 68 regarding the irrevocability of contributions?

A—No. A provision for the reversion of plan assets to an employer prior to the point at which all obligations associated with the plan have been fulfilled is not consistent with the criterion related to irrevocability of contributions. Pensions that are provided through a plan that has such a provision are not within the scope of Statement 68, and an employer should continue to report those pensions by applying the requirements of Statements 27 and 50, as amended, as applicable.

5.118 Types of Pensions

5.119 Classifying Pensions as Defined Benefit or Defined Contribution

5.119.1. Q—The terms of a pension specify that an employer is required to contribute 7.5 percent of each employee’s annual salary to an individual employee account. Individual employee accounts are credited with interest at a rate of 5 percent per year, as specified in the benefit terms, and are assessed an administrative fee based on the average balance of assets in the account for the year. During retirement, an employee draws down the balance of the account, with interest continuing to accrue at the specified interest rate. Should this pension be classified as defined benefit or as defined contribution for purposes of applying Statement 68?

A—This pension is defined benefit for purposes of applying Statement 68. To be classified as a defined contribution pension, paragraph 10 of Statement 68 specifies that all three of the following criteria are required to be met:

a. An individual account is provided for each employee.
b. The plan terms define the amount of contributions that the employer is required to make (or credits that it is required to provide) to an active employee’s account for periods in which the employee renders service.
c. The pension that an employee will receive will depend only on the contributions (or credits) to the employee’s account, actual earnings on investments of those contributions (or credits), and the effects of forfeitures of contributions (or credits) made for other employees, as well as pension plan administrative costs, that are allocated to the employee’s account.

Although the pension provided in this question meets the first two of these criteria, it does not meet the third criterion because the interest credited to an employee’s account is based on a specified rate regardless of the actual earnings on the underlying investments made with the assets in the account. Because the pension does not meet all three of the criteria identified in
paragraph 10 of Statement 68 to be classified as defined contribution, it should be classified as defined benefit for purposes of applying Statement 68.

5.119.2. Q—If, instead of crediting interest to the employees’ accounts at a specified rate of return, the benefit terms described in Question 5.119.1 provide that interest on employees’ account balances is determined based on an outside index, how should the pension be classified for accounting and financial reporting purposes?

A—Unless the investments of each employee’s account mirror the investments that comprise the outside index, the crediting of interest earnings based on a rate that is tied to the performance of an outside index does not represent actual earnings on investments in the employees’ accounts, and the pension should be classified as defined benefit for purposes of applying Statement 68.

5.119.3. Q—The terms of a pension meet the criteria in paragraphs 10a and 10b of Statement 68 to be classified as defined contribution but provide that, upon retirement, the balance in an employee’s individual account is converted to an immediate life annuity paid by the pension plan. Annuity payments are calculated at the employee’s retirement date based on mortality tables and an interest rate established by the pension plan’s administrative board. The total amount of payments received is not otherwise limited by the amounts in the employee’s account—that is, if the employee lives longer than projected at retirement, benefit payments continue at the amount calculated at retirement until the employee’s death. Is the pension defined contribution or defined benefit for financial reporting purposes?

A—The pension is defined benefit. Although the amount of an employee’s annuity payment is based on the individual account balance at retirement, the total amount of benefits received by the employee does not depend only on “the contributions (or credits) to the employee’s account, actual earnings on investments of those contributions (or credits), and the effects of forfeitures of contributions (or credits) made for other employees, as well as pension plan administrative costs, that are allocated to the employee’s account.” The total amount of benefits also depends on the number of years the employee lives to receive benefit payments. Further, the amount of the benefit payments depends upon the interest rate established by the plan, rather than on actual earnings on the investment of assets in the account. Therefore, the annuitization of the employee’s account balance under the benefit terms results in a pension that does not depend solely on the factors identified in paragraph 10c of Statement 68.

5.119.4. Q—The terms of a pension otherwise meet the criteria in paragraph 10 of Statement 68 to be classified as defined contribution but provide that after an employee retires, the employee has the option to annuitize some or all of their account balance through the purchase of an individual annuity contract with a third party. Is this plan defined contribution for financial reporting purposes?

A—Yes. In the circumstance described in this question, the purchase of the annuity is a separate transaction between the employee and the third party. Because there is no potential for a change in the obligation of the employer related to the amounts that will be provided to the employee as a result of the annuity purchase option, in this case, the annuitization of the employee’s account balance does not impact the classification of the pension as defined contribution.

5.120 Types of Defined Benefit Pension Plans and Employers
5.120.1. Q—A PERS administers the assets, the payment of benefits, and the general recordkeeping and support services for pensions provided to the employees of three employer governments. A separate actuarial valuation is performed for separate classes of employees (for example, general government employees versus public safety employees), and employers make contributions for each class at the rate for the class applied to the employer’s active-employee covered payroll for the class. Plan assets legally are available to pay benefits to any employee. What type of plan(s) is the PERS administering?

A—The classification of the plan depends on whether there is a legal segregation of assets for purposes of providing benefits to the different classes of employees. In this situation, although different rates are calculated for different classes of employees, all plan assets legally are available to pay benefits of any employee, regardless of their employment class. Therefore, this plan is a cost-sharing multiple-employer plan for purposes of applying Statement 68.

5.120.2. Q—If the facts regarding the plan in Question 5.120.1 were changed, to the extent that separate actuarial valuations were performed for separate employers based on their employees and an allocation of assets to each employer, rather than for separate classes of employees, would the separate valuations change the classification of the plan from a cost-sharing multiple-employer plan to an agent multiple-employer plan?

A—No. The classification of the plan depends on whether assets held by the pension plan legally can be used to pay the benefits of the employees of any of the employers. In this situation, although different contribution rates are established for different employers, all plan assets legally are available to pay benefits pertaining to the employees of any employer. Therefore, this plan is classified as a cost-sharing multiple-employer plan for purposes of applying Statement 68.

5.120.3. Q—A defined benefit pension plan is used to provide pensions to the employees of a state government and several governments that are component units of the state. There are no other entities whose employees are provided with pensions through the plan. The assets in the plan legally can be used to pay benefits to the employees of the state or any of the component units. Is this plan a single-employer, agent multiple-employer, or cost-sharing multiple-employer plan?

A—This plan is a single-employer plan for financial reporting purposes. Defined benefit pension plans are classified according to the number of employers whose employees are provided with benefits through the plan and whether pension obligations and pension plan assets are shared. Paragraph 11 of Statement 68 specifies that a primary government and its component units should be considered to be one employer for purposes of classifying a defined benefit pension plan as single employer or multiple employer. (See Questions 5.125.1–5.125.3 for a discussion of issues related to employer reporting in this circumstance.)

5.120.4. Q—A defined benefit pension plan is used to provide pensions to the employees of a state government, several governments that are component units of the state, and governments other than the state and the component units. Is this plan a single-employer, agent multiple-employer, or cost-sharing multiple-employer plan?

A—The plan is a multiple-employer plan for financial reporting purposes. If (a) a separate account is maintained for each of the governments or (b) a separate account is maintained for the state and its component units together and separate accounts are maintained for each of the other governments, such that the assets in each of the separate accounts legally are available to pay the benefits of only the employees of the government or governments whose assets are maintained in the separate account, the plan would be classified as an agent multiple-employer
plan. If, instead, the pension plan assets legally can be used to pay the benefits of the employees of any of the governments, the plan would be classified as a cost-sharing multiple-employer plan.

5.120.5. Q—For purposes of classifying a defined benefit pension plan as single employer or multiple employer under paragraph 11 of Statement 68, does it matter whether the component unit is discretely presented or blended by the primary government?

A—No. For purposes of paragraph 11 of Statement 68, the primary government and its component unit are considered to be one employer regardless of whether the component unit is discretely presented or blended by the primary government.

5.120.6. Q—A PERS administers a single trust fund through which pensions are provided to employees of local governments in a state. For certain employers (“nonpool employers”), the PERS maintains separate asset accounts. The assets and obligations of other employers (“pool employers”) are pooled. How should this arrangement be classified for purposes of applying Statement 68?

A—If the assets of each of the nonpool employers cannot legally be used to pay benefits to the employees of any other employer, the portion of the trust that is being used to administer benefits to the employees of the nonpool employers is a separate (agent multiple-employer) plan, and nonpool employers should apply the requirements of Statement 68 for agent employers. In this circumstance, the portion of the trust that is being used to administer the benefits of the employees of pool employers is a cost-sharing multiple-employer plan, and pool employers should apply the requirements of Statement 68 for cost-sharing employers. If, however, the assets in the trust may legally be used to pay benefits to the employees of any of the employers (pooled or nonpooled), the arrangement is one cost-sharing multiple-employer plan for financial reporting purposes, and all of the employers should apply the requirements of Statement 68 for cost-sharing employers.

5.121 Number of Defined Benefit Pension Plans

5.121.1. Q—A defined benefit plan is used to provide pensions to two classes of employees—those in elected positions and those in nonelected positions. Does Statement 68 require that the employer report the benefits provided to each class of employees as a separate plan?

A—If, on an ongoing basis, all assets are available for the payment of pension benefits to either class of employees, even if the benefits differ by class, there is only one plan for financial reporting purposes. If, on an ongoing basis, a portion of the assets is legally restricted for the payment of benefits to one of the two membership classes, there are two separate plans for financial reporting purposes, even if the assets are pooled for investment purposes.

5.121.2. Q—If, within a single trust, a portion of the assets are legally segregated to pay the defined benefit pensions of a particular class of the employees of all local governments within a state (for example, elected officials) and a portion is legally segregated to pay the defined benefit pensions of another class of employees of the local governments, should the portion of the assets associated with each class be considered assets of a separate plan?

A—Yes, if, on an ongoing basis, each portion of assets held in the trust may not legally be used to pay benefits to other classes of employees. Paragraph 14 of Statement 68 requires, in that circumstance, that the portion of trust assets segregated to pay benefits to each class of
employees be considered assets of a separate defined benefit pension plan for financial reporting purposes. In this case, because each plan is used to provide benefits to more than one employer, each plan would be classified as a separate multiple-employer plan.

5.121.3. Q—Within a trust used to administer defined benefit pensions, a certain portion of employer contributions and earnings on those contributions are accumulated in a separate account to be used as the basis for determining ad hoc COLAs that, if granted, will adjust the benefits of all retirees. Should the assets in the separate account be considered assets of a separate pension plan?

A—No. Paragraph 14 of Statement 68 requires that “if, on an ongoing basis, all assets accumulated in a defined benefit pension plan for the payment of benefits may legally be used to pay benefits . . . to any of the employees, the total assets should be reported as assets of one defined benefit pension plan even if administrative policy requires that separate reserves, funds, or accounts for specific groups of employees, employers, or types of benefits be maintained . . . .” That paragraph further differentiates between a separate account used as described in this question—that is, to provide an additional benefit to all retirees—and an account legally restricted for the benefits to only certain classes or groups of employees or to employees who are employees of certain entities.

5.122 Special Funding Situations—Defined

5.122.1. Q—For purposes of evaluating whether there is a special funding situation under Statement 68, what does it mean for a nonemployer entity to be legally responsible for contributions to a pension plan?

A—For purposes of applying paragraph 15 of Statement 68, a nonemployer entity is legally responsible for contributions if it is required by legal or contractual provisions to make the contributions. Sources of legal provisions include those arising from constitutions, statutes, charters, ordinances, resolutions, governing body orders, and intergovernmental grant or contract regulations. Therefore, for purposes of Statement 68, a nonemployer contributing entity should be considered legally responsible for contributions if, for example, there is a statutory requirement that it make a contribution. (See also Questions 5.122.2—5.122.4.)

5.122.2. Q—If a state legislature is not bound by the decisions of a prior legislature and the state’s requirement to contribute directly to a pension plan as a nonemployer entity is established in statute, could the state ever have a special funding situation?

A—Yes. The fact that a decision of one legislature cannot bind a subsequent legislature should not be considered an indication that the nonemployer contributing entity does not have a legal obligation to make a contribution for the purposes of applying paragraph 15 of Statement 68. Nor should the circumstance be considered a condition that makes the contribution dependent upon an event or circumstance unrelated to the pensions. Therefore, if the amount of the contribution is defined in such a manner that it meets the criterion in paragraph 15a of Statement 68 or if the nonemployer entity is the only entity that is legally responsible to make contributions directly to the pension plan, the circumstances would be classified as a special funding situation for purposes of Statement 68.

5.122.3. Q—In the past, a governmental nonemployer entity that is not otherwise identified as being responsible for making contributions to a defined benefit pension plan has made contributions directly to the pension plan as a nonemployer entity. Should the nonemployer entity’s
involvement be accounted for as a special funding situation? If not, which accounting and financial reporting standards apply?

A—No. The first characteristic of a special funding situation as described in paragraph 15 of Statement 68 is that the nonemployer entity is legally responsible for making contributions directly to the pension plan. A historical pattern of appropriating resources to make contributions directly to the pension plan is not equivalent to a legal obligation for the nonemployer entity to make contributions to the pension plan. Therefore, in this circumstance, the nonemployer entity’s involvement should not be accounted for as a special funding situation. The employers that provide benefits through the plan should apply the requirements of Statement 68 for employers that are not in special funding situations. In periods in which it makes contributions, the nonemployer entity should apply the requirements of paragraph 13 of Statement No. 24, Accounting and Financial Reporting for Certain Grants and Other Financial Assistance, as amended, for on-behalf payments of fringe benefits.

5.122.4. Q—Would the answer to Question 5.122.3 be different if the governmental nonemployer contributing entity’s resources have been appropriated specifically for the purpose of making the contributions to the pension plan?

A—No. An appropriation of resources for purposes of making a contribution to the pension plan is not, by itself, sufficient to create a legal requirement for the contributions for purposes of applying paragraph 15 of Statement 68.

5.122.5. Q—If an employer’s contributions to a pension plan are reimbursed through a federal grant, should this be accounted for as a special funding situation with the grantor as a nonemployer contributing entity?

A—No. Among other conditions, paragraph 15 of Statement 68 specifies that in order to be a special funding situation, the nonemployer contributing entity is required to make contributions directly to the pension plan. The federal grant is provided to the employer as a reimbursement of the employer’s direct contributions to the pension plan. Therefore, the circumstances do not meet the definition of a special funding situation.

5.122.6. Q—In evaluating whether a special funding situation exists, does it matter if a nonemployer contributing entity is considered to be a state or local government for financial reporting purposes?

A—No. For purposes of evaluating whether a special funding situation exists, the type of entity (governmental or nongovernmental) for financial reporting purposes is not a factor.

5.122.7. Q—If a nonemployer contributing entity’s contribution requirement is defined in statute to be a specified percentage of the actuarially determined contribution of the employer, is the amount of the contribution “dependent upon one or more events or circumstances unrelated to the pensions”?

A—No. A contribution amount that is defined as a percentage of an actuarially determined contribution is related to the pensions provided through the plan and, therefore, would meet the condition described in paragraph 15a of Statement 68.
5.122.8. Q—A governmental nonemployer contributing entity has a legal requirement to make contributions directly to a defined benefit pension plan. In the current measurement period, the nonemployer contributing entity’s contribution requirement has the characteristics of a special funding situation under paragraph 15 of Statement 68. However, legislation has been passed that reduces the nonemployer contributing entity’s contribution requirement to zero in steps over the next five years. Should the circumstances be accounted for by the nonemployer contributing entity as a special funding situation?

A—Yes. Because the circumstances meet the requirements of paragraph 15 of Statement 68 to be accounted for as a special funding situation in the current period, the nonemployer contributing entity should apply the requirements of Statement 68 applicable to those situations. However, in establishing the governmental nonemployer contributing entity’s proportion under paragraphs 97–99 of Statement 68, the nonemployer contributing entity is encouraged to consider the provisions of the legislation. (See also Question 5.217.5.)

5.123 Defined Benefit Pensions

5.124 Liabilities to Employees for Pensions

5.125 Reporting by primary governments and component units

5.125.1. Q—A single-employer defined benefit pension plan is used to provide pensions to the employees of a state government and several governments that are component units of the state. In their stand-alone financial reports, should each of the component units report as a single employer?

A—No. Paragraph 18 of Statement 68 requires that component units apply the cost-sharing employer requirements of Statement 68 for their own stand-alone financial reports. Therefore, each government would report its proportionate share of the collective net pension liability and would follow the requirements of paragraphs 48–82 of Statement 68 (for cost-sharing employers that do not have a special funding situation) or paragraphs 92–96 of that Statement (for cost-sharing employers that have a special funding situation). Only in the financial report of the reporting entity (that is, the financial report that includes both the state and its component units) would note disclosures and RSI be presented in conformity with the requirements of paragraphs 37–47 of Statement 68 for a single employer.

5.125.2. Q—In the circumstances described in Question 5.125.1, if the component units do not issue stand-alone financial reports, is a portion of the net pension liability required to be allocated to the component units as if they were cost-sharing employers for purposes of the reporting entity’s financial report?

A—Yes. The notion of the reporting entity described in Statement 14, as amended, is one in which the financial data of the component units is included with the financial data of the primary government. Regardless of whether the financial data (in this case, the net pension liability and related measures) is issued in stand-alone financial reports of the component units, the reporting entity’s financial report should include that data as if it had been. Paragraph 18 of Statement 68 requires that in stand-alone financial statements, the component units account for and report their participation in the pension plan as if they were cost-sharing employers. Therefore, the financial report of the reporting entity should include the primary government’s

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7In sections 5.115–5.256, unless otherwise indicated, references to net pension liability also apply to the situation in which the pension plan’s fiduciary net position exceeds the total pension liability, resulting in a net pension asset.
and the component units’ proportionate shares of the collective net pension liability and related measures as if the entities were cost-sharing employers.

5.125.3. Q—For purposes of applying the requirements of paragraph 18 of Statement 68 regarding the reporting of information about pensions in the stand-alone reports of a primary government and its component units when those governments provide benefits through the same single-employer or individual agent-employer pension plan, does it matter whether the component unit is discreetly presented or blended by the primary government?

A—No. For purposes of paragraph 18 of Statement 68, in stand-alone financial reports, the primary government and its component units each should account for and report its participation in the single-employer or individual agent-employer pension plan as if it was a cost-sharing employer, regardless of whether the component units are discreetly presented or blended by the primary government.

5.126 Use of disaggregated measures

5.127 Single and agent employers

5.128 Recognition and measurement in financial statements prepared using the economic resources measurement focus and accrual basis of accounting by employers that do not have a special funding situation

5.129 Net Pension Liability

5.129.1. Q—What guidance does Statement 68 provide regarding recognizing a portion of the net pension liability in fund financial statements if a portion of the net pension liability of a single or agent employer will be paid from an enterprise, internal service, or fiduciary fund?

A—Except for blended component units, which are discussed in Questions 5.125.2 and 5.125.3, Statement 68 does not establish specific requirements for allocation of the net pension liability or other pension-related measures to individual funds. However, for proprietary and fiduciary funds, consideration should be given to NCGA Statement 1, paragraph 42, as amended, which requires that long-term liabilities that are “directly related to and expected to be paid from” those funds be reported in the statement of net position or statement of fiduciary net position, respectively.

5.130 Measurement Date

5.130.1. Q—If a single employer’s fiscal year-end is the same as the fiscal year-end of the pension plan through which it provides benefits, can the employer report a net pension liability as of a measurement date that is one year earlier than the “as of” date of the net pension liability reported by the plan at the same fiscal year-end?

A—Yes. To avoid a circumstance in which employer financial reports potentially would be delayed awaiting information that also is included in the pension plan’s financial report, Statement 68 permits the measurement date of the net pension liability reported by a single or agent employer to be as of a date no earlier than the end of its prior fiscal year provided that the actuarial valuation used to determine the net pension liability meets the timing requirements of paragraph 22 of Statement 68 and that the measure meets the requirement of paragraph 23 of Statement 68 that the plan and the employer use the same assumptions when measuring similar or related information. (See Questions 5.134.1–5.134.3.) Single-employer pension plans are required by Statement 67 to report information about the net pension liability of the employer.
as of the plan’s fiscal year-end. Therefore, for example, in financial statements as of June 30, 20X5, a single-employer pension plan is required to report a net pension liability measured as of June 30, 20X5, whereas the single employer that provides benefits through the plan can report a net pension liability with a measurement date of June 30, 20X4, if the requirements of paragraphs 22 and 23 of Statement 68 are met.

5.130.2. Q—If an employer participates in more than one defined benefit pension plan, is the employer required to use the same measurement date for each (collective) net pension liability?

A—No. Paragraph 18 of Statement 68 specifies that the requirements of that Statement related to liabilities to employees for pensions, which include the provisions of the Statement for the selection of the measurement date of the (collective) net pension liability, should be applied separately to the pensions provided through each defined benefit pension plan. Therefore, provided that the measurement date for each (collective) net pension liability meets the requirements of Statement 68, the related pension liabilities presented in an employer’s financial report can have different measurement dates. For example, in financial statements for its fiscal year ended June 30, 20X5, an employer can report a net pension liability with a measurement date of December 31, 20X4, for pensions provided through single-employer Pension Plan A and a proportionate share of the collective net pension liability with a measurement date of March 31, 20X5, for pensions provided through cost-sharing Pension Plan B. (See Question 5.146.1 regarding note disclosure requirements when different measurement dates are used.)

5.131 The Pension Plan’s Fiduciary Net Position

5.131.1. Q—Do the provisions for update procedures for the total pension liability also apply to valuation of the pension plan’s fiduciary net position component of the net pension liability? That is, can the measure of the pension plan’s fiduciary net position from an earlier date be rolled forward for use in the measure of the net pension liability at the current measurement date?

A—No. Paragraph 20 of Statement 68 requires that the pension plan’s fiduciary net position component of the net pension liability be determined at the measurement date using the same valuation methods that would be applied by the pension plan for purposes of preparing the pension plan’s statement of fiduciary net position. (See Question 5.134.4 for additional discussion of update procedures for the total pension liability.)

5.131.2. Q—If a change occurs in a factor relevant to measurement of the pension plan’s fiduciary net position between the measurement date of the net pension liability and the employer’s current fiscal year-end, should the net pension liability that is reported by the employer in the current fiscal year be updated to include the effects of the change?

A—No. The employer should report the net pension liability determined as of the measurement date. The effects of a change in the pension plan’s fiduciary net position that occurs subsequent to the measurement date of the net pension liability reported in the current fiscal year should be reflected in the net pension liability as of the next measurement date—that is, in the next fiscal year. (See Question 5.153.2 regarding note disclosures about changes subsequent to the measurement date.)

5.131.3. Q—In years in which investment returns exceed expectations, an agent multiple-employer pension plan reports a portion of those returns in an investment reserve at the aggregated plan level, and the amounts in the reserve account are excluded from the plan assets of the individual employers’ plans for purposes of determining their contribution requirements. The amounts
remain in the reserve account until a year in which investment returns are lower than expected, at which time a portion of the investment account is allocated to individual employers’ plans. For purposes of Statement 68, can amounts in the reserve account be excluded from the measures of the pension plan’s fiduciary net position used to determine the net pension liabilities reported by the individual employers?

A—No. For purposes of Statement 68, the assets in the reserve account should be allocated to the fiduciary net position of the pension plans of the individual employers. To exclude those assets would overstate the net pension liabilities of all of the employers that provide benefits through the agent multiple-employer pension plan.

5.132 Financial Statement Display

5.132.1. Q—If the total pension liability is less than the pension plan’s fiduciary net position, should the net balance be displayed in a single or agent employer’s statement of net position as a negative net pension liability or as a net pension asset?

A—A net pension liability that is negative is, and should be displayed as, an asset in the employer’s statement of net position.

5.132.2. Q—Should a net pension liability (or aggregation of net pension liabilities) be displayed on a separate line on the face of the financial statements?

A—The net pension liability is not required to be displayed separately on the face of the financial statements. However, for some governments, it will be a significant balance, which may be displayed separately on the face of the financial statements. Liabilities for net pension liabilities associated with different pension plans may be aggregated for display, and pension assets for net pension assets associated with different plans may be aggregated for display. However, aggregated pension assets and aggregated pension liabilities should be separately displayed.

5.132.3. Q—Can net pension liabilities associated with different plans be displayed in the aggregate if the liabilities do not have the same measurement date?

A—Yes. Statement 68 does not limit the aggregation of pension liabilities based on measurement dates.

5.133 Total Pension Liability

5.134 Timing and frequency of actuarial valuations

5.134.1. Q—Is the actuarial valuation date required to have the same relationship to the measurement date in each reporting period (or, for employers that have biennial actuarial valuations, to the measurement date in every other reporting period)?

A—No. Unlike the measurement date of the net pension liability, which is required to maintain the same relationship with the employer’s fiscal year-end from period to period (for example, in every year, the employer uses a measurement date of June 30 of the prior fiscal year), the date of the actuarial valuation that is used to determine the employer’s net pension liability at the measurement date can vary from period to period (or every 2 periods when biennial valuations are used) provided that it is within 30 months and 1 day of the employer’s fiscal year-end.
5.134.2. Q—Actuarial valuations to determine the total pension liability for pensions provided through a single-employer plan are performed as of June 30 each year, which also is the fiscal year-end of the pension plan and the employer. Because the results of the actuarial valuation are not available until several months after the actuarial valuation date, the pension plan, in its financial report, discloses information about the total pension liability based on an update of the results of the actuarial valuation as of the end of its prior fiscal year. The employer elects to use a measurement date one year prior to its fiscal year-end—that is, in its financial statements as of June 30, 20X5, it reports a net pension liability with a measurement date of June 30, 20X4. At June 30, 20X5, as the basis for the total pension liability, should the employer use the results of the update of the June 30, 20X3 actuarial valuation that was used to report information about the total pension liability in the pension plan’s financial report as of June 30, 20X4, or should the employer use the results of the actuarial valuation as of June 30, 20X4?

A—Paragraph 23 of Statement 68 requires that the pension plan and employer use the same assumptions when measuring similar or related pension information. Therefore, if any assumption used in the actuarial valuation as of June 30, 20X4, was different from an assumption used in the update of the June 30, 20X3 actuarial valuation used by the pension plan to report the net pension liability as of June 30, 20X4, the employer is required to use the results of the same update of the June 30, 20X3 actuarial valuation.

5.134.3. Q—What is the earliest date of an actuarial valuation that can be used as the basis for determining the total pension liability component of the net pension liability reported by a single or agent employer at its June 30, 20X5 fiscal year-end?

A—Paragraph 22 of Statement 68 permits use of an actuarial valuation as of a date 30 months and 1 day earlier than the employer’s most recent fiscal year-end as the basis for the total pension liability reported by a single or agent employer. Therefore, in its June 30, 20X5 financial statements, the employer can use the results of an actuarial valuation as of December 31, 20X2, or later.

5.134.4. Q—The measurement date for the net pension liability of a single or agent employer is June 30. Actuarial valuations of the total pension liability component of the net pension liability are obtained annually as of December 31. In conformity with the requirements of paragraph 22 of Statement 68, the results from the mid-year actuarial valuation are updated to June 30. Are there specific procedures that are required for an update for financial reporting purposes?

A—No. Statement 68 does not establish specific procedures for this purpose. Therefore, professional judgment should be applied to determine the extent of procedures necessary to faithfully represent the total pension liability as of the measurement date. In all circumstances, the total pension liability should include all significant effects of transactions and other events between the actuarial valuation date and the measurement date. In some circumstances, for example, if there are few differences between expected and actual experience, no changes in benefit terms, and no circumstances suggesting that a significant change of assumption is needed, it might be reasonable to roll forward the results of the mid-year actuarial valuation to the measurement date with few adjustments. However, in other circumstances, more significant adjustments might be necessary to update the results of the mid-year actuarial valuation to the measurement date. (See Question 5.134.5 for examples of events that might have a significant effect on the total pension liability.) The Statement also requires that in evaluating the extent of procedures necessary to update the measure to the measurement date, among the factors that
should be considered is whether a new actuarial valuation is needed for this purpose. (See Question 5.153.1 regarding note disclosures when update procedures are used.)

5.134.5. Q—What are some examples of transactions or other events that can occur between the actuarial valuation date and the measurement date that might have a significant effect on the total pension liability?

A—A change in the total pension liability can arise from a single factor or a combination of factors. Some examples of circumstances that might have a significant effect on the total pension liability include a change of benefit terms, a change in the size or composition of the covered group, a change in the municipal bond yield or index rate component of the discount rate, and a change in the pension plan’s fiduciary net position such that the discount rate used in the calculation of the total pension liability is impacted.

5.134.6. Q—If a change occurs in a factor relevant to measurement of the total pension liability between the measurement date of the net pension liability and the employer’s current fiscal year-end, should the net pension liability that is reported by the employer in its current fiscal year be updated to include the effects of the change?

A—No. The employer should report the net pension liability determined as of the measurement date. The effects on the total pension liability of a change that occurs subsequent to the measurement date of the net pension liability reported in the current fiscal year should be reflected in the net pension liability as of the next measurement date—that is, in the employer’s next fiscal year. (See Question 5.153.2 regarding note disclosures related to changes subsequent to the measurement date.)

5.134.7. Q—When actuarial valuations are performed biennially, does Statement 68 require an update to the total pension liability in the intervening year for purposes of financial reporting by single or agent employers?

A—Yes. The total pension liability reported in a single or agent employer’s financial statements should be a new measure each year, based either on a new actuarial valuation as of the measurement date or on an actuarial valuation performed as of a date no earlier than 30 months and 1 day prior to the end of the employer’s fiscal year that is updated to the measurement date. If update procedures are used and significant changes occur in, for example, benefits, the covered population, or other factors affecting the valuation results between the actuarial valuation date and the measurement date of the net pension liability, professional judgment should be used to determine the extent of the procedures needed to roll forward the measurement of the total pension liability, and consideration should be given to whether a new actuarial valuation is needed. (See also Question 5.134.4.)

5.135  Selection of assumptions

5.136  Projection of benefit payments

5.136.1. Q—Should refunds of employee contributions through a defined benefit pension plan be included in the projection of benefit payments for purposes of measuring the total pension liability of a single or agent employer?

A—Yes. When provided through a defined benefit pension plan, refunds of employee contributions are a form of benefit payment for purposes of Statement 68 and should be included
in the projection of benefit payments for purposes of measuring the total pension liability of a single or agent employer, including determination of the discount rate to be applied in the measurement.

5.136.2. Q—The amount of a defined benefit pension is determined based on an employee’s years of service and final three-year average pay. The calculation of pay for this purpose includes the employee’s base salary and overtime pay. Should the projection of benefit payments include an assumption about overtime pay?

A—Yes. In this circumstance, overtime pay should be considered in the projection of benefit payments. Paragraph 24 of Statement 68 requires that the projection of benefit payments include all benefits to be provided to the employees in accordance with the benefit terms. That paragraph further specifically requires that the effects of projected salary changes be included in the projection of benefit payments in circumstances in which the pension formula incorporates future compensation levels. Although not part of the employee’s base salary, the pension formula establishes overtime compensation as a relevant factor in determining the amount of an employee’s pension. Therefore, consistent with the requirements of paragraph 24 of Statement 68, the projected impact of future overtime compensation on the benefit payments that will be made to the employee should be included in the measure.

5.136.3. Q—A defined benefit pension plan’s enabling statute provides for a COLA if the investment earnings rate for the plan’s fiscal year exceeds the actuarially assumed rate. Should this COLA be treated as an automatic COLA?

A—Yes. Paragraph 24 of Statement 68 requires that the effects of any COLAs that are embedded in the benefit terms and for which there is no discretion as to timing or amount be included in the projection of future benefit payments. In this example, although a certain economic condition is required to be met for the COLA to be effective, if that condition is met, there is no discretion regarding whether the COLA will be granted.

5.136.4. Q—A defined benefit pension plan’s enabling statute provides that the board of trustees can annually authorize a COLA not to exceed a specified percentage increase or the change in the consumer price index, whichever is lower. The maximum allowable COLA has always been authorized. Should the effects of this COLA provision be included in the projection of future benefit payments?

A—This COLA is not automatic because approval of the board of trustees is required to authorize the benefit increase. Therefore, the effects of the COLA provision should be included in the projection of future benefit payments only if the provision is evaluated to be substantively automatic. Footnote 9 of Statement 68 identifies some of the factors that might be relevant in making this determination—the historical pattern of granting the changes, the consistency in the amounts of the changes or in the amounts of the changes relative to a defined cost-of-living or inflation index, and whether there is evidence to conclude that changes might not continue to be granted in the future despite what might otherwise be a pattern that would indicate such changes are substantively automatic.

5.136.5. Q—When should the effects of an ad hoc COLA that is determined not to be substantively automatic be included in the projection of future benefit payments?
A—If an ad hoc COLA is determined not to be substantively automatic, the effects of benefit changes made as a result of the COLA should be included in the projection of benefit payments for measurement of the total pension liability as of the first measurement date at which the ad hoc COLA has been granted and the amount is known or reasonably estimable.

5.136.6. Q—A collective-bargaining agreement that includes a provision for a postemployment benefit increase has been made prior to the measurement date of the net pension liability. However, the increase does not go into effect until after the current measurement date. Should the increase in projected benefit payments as a result of this agreement be included in the measurement of the total pension liability?

A—Yes. The actuarial present value of projected benefit payments should include benefits to be provided pursuant to a contractual agreement, including a collective-bargaining agreement, that is in effect at the measurement date. In other words, the issue is whether the agreement is in effect at that date, not whether the benefits included in the agreement will begin to accrue or begin to be paid by that date.

5.136.7. Q—A collective-bargaining agreement that includes a provision for a postemployment benefit increase has been made after the employer’s June 30, 20X5 measurement date. Should the increase in projected benefits as a result of this agreement be included in the measurement of the total pension liability at June 30, 20X5?

A—No. Paragraph 24 of Statement 68 requires that projected benefit payments include “all benefits to be provided to current active and inactive employees through the pension plan in accordance with the benefit terms and any additional legal agreements to provide benefits that are in force at the measurement date.” Because the agreement was not in effect at June 30, 20X5, the effect of the increased benefits should not be included in the total pension liability measured as of that date. (See also Question 5.153.2 regarding note disclosures related to changes subsequent to the measurement date.)

5.137 Discount rate

5.137.1. Q—For employers whose employees are provided with pensions through an agent multiple-employer plan, should the discount rate used by each employer to measure its total pension liability be specific to the employer?

A—Paragraph 12 of Statement 68 specifies that the requirements of Statement 68 for agent employers “apply to the pensions provided to the employer’s own employees.” Therefore, for purposes of Statement 68, the discount rate that is used by each employer whose employees are provided with pensions through an agent multiple-employer plan is required to be specific to the employer and is dependent upon the employer’s individual facts and circumstances, including the timing and amount of projected benefit payments to employees provided with pensions through the employer’s individual plan, the individual plan’s fiduciary net position, and the employer’s contribution policy.

5.137.2. Q—If the actuarial valuation date is earlier than a single or agent employer’s measurement date and the long-term expected rate of return assumption remains the same at the measurement date as it was at the actuarial valuation date, does the discount rate have to be
evaluated for significant changes between the actuarial valuation date and the measurement date?

A—Yes. A change in the discount rate can occur due to factors other than a change in the long-term expected rate of return. For example, a change in the municipal bond yield or index rate (if used in the determination of the discount rate) or a change in the projected fiduciary net position of the pension plan that affects the relative weighting of the long-term expected rate of return and the municipal bond yield or index rate can affect the discount rate. Therefore, these and other factors, if applicable, should be considered when evaluating whether changes have occurred that should be reflected in the total pension liability at the measurement date, either through update procedures or through a new actuarial valuation. (See Question 5.134.4 for a discussion of update procedures.)

5.137.3. Q—If, within a single-employer or individual agent-employer pension plan, (a) multiple contribution rates are determined for the employer because different rates are determined for separate classes of employees, (b) each rate is the result of a separate actuarial valuation, and (c) there is separate tracking of the assets held for each employee class, should a separate discount rate be calculated for each employee class or should one discount rate be calculated for the employer?

A—Only one discount rate is required for each employer. However, paragraph 19 of Statement 68 permits separate application of the measurement requirements of the Statement to different classes of employees, provided that the results of the measurements for each class are aggregated for reporting purposes.

5.138 Comparing projections of the pension plan’s fiduciary net position to projected benefit payments

5.138.1. Q—An employer has an actuarially determined contribution rate and has a written policy of contributing the actuarially determined rate each period. The employer has consistently adhered to its policy for the past 10 years, and there are no known events or conditions that indicate that the employer will not continue to adhere to its policy in the future. In this circumstance, for purposes of determining the discount rate, how would the amount of projected employer contributions that should be included in the projection of the pension plan’s fiduciary net position be determined?

A—In this circumstance, the actuarially determined contribution rate of the employer would be used as the basis for the projection of future employer contributions. Future employer contributions based on the actuarially based funding method should be evaluated to determine the extent to which they are associated with the service costs of future employees. The portion of future contributions that is associated with the service costs of future employees would be excluded from the projection of the pension plan’s fiduciary net position, which would be compared to projected future benefit payments for current active and inactive employees to determine whether and, if so, to what extent the municipal bond yield or index rate should be reflected in the discount rate.

5.138.2. Q—If the benefit payments in a period are projected to be partially covered by the pension plan’s projected fiduciary net position, should the covered portion be discounted using the long-term expected rate of return on pension plan investments, with only the remainder discounted at the required municipal bond yield or index rate?
A—Paragraphs 27 and 30 of Statement 68 require that projected benefit payments for a period be compared to the pension plan’s projected fiduciary net position in the period for purposes of determining whether the long-term expected rate of return or the municipal bond yield or index rate should be used to discount the benefit payments of the period when determining the discount rate. The Statement does not require that a specific approach be used to assign the total of the projected benefit payments in each period to the projected “funded” and “unfunded” categories. Therefore, the total of the benefit payments that are projected to occur in a period during which the pension plan’s fiduciary net position is projected to not be sufficient to make those benefit payments may be divided into projected “funded” and “unfunded” portions or the entire total may be classified as “unfunded.”

5.138.3. Q—Paragraph 29 of Statement 68 indicates that, if the results are sufficiently reliable, any approach to evaluating the sufficiency of the pension plan’s projected fiduciary net position to make projected benefit payments can be used in place of the projections of cash flows that are described in paragraphs 27 and 28 of the Statement. Is a specific method contemplated?

A—No. The determination of whether the results of an alternative approach to making the evaluation required in paragraph 27 of Statement 68 are sufficiently reliable for this purpose is subject to professional judgment.

5.139 Calculating the discount rate

5.139.1. Q—As of what date should the long-term expected rate of return and the municipal bond yield or index rate that are used to establish the discount rate be determined—the valuation date or the measurement date?

A—The long-term expected rate of return on pension plan investments is an assumption, and assumptions generally are not required to be updated between actuarial valuation dates unless there is an indication that the assumption is no longer valid. Therefore, the expectation developed as of the actuarial valuation date can be used at the measurement date unless it is determined to no longer be appropriate. In contrast, the municipal bond yield or index rate is not an assumption and should be determined as of the measurement date. If the actuarial valuation to determine the total pension liability is performed earlier than the measurement date, consideration should be given to changes in the municipal bond yield or index rate, along with other factors that potentially affect the discount rate, such as the pension plan’s fiduciary net position, to evaluate whether those factors would result in changes that should be reflected in the total pension liability at the measurement date, either through update procedures or through a new actuarial valuation. (See Question 5.134.4 for a discussion of update procedures.)

5.140 Attribution of the actuarial present value of projected benefit payments to periods

5.140.1. Q—In what way are multiple exit ages considered in the attribution of the actuarial present value of projected benefit payments to periods for financial reporting purposes?

A—Generally, the end point of the attribution period would not be a single age or single date. Rather, assumptions are made as to when employees will exit from active service. Examples of events that might result in an employee’s exit from active service are the termination of employment, incurrence of a disability, retirement, and death. Assumptions about events that result in exit from active employment are expressed as the probability of the occurrence of the triggering event based on, for example, the employee’s age or number of
years of service. These probabilities are applied to all projected ages/years of service of an employee, resulting in multiple exit ages for each employee.

5.140.2. Q—If an employee that is provided with benefits through a single-employer or individual agent-employer pension plan is inactive but is expected to return to work for the single or agent employer, should the attribution period for the employee extend over expected future years of service?

A—Yes, generally an inactive employee that is expected to return to service for the employer would be assumed to have exit ages that extend through future periods. Therefore, to meet the requirement of paragraph 32d of Statement 68, the attribution period generally should extend through the employee’s assumed retirement age.

If, however, the employee is classified as inactive because of the employee’s participation in a program that meets the Statement 68 definition of a DROP, paragraph 32d of that Statement requires that the date of entry into the DROP be considered the employee’s retirement date (and hence, the end of the attribution period).

5.140.3. Q—If benefit terms include a cap on employees’ service credit that is not part of a DROP, should a portion of the actuarial present value of projected benefit payments be attributed to only those periods in which an employee is expected to earn service credit, or should the attribution period include all periods within an employee’s projected working lifetime?

A—The exchange of benefits for services generally is viewed as related to an employee’s entire career. Therefore, the attribution period should include all periods of an employee’s projected service for the employer, regardless of whether additional service credit is expected to be earned.

5.141 Pension Expense, Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions, and Support of Nonemployer Contributing Entities

5.142 Changes in the Net Pension Liability

5.142.1. Q—At its December 31, 20X3 fiscal year-end, a single or agent employer recognizes a net pension liability with a measurement date of June 30, 20X3. For purposes of reporting pension expense and deferred outflows of resources and deferred inflows of resources related to pensions, over what period should changes in the net pension liability be determined?

A—The changes in the net pension liability to be recognized in conformity with paragraph 33 of Statement 68 are those occurring since the last measurement date—that is, the measurement period. In this circumstance, the measurement period includes all changes after June 30, 20X2 (the prior-year measurement date) and through June 30, 20X3 (the current-year measurement date). With the exception of contributions to the pension plan from the employer subsequent to the measurement date of the net pension liability, which are required by paragraph 34 of Statement 68 to be reported as a deferred outflow of resources related to pensions at the employer’s fiscal year-end, changes in the net pension liability that occur after the measurement date are not accounted for until the next fiscal year. (See also Question 5.153.2 regarding note disclosures about changes subsequent to the measurement date.)

5.142.2. Q—Should the balances of deferred outflows of resources and deferred inflows of resources related to pensions be adjusted for interest?
A—No. All changes, including interest on the total pension liability and changes in the pension plan’s fiduciary net position, are included in the net pension liability. Therefore, interest should not be separately calculated on the balances of deferred outflows of resources and deferred inflows of resources related to pensions.

5.142.3. Q—Should balances of deferred outflows of resources and deferred inflows of resources arising from a single source—that is, from differences between expected and actual experience with regard to economic or demographic factors, changes of assumptions, or differences between projected and actual earnings on pension plan investments—in different periods be reported as separate amounts or net of each other?

A—Consistent with the requirements of paragraph 33a of Statement 68, balances of deferred outflows of resources and deferred inflows of resources arising from differences between expected and actual experience in different periods should not be reported net. Similarly, balances of deferred outflows of resources and deferred inflows of resources arising from changes of assumptions in different periods should not be reported net. In contrast, paragraph 33b of Statement 68 requires that deferred outflows of resources and deferred inflows of resources arising from differences between projected and actual earnings on pension plan investments in different periods be netted and reported as deferred outflows of resources related to pensions if the net balance is a debit and reported as deferred inflows of resources related to pensions if the net balance is a credit.

5.142.4. Q—For purposes of determining pension expense, should the balances of deferred outflows of resources or deferred inflows of resources arising from a single source—for example, differences between expected and actual experience with regard to economic or demographic factors—in different periods be aggregated?

A—No. For purposes of determining pension expense, records of the closed-period “layers” arising in each year, as well as the period over which each of the layers is required to be recognized in pension expense, are needed. However, for presentation in the notes to the financial statements, the layers of deferred outflows of resources should be aggregated to present balances of deferred outflows of resources by source, and the layers of deferred inflows of resources should be aggregated to present balances of deferred inflows of resources by source.

5.142.5. Q—For the measurement period ended June 30, 20X5, can the portion of the change in the net pension liability attributable to service cost be calculated based on the results of the actuarial valuation used to determine the prior year’s net pension liability with a measurement date of June 30, 20X4?

A—Yes. Use of a service cost measure based on the results of the actuarial valuation that determined the beginning net pension liability for the reporting period is consistent with the requirement to calculate interest on the total pension liability over the period. Interest on service cost should be included in the amount reported as interest on the total pension liability. (See Question 5.142.6.)

5.142.6. Q—If the approach described in Question 5.142.5 is used to determine the service cost for the measurement period ended June 30, 20X5, should the amounts identified as interest on the total pension liability be calculated on the beginning total pension liability, adjusted for service cost and actual benefit payments (including refunds of employee contributions), or should projected
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benefit payments from the actuarial valuation that is used to determine the service cost be used for purposes of the adjustment?

A—Interest on the total pension liability should be determined based on the beginning total pension liability, adjusted for service cost and actual benefit payments. Because the actual amounts of benefit payments and contributions are components of the total change in the plan’s fiduciary net position, it would be consistent to use actual amounts to determine other components of the change in the net pension liability, including the changes in the total pension liability resulting from benefit payments and interest on the total pension liability.

5.142.7. Q—How should the effects of an ad hoc COLA granted to retirees be classified for purposes of determining pension expense if the effects of the COLA were not included in the present value of projected benefit payments as of the prior measurement date because the COLA was not determined to be substantively automatic?

A—An ad hoc COLA that is determined not to be substantively automatic is a form of postemployment benefit change. Therefore, the effects of such an ad hoc COLA should be recognized in pension expense for the reporting period in which the change in the net pension liability is recognized, as required by paragraph 33 of Statement 68.

5.142.8. Q—The effects of a COLA that was determined to be substantively automatic were included in the present value of projected benefit payments in the total pension liability as of the prior measurement date. The COLA was not provided in the current measurement period. At the current measurement date, the COLA still is determined to be substantively automatic. In this circumstance, how should the effects on the total pension liability that result from not providing the COLA be classified for purposes of determining pension expense?

A—The effects on the total pension liability that result from not providing the COLA should be accounted for as a difference between expected and actual experience. Paragraph 33a of Statement 68 requires those differences to be recognized in pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.142.9. Q—Would the answer to Question 5.142.8 be different if, at the current measurement date, the COLA is no longer considered to be substantively automatic?

A—No. The effects on the total pension liability that result from the COLA not being provided in the current measurement period should be classified as a difference between expected and actual experience, even if the COLA is determined to no longer be substantively automatic at the current measurement date. Paragraph 33a of Statement 68 requires that portion of the change in the total pension liability to be recognized in pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period. The reclassification of the COLA during the measurement period as ad hoc rather than as substantively automatic is a separate event, and the effects of that reclassification on the total pension liability should be accounted for as a change of benefit terms, which is required by paragraph 33 of Statement 68 to be recognized in pension expense in the reporting period in which the net pension liability recognized by the employer reflects the change.
5.142.10. Q—If the terms of a defined benefit pension plan are amended and a change of assumption is made as a direct result of the amendment, should the effect of the change of assumption on the total pension liability be included with the effect of the change of benefit terms for purposes of determining pension expense?

A—Yes. Although, generally, the effect of a change of assumption on the total pension liability should be separated from the effect of a change of benefit terms, in circumstances in which the change of assumption is adopted as a direct result of the change of benefit terms, the effect of the change of assumption should be classified as a component of the change of benefit terms and recognized in pension expense in the reporting period in which the net pension liability recognized by the employer reflects the change. For example, if the mandatory retirement age in a plan is modified, changes of assumptions about the retirement ages of active employees that are made to adjust for the change of benefit terms would be directly related to the benefit change. Although mathematically separable, if the change of assumptions would not have occurred in the absence of the change of benefit terms, the change of assumptions is, in substance, a component of the change of benefit terms, and the effects of the change should be included in the effects of a change of benefit terms. In contrast, if, at the same actuarial valuation date, a change is made to mortality assumptions based on the results of a recent experience study and mortality rates are not associated with retirement age, the effect of the change of mortality assumption would not be directly related to the change of benefit terms and should be classified as a change of assumption, which is required by paragraph 33a of Statement 68 to be recognized in pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.142.11. Q—How should the effects of a change in the discount rate on the total pension liability be classified?

A—A change in the total pension liability arising from a change in the discount rate should be accounted for as a change of assumption or other input. A change in the discount rate can result from a change in the long-term expected rate of return on pension plan investments (an assumption), a change in the municipal bond yield or index rate (an other input), or a change in the relative weighting of the rates (the result of a change of assumption or other input that impacts projected plan fiduciary net position or projected benefit payments). The resultant effect of the change in the discount rate on the total pension liability should be recognized in pension expense, beginning in the current reporting period, using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.142.12. Q—If a pension plan purchases an allocated insurance contract that meets the criteria in paragraph 25 of Statement 68, how should the effects on the components of the net pension liability be classified for purposes of employer expense recognition?

A—The purchase of the allocated insurance contract results in a reduction of the pension plan’s fiduciary net position for the amount paid for the contract and a reduction in the total pension liability for benefit payments. If there is a difference between the amount recognized as a benefit payment by the pension plan and the amount of the actuarial present value of projected benefit payments that is removed from the total pension liability as a result of the purchase, that amount should be classified as a difference between expected and actual experience and recognized in
pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.142.13. Q—Paragraph 33b of Statement 68 requires that changes in the net pension liability arising from differences between projected and actual earnings on pension plan investments be recognized in pension expense over a closed five-year period beginning in the current measurement period, with any remaining balance from the current period reported net of the remaining balances that arose in prior periods. Can the amount of the net balance from prior periods that is recognized in pension expense in the current period be determined by multiplying the remaining net balance that arose in prior periods by 25 percent?

A—No. Determining the amount to recognize in pension expense by applying 25 percent to the remaining net balance is an example of an open-period method, and paragraph 33b of Statement 68 requires that these differences be recognized in expense using a closed-period method. For example, in 20X5, using a closed-period, straight-line method, the amount of the remaining net balance that arose in prior periods to recognize in pension expense in the current period would be 25 percent of the portion of the remaining balance that arose in 20X4, 33 percent of the portion of the remaining balance that arose in 20X3, 50 percent of the portion of the remaining balance that arose in 20X2, and 100 percent of the portion of the remaining balance that arose in 20X1. Alternatively, the amounts to recognize in pension expense in 20X5 could be determined as 20 percent of each of the differences that arose in 20X1–20X4.

5.142.14. Q—How should the projected earnings on pension plan investments be calculated for purposes of determining the difference between projected and actual earnings?

A—Projected earnings on pension plan investments should consider changes in invested amounts and should be calculated as the return that actual invested amounts would have earned at the assumed rate of return over the measurement period. For this purpose, the assumed rate of return should be net of investment expense, but not net of administrative expense, and should reflect the expectation of the rate as of the beginning of the measurement period.

5.142.15. Q—Can an employer apply a method for recognition of pension expense for differences between expected and actual experience, changes of assumptions or other inputs, or a difference between projected and actual earnings on pension plan investments that would result in all of the amount being recognized in the year in which the change is reflected in the net pension liability or all of the amount being recognized in the final year of the recognition period required in paragraph 33 of Statement 68?

A—No. Changes in the total pension liability arising from differences between expected and actual experience or changes of assumptions or other inputs are required to be recognized using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with benefits through the plan (active employees and inactive employees), determined at the beginning of the measurement period. Differences between projected and actual earnings on pension plan investments are required to be recognized using a systematic and rational method over a closed five-year period. Recognizing all of the change associated with these events in the pension expense of a single year is inconsistent with these provisions of Statement 68.
5.142.16. Q—Paragraphs 33a and 33b of Statement 68 require that certain changes in the net pension liability be recognized in pension expense over specified periods using a systematic and rational method. What are examples of systematic and rational methods?

A—The simplest systematic and rational method is the straight-line method. The level-percentage-of-payroll is another example of a systematic and rational attribution method. However, any systematic and rational method can be used.

5.142.17. Q—The employees of a government include a large number of inactive employees who are entitled to, but have not yet requested, a refund of their contributions to the plan and earnings on those contributions. The amount of the refunds will change only in accordance with actual earnings on plan investments and, as such, are not associated with certain of the changes in the net pension liability that are reported as deferred outflows of resources and deferred inflows of resources related to pensions. Can these employees be excluded from the determination of the average of the expected remaining service lives of employees?

A—No. Statement 68 requires that the average of the expected service lives of employees include all active and inactive employees that are provided with benefits (including refunds of employee contributions) through the plan.

5.142.18. Q—If changes in the total pension liability arising from differences between expected and actual experience or a change of assumption or other input occur only in the portion of the total pension liability associated with active employees (for example, the actual change in salary since the last measurement period was different from the assumed change in salary), can the changes be recognized in pension expense over the average of the expected remaining service lives of active employees?

A—No. Paragraph 33a of Statement 68 requires differences between expected and actual experience and changes of assumptions to be recognized in pension expense over the average of the expected remaining service lives of all employees—active employees and inactive employees—regardless of whether the change is directly associated with certain individual employees.

5.142.19. Q—Over what period should a change in the total pension liability arising from differences between expected and actual experience or changes of assumptions or other inputs be recognized in pension expense if the average of the expected remaining service lives of employees is less than one year as of the beginning of the measurement period, for example, as might occur in a closed plan?

A—in this circumstance, changes in the total pension liability arising from differences between expected and actual experience or changes of assumptions should be recognized in pension expense over one period. This results in all changes in the total pension liability being recognized in pension expense in full in the reporting period in which they are reflected in the net pension liability reported by the employer.

5.142.20. Q—In determining the average of the expected remaining service lives of employees for purposes of measuring pension expense, should the probabilities of different decrements, such as disability, death, retirement, or separation from service, be considered?

A—Yes. Pension expense and the total pension liability are related measures, and application of the requirements of Statement 68 for attribution of the present value of projected benefit
payments to periods generally would result in consideration of the probability of various decrements for purposes of determining the total pension liability. (See Question 5.140.1.) Because probabilities of decrements are required to be considered relative to expected service lives when measuring the total pension liability, it would be inconsistent to omit consideration of those events when measuring the average of the expected remaining service lives for use in determining pension expense.

5.142.21. Q—Paragraph 33c of Statement 68 requires that a single or agent employer not recognize pension expense for a change in a net pension liability resulting from its contributions to the pension plan during the measurement period. How should a single or agent employer account for its contributions to the pension plan during the measurement period?

A—Single or agent employer contributions to the pension plan during the measurement period increase the pension plan’s fiduciary net position and, therefore, should be accounted for by the employer as a reduction of the net pension liability. (See Question 5.143.1 regarding accounting for contributions made subsequent to the measurement date.)

5.142.22. Q—An employer issues $100 million of pension obligation bonds. The proceeds from the bond issue are remitted directly into the pension trust fund, which the employer includes in its annual financial statements; they do not flow through the employer’s general fund. How should the transaction be accounted for?

A—Regardless of the funds’ flow, the substance of the transaction is that the employer has issued general bonded debt, from which it has derived the proceeds, and has applied the proceeds to make a contribution to the plan. Even though the employer, in this case, includes the plan as a pension trust fund in its financial statements, the employer and the plan are separate legal entities, and this transaction should be viewed as an external transaction for financial reporting purposes. The employer’s first entry, therefore, should be to recognize the bond issue. Its second, unless the amounts remitted to the pension plan are for payment of an existing payable to the pension plan, should be to recognize its contribution to the plan as a reduction of the net pension liability (or as a deferred outflow of resources if the contribution is made subsequent to the measurement date of the net pension liability reported in the current period).

If the amounts remitted to the pension plan are for payment of an existing payable to the plan, the employer’s second entry should be to recognize the reduction of that payable. In this case, there would be no change in the pension plan’s fiduciary net position resulting from the receipt of the bond proceeds, and there would be no effect on the net pension liability to be recognized as a result of the transaction.

5.142.23. Q—How should a single or agent employer classify revenue that is recognized in conformity with paragraph 33d of Statement 68 for the support provided by a nonemployer contributing entity that is not in a special funding situation?

A—The employer should classify this revenue in the same manner as it classifies grants from other entities.
5.143.1. Q—What should be included in the amounts reported as deferred outflows of resources for a single or agent employer’s contributions made subsequent to the measurement date?

A—For purposes of paragraph 34 of Statement 68, the deferred outflow of resources reported by an employer should include contributions made by the employer during its fiscal year that will be reflected in the net pension liability in the next measurement period—that is, the amount of contributions through the end of the employer’s fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period. The deferred outflow of resources would not include the employer’s payments subsequent to the measurement date to satisfy a contribution receivable recognized by the plan prior to the end of the current measurement period.

5.144 Recognition and measurement in financial statements prepared using the economic resources measurement focus and accrual basis of accounting by employers that have a special funding situation


5.145 Recognition in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting—all single and agent employers

5.145.1. Q—If, at the measurement date, the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, should any portion of a single or agent employer’s net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A—No. In circumstances in which the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, no portion of the net pension liability should be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

5.145.2. Q—If, at the measurement date, the pension plan’s fiduciary net position is not sufficient to make benefit payments that are due and payable, should any portion of a single or agent employer’s net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A—Yes. In circumstances in which the pension plan’s fiduciary net position is not sufficient to make benefit payments that are due and payable, the employer should recognize an amount equal to the amount of benefits due and payable that exceeds the pension plan’s fiduciary net position as a net pension liability in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

5.146 Notes to financial statements—all single and agent employers

5.146.1. Q—If an employer reports pension liabilities that have different measurement dates, is the employer required to update the measures to the same measurement date for purposes of presenting the total pension-related measures required by paragraph 37 of Statement 68 or for disclosing additional information about the pension liabilities that is required by Statement 68?

A—No. Information reported in notes about pension liabilities focuses on conditions as of the measurement date. For purposes of presenting information to meet the requirement of
paragraph 37 of Statement 68 for disclosure of the total amounts of pension-related measures if those amounts are not otherwise identifiable from information presented in the financial statements, the employer should disclose the total of the amounts reported in the financial statements for pensions provided through each plan, regardless of differences in their measurement dates. As specified by paragraphs 38 and 75 of Statement 68, the information that is required to be provided in notes should be disclosed for benefits provided through each defined benefit pension plan in which the employer participates. If different measurement dates are used for pensions provided through different plans, the information in notes about each benefit arrangement should reflect its individual measurement date.

5.146.2. Q—The employees of a primary government and its component units are provided with pensions through a pension plan for which paragraph 18 of Statement 68 requires the reporting entity to apply the requirements for note disclosures applicable to a single or agent employer. Can the reporting entity meet the requirement of paragraph 39 of Statement 68 for separate identification in note disclosures of pension-related amounts associated with the primary government and those associated with its discretely presented component units by disclosing pension-related amounts for discretely presented component units in the aggregate?

A—Yes. The requirement of paragraph 39 of Statement 68 is intended to result in information about the primary government (including its blended component units), on the one hand, and the discretely presented component units in the aggregate, on the other hand.

5.146.3. Q—A single-employer or agent multiple-employer pension plan issues a stand-alone financial report in conformity with Statement 67 that includes certain information that also is required by Statement 68 to be reported by an employer that provides pensions through the plan. For example, a single-employer plan includes a 10-year schedule of changes in the net pension liability using information as of the same measurement date as required to be presented by the employer. Can the employer omit from its report the information included in the pension plan’s stand-alone report if the employer’s report refers to the pension plan’s stand-alone report?

A—All information required by Statement 68 should be included in the single or agent employer’s financial report. The only item for which Statement 68 permits reference to the pension plan’s report in place of including the detail in the employer’s report is the information required by paragraph 43 of Statement 68 about the elements of the pension plan’s fiduciary net position if the pension plan’s report is available on the Internet.

5.147 Pension Plan Description

5.147.1. Q—Should the information that is required by paragraphs 40b and 40c of Statement 68 about benefit terms and the number of employees that are covered by the benefit terms, respectively, be current as of the actuarial valuation date that is used as the basis for the total pension liability, the measurement date of the net pension liability, or the employer’s fiscal year-end?

A—The requirements of paragraphs 40b and 40c of Statement 68 are intended to result in the disclosure of information about the benefit terms at the measurement date of the net pension liability. If a change occurs in the benefit terms or the number of employees that are covered by the benefit terms between the measurement date and the employer’s fiscal year-end such that the effect of the change on the net pension liability is expected to be significant, paragraph 45f of Statement 68 requires information about the change to be disclosed.
5.147.2. Q—Under the benefit terms of pensions provided through an agent multiple-employer plan, an employee earns service credit for years of employment with any of the employers that provide benefits through the plan. Each employer remains responsible for financing the portion of an employee’s benefits related to the service credit earned when the employee worked for that employer. As such, some portion of the change in the employer’s total pension liability may arise, for example, from differences between expected and actual experience related to an employee who no longer works for the employer but who still works for another employer that participates in the agent multiple-employer plan. In this circumstance, should the employee be considered an active employee or an inactive employee?

A—The employee should be considered active by the employee’s current employer. The employee should be considered inactive by all of the employee’s former employers within the agent plan. The amount of the total pension liability for an inactive employee may change due to differences between expected and actual experience or due to changes of assumptions or other inputs.

5.147.3. Q—Should all contributions made to the pension plan by a single or agent employer during the employer’s fiscal year be included in the amount of contributions that paragraph 40d of Statement 68 requires to be disclosed?

A—No. For purposes of paragraph 40d of Statement 68, contributions should include only (a) the amount of actual contributions, which are cash contributions from the employer to the pension plan that would be recognized as additions from contributions in the pension plan’s statement of changes in fiduciary net position during the period that coincides with the employer’s fiscal year, and (b) the amount of contributions from the employer to the pension plan that would be recognized by the pension plan as a current receivable during the period that coincides with the employer’s fiscal year. This would exclude, for example, payments made to satisfy employer payables to the pension plan that arose in an earlier fiscal year. (See also Question 5.147.4.)

5.147.4. Q—For purposes of providing information about contributions that is required by paragraph 40d of Statement 68, what should be considered a contribution recognized by the pension plan as a current receivable?

A—For purposes of paragraph 40d of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the employer’s contributions during the employer’s reporting period and (b) would be collectible within a year as of the end of the employer’s reporting period. For example, a receivable recognized by the pension plan for an employer’s contributions related to the last month of the employer’s fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable of the pension plan.
A—The single or agent employer should apply paragraph 43 of Statement 68 regarding note disclosures about the pension plan’s fiduciary net position. That paragraph requires that the employer disclose all information required by Statement 68 and other standards about the pension plan’s assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position. Therefore, the employer would have to include information in its financial statements to comply with all note disclosure requirements applicable to the pension plan. This information includes the information required by Statement 67, as well as information required by other Statements. For example, the employer would be required to present information to comply with disclosure requirements related to pension plan deposits and investments, including information required by Statements 3, 31, and 40, as amended, as applicable.

5.151 Changes in the Net Pension Liability

5.152 Schedule of Changes in the Net Pension Liability

5.152.1. Q—If part of the total service cost for pensions provided through a single-employer or individual agent-employer pension plan is identified as being paid by the employees through their annual contribution requirement, should the amount presented in the schedule of changes in the net pension liability be only the portion of the total service cost that is required to be paid by the employer?

A—No. Paragraph 139 of Statement 68 defines service costs as “the portions of the actuarial present value of projected benefit payments that are attributed to valuation years.” The actuarial present value of projected benefit payments generally would not include a reduction for expected employee contributions. Therefore, the amount presented as service cost in the schedule of changes in the net pension liability should be the total service cost of the measurement period.

5.153 Additional Information

5.153.1. Q—If a single or agent employer reports a net pension liability that is based on the results from an actuarial valuation that has been updated to the measurement date, what information is the employer required to disclose regarding the update?

A—Information about the measure of total pension liability (for example, the assumptions used in the measurement) should reflect amounts and circumstances as of the measurement date. However, if update procedures were used to develop the measure of the total pension liability, paragraph 45a of Statement 68 requires that the employer disclose that fact. No other specific information about the update process is required.

5.153.2. Q—What information, if any, is required to be disclosed about a change in a relevant factor that occurs between the measurement date of the net pension liability and the employer’s current fiscal year-end?

A—For a change that is expected to have a significant effect on the net pension liability, in its financial report for the current fiscal year, the employer should provide information required by paragraph 45f of Statement 68 about the nature of the change, as well as the amount of the expected impact of the change on the net pension liability, if known. For example, if a change of benefit terms is made between the measurement date and the end of the employer’s current fiscal year and an estimate of the effect of the change of benefit terms on the net pension
liability has been made and is evaluated by the employer to be significant, the employer should include in note disclosures a brief description of the benefit change and the estimated amount of the expected resultant change in the net pension liability. (See Questions 5.131.2 and 5.134.6 regarding the timing of the recognition of the effects of such changes.)

5.154 Required supplementary information—all single and agent employers

5.154.1. Q—If employer contributions to the pension plan are determined based on the pensionable payroll of covered employees and the pensionable payroll is different from the total payroll of those employees, which measure of payroll should be presented in the 10-year schedules required by paragraphs 46b, 46c, and 46d of Statement 68?

A—The amount of the total payroll of the covered employees (termed covered-employee payroll in Statement 68) on the accrual basis of accounting for the relevant period should be presented in the 10-year schedules required by paragraph 46 of Statement 68, and that amount also should be used as the basis for the ratios required by that paragraph. See Question 5.154.2 for a discussion of the relevant period for each of the schedules required by paragraphs 46b, 46c, and 46d of Statement 68.

5.154.2. Q—The measurement date of a single or agent employer’s net pension liability is December 31, 20X4, and is different from its fiscal year-end, which is June 30, 20X5. For purposes of presenting information about the employer’s covered-employee payroll in the schedules of RSI required by paragraph 46 of Statement 68, which measure(s) of covered-employee payroll should be used?

A—In the employer’s schedule of RSI that presents the components of the net pension liability and related ratios as required by paragraph 46b of Statement 68, the amount of covered-employee payroll presented should be the annual covered-employee payroll during the measurement period that ends on the measurement date of the net pension liability—that is, the period from January 1, 20X4, to December 31, 20X4. If the employer presents a contribution-related schedule in conformity with paragraph 46c or paragraph 46d of Statement 68, the measure of covered-employee payroll included in that schedule should be the annual covered-employee payroll during the employer’s fiscal year—that is, the period from July 1, 20X4, to June 30, 20X5.

5.155 Paragraph 46a

5.156 Paragraph 46b

5.157 Paragraphs 46c and 46d

5.157.1. Q—Should all contributions made to the pension plan by a single or agent employer during the employer’s fiscal year be included in the amount of contributions reported in the schedule of RSI that is required by paragraph 46c or paragraph 46d of Statement 68, as applicable?

A—No. For purposes of paragraphs 46c and 46d of Statement 68, contributions are amounts that are not associated with separately financed specific liabilities of the individual employer and include only the amounts that would be recognized as additions from the employer’s contributions in the pension plan’s statement of changes in fiduciary net position during the period that coincides with the employer’s fiscal year for (a) actual contributions, which are cash contributions from the employer to the pension plan, and (b) current receivables. This would include, for example, the amount of legally required employer contributions that are not associated with a specific liability of the individual employer to the pension plan and that would be
recognized as a current receivable by the pension plan as of the end of the employer’s fiscal year. It would exclude, for example, employer payments made to satisfy pension plan receivables that arose in an earlier employer fiscal year. (See also Question 5.157.2 regarding current receivables.)

5.157.2. Q—For purposes of reporting contributions in the schedule of RSI that is required by paragraph 46c or 46d of Statement 68, as applicable, what should be considered a contribution recognized by the pension plan as a current receivable?

A—For purposes of paragraphs 46c and 46d of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the employer’s contributions during the employer’s reporting period, (b) would be collectible within a year, and (c) is not associated with separately financed specific liabilities of the employer. For example, a receivable recognized by the pension plan for an employer’s contributions related to the last month of the employer’s fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable.

5.157.3. Q—If a single or agent employer has an actuarially determined contribution amount but contributes according to a statutorily established rate, which RSI schedule(s) related to contributions is the employer required to present?

A—The employer should present the information required in paragraph 46c of Statement 68, which includes amounts to compare the actuarially determined contribution of the employer during the employer’s fiscal year to the amount of employer contributions recognized by the pension plan in relation to the actuarially determined contribution during the same period. The requirements of paragraph 46c of Statement 68 apply if an actuarially determined contribution of the employer is calculated for any purpose, regardless of whether the employer’s contribution requirements or contribution policy is based on the actuarially determined contribution amount. Only if an actuarially determined contribution is not calculated should a single or agent employer whose contribution requirements are statutorily or contractually established present the schedule required by paragraph 46d of Statement 68, which includes amounts to compare the employer’s statutorily or contractually required contribution during the employer’s fiscal year to contributions made by the employer during the same period.

5.157.4. Q—If a contribution rate for the period from July 1, 20X2, to June 30, 20X3, is adopted at October 31, 20X1, based on the results of an actuarial valuation as of June 30, 20X1, should the resulting actuarially determined contribution be reported in the schedule of contributions for the employer’s fiscal year ended June 30, 20X2, or June 30, 20X3?

A—The actuarially determined contribution is an amount determined based on the most recent measurement available when the contribution for the reporting period was adopted. Therefore, in this example, assuming that the results of the June 30, 20X1 actuarial valuation are the most recent results available as of October 31, 20X1, amounts based on those results should first be presented in the contribution schedule required by paragraph 46c of Statement 68 for the employer’s fiscal year ended June 30, 20X3.

5.157.5. Q—If an actuarially determined contribution is calculated for the pension plan’s fiscal year and the employer’s fiscal year does not coincide with the fiscal year of the plan, what amount should be reported in the contribution-related schedule required by paragraph 46c of Statement 68?
Pensions—Plan and Employer Accounting and Reporting

A—Information reported in the contribution schedule required by paragraph 46c of Statement 68 should be the amounts that are applicable to each of the employer’s fiscal years presented. If the actuarially determined contribution is not calculated for the employer’s fiscal year, the amount to be included in the schedule would be determined as the aggregate of the actuarially determined contributions for the portions of the plan’s fiscal years that overlap the employer’s fiscal year. For example, an employer’s fiscal year is from July 1 to June 30, and the plan’s fiscal year is from January 1 to December 31. The actuarially determined contribution applicable to the employer’s fiscal year ended June 30, 20X6, would be the actuarially determined contribution for the last six months of the plan’s fiscal year 20X5 (because that fiscal year overlapped the first six months of the employer’s fiscal year), plus the actuarially determined contribution for the first six months of the plan’s fiscal year 20X6 (because that fiscal year overlapped the last six months of the employer’s fiscal year).

5.157.6. Q—Should the schedule of contribution-related information required by paragraph 46c of Statement 68 include information for the year between actuarial valuations if actuarially determined contributions are calculated biennially?

A—Yes. The actuarially determined contribution for the period between actuarial valuations should be reported, using the results of the actuarial valuation that established the contribution applicable to that period.

5.157.7. Q—What actuarial methods and assumptions should be used to calculate the actuarially determined contribution reported in conformity with the requirements of paragraph 46c of Statement 68?

A—For purposes of applying the requirements of paragraph 46c of Statement 68, an actuarially determined contribution is defined, in part, as a contribution calculated in conformity with Actuarial Standards of Practice. That is, a calculation that applies relevant guidance from Actuarial Standards of Practice, for example, standards related to the selection of economic or demographic assumptions. Statement 68 does not establish requirements for the specific methods and assumptions used to calculate an actuarially determined contribution.

5.157.8. Q—If the contribution requirements of an employer are determined using an actuarial value of assets that incorporates differences between projected and actual earnings on pension plan investments over a three-year period, can that method continue to be used to determine contribution requirements after implementation of Statement 68?

A—Yes. Statement 68 does not establish requirements for the specific methods and assumptions, if any, used for funding purposes. Therefore, an actuarial value of assets can continue to be used for funding purposes. However, for purposes of complying with Statement 68, all changes in the pension plan’s fiduciary net position, including the full amount of the actual earnings on pension plan investments, should be included in the calculation of the net pension liability and changes in the net pension liability in the measurement period in which they occur.

5.157.9. Q—Paragraph 138 of Statement 68 states that schedules of RSI “should not include information that is not measured in accordance with the requirements of this Statement.” Does that mean that information about actuarially determined contributions should be presented only if it is calculated using the same methods and assumptions as are required to be applied for purposes of measuring the net pension liability?
A—No. As noted in Question 5.157.7, an actuarially determined contribution is defined, in part, as a contribution calculated in conformity with Actuarial Standards of Practice; however, Statement 68 does not establish requirements for the specific methods and assumptions that are used to calculate an actuarially determined contribution. Therefore, if calculated, a single or agent employer should present measures of actuarially determined contributions, regardless of the methods and assumptions used to calculate them.

5.157.10. Q—Should amounts recognized by a single-employer or individual agent-employer pension plan for contributions pursuant to a separately financed specific liability of the employer be included in the amount reported by the employer as contributions in relation to the actuarially determined contribution, as required by paragraph 46c of Statement 68, or as contributions in relation to statutorily or contractually required contributions, as required by paragraph 46d of Statement 68, as applicable?

A—No. The measure of the actuarially determined contribution that is required by paragraph 46c(1) of Statement 68 or the statutorily or contractually required contribution that is required by paragraph 46d(1) of Statement 68 excludes amounts, if any, to separately finance specific liabilities of the individual employer to the pension plan. Similarly, the amount of contributions presented in relation to the actuarially determined or statutorily or contractually required contribution, as applicable, should exclude amounts recognized as additions to the pension plan for separately financed specific liabilities of the individual employer to the pension plan.

5.157.11. Q—When contribution rates are established for the employer in a single-employer or agent pension plan and a nonemployer contributing entity, should the schedule of RSI that presents contributions made as compared to actuarially determined or to statutorily or contractually required contributions (paragraph 46c or paragraph 46d of Statement 68, respectively) in the financial report of the employer include amounts for the nonemployer contributing entity?

A—No. The schedule should include information about contributions made by, and the actuarially determined or statutorily or contractually required contributions of, only the single or agent employer.

5.157.12. Q—May employee contributions be added to the RSI schedule that presents contributions made as compared to actuarially determined or statutorily or contractually required contributions (paragraph 46c or paragraph 46d of Statement 68, respectively)?

A—No. Including employee contributions in the schedule could obscure information about employer contribution decisions. Instead, employee contribution rates (in dollars or as a percentage of covered payroll) should be disclosed in the notes to the financial statements as required by paragraph 40d of Statement 68.

5.157.13. Q—The dollar amount of a single or agent employer’s actuarially determined contribution is calculated based on the projected covered payroll for the year to which the contribution will apply. An actuarially determined contribution rate, expressed as a percentage of the projected covered payroll also is calculated. The employer contributes based on that actuarially determined contribution rate, applied to its actual covered payroll, which frequently is not the same as the projected covered payroll. Thus, the dollar amount of employer contributions may differ from the dollar amount of the actuarially determined contribution that is calculated because of the difference between projected and actual covered payrolls. Which amount should be reported as
the actuarially determined contribution in the employer’s schedule of contribution-related
information required by paragraph 46c of Statement 68?

A—The intent of the schedule required by paragraph 46c of Statement 68 is to provide
information to allow a reader to evaluate the degree to which an employer is meeting actuarially
determined financing requirements. Therefore, the actuarially determined contribution and the
amount of contributions recognized by the pension plan in relation to that contribution should be
presented on a comparable basis. Thus, for this schedule, the dollar amount of the actuarially
determined contribution should be adjusted, if necessary, so that the amount reported is based
on the same measure of payroll as the contributions recognized as additions in the pension
plan’s statement of changes in fiduciary net position. (See Illustration 12 in nonauthoritative
Appendix B5-2 for an example.)

5.158 Notes to Required Schedules

5.159 Cost-sharing employers

5.160 Recognition and measurement in financial statements prepared using the economic resources measurement focus
and accrual basis of accounting by employers that do not have a special funding situation

5.161 Proportionate Share of the Collective Net Pension Liability

5.161.1. Q—Historically, a cost-sharing employer has contributed 100 percent of its contractually required
contributions, which are actuarially determined. Is the employer required to recognize a portion of
the collective net pension liability even though it has contributed an amount equal to its
contractually required contributions in the past?

A—Yes. Statement 68 requires that a cost-sharing employer recognize its proportionate share of
the collective net pension liability determined in conformity with the provisions of paragraphs
48–50 of Statement 68, regardless of whether it has made its contractually required
contributions in the past.

5.161.2. Q—What guidance does Statement 68 provide regarding recognizing a cost-sharing employer’s
proportionate share of the collective net pension liability if a portion of the liability will be paid
from an enterprise, internal service, or fiduciary fund?

A—Except for blended component units, which are discussed in Questions 5.125.2 and 5.125.3,
Statement 68 does not establish specific requirements for allocation of the employer’s
proportionate share of the collective net pension liability or other pension-related measures to
individual funds. However, for proprietary and fiduciary funds, consideration should be given to
NCGA Statement 1, paragraph 42, as amended, which requires that long-term liabilities that are
“directly related to and expected to be paid from” those funds be reported in the statement of net
position or statement of fiduciary net position, respectively.

5.162 Measurement Date

5.162.1. Q—If a cost-sharing employer’s fiscal year-end is the same as the fiscal year-end of the pension
plan through which it provides benefits, can the employer report its proportionate share of the
collective net pension liability as of a measurement date that is one year earlier than the “as of”
date of the (collective) net pension liability reported by the plan at the same fiscal year-end?
Pensions—Plan and Employer Accounting and Reporting

A—Yes. To avoid a circumstance in which employer financial reports potentially would be delayed awaiting information that also is included in the pension plan’s financial report, Statement 68 permits the measurement date of the collective net pension liability used by a cost-sharing employer to determine its reported pension liability to be as of a date no earlier than the end of its prior fiscal year, provided that the actuarial valuation used to determine the collective net pension liability meets the timing requirements of paragraph 60 of Statement 68 and that the measure meets the requirement of paragraph 61 of Statement 68 that the plan and the employers use the same assumptions when measuring similar or related information. (See Questions 5.176.1–5.176.3.) Cost-sharing pension plans are required by Statement 67 to report information about the (collective) net pension liability as of the plan’s fiscal year-end. Therefore, for example, in financial statements as of June 30, 20X5, a cost-sharing pension plan is required to report a (collective) net pension liability measured as of June 30, 20X5, whereas a cost-sharing employer that provides benefits through the plan can report a proportionate share of the collective net pension liability with a measurement date of June 30, 20X4, if the requirements of paragraphs 60 and 61 of Statement 68 are met.

5.162.2. Q—If an employer participates in more than one defined benefit pension plan, is the employer required to use the same measurement date for each (collective) net pension liability?

A—No. Paragraph 18 of Statement 68 specifies that the requirements of that Statement related to liabilities to employees for pensions, which include the provisions of the Statement for the selection of the measurement date of the (collective) net pension liability, should be applied separately to the pensions provided through each defined benefit pension plan. Therefore, provided that the measurement date for each (collective) net pension liability meets the requirements of Statement 68, the related pension liabilities presented in an employer’s financial report can have different measurement dates. For example, in financial statements for its fiscal year ended June 30, 20X5, an employer can report a net pension liability with a measurement date of December 31, 20X4, for pensions provided through single-employer Pension Plan A and a proportionate share of the collective net pension liability with a measurement date of March 31, 20X5, for pensions provided through cost-sharing Pension Plan B. (See Question 5.186.1 regarding note disclosure requirements when different measurement dates are used.)

5.163 Determining a Cost-Sharing Employer’s Proportion

5.163.1. Q—A cost-sharing plan is used to provide pensions to the employees of Employer A and Employer B. Employers are required to make contributions to the plan as a specified percentage of active-employee payroll. An employee is employed by Employer A for 18 years and then is employed by Employer B for 6 years. The employee retires from Employer B. Should Employer A and Employer B report proportionate shares of the collective net pension liability that reflect the length of service provided to each employer? That is, should Employer A report 75 percent of the net pension liability (18 years ÷ 24 years) for pensions of the employee and Employer B report 25 percent of that liability (6 years ÷ 24 years)?

A—No. The relative length of past service provided by an employee to an individual cost-sharing employer generally is not relevant to the proportionate share of the net pension liability that should be reported by the employer. In a cost-sharing plan, the cost of the pension provided to an individual employee is not directly associated with the employer to which the employee provides services. Instead, the pensions of all employees are pooled, and the pooled costs are shared among the participating employers through the assessment of periodic contributions. Therefore, paragraphs 48 and 49 of Statement 68 require that a cost-sharing
employer report a proportionate share of the collective net pension liability that is determined by multiplying the collective net pension liability by a proportion that is based on the manner in which contributions are assessed—for instance, in this example, projected active-employee payroll might be used as the basis for determining each employer’s proportion.

5.163.2. Q—Can the basis on which an employer’s proportion is determined be changed? For example, if in its prior fiscal year, an employer’s proportion was determined based on contributions during the measurement period, can the employer’s proportion be determined in the subsequent period using an average of contributions over the past five measurement periods?

A—Yes. The employer’s proportion is an assumption and, like other assumptions, is subject to change as, for example, new events occur, more experience is acquired, or additional information is obtained. A change in the basis for the employer’s proportion might affect the applicability of certain requirements of Statement 68, including those in paragraphs 54 and 55 of Statement 68, which address changes in the employer’s proportion and contributions made as compared to the employer’s proportionate share of total employer and nonemployer contributing entity contributions, respectively. For example, a change from a proportion based on contributions made during the measurement period to a proportion based on an average of contributions in past measurement periods might result in differences in each future measurement period between the employer’s contributions and its proportionate share of total employer and nonemployer entity contributions, for which paragraph 55 of Statement 68 establishes requirements. (See Question 5.191.3 for a discussion of note disclosures regarding changes in proportion.)

5.163.3. Q—Can a measure of employer plus employee contributions be used as the basis for an employer’s proportion?

A—No. Paragraph 48a of Statement 68 specifies that an employer’s proportion is “a measure of the proportionate relationship of (1) the employer ... to (2) all employers and all nonemployer contributing entities.” Employees are specifically excluded from the definition of nonemployer contributing entities in paragraph 139 (glossary) of Statement 68. Therefore, employee contributions should not be considered in the determination of the employer’s proportion.

5.163.4. Q—A cost-sharing plan that is used to provide benefits to employees of several governmental employers also is used to provide benefits to certain nongovernmental employers. When a governmental employer determines its proportion for purposes of reporting its proportionate share of the collective net pension liability and related measures under Statement 68, should the proportion represent the relationship of the employer to all employers that provide benefits through the plan or the relationship of the employer to only the other governmental employers?

A—The governmental employer’s proportion should be representative of its relationship to all employers that provide benefits through the pension plan, regardless of whether those employers are governmental or nongovernmental for financial reporting purposes.

5.163.5. Q—In a cost-sharing pension plan in which employers’ proportions are based on each employer’s dollar amount of required contributions, an employer enters the plan with three months left in the measurement period. Should the employers’ proportions at the measurement date reflect
only 3 months of required contributions from the new employer but 12 months of required contributions from the other employers?

A—No. An adjustment should be made so that each employer’s proportion is determined using a measure of required contributions over the same period of time.

5.163.6. Q—A state is legally required to make contributions to a cost-sharing defined benefit pension plan as a nonemployer contributing entity, but the circumstances do not meet the criteria for a special funding situation. Do the state’s contributions affect the determination of the employers’ proportions for purposes of applying paragraph 48 of Statement 68? If so, how?

A—Yes. Paragraph 48 of Statement 68 requires that an employer’s proportion consider the contributions made by nonemployer contributing entities that provide support for the employer but that are not in a special funding situation. That is, for purposes of determining each employer’s portion, the contributions of the nonemployer contributing entity for that employer are treated as if they were made by that employer. (See Illustration 13 in nonauthoritative Appendix B5-2 for an example calculation of an employer’s proportion when contributions are made by a nonemployer contributing entity not in a special funding situation.)

5.163.7. Q—With regard to the requirement in paragraph 50 of Statement 68 related to the timing of the establishment of the employer’s proportion, what are examples of an actuarially determined proportion?

A—Examples of actuarially determined proportions for purposes of paragraph 50 of Statement 68 include (a) a proportion based on the long-term projected payrolls of each of the employers that provide benefits through a plan in which contributions are assessed in relation to payroll and the employers do not have a special funding situation and (b) a proportion based on a projection of the future actuarially determined contribution amounts of each of the contributing entities if contribution requirements are based on those amounts.

5.163.8. Q—Are all employers whose employees are provided with pensions through the same cost-sharing plan required to use the same basis to establish their proportions under paragraphs 48 and 49 of Statement 68?

A—No. An employer’s selection of a basis for the establishment of its proportion under paragraphs 48 and 49 of Statement 68 is independent of the selection of a basis by other employers whose employees are provided with pensions through the cost-sharing plan. For example, one cost-sharing employer can determine its proportion based on contributions during the measurement period, while another employer uses the average of contributions over the past five measurement periods as the basis for its proportion.

5.163.9. Q—An employer has an expectation that its future contribution requirements will diminish relative to the contribution requirements of all contributing entities and ultimately will be zero—for example, the employer begins providing pensions to new hires through a defined contribution plan, rather than through the cost-sharing plan, so that its future covered payroll and, hence, its future contributions will decrease relative to others over time because contributions are assessed as a percentage of covered payroll. For purposes of paragraphs 48–50 of Statement 68, can the employer assume that its proportion is zero percent because in the long term it expects its required contributions to reduce to zero?
A—No. Even though the employer expects that its share of required contributions ultimately will reduce to zero, it would not be appropriate to use zero percent as its share in the current period because it expects to be required to make contributions in some future periods. It should use an approach for determining its basis that is consistent with the manner in which contributions are assessed, and if it chooses to use a forward-looking basis as is encouraged in paragraph 48a of Statement 68, that basis should consider both short-term and long-term contribution requirements. For example, the employer could determine its proportion by comparing the present value of its expected future contributions to the present value of the expected future contributions of all contributing entities.

5.163.10. Q—If some or all of an employer’s required contributions to a pension plan are reimbursed to the employer through a federal grant, should amounts to be reimbursed be counted as a contribution from the employer for purposes of determining the employer’s proportion?

A—Yes. The amount of required contributions that will be reimbursed to the employer should be considered employer contributions when determining the relationship of the employer to all contributing entities.

5.164 Financial Statement Display

5.164.1. Q—If the total pension liability is less than the pension plan’s fiduciary net position, should a cost-sharing employer’s proportionate share of the collective net balance be displayed in the employer’s statement of net position as a negative liability or as an asset?

A—A net pension liability that is negative is an asset. Therefore, the cost-sharing employer should display its proportionate share of the collective balance as an asset in its statement of net position.

5.164.2. Q—Should a cost-sharing employer’s proportionate share of the collective net pension liability (or an aggregation of the employer’s liabilities for net pension liabilities associated with different pension plans) be displayed on a separate line on the face of the financial statements?

A—The employer’s proportionate share of the collective net pension liability is not required to be displayed separately on the face of the financial statements. However, for some governments, it will be a significant balance, which may be displayed separately on the face of the financial statements. Liabilities for net pension liabilities associated with different plans may be aggregated for display, and assets for net pension assets associated with different plans may be aggregated for display. However, aggregated pension assets and aggregated pension liabilities should be separately displayed.

5.164.3. Q—Can liabilities for net pension liabilities associated with different plans be displayed in the aggregate if the liabilities do not have the same measurement date?

A—Yes. Statement 68 does not limit the aggregation of pension liabilities based on measurement dates.

5.165 Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

5.165.1. Q—Should a cost-sharing employer’s deferred outflows of resources and deferred inflows of resources arising from changes in proportion or contributions during the measurement period (as
discussed in paragraphs 54 and 55 of Statement 68) be reported as separate amounts or net of each other?

A—Deferred outflows of resources and deferred inflows of resources arising from a change in proportion (as discussed in paragraph 54 of Statement 68) or from contributions during the measurement period (as discussed in paragraph 55 of Statement 68) in the same measurement period may be netted and reported, in a single year, as a deferred outflow of resources related to pensions if the net balance is a debit or as a deferred inflow of resources related to pensions if the net balance is a credit. However, the resultant deferred outflow of resources or deferred inflow of resources balance in one period should not be netted against deferral balances arising in other periods from changes in proportion and contributions.

5.165.2. Q—Upon joining a cost-sharing plan (the new plan), an employer enters into a long-term installment contract with the new plan for the portion of the past service cost associated with its employees that exceeds assets transferred into the plan. How should the employer account for the installment contract and the transfer of assets into the new plan in financial statements prepared using the economic resources measurement focus and accrual basis of accounting?

A—The employer should account for the amount of the installment contract as a payable to the new plan under paragraph 120 of Statement 68. In addition, for purposes of applying the requirements of paragraphs 52–57 of Statement 68, both the amount of the installment contract payable and the amount of the assets transferred into the new plan should be accounted for as contributions from the employer for a separately financed specific liability of the individual employer.

5.165.3. Q—If the cost-sharing employer in Question 5.165.2 enters the new plan in the middle of the employer’s fiscal year (the entrance date) and the measurement date of the collective net pension liability is before the entrance date, what is the employer’s proportion relative to the new plan in the fiscal year that it enters the plan?

A—Paragraph 50 of Statement 68 requires that the employer’s proportion be determined at the measurement date. Therefore, the employer’s proportion would be zero in the fiscal year that it enters the plan.

5.165.4. Q—For the cost-sharing employer in Question 5.165.2, should payments made by the employer to the new plan relative to the installment contract payable affect the amount of pension expense recognized?

A—No. Payments made by the cost-sharing employer relative to the installment contract payable reduce the reported payable and do not affect the amounts reported by the employer as pension expense.

5.166 Proportionate Share

5.166.1. Q—If an employer enters into a cost-sharing pension plan in the middle of the measurement period, should the employer’s proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions in the period of its entrance be based on changes in the collective net pension liability over the entire measurement period, or should it prorate its proportionate shares to reflect the fact that it was a participant in the plan for less than the full measurement period?
A—The employer should report its proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions based on the events of the full measurement period.

5.166.2. Q—If an employer uses different proportions to determine its share of different pieces of the collective net pension liability (for example, for different classes of employees), can it determine its total proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions using a single (overall) proportion applied to the collective measures, or for each collective measure, is it required to continue to attribute the piece associated with each class of employees using the relevant proportion?

A—Either approach is permitted. Paragraph 53 of Statement 68 requires that the employer’s proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions be determined using the employer’s proportion of the collective net pension liability, which is a single proportion that is calculated as the employer’s proportionate share of the collective net pension liability divided by the collective net pension liability. However, paragraph 19 of Statement 68 broadly establishes the permissibility of applying the measurement requirements of the Statement to individual classes or groups if “separate actuarial valuations are performed for different classes or groups of employees because different contribution rates apply for each class or group depending on the applicable benefit structures, benefit formulas, or other factors...” Regardless of the approach that is used, an employer should recognize and report only the aggregated amount of the employer’s proportionate share of each measure.

5.167 Change in Proportion

5.167.1. Q—If a cost-sharing employer’s proportion changes from the proportion used in the prior period, how should the net effect of that change be determined?

A—The net effect of the change in proportion should be determined in conformity with paragraph 54 of Statement 68. That paragraph requires that the effect be measured as of the beginning of the period. Therefore, the net effect is the debit (deferred outflow of resources) or credit (deferred inflow of resources) that is required to reflect the employer’s new proportion in its proportionate shares of the collective net pension liability and collective deferred outflows of resources and deferred inflows of resources related to pensions as of the beginning of the measurement period. (See Illustrations 8b and 9b in nonauthoritative Appendix B5-2 for examples of the calculation of the net effect of the change of proportion for cost-sharing employers.)

5.167.2. Q—Should the length of the period over which the net effect of a change in a cost-sharing employer’s proportion is recognized in the employer’s pension expense be the average of the expected remaining service lives of the employer’s own employees or the average of the expected remaining service lives of all employees that are provided with pensions through the plan?

A—Paragraph 54 of Statement 68 requires that the cost-sharing employer recognize the net effect of a change in its proportion over a period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan. This is the same period that is used for the determination of collective pension expense for the effects of changes of
assumptions on the collective net pension liability during the measurement period in which the employer is recognizing its change of proportion.

5.168 Contributions during the Measurement Period

5.168.1. Q—How should a cost-sharing employer account for its contributions to the pension plan during the measurement period?

A—A cost-sharing employer should apply the requirements of paragraphs 55 and 56 of Statement 68 to account for the effects of its own contributions to the pension plan. Paragraph 55 of Statement 68 requires that differences between (a) the employer’s contributions other than those to separately finance specific liabilities of the individual employer to the pension plan and (b) its proportionate share of the total of such contributions made by all employers and nonemployer contributing entities be recognized in pension expense over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan beginning in the current measurement period. (See Illustrations 8b and 9b in nonauthoritative Appendix B5-2 for examples.) Paragraph 56 of Statement 68 requires that the employer recognize pension expense for the difference between its contributions made during the measurement period to separately finance specific liabilities of the individual employer and the employer’s proportionate share of those contributions. (See Question 5.169.1 regarding accounting for contributions subsequent to the measurement date.)

5.169 Employer Contributions Subsequent to the Measurement Date

5.169.1. Q—What should be included in the amounts reported as deferred outflows of resources for a cost-sharing employer’s contributions made subsequent to the measurement date?

A—For purposes of paragraph 57 of Statement 68, the deferred outflow of resources reported by an employer should include contributions made by the employer during its fiscal year that will be reflected in the net pension liability in the next measurement period—that is, the amount of contributions through the end of the employer’s fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period. The deferred outflow of resources would not include the employer’s payments subsequent to the measurement date to satisfy a contribution receivable recognized by the plan prior to the end of the current measurement period. (See also Question 5.183.21.)

5.170 Support of Nonemployer Contributing Entities That Are Not in a Special Funding Situation

5.170.1. Q—As a nonemployer contributing entity, a state that is not in a special funding situation makes a direct contribution to a cost-sharing pension plan to improve the overall funded status of the plan. In the measurement period in which the contribution is reflected in the collective net pension liability, does each employer that provides pensions through the plan have to recognize revenue for a portion of the state’s contribution to the plan?

A—Yes. Paragraph 58 of Statement 68 requires that each employer in a cost-sharing pension plan recognize revenue for contributions to the pension plan from the nonemployer contributing entity that is not in a special funding situation. The amount of revenue recognized should include contributions from the nonemployer contributing entity to separately finance liabilities of the individual employer, as well as the employer’s proportionate share of the nonemployer contributing entity’s contributions to the pension plan for purposes other than separate financing of employers’ specific liabilities to the pension plan.
Q—How should a cost-sharing employer classify revenue that is recognized in conformity with paragraph 58 of Statement 68 for the support provided by a nonemployer contributing entity that is not in a special funding situation?

A—The employer should classify this revenue in the same manner as it classifies grants from other entities.

5.172 Collective Net Pension Liability

5.173 Measurement date

See Questions 5.162.1 and 5.162.2.

5.174 The pension plan’s fiduciary net position

5.174.1 Q—Do the provisions for update procedures for the total pension liability also apply to valuation of the pension plan’s fiduciary net position component of the collective net pension liability? That is, can the measure of the pension plan’s fiduciary net position from an earlier date be rolled forward for use in the measure of the collective net pension liability at the current measurement date?

A—No. Paragraph 59 of Statement 68 requires that the pension plan’s fiduciary net position component of the collective net pension liability be determined at the measurement date using the same valuation methods that would be applied by the pension plan for purposes of preparing the plan’s statement of fiduciary net position. (See Question 5.176.4 for additional discussion related to update procedures for the total pension liability.)

5.174.2 Q—If a change occurs in a factor relevant to measurement of the pension plan’s fiduciary net position between the measurement date of the collective net pension liability and the employer’s current fiscal year-end, should the employer’s proportionate share of the collective net pension liability be updated in the employer’s current fiscal year to include the effects of the change?

A—No. The employer should report its proportionate share of the collective net pension liability determined as of the measurement date. The effects of a change in the pension plan’s fiduciary net position that occurs subsequent to the measurement date of the collective net pension liability that is used to determine the amounts reported by the employer in the current fiscal year should be reflected in the collective net pension liability as of the next measurement date—that is, in the employer’s next fiscal year. (See Question 5.191.4 about note disclosures related to changes subsequent to the measurement date.)

5.175 Total pension liability

5.176 Timing and frequency of actuarial valuations

5.176.1 Q—Is the actuarial valuation date required to have the same relationship to the measurement date in each reporting period (or, for employers that have biennial actuarial valuations, to the measurement date in every other reporting period)?
A—No. Unlike the measurement date of the net pension liability, which is required to maintain the same relationship with the employer’s fiscal year-end from period to period (for example, in every year, the employer uses a measurement date of June 30 of the prior fiscal year), the date of the actuarial valuation that is used to determine the collective net pension liability at the measurement date can vary from period to period (or every 2 periods when biennial valuations are used) provided that it is within 30 months and 1 day of the employer’s fiscal year-end.

5.176.2. 

Q—Actuarial valuations to determine the total pension liability for pensions provided through a cost-sharing plan are performed as of June 30 each year, which also is the fiscal year-end of the pension plan. Because the results of the actuarial valuation are not available until several months after the actuarial valuation date, the pension plan, in its financial report, discloses information about the total pension liability based on an update of the results of the actuarial valuation as of the end of its prior fiscal year. An employer that provides benefits through the plan has a June 30 fiscal year-end and elects to use a measurement date one year prior to its fiscal year-end—that is, in its financial statements as of June 30, 20X5, it reports its proportionate share of the collective net pension liability with a measurement date of June 30, 20X4. At June 30, 20X5, as the basis for the total pension liability component of the collective net pension liability, should the employer use the results of the update of the June 30, 20X3 actuarial valuation that was used to report information about the total pension liability in the pension plan’s financial report as of June 30, 20X4, or should the employer use the results of the actuarial valuation as of June 30, 20X4?

A—Paragraph 61 of Statement 68 requires that the pension plan and employer use the same assumptions when measuring similar or related pension information. Therefore, if any assumption used in the actuarial valuation as of June 30, 20X4, was different from an assumption used in the update of the June 30, 20X3 actuarial valuation used by the pension plan to report the collective net pension liability as of June 30, 20X4, the employer is required to use the results of the same update of the June 30, 20X3 actuarial valuation.

5.176.3. 

Q—What is the earliest date of an actuarial valuation that can be used as the basis for determining the total pension liability component of the collective net pension liability, a proportion of which is reported by a cost-sharing employer at its June 30, 20X5 fiscal year-end?

A—Paragraph 60 of Statement 68 permits use of an actuarial valuation as of a date 30 months and 1 day earlier than the employer’s most recent fiscal year-end as the basis for the total pension liability that is used to determine a cost-sharing employer’s proportionate share of the collective net pension liability. Therefore, in its June 30, 20X5 financial statements, the employer can use the results of an actuarial valuation as of December 31, 20X2, or later.

5.176.4. 

Q—The measurement date of the collective net pension liability for benefits provided through a cost-sharing plan is June 30. Actuarial valuations of the total pension liability component of the collective net pension liability are obtained annually as of December 31. In conformity with the requirements of paragraph 60 of Statement 68, the results from the mid-year actuarial valuation are updated to June 30. Are there specific procedures that are required for an update for financial reporting purposes?

A—No. Statement 68 does not establish specific procedures for this purpose. Therefore, professional judgment should be applied to determine the extent of procedures necessary to faithfully represent the total pension liability as of the measurement date. In all circumstances, the
total pension liability should include all significant effects of transactions and other events between the actuarial valuation date and the measurement date. In some circumstances, for example, if there are few differences between expected and actual experience, no changes in benefit terms, and no circumstances suggesting that a significant change of assumption is needed, it might be reasonable to roll forward the results of the mid-year actuarial valuation to the measurement date with few adjustments. However, in other circumstances, more significant adjustments might be necessary to update the results of the mid-year actuarial valuation to the measurement date. (See Question 5.176.5 for examples of events that might have a significant effect on the total pension liability.) The Statement also requires that in evaluating the extent of procedures necessary to update the measure to the measurement date, among the factors that should be considered is whether a new actuarial valuation is needed for this purpose. (See Question 5.191.2 regarding note disclosures when update procedures are used.)

5.176.5. Q—What are some examples of transactions or other events that can occur between the actuarial valuation date and the measurement date that might have a significant effect on the total pension liability?

A—A change in the total pension liability can arise from a single factor or a combination of factors. Some examples of circumstances that might have a significant effect on the total pension liability include a change of benefit terms, a change in the size or composition of the covered group, a change in the municipal bond yield or index rate component of the discount rate, and a change in the pension plan’s fiduciary net position such that the discount rate used in the calculation of the total pension liability is impacted.

5.176.6. Q—If a change occurs in a factor relevant to measurement of the total pension liability between the measurement date of the collective net pension liability and the employer’s current fiscal year-end, should the employer update the amount reported as its proportionate share of the collective net pension liability in the employer’s current fiscal year to include the effects of the change?

A—No. The employer should report its proportionate share of the collective net pension liability determined as of the measurement date. The effects on the total pension liability of a change that occurs subsequent to the measurement date of the collective net pension liability that is used in the employer’s liability measure reported in the current fiscal year should be reflected in the collective net pension liability as of the next measurement date—that is, in the employer’s next fiscal year. (See Question 5.191.4 regarding note disclosures related to changes subsequent to the measurement date.)

5.176.7. Q—When actuarial valuations are performed biennially, does Statement 68 require an update to the total pension liability in the intervening year for cost-sharing employer financial reporting purposes?

A—Yes. The total pension liability should be a new measure each year, based either on a new actuarial valuation as of the measurement date or on an actuarial valuation performed as of a date no earlier than 30 months and 1 day prior to the end of the employer’s fiscal year that is updated to the measurement date. If update procedures are used and significant changes occur in, for example, benefits, the covered population, or other factors affecting the valuation results between the actuarial valuation date and the measurement date of the collective net pension liability, professional judgment should be used to determine the extent of the procedures needed to roll forward the measurement of the total pension liability, and consideration should be given to whether a new actuarial valuation is needed. (See also Question 5.176.4.)
5.177 Selection of assumptions

5.178 Projection of benefit payments

5.178.1. Q—Should refunds of employee contributions through a cost-sharing pension plan be included in the projection of benefit payments for purposes of measuring the total pension liability?

A—Yes. When provided through a defined benefit pension plan, refunds of employee contributions are a form of benefit payment for purposes of Statement 68 and should be included in the projection of benefit payments for purposes of measuring the total pension liability, including determination of the discount rate to be applied in the measurement.

5.178.2. Q—The amount of a defined benefit pension is determined based on an employees’s years of service and final three-year average pay. The calculation of pay for this purpose includes the employee’s base salary and overtime pay. Should the projection of benefit payments include an assumption about overtime pay?

A—Yes. In this circumstance, overtime pay should be considered in the projection of benefit payments. Paragraph 62 of Statement 68 requires that the projection of benefit payments include all benefits to be provided to the employees in accordance with the benefit terms. That paragraph further specifically requires that the effects of projected salary changes be included in the projection of benefit payments in circumstances in which the pension formula incorporates future compensation levels. Although not part of the employee’s base salary, the pension formula establishes overtime compensation as a relevant factor in determining the amount of an employee’s pension. Therefore, consistent with the requirements of paragraph 62 of Statement 68, the projected impact of future overtime compensation on the benefit payments that will be made to the employee should be included in the measure.

5.178.3. Q—A defined benefit pension plan’s enabling statute provides for a COLA if the investment earnings rate for the plan’s fiscal year exceeds the actuarially assumed rate. Should this COLA be treated as an automatic COLA?

A—Yes. Paragraph 62 of Statement 68 requires that the effects of any COLAs that are embedded in the benefit terms and for which there is no discretion as to timing or amount be included in the projection of future benefit payments. In this example, although a certain economic condition is required to be met for the COLA to be effective, if that condition is met, there is no discretion regarding whether the COLA will be granted.

5.178.4. Q—A defined benefit pension plan’s enabling statute provides that the board of trustees can annually authorize a COLA not to exceed a specified percentage increase or the change in the consumer price index, whichever is lower. The maximum allowable COLA has always been authorized. Should the effects of this COLA provision be included in the projection of future benefit payments?

A—This COLA is not automatic because approval of the board of trustees is required to authorize the benefit increase. Therefore, the effects of the COLA provision should be included in the projection of future benefit payments only if the provision is evaluated to be substantively automatic. Footnote 17 of Statement 68 identifies some of the factors that might be relevant in making this determination—the historical pattern of granting the changes, the consistency in the amounts of the changes or in the amounts of the changes relative to a defined cost-of-living or
inflation index, and whether there is evidence to conclude that changes might not continue to be
granted in the future despite what might otherwise be a pattern that would indicate such
changes are substantively automatic.

5.178.5. Q—When should the effects of an hoc COLA that is determined not to be substantively automatic
be included in the projection of future benefit payments?

A—If an ad hoc COLA is determined not to be substantively automatic, the effects of benefit
changes made as a result of the COLA should be included in the measurement of the total
pension liability as of the first measurement date at which the ad hoc COLA has been
granted and the amount is known or reasonably estimable.

5.178.6. Q—A collective-bargaining agreement that includes a provision for a postemployment benefit
increase has been made prior to the measurement date of the collective net pension liability.
However, the increase does not go into effect until after the current measurement date. Should
the increase in projected benefit payments as a result of this agreement be included in the
measurement of the total pension liability?

A—Yes. The actuarial present value of projected benefit payments should include benefits to
be provided pursuant to a contractual agreement, including a collective-bargaining
agreement, that is in effect at the measurement date. In other words, the issue is whether the agreement is in effect at that date, not whether the benefits included in the agreement will begin
to accrue or begin to be paid by that date.

5.178.7. Q—A collective-bargaining agreement that includes a provision for a postemployment benefit
increase has been made after the employer’s June 30, 20X5 measurement date. Should the
increase in projected benefits as a result of this agreement be included in the measurement of the
total pension liability at June 30, 20X5?

A—No. Paragraph 62 of Statement 68 requires that projected benefit payments include “all
benefits to be provided to current active and inactive employees through the pension plan in
accordance with the benefit terms and any additional legal agreements to provide benefits that are
in force at the measurement date.” Because the agreement was not in effect at June 30, 20X5, the
effect of the increased benefits should not be included in the total pension liability measured as
of that date. (See also Question 5.191.4 regarding note disclosures about changes
subsequent to the measurement date.)

5.179 Discount rate

5.179.1. Q—If the actuarial valuation date is earlier than a cost-sharing employer’s measurement date and
the long-term expected rate of return assumption remains the same at the measurement date
as it was at the actuarial valuation date, does the discount rate have to be evaluated for
significant changes between the actuarial valuation date and the measurement date?

A—Yes. A change in the discount rate can occur due to factors other than a change in the long-
term expected rate of return. For example, a change in the municipal bond yield or index rate (if
used in the determination of the discount rate) or a change in the projected fiduciary net position
of the pension plan that affects the relative weighting of the long-term expected rate of return
and the municipal bond yield or index rate can affect the discount rate. Therefore, these and
other factors, if applicable, should be considered when evaluating whether changes have
occurred that should be reflected in the total pension liability at the measurement date, either
through update procedures or through a new actuarial valuation. (See Question 5.176.4 for a discussion of update procedures.)

5.179.2. Q—In a cost-sharing pension plan in which (a) multiple contribution rates are determined for each employer because different rates are determined for separate classes of employees, (b) each rate is the result of a separate actuarial valuation, and (c) there is separate tracking of the assets held for each employee class, should a separate discount rate be calculated for each employee class or should one discount rate be calculated for the benefit arrangement as a whole?

A—Only one discount rate is required. However, paragraph 19 of Statement 68 permits separate application of the measurement requirements of the Statement to different classes of employees, provided that the results of the measurements for each class are aggregated for reporting purposes.

5.180 Comparing projections of the pension plan’s fiduciary net position to projected benefit payments

5.180.1. Q—Employers in a cost-sharing plan are contractually required to make contributions to the pension plan at an actuarially determined rate. The employers have consistently made their required contributions for the past 10 years, and there are no known events or conditions that indicate that the employers will not continue to make their required contributions in the future. In this circumstance, for purposes of determining the discount rate, how would the amount of projected employer contributions that should be included in the projection of the pension plan’s fiduciary net position be determined?

A—In this circumstance, the required contribution rate of the employers would be used as the basis for the projection of future employer contributions. Future employer contributions based on the actuarially based funding method should be evaluated to determine the extent to which they are associated with the service costs of future employees. The portion of future contributions that is associated with the service costs of future employees would be excluded from the projection of the pension plan’s fiduciary net position, which would be compared to projected future benefit payments for current active and inactive employees to determine whether and, if so, to what extent the municipal bond yield or index rate should be reflected in the discount rate.

5.180.2. Q—If the benefit payments in a period are projected to be partially covered by the pension plan’s projected fiduciary net position, should the covered portion be discounted using the long-term expected rate of return on pension plan investments, with only the remainder discounted at the required municipal bond yield or index rate?

A—Paragraphs 65 and 68 of Statement 68 require that projected benefit payments for a period be compared to the pension plan’s projected fiduciary net position in the period for purposes of determining whether the long-term expected rate of return or the municipal bond yield or index rate should be used to discount the benefit payments of the period when determining the discount rate. The Statement does not require that a specific approach be used to assign the total of the projected benefit payments in each period to the projected “funded” and “unfunded” categories. Therefore, the total of the benefit payments that are projected to occur in a period during which the pension plan’s fiduciary net position is projected to not be sufficient to make those benefit payments may be divided into projected “funded” and “unfunded” portions or the entire total may be classified as “unfunded.”
5.180.3. Q—Paragraph 67 of Statement 68 indicates that, if the results are sufficiently reliable, any approach to evaluating the sufficiency of the pension plan’s projected fiduciary net position to make projected benefit payments can be used in place of the projections of cash flows that are described in paragraphs 65 and 66 of the Statement. Is a specific method contemplated?

A—No. The determination of whether the results of an alternative approach to making the evaluation required in paragraph 65 of Statement 68 are sufficiently reliable for this purpose is subject to professional judgment.

5.181 Calculating the discount rate

5.181.1. Q—As of what date should the long-term expected rate of return and the municipal bond yield or index rate that are used to establish the discount rate be determined—the valuation date or the measurement date?

A—The long-term expected rate of return on pension plan investments is an assumption, and assumptions generally are not required to be updated between actuarial valuation dates unless there is an indication that the assumption is no longer valid. Therefore, the expectation developed as of the actuarial valuation date can be used at the measurement date unless it is determined to no longer be appropriate. In contrast, the municipal bond yield or index rate is not an assumption and should be determined as of the measurement date. If the actuarial valuation to determine the total pension liability is performed earlier than the measurement date, consideration should be given to changes in the municipal bond yield or index rate, along with other factors that potentially affect the discount rate, such as the pension plan’s fiduciary net position, to evaluate whether those factors would result in changes that should be reflected in the total pension liability at the measurement date, either through update procedures or through a new actuarial valuation. (See Question 5.176.4 for a discussion of update procedures.)

5.182 Attribution of the actuarial present value of projected benefit payments to periods

5.182.1. Q—In what way are multiple exit ages considered in the attribution of the actuarial present value of projected benefit payments to periods for financial reporting purposes?

A—Generally, the end point of the attribution period would not be a single age or single date. Rather, assumptions are made as to when employees will exit from active service. Examples of events that might result in an employee’s exit from active service are the termination of employment, incurrence of a disability, retirement, and death. Assumptions about events that result in exit from active employment are expressed as the probability of the occurrence of the triggering event based on, for example, the employee’s age or number of years of service. These probabilities are applied to all projected ages/years of service of an employee, resulting in multiple exit ages for each employee.

5.182.2. Q—If an employee that is provided with benefits through a cost-sharing plan is inactive but is expected to return to work for an employer that provides benefits through the plan, should the attribution period for the employee extend over expected future years of service?

A—Yes, generally an inactive employee that is expected to return to service for an employer that provides benefits through the cost-sharing plan would be assumed to have exit ages that extend through future periods. Therefore, to meet the requirement of paragraph 70d of Statement 68, the attribution period generally should extend through the employee’s assumed retirement age. If, however, the employee is classified as inactive because of the employee’s
participation in a program that meets the Statement 68 definition of a DROP, paragraph 70d of that Statement requires that the date of entry into the DROP be considered the employee’s retirement date (and hence, the end of the attribution period).

5.182.3. Q—If benefit terms include a cap on employees’ service credit that is not part of a DROP, should a portion of the actuarial present value of projected benefit payments be attributed to only those periods in which an employee is expected to earn service credit, or should the attribution period include all periods within an employee’s projected working lifetime?

A—The exchange of benefits for services generally is viewed as related to an employee’s entire career. Therefore, the attribution period should include all periods of an employee’s projected service for an employer that provides benefits through the plan, regardless of whether additional service credit is expected to be earned.

5.183 Collective Pension Expense and Collective Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

5.183.1. Q—For purposes of measuring collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions, over what period should changes in the collective net pension liability be determined?

A—The changes in the collective net pension liability to be included in collective pension expense in conformity with paragraph 71 of Statement 68 are those occurring since the last measurement date—that is, the measurement period. Changes in the collective net pension liability that occur after the measurement date are not incorporated into collective pension expense or collective deferred outflows of resources or deferred inflows of resources related to pensions until the next measurement period. (See also Question 5.191.4 regarding note disclosures about changes subsequent to the measurement date.)

5.183.2. Q—Should the balances of collective deferred outflows of resources and collective deferred inflows of resources related to pensions be adjusted for interest?

A—No. All changes, including interest on the total pension liability and changes in the pension plan’s fiduciary net position, are included in the collective net pension liability. Therefore, interest should not separately be calculated on the balances of collective deferred outflows of resources and deferred inflows of resources related to pensions.

5.183.3. Q—For purposes of determining collective deferred outflows of resources and deferred inflows of resources related to pensions, should balances of collective deferred outflows of resources and deferred inflows of resources arising from a single source—that is, from differences between expected and actual experience with regard to economic or demographic factors, changes of assumptions, or differences between projected and actual earnings on pension plan investments—in different periods be treated as separate amounts or net of each other?

A—Consistent with the requirements of paragraph 71a of Statement 68, collective balances of deferred outflows of resources and deferred inflows of resources arising from differences between expected and actual experience in different periods should not be treated net. Similarly, collective balances of deferred outflows of resources and deferred inflows of resources arising from changes of assumptions in different periods should not be treated net. In contrast, paragraph 71b of Statement 68 requires that deferred outflows of resources and deferred inflows of resources arising from differences between projected and actual earnings on pension plan investments...
in different periods be netted and treated as collective deferred outflows of resources related to pensions if the net balance is a debit and treated as collective deferred inflows of resources related to pensions if the net balance is a credit.

5.183.4. Q—For purposes of determining collective pension expense, should the balances of amounts resulting from changes in the collective net pension liability from a single source—for example, differences between expected and actual experience with regard to economic or demographic factors—in different years be aggregated?

A—No. In order to determine collective pension expense, records of the closed-period “layers” arising in each year, as well as the period over which each of the layers is required to be included in collective pension expense, are needed.

5.183.5. Q—For the measurement period ended June 30, 20X5, can the portion of the change in the collective net pension liability attributable to service cost be calculated based on the results of the actuarial valuation used to determine the prior year’s collective net pension liability with a measurement date of June 30, 20X4?

A—Yes. Use of a service cost measure based on the results of the actuarial valuation that determined the beginning collective net pension liability for the reporting period is consistent with the requirement to calculate interest on the total pension liability over the period. Interest on service cost should be included in interest on the total pension liability. (See Question 5.183.6.)

5.183.6. Q—If the approach described in Question 5.183.5 is used to determine the service cost for the measurement period ended June 30, 20X5, should the amounts identified as interest on the total pension liability be calculated on the beginning total pension liability, adjusted for service cost and actual benefit payments (including refunds of employee contributions), or should projected benefit payments from the actuarial valuation that is used to determine the service cost be used for purposes of the adjustment?

A—Interest on the total pension liability should be determined based on the beginning total pension liability, adjusted for service cost and actual benefit payments. Because the actual amounts of benefit payments and contributions are components of the total change in the plan’s fiduciary net position, it would be consistent to use actual amounts to determine other components of the change in the collective net pension liability, including the changes in the total pension liability resulting from benefit payments and interest on the total pension liability.

5.183.7. Q—How should the effects of an ad hoc COLA granted to retirees be classified for purposes of determining collective pension expense if the effects of the COLA were not included in the present value of projected benefit payments as of the prior measurement date because the COLA was not determined to be substantively automatic?

A—An ad hoc COLA that is determined not to be substantively automatic is a form of postemployment benefit change. Therefore, the effects of such an ad hoc COLA should be included in collective pension expense in the measurement period in which the change is included in the collective net pension liability, as required by paragraph 71 of Statement 68.

5.183.8. Q—The effects of a COLA that was determined to be substantively automatic were included in the present value of projected benefit payments in the total pension liability as of the prior measurement date. The COLA was not provided in the current measurement period. At the
current measurement date, the COLA still is determined to be substantively automatic. In this circumstance, how should the effects on the total pension liability that result from not providing the COLA be classified for purposes of determining collective pension expense?

A—The effects on the total pension liability that result from not providing the COLA should be accounted for as a difference between expected and actual experience. Paragraph 71a of Statement 68 requires those differences to be included in collective pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.183.9. Q—Would the answer to Question 5.183.8 be different if, at the current measurement date, the COLA is no longer considered to be substantively automatic?

A—No. The effects on the total pension liability that result from the COLA not being provided in the current measurement period should be classified as a difference between expected and actual experience, even if the COLA is determined to no longer be substantively automatic at the current measurement date. Paragraph 71a of Statement 68 requires that portion of the change in the total pension liability to be included in collective pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period. The reclassification of the COLA during the measurement period as ad hoc rather than as substantively automatic is a separate event, and the effects of that reclassification on the total pension liability should be accounted for as a change of benefit terms, which is required by paragraph 71 of Statement 68 to be included in collective pension expense in the measurement period in which the change is included in the collective net pension liability.

5.183.10. Q—If the terms of a defined benefit pension plan are amended and a change of assumption is made as a direct result of the amendment, should the effect of the change of assumption on the total pension liability be included with the effect of the change of benefit terms for purposes of determining collective pension expense?

A—Yes. Although, generally, the effect of a change of assumption on the total pension liability should be separated from the effect of a change of benefit terms, in circumstances in which the change of assumption is adopted as a direct result of the change of benefit terms, the effect of the change of assumption should be classified as a component of the change of benefit terms and included in collective pension expense in the measurement period in which the change is included in the collective net pension liability. For example, if the mandatory retirement age in a plan is modified, changes of assumptions about the retirement ages of active employees that are made to adjust for the change of benefit terms would be directly related to the benefit change. Although mathematically separable, if the change of assumptions would not have occurred in the absence of the change of benefit terms, the change of assumptions is, in substance, a component of the change of benefit terms, and the effects of the change should be included in collective pension expense as a change of benefit terms. In contrast, if, at the same actuarial valuation date, a change is made to mortality assumptions based on the results of a recent experience study and mortality rates are not associated with retirement age, the effect of the change of mortality assumption would not be directly related to the change of benefit terms and should be classified as a change of assumption, which is required by paragraph 71a of Statement 68 to be included in collective pension expense using a systematic and rational method over a
closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.183.11. Q—How should the effects of a change in the discount rate on the total pension liability be classified?

A—A change in the total pension liability arising from a change in the discount rate should be accounted for as a change of assumption or other input. A change in the discount rate can result from a change in the long-term expected rate of return on pension plan investments (an assumption), a change in the municipal bond yield or index rate (an other input), or a change in the relative weighting of the rates (the result of a change of assumption or other input that impacts projected plan fiduciary net position or projected benefit payments). The resultant effect of the change in the discount rate on the total pension liability should be included in collective pension expense, beginning in the current reporting period, using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.183.12. Q—If a pension plan purchases an allocated insurance contract that meets the criteria in paragraph 63 of Statement 68, how should the effects on the components of the collective net pension liability be classified for purposes of determining collective pension expense?

A—The purchase of the allocated insurance contract results in a reduction of the pension plan’s fiduciary net position for the amount paid for the contract and a reduction in the total pension liability for benefit payments. If there is a difference between the amount recognized as a benefit payment by the pension plan and the amount of the actuarial present value of projected benefit payments that is removed from the total pension liability as a result of the purchase, that amount should be classified as a difference between expected and actual experience and included in collective pension expense using a systematic and rational method over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan, determined at the beginning of the measurement period.

5.183.13. Q—Paragraph 71b of Statement 68 requires that changes in the collective net pension liability arising from differences between projected and actual earnings on pension plan investments be included in collective pension expense over a closed five-year period beginning in the current measurement period, with any remaining balance from the current period netted with the remaining balances that arose in prior periods. Can the amount of the collective net balance from prior periods that is included in collective pension expense in the current period be determined by multiplying the remaining net balance that arose in prior periods by 25 percent?

A—No. Determining the amount to include in pension expense by applying 25 percent to the remaining collective net balance is an example of an open-period method, and paragraph 71b of Statement 68 requires that these differences be included in collective pension expense using a closed-period method. For example, in 20X5, using a closed-period, straight-line method, the amount of the remaining collective net balance that arose in prior periods to include in collective pension expense in the current period would be 25 percent of the portion of the remaining balance that arose in 20X4, 33 percent of the portion of the remaining balance that arose in 20X3, 50 percent of the portion of the remaining balance that arose in 20X2, and 100 percent of the portion of the remaining balance that arose in 20X1. Alternatively, the amounts to
include in pension expense in 20X5 could be determined as 20 percent of each of the
differences that arose in 20X1–20X4.

5.183.14. Q—How should the projected earnings on pension plan investments be calculated for purposes of
determining the difference between projected and actual earnings?

A—Projected earnings on pension plan investments should consider changes in invested
amounts and should be calculated as the return that actual invested amounts would have earned
at the assumed rate of return over the measurement period. For this purpose, the assumed rate of
return should be net of investment expense, but not net of administrative expense, and should
reflect the expectation of the rate as of the beginning of the measurement period.

5.183.15. Q—For purposes of determining collective pension expense, can a method be applied to
differences between expected and actual experience, changes of assumptions or other inputs, or a
difference between projected and actual earnings on pension plan investments that would
result in all of the amount being included in the measurement period in which the change is
reflected in the collective net pension liability or all of the amount being included in collective
pension expense in the final year of the period for inclusion that is required in paragraph 71 of
Statement 68?

A—No. Changes in the total pension liability arising from differences between expected and
actual experience or changes of assumptions or other inputs are required to be included in
collective pension expense using a systematic and rational method over a closed period equal
to the average of the expected remaining service lives of all employees that are provided with
benefits through the plan (active employees and inactive employees), determined at the
beginning of the measurement period. Differences between projected and actual earnings on
pension plan investments are required to be included in collective pension expense using a
systematic and rational method over a closed five-year period. Including all of the change
associated with these events in the collective pension expense of a single year is inconsistent
with these provisions of Statement 68.

5.183.16. Q—Paragraphs 71a and 71b of Statement 68 require that certain changes in the collective net
pension liability be included in collective pension expense over specified periods using a
systematic and rational method. What are examples of systematic and rational methods?

A—The simplest systematic and rational method is the straight-line method. The level-
percentage-of-payroll is another example of a systematic and rational attribution method.
However, any systematic and rational method can be used.

5.183.17. Q—The employees that are provided with benefits through a cost-sharing pension plan include a
large number of inactive employees who are entitled to, but have not yet requested, a refund of
their contributions to the plan and earnings on those contributions. The amount of the refunds
will change only in accordance with actual earnings on plan investments and, as such, are not
associated with certain of the changes in the net pension liability that are reported as deferred
outflows of resources and deferred inflows of resources related to pensions. Can these employees
be excluded from the determination of the average of the expected remaining service lives of
employees?
A—No. Statement 68 requires that the average of the expected service lives of employees include all active and inactive employees that are provided with benefits (including refunds of employee contributions) through the plan.

5.183.18. Q—If changes in the total pension liability arising from differences between expected and actual experience or a change of assumption or other input occur only in the portion of the total pension liability associated with active employees (for example, the actual change in salary since the last measurement period was different from the assumed change in salary), can the changes be included in collective pension expense over the average of the expected remaining service lives of active employees?

A—No. Paragraph 71a of Statement 68 requires differences between expected and actual experience and changes of assumptions to be included in collective pension expense over the average of the expected remaining service lives of all employees—active employees and inactive employees—regardless of whether the change is directly associated with certain individual employees.

5.183.19. Q—Over what period should a change in the total pension liability arising from differences between expected and actual experience or changes of assumptions or other inputs be included in collective pension expense if the average of the expected remaining service lives of employees is less than one year as of the beginning of the measurement period, for example, as might occur in a closed plan?

A—In this circumstance, changes in the total pension liability arising from differences between expected and actual experience or changes of assumptions should be included in collective pension expense over one period. This results in all changes in the total pension liability other than the effect of collective employer contributions being included in collective pension expense in full in the measurement period in which they are reflected in the collective net pension liability.

5.183.20. Q—In determining the average of the expected remaining service lives of employees for purposes of measuring collective pension expense, should the probabilities of different decrements, such as disability, death, retirement, or separation from service, be considered?

A—Yes. Collective pension expense and the total pension liability are related measures, and application of the requirements for attribution of the present value of projected benefit payments to periods generally would result in consideration of the probability of various decrements for purposes of determining the total pension liability. (See Question 5.182.1.) Because probabilities of decrements are required to be considered relative to expected service lives when measuring the total pension liability, it would be inconsistent to omit consideration of those events when measuring the average of the expected remaining service lives for use in determining collective pension expense.

5.183.21. Q—What should be included in collective deferred outflows of resources for contributions made by cost-sharing employers subsequent to the measurement date?

A—Collective deferred outflows of resources should not include amounts related to contributions made subsequent to the measurement date. A contribution made after the measurement date should be reported individually by the cost-sharing employer that made the contribution as a deferred outflow of resources in conformity with paragraph 57 of Statement 68. (See also Question 5.169.1.)
5.184 Recognition and measurement in financial statements prepared using the economic resources measurement focus and accrual basis of accounting by employers that have a special funding situation

See Sections 5.208–5.211 addressing paragraphs 92–96 of Statement 68, as well as Sections 5.161–5.169 and 5.185–5.194 addressing paragraphs 48–57 and 73–82 of Statement 68.

5.185 Recognition in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting— all cost-sharing employers

5.185.1. Q—If, at the measurement date, the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, should any portion of a cost-sharing employer’s proportionate share of the collective net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A—No. In circumstances in which the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, no portion of the employer’s proportionate share of the collective net pension liability should be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

5.185.2. Q—If, at the measurement date, the pension plan’s fiduciary net position is not sufficient to make benefit payments that are due and payable, should any portion of a cost-sharing employer’s proportionate share of the collective net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A—Yes. In circumstances in which the pension plan’s fiduciary net position is not sufficient to make benefit payments that are due and payable, the employer should recognize an amount equal to its proportionate share of the amount of benefits due and payable that exceeds the pension plan’s fiduciary net position as its proportionate share of the collective net pension liability in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

5.186 Notes to financial statements— all cost-sharing employers

5.186.1. Q—If an employer reports pension liabilities that have different measurement dates, is the employer required to update the measures to the same measurement date for purposes of presenting the total pension-related measures required by paragraph 74 of Statement 68 or for disclosing additional information about the pension liabilities that is required by Statement 68?

A—No. Information reported in notes about pension liabilities focuses on conditions as of the measurement date. For purposes of presenting information to meet the requirement of paragraph 74 of Statement 68 for disclosure of the total amounts of pension-related measures if those amounts are not otherwise identifiable from information presented in the financial statements, the employer should disclose the totals of the amounts reported in the financial statements for pensions provided through each plan, regardless of differences in their measurement dates. As specified by paragraphs 38 and 75 of Statement 68, the information that is required to be provided in notes should be disclosed for benefits provided through each defined benefit pension plan in which the employer participates. If different measurement dates are used for pensions provided through
different plans, the information in notes about each benefit arrangement should reflect its individual measurement date.

5.186.2. Q—A cost-sharing pension plan issues a stand-alone financial report in conformity with Statement 67 that includes certain information that also is required by Statement 68 to be reported by an employer that provides pensions through the plan. For example, the plan discloses information about the assumptions and other inputs that are used in the measurement of the total pension liability for the same period that is used as the measurement period by the employer. Can the employer omit from its report the information included in the pension plan’s stand-alone report if the employer’s report refers to the pension plan’s stand-alone report?

A—All information required by Statement 68 should be included in the cost-sharing employer’s financial report. The only item for which Statement 68 permits reference to the pension plan’s report in place of including the detail in the employer’s report is the information required by paragraph 79 of Statement 68 about the elements of the pension plan’s fiduciary net position if the pension plan’s report is available on the Internet.

5.187 Pension Plan Description

5.187.1. Q—Should the information that is required by paragraph 76b of Statement 68 about benefit terms be current as of the actuarial valuation date that is used as the basis for the total pension liability, the measurement date of the collective net pension liability, or the employer’s fiscal year-end?

A—The requirement of paragraph 76b of Statement 68 is intended to result in the disclosure of information about the benefit terms at the measurement date of the collective net pension liability. If a change occurs in the benefit terms between the measurement date and the employer’s fiscal year-end such that the effect of the change on the employer’s proportionate share of the collective net pension liability is expected to be significant, paragraph 80f of Statement 68 requires information about the change to be disclosed.

5.187.2. Q—Should all contributions made to the pension plan by a cost-sharing employer during the employer’s fiscal year be included in the amount of contributions that paragraph 76c of Statement 68 requires to be disclosed?

A—No. For purposes of paragraph 76c of Statement 68, contributions should include only (a) the amount of actual contributions, which are cash contributions from the employer to the pension plan that would be recognized as additions from contributions in the pension plan’s schedule of changes in fiduciary net position during the period that coincides with the employer’s fiscal year, and (b) the amount of contributions from the employer to the pension plan that would be recognized by the pension plan as a current receivable during the period that coincides with the employer’s fiscal year. This would exclude, for example, payments made to satisfy employer payables to the pension plan that arose in an earlier fiscal year. (See also Question 5.187.3.)

5.187.3. Q—For purposes of providing information about contributions that is required by paragraph 76c of Statement 68, what should be considered a contribution recognized by the pension plan as a current receivable?

A—For purposes of paragraph 76c of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the employer’s
contributions during the employer’s reporting period and (b) would be collectible within a year as of the end of the employer’s reporting period. For example, a receivable recognized by the pension plan for an employer’s contributions related to the last month of the employer’s fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable of the pension plan.

5.188 Information about the Employer’s Proportionate Share of the Collective Net Pension Liability

5.189 Assumptions and Other Inputs

5.190 The Pension Plan’s Fiduciary Net Position

5.190.1 Q—If a cost-sharing employer provides pensions through a defined benefit plan for which financial statements are not publicly available on the Internet, what information should be disclosed in the employer’s financial statements regarding the pension plan’s fiduciary net position?

A—The cost-sharing employer should apply paragraph 79 of Statement 68 regarding note disclosures about the pension plan’s fiduciary net position. That paragraph requires that the employer disclose all information required by Statement 68 and other standards about the pension plan’s assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position. Therefore, the employer would have to include information in its financial statements to comply with all note disclosure requirements applicable to the pension plan. This information includes the information required by Statement 67, as well as information required by other Statements. For example, the employer would be required to present information to comply with disclosure requirements related to pension plan deposits and investments, including information required by Statements 3, 31, and 40, as amended, as applicable.

5.191 Other Information

5.191.1 Q—If a cost-sharing employer uses different proportions to determine its share of different pieces of the collective net pension liability (for example, for different classes of employees), is the employer required to disclose its proportion of the net pension liability for each class?

A—No. Paragraph 80b of Statement 68 requires disclosure of only the employer’s overall proportion of the collective net pension liability, with a discussion of the basis on which the proportion is determined.

5.191.2 Q—If a cost-sharing employer reports a proportionate share of a collective net pension liability that results from an actuarial valuation that has been updated to the measurement date, what information is the employer required to disclose regarding the update?

A—Information about the measure of total pension liability (for example, the assumptions used in the measurement) should reflect amounts and circumstances as of the measurement date. However, if update procedures were used to develop the measure of the total pension liability, paragraph 80c of Statement 68 requires that the employer disclose that fact. No other specific information about the update process is required.

5.191.3 Q—If the proportion used to determine a cost-sharing employer’s proportionate share of the collective net pension liability reported in the current period changed from the proportion used to determine the liability reported in the prior period, is the employer required to disclose the effect of the change in proportion on each of the measures reported in its financial
statements—that is, its proportionate share of the collective net pension liability, deferred outflows of resources related to pensions, deferred inflows of resources related to pensions, and pension expense?

A—No. Although a change in the employer’s proportion affects the amount of the employer’s proportionate share of the collective net pension liability, deferred outflows of resources related to pensions, deferred inflows of resources related to pensions, and pension expense, the cost-sharing employer is not required to identify the effect of a change in proportion on each of those amounts. Instead, the employer should disclose the change in its proportion as required by paragraph 80b of Statement 68 by providing, for example, its former proportion and its new proportion, and it should disclose the portion of its reported balance of deferred outflows of resources or deferred inflows of resources that is associated with changes in proportion, as required by paragraph 80h(4) of Statement 68.

5.191.4. Q—What information, if any, is required to be disclosed about a change in a relevant factor that occurs between the measurement date of the collective net pension liability and the employer’s current fiscal year-end?

A—For a change that is expected to have a significant effect on the employer’s proportionate share of the collective net pension liability, in its financial report for the current fiscal year, the employer should provide information required by paragraph 80f of Statement 68 about the nature of the change, as well as the amount of the expected impact of the change on the employer’s proportionate share of the collective net pension liability, if known. For example, if a change of benefit terms is made between the measurement date and the end of the employer’s current fiscal year and an estimate of the effect of the change of benefit terms on the employer’s proportionate share of the collective net pension liability has been made and is evaluated by the employer to be significant, the employer should include in note disclosures a brief description of the benefit change and the estimated amount of the expected resultant change in the employer’s proportionate share of the collective net pension liability. (See Questions 5.174.2 and 5.176.6 regarding the timing of the recognition of the effects of such changes.)

5.191.5. Q—For purposes of the disclosure of pension expense that is expected to be recognized as a result of amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions as required by paragraph 80i(1) of Statement 68, at what date should the proportion that is applied to calculate the amounts be determined?

A—The amounts of pension expense disclosed for each of the subsequent periods required by paragraph 80i(1) of Statement 68 should be determined using the employer’s proportion at the measurement date of the collective net pension liability on which the pension liability reported by the employer in the current period is based.

5.192 Required supplementary information—all cost-sharing employers

5.192.1. Q—A cost-sharing multiple-employer plan is used to provide pensions only to volunteer firemen. The volunteers are not paid a salary. Therefore, there is no covered-employee payroll. How does this affect requirements for cost-sharing employer presentation of information in schedules of RSI about measures of the employer’s proportionate share of the collective net pension liability and employer contributions in relation to covered-employee payroll?

A—The requirements of Statement 68, paragraphs 81a and 81b, for ratios that present the employer’s proportionate share of the collective net pension liability and employer contributions,
respectively, as a percentage of covered-employee payroll would not be applicable for employers that provide benefits through this plan. Therefore, those ratios should not be presented in the RSI schedules.

5.192.2. Q—If employer contributions to the pension plan are determined based on the pensionable payroll of covered employees and the pensionable payroll is different from the total payroll of those employees, which measure of payroll should be presented in the 10-year schedules required by paragraphs 81a and 81b of Statement 68?

A—The amount of the total payroll of the covered employees (termed covered-employee payroll in Statement 68) on the accrual basis of accounting for the relevant period should be presented in the 10-year schedules required by paragraph 81 of Statement 68, and that amount also should be used as the basis for the ratios required by that paragraph. See Question 5.192.3 for a discussion of the relevant periods for each of the schedules required by paragraphs 81a and 81b of Statement 68.

5.192.3. Q—The measurement date of the collective net pension liability is December 31, 20X4, and is different from the employer’s fiscal year-end, which is June 30, 20X5. For purposes of presenting information about the employer’s covered-employee payroll in the schedules of RSI required by paragraph 81 of Statement 68, which measure(s) of covered-employee payroll should be used?

A—in the employer’s schedule of RSI that presents the amounts associated with the employer’s proportionate share of the collective net pension liability and related ratios as required by paragraph 81a of Statement 68, the amount of covered-employee payroll presented should be the annual covered-employee payroll during the measurement period that ends on the measurement date of the collective net pension liability—that is, the period from January 1, 20X4, to December 31, 20X4. If the employer presents the contribution-related schedule in conformity with paragraph 81b of Statement 68, the measure of covered-employee payroll included in that schedule should be the annual covered-employee payroll during the employer’s fiscal year—that is, the period from July 1, 20X4, to June 30, 20X5.

5.193 Paragraph 81a

5.194 Paragraph 81b

5.194.1. Q—Should all contributions made to the pension plan by a cost-sharing employer during the employer’s fiscal year be included in the amount of contributions reported in the schedule of RSI that is required by paragraph 81b of Statement 68?

A—No. For purposes of paragraph 81b of Statement 68, contributions are amounts that are not associated with separately financed specific liabilities of the individual employer and include only the amounts that would be recognized as additions from the employer’s contributions in the pension plan’s statement of changes in fiduciary net position during the period that coincides with the employer’s fiscal year for (a) actual contributions, which are cash contributions from the employer to the pension plan, and (b) current receivables. This would include, for example, the amount of legally required employer contributions that are not associated with a specific liability of the individual employer to the pension plan and that would be recognized as a current receivable by the pension plan as of the end of the employer’s fiscal year. It would exclude, for example, employer payments made to satisfy pension plan receivables that arose in an earlier employer fiscal year. (See also Question 5.194.2 regarding current receivables.)
5.194.2. Q—For purposes of reporting contributions in the schedule of RSI that is required by paragraph 81b of Statement 68, what should be considered a contribution recognized by the pension plan as a current receivable?

A—For purposes of paragraph 81b of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the employer’s contributions during the employer’s reporting period, (b) would be collectible within a year, and (c) is not associated with separately financed specific liabilities of the employer. For example, a receivable recognized by the pension plan for an employer’s contributions related to the last month of the employer’s fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable.

5.194.3. Q—If the contribution requirements of a cost-sharing employer are determined using an actuarial value of assets that incorporates differences between projected and actual earnings on pension plan investments over a three-year period, can that method continue to be used to determine contribution requirements after implementation of Statement 68?

A—Yes. Statement 68 does not establish requirements for the specific methods and assumptions, if any, used for funding purposes. Therefore, an actuarial value of assets can continue to be used for funding purposes. However, for purposes of complying with Statement 68, all changes in the pension plan’s fiduciary net position, including the full amount of the actual earnings on pension plan investments, should be included in the calculation of the collective net pension liability and changes in the collective net pension liability in the measurement period in which they occur.

5.194.4. Q—Should contributions recognized by a pension plan for amounts payable to the plan by a cost-sharing employer pursuant to an installment contract for the amount of the employer’s unfunded past service liability when it entered the cost-sharing plan be included in the amount reported by the employer as contributions in relation to statutorily or contractually required contributions, as required by paragraph 81b of Statement 68?

A—No. The amount financed by the employer under the installment contract is an example of an individual employer’s separately financed liability to the pension plan. The measure of the statutorily or contractually required contribution that is required by paragraph 81b(1) of Statement 68 excludes amounts, if any, to separately finance specific liabilities of the individual employer to the pension plan. Similarly, the amount of contributions presented in relation to the statutorily or contractually required contribution, as applicable, should exclude amounts recognized as additions to the pension plan for separately financed specific liabilities of the individual employer to the pension plan.

5.194.5. Q—When statutorily or contractually required contribution rates are established for the employer in a cost-sharing pension plan and a nonemployer contributing entity, should the schedule of RSI that presents contributions made as compared to statutorily or contractually required contributions (paragraph 81b of Statement 68) in the financial report of the employer include amounts for the nonemployer contributing entity?

A—No. The schedule should include information about contributions made by, and the statutorily or contractually required contributions of, only the cost-sharing employer.
5.194.6. Q—May employee contributions be added to the RSI schedule that presents contributions made as compared to statutorily or contractually required contributions (paragraph 81b of Statement 68)?

A—No. Including employee contributions in the schedule could obscure information about employer contribution decisions. Instead, employee contribution rates (in dollars or as a percentage of covered payroll) should be disclosed in the notes to the financial statements as required by paragraph 76c of Statement 68.

5.195 Notes to Required Schedules

5.196 Special funding situations

5.197 Single or agent employers

5.198 Recognition and Measurement in Financial Statements Prepared Using the Economic Resources Measurement Focus and Accrual Basis of Accounting

5.199 Proportionate Share of the Collective Net Pension Liability


5.200 Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

5.200.1. Q—For a single or agent employer that has a special funding situation, should the balances of deferred outflows of resources and deferred inflows of resources arising from changes in proportion or contributions during the measurement period (as discussed in paragraphs 86 and 87 of Statement 68) be reported as separate amounts or net of each other?

A—Deferred outflows of resources and deferred inflows of resources arising from a change in proportion (as discussed in paragraph 86 of Statement 68) or from contributions during the measurement period (as discussed in paragraph 87 of Statement 68) in the same measurement period may be netted and reported, in a single year, as a deferred outflow of resources related to pensions if the net balance is a debit or as a deferred inflow of resources related to pensions if the net balance is a credit. However, the resultant deferred outflow of resources or deferred inflow of resources balance in one period should not be netted against deferral balances arising in other periods from changes in proportion and contributions.

5.201 Proportionate share

See Section 5.142 addressing paragraph 33 of Statement 68.

5.202 Change in proportion

5.202.1. Q—If the proportion that is associated with a single or agent employer that has a special funding situation changes from the proportion used in the prior period, how should the net effect of that change be determined?

A—The net effect of the change in proportion should be determined in conformity with paragraph 86 of Statement 68. That paragraph requires that the effect be measured as of the beginning of the period. Therefore, the net effect is the debit (deferred outflow of resources) or credit (deferred inflow of resources) that is required to reflect the employer’s new proportion in
its proportionate shares of the collective net pension liability and collective deferred outflows of resources and deferred inflows of resources related to pensions as of the beginning of the measurement period. (See Illustration 9b in nonauthoritative Appendix B5-2 for an example of the calculation of the net effect of the change of proportion for a cost-sharing employer that has a special funding situation.)

**5.203 Contributions during the measurement period**

5.203.1. Q—How should a single or agent employer that has a special funding situation account for its contributions to the pension plan during the measurement period?

A—A single or agent employer that has a special funding situation should apply the requirements of paragraphs 87 and 88 of Statement 68 to account for the effects of its own contributions to the pension plan. Paragraph 87 of Statement 68 requires that differences between (a) the employer’s contributions other than those to separately finance specific liabilities of the individual employer to the pension plan and (b) its proportionate share of the total of such contributions made by the employer and nonemployer contributing entities be recognized in pension expense over a closed period equal to the average of the expected remaining service lives of all employees provided with pensions through the plan beginning in the current measurement period. Paragraph 88 of Statement 68 requires that the employer recognize pension expense for the difference between its contributions made during the measurement period to separately finance specific liabilities of the individual employer and the employer’s proportionate share of those contributions. (See Question 5.204.1 regarding accounting for contributions made subsequent to the measurement date.)

**5.204 Employer contributions subsequent to the measurement date**

5.204.1. Q—What should be included in the amounts reported as deferred outflows of resources for a single or agent employer’s contributions made subsequent to the measurement date?

A—For purposes of paragraph 89 of Statement 68, the deferred outflow of resources reported by an employer should include only contributions made by the employer during its fiscal year that will be reflected in the net pension liability in the next measurement period—that is, the amount of contributions through the end of the employer’s fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period. The deferred outflow of resources would not include the employer’s payments subsequent to the measurement date to satisfy a contribution receivable recognized by the plan prior to the end of the current measurement period.

**5.205 Support of Nonemployer Contributing Entities in a Special Funding Situation**

5.205.1. Q—For what measurement period should the revenue required by paragraph 90 of Statement 68 be recognized? For example, if an employer’s fiscal year-end is December 31 and the collective net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions are determined as of June 30 each year, what should be the measurement period for the recognition of a revenue for the support provided by a nonemployer contributing entity?

A—The employer should use the same measurement period for purposes of applying paragraph 90 of Statement 68 as is used to determine collective pension expense. For example, the pension-related amounts reported in the employer’s financial statements as of
December 31, 20X4, are based on the collective net pension liability with a measurement date of June 30, 20X4. Therefore, the pension expense and the related revenue associated with the support provided by a nonemployer contributing entity in a special funding situation would be based upon changes in the collective net pension liability between July 1, 20X3, and June 30, 20X4 (the measurement period).

5.205.2. Q—If a nonemployer contributing entity in a special funding situation makes a contribution subsequent to the measurement date of the collective net pension liability, is there a collective deferred outflow of resources related to that contribution that should be allocated to the single or agent employer and nonemployer contributing entities based on their proportionate shares?

A—No. Measurement of collective amounts is limited to the measurement period. In a special funding situation, a contribution by a nonemployer contributing entity subsequent to the measurement date of the collective net pension liability is recognized as a deferred outflow of resources related to pensions by only the entity that made the contribution.

5.206 Additional Requirements

See Sections 5.145–5.158 addressing paragraphs 36–47 of Statement 68.

5.207 Cost-sharing employers

5.208 Recognition and Measurement in Financial Statements Prepared Using the Economic Resources Measurement Focus and Accrual Basis of Accounting

5.208.1. Q—A state is the only entity that has a legal obligation to make contributions directly to a cost-sharing pension plan that is used to provide benefits to employees of local governments. Therefore, the state reports 100 percent of the net pension liability associated with benefits provided through the cost-sharing plan. In this circumstance, are the local governments required to recognize any pension-related amounts in their financial statements?

A—Yes. Although the local governments would not recognize any portion of the collective net pension liability or collective deferred outflows of resources and deferred inflows of resources related to pensions because each employer’s proportionate share determined under paragraph 48 of Statement 68 is zero percent, paragraphs 94 and 95 of Statement 68, respectively, require that a cost-sharing employer in a special funding situation recognize pension expense and a revenue equal to the portion of the nonemployer contributing entity’s pension expense that is associated with the employer. (See Questions 5.211.1 and 5.211.2.) Even though the employer does not recognize a proportionate share of the collective net pension liability, paragraphs 75 and 81 of Statement 68 require that the employer present note disclosures and schedules of RSI that include the information that is detailed in paragraphs 76–82 of Statement 68 for each cost-sharing pension plan through which pensions are provided to the employer’s employees.

5.209 Proportionate Share of the Collective Net Pension Liability

See Sections 5.161–5.164 addressing paragraphs 48–51 of Statement 68.

5.210 Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

See Sections 5.165–5.169 addressing paragraphs 52–57 of Statement 68.

5.211 Support of Nonemployer Contributing Entities in a Special Funding Situation
5.211.1. Q—For purposes of determining the portion of the expense of a nonemployer contributing entity in a special funding situation that is associated with each of the employers in a cost-sharing plan, what basis should be used to determine the relevant employer proportion?

A—Statement 68 does not specify the basis to be used for this purpose. However, the resulting proportion should represent the relationship of the employer to the total of all employers that are provided support as a result of the special funding situation.

5.211.2. Q—For what measurement period should the pension expense and the revenue required by paragraphs 94 and 95 of Statement 68, respectively, be recognized? For example, if an employer’s fiscal year-end is December 31 and the collective net pension liability, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions are determined as of June 30 each year, what should be the measurement period for the recognition of pension expense and a revenue for the support provided by a nonemployer contributing entity?

A—The employer should use the same measurement period for purposes of applying paragraphs 94 and 95 of Statement 68 as is used to determine collective pension expense. For example, the pension-related amounts reported in the employer’s financial statements as of December 31, 20X4, are based on the collective net pension liability with a measurement date of June 30, 20X4. Therefore, the pension expense and the related revenue associated with the support provided by a nonemployer contributing entity in a special funding situation would be based upon changes in the collective net pension liability between July 1, 20X3, and June 30, 20X4 (the measurement period).

5.211.3. Q—If a nonemployer contributing entity in a special funding situation makes a contribution subsequent to the measurement date of the collective net pension liability, is there a collective deferred outflow of resources related to that contribution that should be allocated to all employers and nonemployer contributing entities based on their proportionate shares?

A—No. Measurement of collective amounts is limited to the measurement period. In a special funding situation, a contribution by a nonemployer contributing entity subsequent to the measurement date of the collective net pension liability is recognized as a deferred outflow of resources related to pensions by only the entity that made the contribution.

5.212 Additional Requirements

See Sections 5.145–5.158 addressing paragraphs 73–82 of Statement 68.

5.213 Governmental nonemployer contributing entities

5.214 Recognition and Measurement in Financial Statements Prepared Using the Economic Resources Measurement Focus and Accrual Basis of Accounting

5.215 Proportionate Share of the Collective Net Pension Liability

5.215.1. Q—Historically, a governmental nonemployer contributing entity has contributed 100 percent of its statutorily required contributions, which are actuarially determined. Is the government required to recognize a portion of the collective net pension liability even though it has contributed an amount equal to its statutorily required contributions in the past?
A—Yes. Statement 68 requires that a governmental nonemployer contributing entity recognize its proportionate share of the collective net pension liability determined in conformity with the provisions of paragraphs 97–99 of Statement 68, regardless of whether it has made its statutorily required contributions in the past.

5.216 Measurement date

5.216.1 Q—If a governmental nonemployer contributing entity’s fiscal year-end is the same as the fiscal year-end of the pension plan to which it contributes, can the entity report its proportionate share of the collective net pension liability as of a measurement date that is one year earlier than the “as of” date of the (collective) net pension liability reported by the plan at the same fiscal year-end?

A—Yes. To avoid a circumstance in which the nonemployer contributing entity’s financial reports potentially would be delayed awaiting information that also is included in the pension plan’s financial report, Statement 68 permits the measurement date of the collective net pension liability used by a governmental nonemployer contributing entity to determine its recognized pension liability to be as of a date no earlier than the end of its prior fiscal year provided that the actuarial valuation used to determine the total pension liability meets the timing requirements of paragraph 22 or paragraph 60 of Statement 68, as applicable, and that the measurement meets the requirement of paragraph 23 or paragraph 61 of Statement 68, as applicable, that the plan, the employer(s), and nonemployer contributing entities use the same assumptions when measuring similar or related information. (See Questions 5.134.1–5.134.3 and 5.176.1–5.176.3.) Cost-sharing pension plans are required by Statement 67 to report information about the (collective) net pension liability as of the plan’s fiscal year-end. Therefore, for example, in financial statements as of June 30, 20X5, a cost-sharing pension plan is required to report a (collective) net pension liability measured as of June 30, 20X5, whereas a governmental nonemployer contributing entity that has a special funding situation for benefits provided through the plan can report a proportionate share of the collective net pension liability with a measurement date of June 30, 20X4, if the requirements of paragraphs 22 and 23 or paragraphs 60 and 61 of Statement 68, as applicable, are met.

5.216.2 Q—If a governmental nonemployer contributing entity participates in more than one defined benefit pension plan (as an employer or as a nonemployer contributing entity in a special funding situation), is the government required to use the same measurement date for each (collective) net pension liability?

A—No. Paragraph 18 of Statement 68 specifies that the requirements of that Statement related to liabilities to employees for pensions, which include the provisions of the Statement for the selection of the measurement date of the (collective) net pension liability, should be applied separately to the pensions provided through each defined benefit pension plan. Therefore, provided that the measurement date for each (collective) net pension liability meets the requirements of Statement 68, the related pension liabilities presented in the government’s financial report can have different measurement dates. For example, in financial statements for its fiscal year ended June 30, 20X5, the governmental nonemployer contributing entity can report a proportionate share of the collective net pension liability with a measurement date of December 31, 20X4, for pensions provided through single-employer Pension Plan A and a proportionate share of the collective net pension liability with a measurement date of March 31, 20X5, for pensions provided through cost-sharing Pension Plan B. (See Question 5.227.1 regarding note disclosure requirements when different measurement dates are used.)
5.217 Determining a governmental nonemployer contributing entity’s proportion

5.217.1. Q—Can the basis on which a governmental nonemployer contributing entity’s proportion is determined be changed? For example, if in its prior fiscal year, an entity’s proportion was determined based on contributions during the measurement period, can the entity’s proportion be determined in the subsequent period using an average of contributions over the past five measurement periods?

A—Yes. The entity’s proportion is an assumption and, like other assumptions, is subject to change as, for example, new events occur, more experience is acquired, or additional information is obtained. A change in the basis for the entity’s proportion might affect the applicability of certain requirements of Statement 68, including those in paragraphs 103 and 104 of Statement 68, which address changes in the nonemployer contributing entity’s proportion and contributions made as compared to the entity’s proportionate share of total employer and nonemployer contributing entity contributions, respectively. For example, a change from a proportion based on contributions made during the measurement period to a proportion based on an average of contributions in past measurement periods might result in differences in each future measurement period between the entity’s contributions and its proportionate share of total employer and nonemployer entity contributions, for which paragraph 104 of Statement 68 establishes requirements. (See Question 5.232.3 for a discussion of note disclosures regarding changes in proportion.)

5.217.2. Q—A cost-sharing plan that is used to provide benefits to employees of several governmental employers also is used to provide benefits to certain nongovernmental employers. When a governmental nonemployer contributing entity determines its proportion for purposes of reporting its proportionate share of the collective net pension liability and related measures under Statement 68, should the proportion represent the relationship of the governmental nonemployer contributing entity to all employers that provide benefits through the plan and nonemployer contributing entities or the relationship of the governmental nonemployer contributing entity to only the governmental employers and nonemployer contributing entities?

A—The governmental nonemployer contributing entity’s proportion should be representative of its relationship to all employers that provide benefits through the pension plan and all nonemployer contributing entities, regardless of whether those employers and nonemployer contributing entities are governmental or nongovernmental for financial reporting purposes.

5.217.3. Q—with regard to the requirement in paragraph 99 of Statement 68 related to the timing of the establishment of the governmental nonemployer contributing entity’s proportion, what is an example of an actuarially determined proportion?

A—An example of an actuarially determined proportion for purposes of paragraph 99 of Statement 68 is a proportion based on a projection of the future actuarially determined contribution amounts of each of the contributing entities if contribution requirements are based on those amounts.

5.217.4. Q—are the employers whose employees are provided with pensions through a defined benefit plan with a special funding situation and the governmental nonemployer contributing entity that makes contributions to the plan required to use the same basis to establish their proportions under Statement 68?
A—No. An employer or governmental nonemployer contributing entity’s selection of a basis for the establishment of its proportion under Statement 68 is independent of the selection of a basis by other employers whose employees are provided with pensions through the cost-sharing plan or nonemployer contributing entities in a special funding situation for those pensions. For example, the governmental nonemployer contributing entity can determine its proportion based on contributions during the measurement period, while an employer uses the average of contributions over the past five measurement periods as the basis for its proportion.

5.217.5. Q—A governmental nonemployer contributing entity in a special funding situation has an expectation that its future contribution requirements will diminish relative to the contribution requirements of the other contributing entities and ultimately will be zero—for example, legislation has been passed that includes a phase-out of the nonemployer entity’s contributions over a defined period of time, with 100 percent of the contribution requirement eliminated at the end of the phase-out period. For purposes of paragraphs 97–99 of Statement 68, can the entity assume that its proportion is zero percent because in the long-term it expects its required contributions to reduce to zero?

A—No. Even though the governmental nonemployer contributing entity expects that its share of required contributions ultimately will reduce to zero, it would not be appropriate to use zero percent as its share in the current period because it expects to be required to make contributions in some future periods. It should use an approach for determining its basis that is consistent with the manner in which contributions are assessed, and if it chooses to use a forward-looking basis as is encouraged in paragraph 97a of Statement 68, that basis should consider both short-term and long-term contribution requirements. For example, the governmental nonemployer contributing entity could determine its proportion by comparing the present value of its expected future contributions to the present value of the expected future contributions of all contributing entities.

5.217.6. Q—If a governmental nonemployer contributing entity is in a special funding situation for benefits provided through a pension plan in which some or all of the employers’ required contributions to the plan are reimbursed to the employers through federal grants, should amounts to be reimbursed to the employers be counted as contributions from the employers for purposes of determining the nonemployer contributing entity’s proportion?

A—Yes. The amount of required contributions that will be reimbursed to the employers should be considered employer contributions when determining each entity’s proportion.

5.218 Financial statement display

5.218.1. Q—If the total pension liability is less than the pension plan’s fiduciary net position, should a governmental nonemployer contributing entity’s proportionate share of the collective net balance be displayed in the entity’s statement of net position as a negative liability or as an asset?

A—A net pension liability that is negative is an asset. Therefore, the entity should display its proportionate share of the collective balance as an asset in its statement of net position.

5.218.2. Q—Should a governmental nonemployer contributing entity’s proportionate share of the collective net pension liability (or an aggregation of the entity’s liabilities for net pension liabilities associated with different pension plans) be displayed on a separate line on the face of the financial statements?
A—The entity’s proportionate share of the collective net pension liability is not required to be displayed separately on the face of the financial statements. However, for some governments, it will be a significant balance, which may be displayed separately on the face of the financial statements. Liabilities for net pension liabilities associated with different plans may be aggregated for display, and assets for net pension assets associated with different plans may be aggregated for display. However, aggregated pension assets and aggregated pension liabilities should be separately displayed.

5.218.3.  Q—Can liabilities for net pension liabilities associated with different plans be displayed in the aggregate if the liabilities do not have the same measurement date?

A—Yes. Statement 68 does not limit the aggregation of pension liabilities based on measurement dates.

5.219  Expense and Deferred Outflows of Resources and Deferred Inflows of Resources

5.219.1.  Q—Should a governmental nonemployer contributing entity’s balances of deferred outflows of resources and deferred inflows of resources arising from changes in proportion or contributions during the measurement period (as discussed in paragraphs 103 and 104 of Statement 68) be reported as separate amounts or net?

A—Deferred outflows of resources and deferred inflows of resources arising from a change in proportion (as discussed in paragraph 103 of Statement 68) or from contributions during the measurement period (as discussed in paragraph 104 of Statement 68) in the same measurement period may be netted and reported, in a single year, as a deferred outflow of resources related to pensions if the net balance is a debit or as a deferred inflow of resources related to pensions if the net balance is a credit. However, the resultant deferred outflow of resources or deferred inflow of resources balance in one period should not be netted against deferral balances arising in other periods from changes in proportion and contributions.

5.220  Proportionate share

5.220.1.  Q—If a governmental nonemployer contributing entity uses different proportions to determine its share of different pieces of the collective net pension liability (for example, for different classes of employees), can it determine its total proportionate share of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions using a single (overall) proportion applied to the collective measures or, for each collective measure, is it required to continue to attribute the piece associated with each class of employees using the relevant proportion?

A—Either approach is permitted. Paragraph 102 of Statement 68 requires that the entity’s proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions be determined using the entity’s proportion of the collective net pension liability, which is a single proportion that is calculated as the entity’s proportionate share of the collective net pension liability divided by the collective net pension liability. However, paragraph 19 of Statement 68 broadly establishes the permissibility of applying the measurement requirements of the Statement to individual classes or groups if “separate actuarial valuations are performed for different classes or groups of employees because different contribution rates apply for each class or group depending on the applicable benefit structures, benefit formulas, or other factors. . . .” Regardless of the approach that is used,
the governmental nonemployer contributing entity should recognize and report only the aggregated amount of its proportionate share of each measure.

5.221 Change in proportion

5.221.1. Q—If a governmental nonemployer contributing entity’s proportion changes from the proportion used in the prior period, how should the net effect of that change be determined?

A—The net effect of the change in proportion should be determined in conformity with paragraph 103 of Statement 68. That paragraph requires that the effect be measured as of the beginning of the period. Therefore, the net effect is the debit (deferred outflow of resources) or credit (deferred inflow of resources) that is required to reflect the governmental nonemployer contributing entity’s new proportion in its proportionate shares of the collective net pension liability and collective deferred outflows of resources and deferred inflows of resources related to pensions as of the beginning of the measurement period. (See Illustrations 8b and 9b in nonauthoritative Appendix B5-2 for examples of similar calculations of the net effect of the change of proportion for cost-sharing employers.)

5.222 Contributions during the measurement period

5.222.1. Q—How should a governmental nonemployer contributing entity in a special funding situation account for its contributions to the pension plan during the measurement period?

A—A governmental nonemployer contributing entity in a special funding situation should apply the requirements of paragraphs 104 and 105 of Statement 68 to account for the effects of its own contributions to the pension plan. Paragraph 104 of Statement 68 requires that differences between (a) the governmental nonemployer contributing entity’s contributions other than those to separately finance specific liabilities of the individual entity to the pension plan and (b) its proportionate share of the total of all such contributions made by all employers and nonemployer contributing entities be recognized in pension expense over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the plan beginning in the current measurement period. Paragraph 105 of Statement 68 requires that the governmental nonemployer contributing entity recognize pension expense for the difference between its contributions made during the measurement period to separately finance specific liabilities of the individual governmental nonemployer contributing entity and the governmental nonemployer contributing entity’s proportionate share of those contributions. (See Question 5.223.1 regarding accounting for contributions made subsequent to the measurement date.)

5.223 Governmental nonemployer contributing entity contributions subsequent to the measurement date

5.223.1. Q—What should be included in the amounts reported as deferred outflows of resources for a governmental nonemployer contributing entity’s contributions made subsequent to the measurement date?

A—For purposes of paragraph 106 of Statement 68, the deferred outflow of resources reported by a nonemployer contributing entity should include contributions made during its fiscal year that will be reflected in the net pension liability in the next measurement period—that is, the amount of contributions through the end of the nonemployer contributing entity’s fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period. The deferred outflow of resources would not include the nonemployer contributing
entity’s payments subsequent to the measurement date to satisfy a contribution receivable recognized by the plan prior to the end of the current measurement period.

5.224 Recognition in Financial Statements Prepared Using the Current Financial Resources Measurement Focus and Modified Accrual Basis of Accounting

5.224.1. Q—If, at the measurement date, the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, should any portion of a governmental nonemployer contributing entity’s proportionate share of the collective net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A—No. In circumstances in which the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, no portion of the entity’s proportionate share of the collective net pension liability should be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

5.224.2. Q—If, at the measurement date, the pension plan’s fiduciary net position is not sufficient to make benefit payments that are due and payable, should any portion of a governmental nonemployer contributing entity’s proportionate share of the collective net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A—Yes. In circumstances in which the pension plan’s fiduciary net position is not sufficient to make benefit payments that are due and payable, the governmental nonemployer contributing entity should recognize an amount equal to its proportionate share of the amount of benefits due and payable that exceeds the pension plan’s fiduciary net position as its proportionate share of the collective net pension liability in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

5.225 Notes to Financial Statements and Required Supplementary Information

5.226 Governmental Nonemployer Contributing Entities That Recognize a Substantial Proportion of the Collective Net Pension Liability

5.227 Notes to financial statements

5.227.1. Q—If a governmental nonemployer contributing entity employer reports pension liabilities that have different measurement dates, is the entity required to update the measures to the same measurement date for purposes of disclosing the pension-related measures required by paragraphs 109–113 of Statement 68?

A—No. Information reported in notes about pension liabilities focuses on conditions as of the measurement date. As specified by paragraph 108 of Statement 68, the information that is required by paragraphs 109–113 of that Statement should be disclosed for benefits provided through each defined benefit pension plan for which the governmental nonemployer contributing entity recognizes a substantial proportion of the collective net pension liability. If different measurement dates are used for pensions provided through different plans, the information in notes for each benefit arrangement should reflect its individual measurement date.

5.227.2. Q—A pension plan issues a stand-alone financial report in conformity with Statement 67 that includes certain information that also is required by Statement 68 to be reported by a governmental nonemployer contributing entity that reports a substantial proportion of the
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collective net pension liability associated with pensions provided through the plan. For example, the plan discloses information about the assumptions and other inputs that are used in the measurement of the total pension liability for the same period that is used as the measurement period by the nonemployer entity. Can the governmental nonemployer contributing entity omit from its report the information included in the pension plan’s stand-alone report if the entity’s report refers to the pension plan’s stand-alone report?

A—All information required by Statement 68 should be included in the governmental nonemployer contributing entity’s financial report. The only item for which Statement 68 permits reference to the pension plan’s report in place of including the detail in the entity’s report is the information required by paragraph 112 of Statement 68 about the elements of the pension plan’s fiduciary net position if the pension plan’s report is available on the Internet.

5.228 Pension plan description

5.228.1. Q—Should the information that is required by paragraph 109b of Statement 68 about benefit terms be current as of the actuarial valuation date that is used as the basis for the total pension liability, the measurement date of the collective net pension liability, or the governmental nonemployer contributing entity’s fiscal year-end?

A—The requirement of paragraph 109b of Statement 68 is intended to result in the disclosure of information about the benefit terms at the measurement date of the collective net pension liability. If a change occurs in the benefit terms between the measurement date and the governmental nonemployer contributing entity’s fiscal year-end such that the effect of the change on the governmental nonemployer contributing entity’s proportionate share of the collective net pension liability is expected to be significant, paragraph 113e of Statement 68 requires information about the change to be disclosed.

5.228.2. Q—Should all contributions made to the pension plan by a governmental nonemployer contributing entity during the entity’s fiscal year be included in the amount of contributions that paragraph 109c of Statement 68 requires to be disclosed?

A—No. For purposes of paragraph 109c of Statement 68, contributions should include only (a) the amount of actual contributions, which are cash contributions from the nonemployer contributing entity to the pension plan that would be recognized as additions from contributions in the pension plan’s statement of changes in fiduciary net position during the period that coincides with the nonemployer contributing entity’s fiscal year, and (b) the amount of contributions from the nonemployer contributing entity to the pension plan that would be recognized by the pension plan as a current receivable during the period that coincides with the nonemployer contributing entity’s fiscal year. This would exclude, for example, payments made to satisfy payables to the pension plan that arose in an earlier fiscal year. (See also Question 5.228.3.)

5.228.3. Q—For purposes of providing information about contributions that is required by paragraph 109c of Statement 68, what should be considered a contribution recognized by the pension plan as a current receivable?

A—For purposes of paragraph 109c of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the nonemployer contributing entity’s contributions during the nonemployer contributing entity’s reporting period and (b) would be collectible within a year as of the end of the nonemployer contributing entity’s reporting period. For example, a receivable recognized by the pension plan for a nonemployer
contributing entity’s contributions related to the last month of the nonemployer contributing entity’s fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable of the pension plan.

5.229  Information about the governmental nonemployee contributing entity’s proportionate share of the collective net pension liability

5.230  Assumptions and other inputs

5.231  Pension plan’s fiduciary net position

5.231.1  Q—If a governmental nonemployer contributing entity has a special funding situation for pensions through a defined benefit plan for which financial statements are not publicly available on the Internet, what information should be disclosed in the nonemployer contributing entity’s financial statements regarding the pension plan’s fiduciary net position?

A—The governmental nonemployer contributing entity should apply paragraph 112 of Statement 68 regarding note disclosures about the pension plan’s fiduciary net position. That paragraph requires that the entity disclose all information required by Statement 68 and other standards about the pension plan’s assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position. Therefore, the entity would have to include information in its financial statements to comply with all note disclosure requirements applicable to the pension plan. This information includes the information required by Statement 67, as well as information required by other Statements. For example, the nonemployer contributing entity would be required to present information to comply with disclosure requirements related to pension plan deposits and investments, including information required by Statements 3, 31, and 40, as amended, as applicable.

5.232  Other information

5.232.1  Q—If a governmental nonemployer contributing entity that reports a substantial proportion of the collective net pension liability uses different proportions to determine its share of different pieces of the collective net pension liability (for example, for different classes of employees), is the nonemployer contributing entity required to disclose its proportion of the net pension liability for each class?

A—No. Paragraph 113a of Statement 68 requires disclosure of only the governmental nonemployer contributing entity’s overall proportion of the collective net pension liability, with a discussion of the basis on which the proportion is determined.

5.232.2  Q—If a governmental nonemployer contributing entity reports a substantial proportion of a collective net pension liability that results from an actuarial valuation that has been updated to the measurement date, what information is the entity required to disclose regarding the update?

A—Information about the measure of total pension liability (for example, the assumptions used in the measurement) should reflect amounts and circumstances as of the measurement date. However, if update procedures were used to develop the measure of the total pension liability, paragraph 113b of Statement 68 requires that the governmental nonemployer contributing entity disclose that fact. No other specific information about the update process is required.

5.232.3  Q—If the proportion used to determine a governmental nonemployer contributing entity’s proportionate share of the collective net pension liability reported in the current period changed
from the proportion used to determine the liability reported in the prior period, is the entity required to disclose the effect of the change in proportion on each of the measures reported in its financial statements—that is, its proportionate share of the collective net pension liability, deferred outflows of resources related to pensions, deferred inflows of resources related to pensions, and pension expense?

A—No. Although a change in the entity’s proportion affects the amount of the nonemployer contributing entity’s proportionate shares of the collective net pension liability, deferred outflows of resources related to pensions, deferred inflows of resources related to pensions, and pension expense, the nonemployer contributing entity is not required to identify the effect of a change in proportion on each of those amounts. Instead, the nonemployer contributing entity should disclose the change in its proportion as required by paragraph 113a of Statement 68 by providing, for example, its former proportion and its new proportion, and it should disclose the portion of its reported balance of deferred outflows of resources or deferred inflows of resources that is associated with changes in proportion, as required by paragraph 113g(4) of Statement 68.

5.232.4. Q—What information, if any, is required to be disclosed about a change in a relevant factor that occurs between the measurement date of the collective net pension liability and the governmental nonemployer contributing entity’s current fiscal year-end?

A—For a change that is expected to have a significant effect on the governmental nonemployer contributing entity’s proportionate share of the collective net pension liability, in its financial report for the current fiscal year, the nonemployer contributing entity should provide information required by paragraph 113e of Statement 68 about the nature of the change, as well as the amount of the expected impact of the change on the nonemployer contributing entity’s proportionate share of the collective net pension liability, if known. For example, if a change of benefit terms is made between the measurement date and the end of the nonemployer contributing entity’s current fiscal year and an estimate of the effect of the change of benefit terms on the nonemployer contributing entity’s proportionate share of the collective net pension liability has been made and is evaluated by the entity to be significant, the nonemployer contributing entity should include in note disclosures a brief description of the benefit change and the estimated amount of the expected resultant change in the nonemployer contributing entity’s proportionate share of the collective net pension liability. (See Questions 5.131.2 and 5.134.6 [single or agent] or Questions 5.174.2 and 5.176.6 [cost-sharing], as applicable, regarding the timing of the inclusion of the effects of such changes in the collective net pension liability.)

5.232.5. Q—For purposes of the disclosure of pension expense that is expected to be recognized as a result of amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions as required by paragraph 113h(1) of Statement 68, at what date should the proportion that is applied to calculate the amounts be determined?

A—The amounts of expense disclosed for each of the subsequent periods required by paragraph 113h(1) of Statement 68 should be determined using the governmental nonemployer contributing entity’s proportion at the measurement date of the collective net pension liability on which the pension liability reported by the nonemployer contributing entity in the current period is based.
5.235  Paragraph 114b

5.235.1. Q—Should all contributions made to the pension plan by a governmental nonemployer contributing entity during the entity’s fiscal year be included in the amount of contributions reported in the schedule of RSI that is required by paragraph 114b of Statement 68?

A—No. For purposes of paragraph 114b of Statement 68, contributions are amounts that are not associated with separately financed specific liabilities of the individual nonemployer contributing entity and include only the amounts that would be recognized as additions from the nonemployer contributing entity’s contributions in the pension plan’s statement of changes in fiduciary net position during the period that coincides with the nonemployer contributing entity’s fiscal year for (a) actual contributions, which are cash contributions from the nonemployer contributing entity to the pension plan, and (b) current receivables. This would include, for example, the amount of the entity’s legally required contributions that are not associated with a specific liability of the individual entity to the pension plan and that would be recognized as a current receivable by the pension plan as of the end of the entity’s fiscal year. It would exclude, for example, the entity’s payments made to satisfy pension plan receivables that arose in an earlier fiscal year of the entity. (See also Question 5.235.2 regarding current receivables.)

5.235.2. Q—For purposes of reporting contributions in the schedule of RSI that is required by paragraph 114b of Statement 68, what should be considered a contribution recognized by the pension plan as a current receivable?

A—For purposes of paragraph 114b of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the entity’s contributions during the nonemployer contributing entity’s reporting period, (b) would be collectible within a year, and (c) is not associated with separately financed specific liabilities of the nonemployer contributing entity. For example, a receivable recognized by the pension plan for an entity’s contributions related to the last month of the entity’s fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable.

5.235.3. Q—If the contribution requirements of a governmental nonemployer contributing entity are determined using an actuarial value of assets that incorporates differences between projected and actual earnings on pension plan investments over a three-year period, can that method continue to be used to determine contribution requirements after implementation of Statement 68?

A—Yes. Statement 68 does not establish requirements for the specific methods and assumptions, if any, used for funding purposes. Therefore, an actuarial value of assets can continue to be used for funding purposes. However, for purposes of complying with Statement 68, all changes in the pension plan’s fiduciary net position, including the full amount of the actual earnings on pension plan investments, should be included in the calculation of the collective net pension liability and changes in the collective net pension liability in the measurement period in which they occur.

5.235.4. Q—Should amounts recognized by a pension plan for contributions from a governmental nonemployer contributing entity pursuant to a separately financed liability of the nonemployer contributing entity be included in the amount reported by the nonemployer contributing entity
as contributions in relation to statutorily or contractually required contributions, as required by paragraph 114b of Statement 68?

A—No. The measure of the statutorily or contractually required contribution that is required by paragraph 114b(1) of Statement 68 excludes amounts, if any, to separately finance specific liabilities of the individual entity to the pension plan. Similarly, the amount of contributions presented in relation to the statutorily or contractually required contribution, as applicable, should exclude amounts recognized as additions to the pension plan for separately financed specific liabilities of the individual entity to the pension plan.

5.235.5. Q—When statutorily or contractually required contribution rates are established for employers in a cost-sharing pension plan and a governmental nonemployer contributing entity in a special funding situation, should the schedule of RSI that presents contributions made as compared to statutorily or contractually required contributions (paragraph 114b of Statement 68) in the financial report of the governmental nonemployer contributing entity include amounts for the employers?

A—No. The schedule should include information about contributions made by, and the statutorily or contractually required contributions of, only the governmental nonemployer contributing entity.

5.236  Notes to required schedules

5.237  Governmental Nonemployer Contributing Entities That Recognize a Less-Than-Substantial Proportion of the Collective Net Pension Liability

5.238  Notes to financial statements

5.239  Required supplementary information

5.240  Circumstances in which a nonemployer entity's legal obligation for contributions directly to a defined benefit pension plan does not meet the definition of a special funding situation

5.241  Employers

See Sections 5.125 and 5.126, as well as Sections 5.129–5.158 (single and agent employers) or Sections 5.161–5.195 (cost-sharing employers), as applicable.

5.242  Governmental nonemployer contributing entities

5.242.1. Q—A governmental nonemployer contributing entity is legally required to make contributions directly to a single-employer defined benefit pension plan but the circumstance does not have the characteristics of a special funding situation. Should the governmental nonemployer contributing entity report a proportionate share of the (collective) net pension liability for benefits provided through the pension plan?

A—No. Because this circumstance is not a special funding situation, the employer, not the nonemployer contributing entity, should report the pension liability for benefits provided through the pension plan. The nonemployer contributing entity should apply the requirements of paragraph 119 of Statement 68, which requires the governmental nonemployer contributing entity to recognize expense/expenditures for its contributions to the pension plan and to classify those amounts in the same manner as it classifies similar grants to other entities, for example, as aid to local governments.
5.243 Payables to a Defined Benefit Pension Plan—All Employers and Governmental Nonemployer Contributing Entities

5.243.1. Q—In a cost-sharing plan, employers’ contractually required contributions are based on an actuarially determined contribution rate, but they have the option to pay the required amount in installments over a 10-year period. How should this arrangement be reported by the employers?

A—Each employer should recognize a contribution equal to its contractually required actuarially determined contributions for its fiscal year. At the end of the fiscal year, the unpaid portion of the amount should be reported as a payable in conformity with the requirements of paragraph 120 of Statement 68. Each employer also should disclose information required by paragraph 122 of Statement 68 about the significant terms and amount of payables outstanding at the end of its reporting period, as well as an explanation that the payables are a result of electing the option to pay the required contributions in installments.

5.244 Notes to financial statements

5.245 Defined Contribution Pensions

5.246 Employers That Do Not Have a Special Funding Situation

5.246.1. Q—If an employer has more than one defined contribution plan, is it required to separately display pension liabilities (or pension assets) for each plan in its financial statements?

A—No. Separate display of liabilities (or assets) for each plan is not required. However, aggregated pension liabilities should be displayed separately from aggregated pension assets.

5.247 Notes to financial statements

5.248 Special Funding Situations

5.249 Employers

5.250 Governmental nonemployer contributing entities

5.251 Notes to financial statements

5.252 Circumstances in Which a Nonemployer Entity’s Legal Obligation for Contributions Directly to a Defined Contribution Pension Plan Does Not Meet the Definition of a Special Funding Situation

5.253 Employers

5.254 Governmental nonemployer contributing entities

5.255 Other Issues

5.255.1. Q—If an employer is required to include amounts paid for compensated absences balances in the amount of payroll on which the employer’s contributions to a defined benefit pension plan is based, should the employer accrue the anticipated amounts as a liability for salary-related payments in conformity with the requirements of Statement No. 16, Accounting for Compensated Absences, paragraph 11?

A—No. The employer’s additional contributions to the pension plan that are expected to arise as a result of the payment of compensated absences should not be accrued as an additional liability under Statement 16. Instead, the pension benefits, if any, that are expected to arise as a result of the projected payment of the compensated absences to the employee should be included in the projection of benefit payments for purposes of Statement 68 and, therefore, would be included
in the net pension liability. Payments to the pension plan that are made as a result of the compensated absence would be recognized as an increase in the pension plan’s fiduciary net position in the period in which the payments are due and would, at that time, reduce the employer’s net pension liability.

### 5.256 Effective Date and Transition

#### 5.256.1

Q—An employer with a June 30 fiscal year is first implementing Statement 68, as amended, in its June 30, 2015 financial statements. The employer’s net pension liability reported at June 30, 2015, has a measurement date of June 30, 2014 (and a corresponding measurement period of July 1, 2013, to June 30, 2014). The employer does not present comparative financial statements. What is the date for measurement of the prior-period adjustment?

A—The prior-period adjustment amount should include amounts as of the beginning of the employer’s fiscal year—that is, July 1, 2014. For example, it should include the effects of (a) the deferred outflow of resources determined at the beginning of the fiscal year for the amount, if any, of the employer’s contributions since the beginning of the measurement period—in this example, contributions from July 1, 2013, to June 30, 2014—and (b) the net pension liability and other deferred outflows of resources and deferred inflows of resources, if applicable (see Questions 5.256.4 and 5.256.5), determined as of the measurement date that is used to determine the beginning net pension liability in the year of initial implementation—in this example, June 30, 2013.

#### 5.256.2

Q—What are the components of the prior-period adjustment to beginning net position when Statement 68, as amended, is first implemented?

A—The prior-period adjustment should (a) remove the net pension obligation (asset) balance determined in accordance with Statement 27, as amended, if any, and any payables to the pension plan associated with formal commitments; (b) add the balance of the net pension liability (or proportionate share of the collective net pension liability), if any, as of the beginning of the initial period of implementation (determined as of the measurement date that would have been applied in the prior fiscal year if Statement 68 had been in effect—see Question 5.256.1); (c) add a deferred outflows of resources balance for the government’s contributions to the pension plan made between the measurement date of the beginning net pension liability and the beginning of the government’s fiscal year, if any; and (d) add balances associated with all other deferred outflows of resources and deferred inflows of resources, if applicable (see Questions 5.256.4 and 5.256.5), determined as of the same date as the beginning net pension liability. If there are payables to the pension plan that are not associated with formal commitments as of the beginning of the initial period of implementation, those balances should remain because Statement 68 continues the measurement and recognition requirements of Statement 27 for those transactions.

#### 5.256.3

Q—Biennial actuarial valuations are performed for pensions provided through a single-employer plan. The employer has a June 30 fiscal year-end and is planning to use the results of the December 31, 2014 actuarial valuation to report a net pension liability with a measurement date of December 31, 2014, at June 30, 2015, the end of its initial year of implementation of Statement 68, as amended. The employer also will use the results of the December 31, 2014 actuarial valuation as the basis for reporting a net pension liability with a measurement date of December 31, 2015 (determined using roll-forward procedures), in its June 30, 2016 financial statements. Can the results of this same actuarial valuation be “rolled back” to be used as the
basis for the employer’s net pension liability that will be included in the amount of the prior-period adjustment reported upon implementation of Statement 68, as amended?

A—The fact that this actuarial valuation is used to determine measurements at three different fiscal year-ends is not inconsistent with the requirement that actuarial valuations be performed at least biennially. However, the net pension liability reported by the pension plan and the employer as of a single date is required to be measured using the same assumptions. Therefore, the actuarial valuation can be rolled back to December 31, 2013, to determine the employer’s net pension liability at the beginning of the initial period of implementation for purposes of determining the amount of the prior-period adjustment (see Questions 5.256.1 and 5.256.2), provided that (a) the net pension liability that results from the rollback reflects the significant effects of only transactions and other events that occurred to that date and (b) if the plan reported a net pension liability as of December 31, 2013, the measure reported by the plan used the same assumptions as used in the rolled back measure.

5.256.4. Q—An employer has historical records of the investment activity for a pension plan such that, at the beginning of the initial period of implementation of Statement 68, as amended, the amounts of the deferred outflows of resources and deferred inflows of resources arising from differences between projected and actual earnings on pension plan investments can be determined. It also has records for contributions made before that date. However, the employer cannot determine the amounts of the deferred outflows of resources and deferred inflows of resources arising from differences between expected and actual experience or changes of assumptions because actuarial valuations for prior years used different methods or assumptions than those required by Statement 68. At transition, should the employer report the deferred outflows of resources and deferred inflows of resources associated with investment earnings and contributions?

A—At transition, paragraph 3 of Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date, requires the employer to report a prior-period adjustment that includes amounts for deferred outflows of resources arising from contributions, if any, made between the measurement date of the beginning net pension liability and the beginning of the employer’s fiscal year. However, that paragraph requires an employer to report either all other deferral balances or none of the others at transition. Therefore, because the employer cannot determine the total beginning deferral balances for differences between expected and actual experience and changes of assumptions, it should not report a prior-period adjustment for the deferral balances arising from differences between projected and actual earnings on pension plan investments.

5.256.5. Q—At the beginning of the initial period of implementation of Statement 68, as amended, a government is able to determine the amount of deferred outflows of resources and deferred inflows of resources for changes in the net pension liability associated with differences between expected and actual experience and changes of assumptions in one prior year. However, information is not available to determine the amounts of the changes in the net pension liability associated with those types of events in earlier years. Should the government report beginning deferred outflows of resources and deferred inflows of resources that include the effects of only the prior year’s changes in the net pension liability?

A—No. At transition, if a government is not able to determine the amounts of deferred outflows of resources or deferred inflows of resources arising from changes in the net pension liability resulting from differences between expected and actual experience and changes of assumptions in all prior periods, it should report none of them. However, paragraph 3 of Statement 71 requires the
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government to report a prior-period adjustment for deferred outflows of resources arising from contributions, if any, made between the measurement date of the beginning net pension liability (see Questions 5.256.1, 5.256.2, and 5.256.4) and the beginning of the government’s fiscal year.

5.256.6. Q—If an employer reported a net pension asset of $150 million and no payables to the pension plan associated with formal commitments under the requirements of Statement 27 but at the beginning of the initial year of implementation of Statement 68 will report a net pension liability of $175 million and no deferred outflows of resources or deferred inflows of resources related to pensions, what would the employer recognize as a prior-period adjustment?

A—The employer would report an adjustment to (reduction of) beginning net position in the amount of $325 million, calculated as the total of $150 million (to reverse the net pension asset previously reported) and $175 million (to record the beginning net pension liability).

Accounting and Financial Reporting for Certain Investments and for External Investment Pools

11. Questions and answers in this paragraph address issues related to accounting and financial reporting for certain investments and for external investment pools.

6.1 Introduction

6.2 Scope and Applicability of Statement 31, as Amended

6.3 Transactions Covered by Statement 31, as Amended

6.3.1. [Not used in GASBIG 2015-1]

6.3.2. [Not used in GASBIG 2015-1]

6.4 Transactions Not Covered by Statement 31, as Amended

6.4.1. [Not used in GASBIG 2015-1]

6.4.2. [Not used in GASBIG 2015-1]

6.4.3. [Not used in GASBIG 2015-1]

6.4.4. Q—How should a government report long-term securities that have been placed in trust to defease the government’s outstanding bonds?

A—If legal or in-substance defeasance as defined by Statement No. 7, Advance Refundings Resulting in Defeasance of Debt, or No. 23, Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities, has been established, the debt and the related assets are not reported in the government’s financial statements. The securities would not be subject to the provisions of Statement 31, as amended. However, if the legal or in-substance provisions have not been met and the securities are still reported in the government’s financial statements, Statement 31, as amended, would apply.
Accounting and Financial Reporting for Certain Investments and for External Investment Pools

6.4.5. Q—In order to finance its own equipment purchase, a city’s internal service fund issues a promissory note that is purchased by the city’s general fund. Should the general fund report the note as an investment, or should this transaction be reported as an interfund loan?

A—The general and internal service funds should report the transaction as an interfund loan in the fund financial statements.

6.4.6. [Not used in GASB/GAAP 2015-1]

6.5 Pension and Deferred Compensation Plans

6.5.1. [Not used in GASB/GAAP 2015-1]

6.5.2. [Not used in GASB/GAAP 2015-1]

6.5.3. [Not used in GASB/GAAP 2015-1]

6.6 Fiduciary Activities

6.6.1. Q—Statement 31 does not apply to securities and other instruments if they are not held by the governmental entity for investment purposes, either for itself or for parties for which it serves as investment manager or other fiduciary (paragraph 5). What are some examples of such situations?

A—Examples of situations for which a government could be holding investment securities as a fiduciary, but not for investment purposes, include contractors’ performance deposits, securities held in trust as bank regulator, and workers’ compensation deposits held as protection against employer defaults. However, if the government actually manages investments for such deposits—for example, a contractor provides cash as a performance deposit and the government places that cash into securities—those securities are considered investments that are subject to the provisions of Statement 31, as amended.

6.6.2. [Not used in GASB/GAAP 2015-1]

6.6.3. [Not used in GASB/GAAP 2015-1]

6.7 Governments That Follow FASB or AICPA Guidance

6.7.1. [Not used in GASB/GAAP 2015-1]

6.7.2. [Not used in GASB/GAAP 2015-1]

6.7.3. [Not used in GASB/GAAP 2015-1]

6.7.4. [Not used in GASB/GAAP 2015-1]

6.8 Public Entity Risk Pools

6.8.1. [Not used in GASB/GAAP 2015-1]

6.9 Restricted Assets, Sinking Funds, and Reserve Funds
6.9.1. [Not used in GASBIG 2015-1]
6.9.2. [Not used in GASBIG 2015-1]

6.10 Investments That Carry “Below-Market” Yields
6.10.1. [Not used in GASBIG 2015-1]

6.11 Definition of and Determining Fair Value
6.11.1. [Not used in GASBIG 2015-1]
6.11.2. [Not used in GASBIG 2015-1]
6.11.3. [Not used in GASBIG 2015-1]
6.11.4. [Not used in GASBIG 2015-1]
6.11.5. [Not used in GASBIG 2015-1]
6.11.6. [Not used in GASBIG 2015-1]
6.11.7. [Not used in GASBIG 2015-1]

6.12 Valuation of Investments
6.12.1. [Not used in GASBIG 2015-1]
6.12.2. Q—How should investments with impaired values be reported?

A—For investments that are reported at fair value, that valuation already considers potential impairments. For other investments that are covered by Statement 31, as amended, and that are reported using cost-based measures, valuation should consider whether the fair value of the investment is significantly affected by the impairment of the credit standing of the issuer or by other factors. Although Statement 31 implies that the unrealized loss represented by the impairment should be recognized, it does not specifically require it. In fact, paragraph 76 of the Basis for Conclusions states that when there is an impairment, the cost-based measure should be reevaluated. Therefore, professional judgment should be applied in determining the amount and timing of a write-down. For investments that are accounted for using the equity method, paragraph 209 of Statement 62 requires that a decline in value of an investment that is other than temporary be accounted for in the same manner as a loss in value of other long-term assets.

6.12.3. Q—Would a change in one credit quality grade for commercial paper be considered an impairment significant enough to adjust the cost basis of the investment?

A—Generally not. Routine changes in ratings do not necessarily indicate impairment. However, there may be situations—for example, a downgrade of a security to below investment grade—

Terms defined in paragraph 12 are shown in **boldface type** the first time they appear in this paragraph.
in which a preparer might consider one change in credit quality grade to be an impairment significant enough to require an adjustment. For example, if a government is required by statute to carry securities above a certain grade and a specific security falls below that grade, that security could be required to be liquidated.

6.12.4. Q—An internal investment pool has investments that mature in less than one year from the date of purchase. Can these investments be reported at fair value?

A—It depends on the types of investments in the pool. All of the money market investments and participating interest-earning investment contracts may be reported at fair value. However, nonparticipating interest-earning investment contracts should be reported using cost-based measures. (See Question 6.17.3.)

6.12.5. [Not used in GASBIG 2015-1]

6.12.6. [Not used in GASBIG 2015-1]

6.12.7. Q—When an interest-bearing bond is fair-valued between interest payment dates, how does fair value consider the accrued interest?

A—Industry practice is not to consider accrued interest in quotations. For example, consider a bond selling at 102 that is purchased between its semiannual interest payment dates. The purchaser would be expected to pay the counterparty 102, plus the amount of accrued interest the counterparty is entitled to. This purchased interest will be received by the purchaser of the bond on the next interest payment date.

6.12.8. [Not used in GASBIG 2015-1]

6.12.9. Q—In its securities lending program, a government receives cash as collateral. With the cash collateral, the government purchases additional securities and invests in a securities lending pool. How should the investments arising from investing the cash collateral be measured?

A—Collateral in the form of investments that arise from invested cash collateral should be measured according to Statement 31. In most cases, securities lending transactions’ invested collateral should be measured at fair value.

6.12.10. [Not used in GASBIG 2015-1]

6.12.11. Q—How should the reporting of investments at fair value be applied to zero-coupon bonds?

A—The bonds should be reported at their fair value at the reporting date, and any change in fair value should be reported as a change in net position. The fair value of the bonds ultimately will approach face value—the amount of the proceeds that will be received—as the maturity date nears.

6.13 Marking-to-Market

6.13.1. [Not used in GASBIG 2015-1]

6.13.2. Q—If investments are reported at fair value, can accounting records be kept on the cost (or amortized cost) basis, with financial statement adjustments for fair value?
A—Yes. There is no requirement to journalize fair value adjustments or to keep accounting records based on fair value. Cost-based records are acceptable, provided that adjustments to fair value are made when financial statements are prepared.

6.14 Amortized Cost

6.14.1. Q—Statement 31 permits certain investments to be reported using cost-based measures. Examples are money market investments that have a remaining maturity at the time of purchase of 1 year or less (paragraph 9 of Statement 31) and debt security investments with remaining maturities of up to 90 days at the date of the financial statements (paragraph 16 of Statement 31, as amended). Is the display of realized gains and losses, and amortization of discounts and premiums in the change statement, permitted in these cases?

A—Although Statement 31 adopts fair value for reporting many investments, cost-based measures are allowed for certain types of investments. As amended, paragraph 13 of Statement 31, including footnote 7, describes how to report fair value changes in the financial statements; realized gains and losses generally should not be displayed separately from the net increase (decrease) in the fair value of investments. Premiums and discounts generally should not be amortized. However, those provisions apply only to investments that are reported using fair value. Paragraph 13, as amended, does not modify current reporting practices for investments that are reported using cost-based measures, including the reporting of realized gains and losses and the amortization of premiums and discounts. If that presentation for cost-based investment income is retained, the financial statements should clearly indicate that this presentation applies only to securities reported at amortized cost.

6.14.2. [Not used in GASB/IG 2015-1]

6.14.3. Q—A city purchases for its general fund a money market investment with a remaining maturity at the time of purchase of less than six months. This is not an interest-bearing investment; instead, it was purchased at a discount. The city reports this investment using amortized cost. If in the current year the city holds the investment for three months, should a proportionate amount of income be reported in the current year?

A—Yes. The amortization of the discount should be recognized as revenue ratably over the period from purchase to maturity.

6.15 Specific Investment Instruments

6.16 Bonds with “Below-Market” Yields

6.16.1. [Not used in GASB/IG 2015-1]

6.17 Interest-Earning Investment Contracts

6.17.1. Q—What is an interest-earning investment contract?

A—An interest-earning investment contract is a direct contract, other than a mortgage or other loan, that a government enters into as a creditor of a financial institution, broker-dealer,

9The accounting literature uses amortization of discounts and accretion interchangeably. In this paragraph, amortization of discounts is used.
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investment company, insurance company, or other financial services company and for which it receives, directly or indirectly, interest payments. Interest-earning investment contracts include time deposits with financial institutions (such as certificates of deposit), repurchase agreements, GICs and BICs, and annuity contracts issued by insurance companies.

6.17.2. Q—Statement 31 provides different valuation standards for participating and nonparticipating interest-earning investment contracts. What is the difference between these two types of contracts?

A—A participating contract can capture market (interest rate) changes through the investment’s negotiability or transferability, or through redemption terms that consider market rates. For example, a government may hold a GIC that has an interest rate that changes based on changes in the federal funds rate or some other index. A nonparticipating contract cannot be negotiated or transferred and its redemption terms do not consider market rates. A common example would be a term deposit with a bank—a certificate of deposit—that cannot be withdrawn before maturity without substantial penalty and with an interest rate that does not change during the term of the deposit.

6.17.3. Q—How should nonparticipating interest-earning investment contracts be valued?

A—Paragraph 8 of Statement 31 requires all entities to report positions in nonparticipating interest-earning investment contracts using cost-based measures, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. As discussed in paragraph 43 of the Basis for Conclusions, this exception from reporting at fair value is provided because those contracts are not able to realize market-based increases or decreases in value under any circumstances.

6.17.4. Q—Are flex repurchase agreements (flex repos) considered nonparticipating interest-earning investment contracts?

A—It depends on the terms of the flex repo. A flex repo is a term repurchase agreement that permits the investor to sell a portion of the collateral securities back to the counterparty before the final maturity date of the transaction. Flex repos frequently are used in construction projects when bond proceeds need to be invested until each portion of construction is required to be paid. A flex repo should be considered nonparticipating (and reported using cost-based measures) if it is neither negotiable nor transferable and if redemption terms do not consider market rates.

6.18 Money Market Investments

6.18.1. Q—What are money market investments?

A—Money market investments are short-term, highly liquid debt instruments, including commercial paper, bankers’ acceptances, and U.S. Treasury and agency obligations. Asset-backed securities, derivative instruments, and structured notes, including notes with call options, are not included in this definition. Investments with call features are discussed in Question 6.19.2.
6.19 Derivative Instruments

Issues associated with implementation of the measurement and disclosure provisions of Statement 53 are addressed in paragraph 16.

6.19.1. [Not used in GASBIG 2015-1]

6.19.2. Q—A Federal Home Loan Bank note maturing in two years has an option that makes the note callable in six months. Does this investment qualify as a money market investment that can be reported at amortized cost in accordance with paragraph 9 of Statement 31?

A—No. The call feature is an embedded derivative instrument that makes the investment a structured note. Statement 31 does not consider structured notes to be money market investments, and therefore the one-year option as discussed in paragraph 9 does not apply to the note.

6.19.3. [Not used in GASBIG 2015-1]

6.20 Real Estate

6.20.1. [Not used in GASBIG 2015-1]

6.20.2. [Not used in GASBIG 2015-1]

6.20.3. Q—When investments in real estate are reported at fair value, what income and expenses are recognized?

A—All rental, lease, and other fees are recognized as revenue. In addition, fair value increases and decreases are recognized in revenue. No depreciation or amortization is recognized on the property. Investment expenses would include those arising from managing the property.

6.21 Short Security Positions

6.21.1. [Not used in GASBIG 2015-1]

6.22 Positions in External Investment Pools

6.22.1. Q—How should a government’s investment positions in 2a7-like external investment pools be measured?

A—Investment positions in 2a7-like pools, whether sponsored by a governmental or a nongovernmental entity, should be measured at the net asset value per share provided by the pool. Because of the constraints provided by Statement 31, as amended, on when a pool is classified as 2a7-like, the net asset value per share of an entity’s position in a 2a7-like pool approximates its fair value.

6.22.2. Q—How does a government determine whether the non-SEC-registered pools in which it invests are 2a7-like?
A—The government should obtain this information from the pool sponsor. It also could review a recent financial statement of the pool. If the pool is a governmental entity, Statement 31, as amended, requires that it provide information in its financial statements that would permit governmental entities to determine whether it is 2a7-like. Financial statements from nongovernmental pool sponsors also can provide information to verify a pool’s representation about its 2a7-like status.

6.22.3. Q—The Office of the Comptroller of the Currency (OCC) prescribes a cost-based money market fund for the banks that it regulates that is similar to the SEC’s Rule 2a7. Can the OCC’s structure allow pool participants to value their investment positions in these types of pools using net asset value per share?

A—No. The SEC’s Rule 2a7 was selected as the sole structure for participants to value their positions using net asset value per share. A pool that complies with the OCC requirements also would need to be 2a7-like for the participants to value their positions using net asset value per share.

6.22.4. Q—If a pool has a legally binding guarantee to support its shares, can a participating government report its investment in the pool using the pool’s net asset value per share even though the pool is not 2a7-like?

A—It depends on the nature and amount of the guarantee. Paragraph 71 of the Basis for Conclusions of Statement 31 describes legally binding guarantees. One example is an irrevocable bank letter of credit that supports share value when the fair value of the pool’s investments is affected. An insurance policy would be a similar guarantee. Also, some pool sponsors may state a guaranteed share value. However, paragraph 71 indicates that to meet the requirements of Statement 31, the guarantee would have to be a stated legal obligation and be evaluated in light of the creditworthiness of the pool sponsor. Also, the fair value of the investments in the pool supplemented by the amount of the guarantee would have to fully support the share price. If the guarantee is a wrap contract associated with a synthetic guaranteed investment contract (SGIC), the provisions of paragraphs 20 and 67 of Statement 53 should be applied.

6.22.5. [Not used in GASBIG 2015-1]

6.22.6. Q—If a government cannot obtain information from a pool sponsor to allow it to determine the fair value of its investment in a non-2a7-like external investment pool, what information might it use to make its best estimate of fair value?

A—The participant in such a pool could obtain the latest available financial statements of the pool. If those statements disclose carrying amount and fair value and the types of investments being held, the participant could use that information and knowledge about changes in fair values of different types of investments since the date of the financial statements to project the current fair value of the pool’s investments. However, to the extent possible, participants should contact pool sponsors to obtain current information about fair value.

6.23 Open-End Mutual Funds

6.23.1. [Not used in GASBIG 2015-1]
6.24 **Equity Securities**

6.24.1 Q—When an equity security is reported at fair value, how are declared dividends recognized for financial reporting purposes?

A—Dividends receivable and revenue are recognized at the ex-dividend date—that is, the first date on which the securities trade without the declared dividends attached. Between the date the dividend is declared and the ex-dividend date, the market price (fair value) of the equity security includes the value of the declared dividends. Because the equity security is reported at fair value, recognizing the dividends receivable and revenue for financial reporting purposes before the ex-dividend date would duplicate the transaction.

6.25 **Option Contracts**

6.25.1 [Not used in GASBIG 2015-1]

6.26 **Reverse Repurchase Agreements**

6.26.1 Q—Paragraph 81 of Statement 3 requires the separate display of assets and liabilities arising from reverse repurchase agreements. How is this applied if a government pools moneys from several funds for investment purposes in an internal investment pool and it is the pool, rather than individual funds, that has the reverse repurchase agreements?

A—A pro rata allocation of the assets and liabilities arising from reverse repurchase agreements should be made to the various funds with equity in the pool. See also Interpretation No. 3, *Financial Reporting for Reverse Repurchase Agreements*, as amended.

6.27 **Recognition and Reporting**

6.27.1 [Not used in GASBIG 2015-1]

6.28 **Display in the Change Statement**

6.28.1 [Not used in GASBIG 2015-1]

6.28.2 Q—Can the change in fair value of investments in the statement of revenues, expenditures, and changes in fund balances of a governmental fund be reported below the *excess of revenues over expenditures*?

A—No. Statement 31 requires the change in fair value to be reported as revenue. Consideration was given to allowing the change to be reported in the statement of revenues, expenditures, and changes in fund balances below the excess of revenues over expenditures; however, it was determined that the nature of fair value changes is not intrinsically different from, and that it should not be separated from, other elements of investment income.

6.28.3 Q—Can a proprietary fund report the change in fair value of investments in the statement of revenues, expenses, and changes in net position as a nonoperating revenue?

A—Yes. The change in the fair value of investments should be reported in the same manner as other investment income, which generally is nonoperating revenue.
6.28.4. [Not used in GASB1G 2015-1]

6.28.5. [Not used in GASB1G 2015-1]

6.28.6. Q—If overall investment income for the year is negative, how should that amount be reported on the change statement?

   A—Paragraph 13 of Statement 31, as amended, provides that governments should report negative investment income as negative revenue.

6.29 Display in the Statement of Net Position/Balance Sheet

6.29.1. [Not used in GASB1G 2015-1]

6.29.2. Q—In the statement of net position/balance sheet, can cost-based investment information be presented parenthetically?

   A—Yes. Cost-based information can be presented in this manner.

6.29.3. Q—Can a government report the entire position of its internal investment pool as cash and cash equivalents in the general fund, with an amount due to other funds for those other funds’ positions in the pool?

   A—No. Paragraph 14 of Statement 31, as amended, provides that the equity position of each fund or component unit in an internal investment pool should be reported as assets in those funds and component units. Therefore, each fund with a position in the internal investment pool should report its position as, for example, equity in cash management pool, equity in internal investment pool, cash and cash equivalents, or investments. Reporting the entire position of the pool in the general fund, with corresponding interfund receivables and payables for the other funds’ equity positions, misrepresents the nature of the positions. Likewise, an agency fund should not report internally pooled investments, with payables to participating funds.

6.30 Display in the Statement of Cash Flows

See paragraph 6.

6.31 Assignment of Interest

6.31.1. Q—Statement 31 requires that when investment income is assigned to another fund because of other than legal or contractual provisions, the income should be recognized in the fund reporting the investments. What is meant by legal or contractual provisions?

   A—In this instance, legal or contractual provisions means the assignment of investment income by an authority greater than management decision. An example is a state law that requires all amounts earned by all investing activities of the state treasurer to be accrued as revenue to the general fund.

6.31.2. Q—A city operates an internal investment pool. Certain grant funds, because of untimely reimbursements, operate in a deficit cash position. Does Statement 31 require that the allocation of interest income consider these deficit positions as de facto loans and, accordingly, that an interest charge be assessed?
A—No. When one fund overdraws its share of the pool, that fund should report an interfund liability to the fund that management deems to have lent that amount to the overdrawn fund. Paragraph 14 of Statement 31, as amended, requires only investment income to be allocated. However, there may be federal, state, local, or contractual requirements that would require such an interest charge, or management may believe that an interest charge is appropriate.

6.31.3. Q—A school district trust fund is reported in a permanent fund. Dividends and interest income received on the investments in that fund are transferred, per state statute, to a special needs program accounted for in a special revenue fund in which it will supplement state grants also restricted to that purpose. However, because the transferred income is calculated on a basis other than fair value, there are differences between the amount the trust fund recognizes as investment income and the amount actually transferred to the special needs program. How does the trust report the difference?

A—Because this trust agreement does not provide for the spending of net appreciation, any unrealized gains should be included in the same fund balance classification as the investments—in this case, nonspendable. If the trust agreement does provide for spending some or all of the net appreciation, and the amount transferred to the special revenue fund is less than the total permitted, the undistributed amount should be classified as restricted.

6.32 Disclosures

See paragraph 4.

6.33 External Investment Pools

6.34 Definition of External Investment Pools

6.34.1. [Not used in GASB 2015-1]

6.34.2. Q—A local government has an investment account at a local bank. That bank pools moneys from various local governments in investments that are authorized by state law. Is this an external investment pool?

A—Yes. An external investment pool may be administered by a nongovernmental entity. If the pool is an SEC-registered open-end mutual fund, participants should value their positions in the pool accordingly.

6.34.3. Q—A local government sponsors an investment pool for special-purpose governments in its jurisdiction. Participation is open to legally separate entities that are not component units of the local government. During the year, non-component-unit entities invested in the pool, but at the reporting date the only participants are component units. Should the pooling that occurred during the year be reported as an external investment pool?

A—Yes. The pool should be reported as an external investment pool. If non-component-unit entities invested in the pool during the year, the external activity should be reported in the sponsoring government’s financial statements in an investment trust fund. This would be the case even though that trust fund would report zero balances in its statement of fiduciary net position as of the reporting date.
6.34.4. Q—A county collects property taxes on behalf of special-purpose districts within the county. Following the month of collection, the proceeds are remitted to the appropriate districts. While the county holds the proceeds, the moneys are invested in the county’s external investment pool. The districts receive investment income but do not participate in investment losses of the pool. Are the districts participants in a governmental external investment pool?

A—No. In the view of the districts, the moneys held by the county are a receivable, not an investment. Receivables are not covered by Statement 31, as amended. See paragraph 2, as amended, and the definition of debt security in paragraph 22 of the Statement. Whether the districts receive any investment income on their invested balances does not affect this analysis. The county should report in an agency fund a liability to the districts and should value the investments purchased with the districts’ moneys according to Statement 31, as amended. If the values of the investments fall below the county’s liability, the county should evaluate its liability in the context of its legal responsibilities.

6.34.5. Q—A county treasurer, per statute, acts as the official treasurer for special-purpose districts within the county. The districts are not component units of the county. Moneys are pooled and invested by the treasurer. Are the districts participants in a governmental external investment pool?

A—It depends on which entity benefits from the investment. An external investment pool invests for the benefit of participants. If the districts participate in the investment income of the pooled investments, they have a position in a governmental external investment pool. Their positions in the pool should be valued according to share value after considering any legally binding guarantee by the pool sponsor—the county. Investment positions in 2a7-like pools should be determined by the pool’s net asset value per share. (See Statement 31, paragraph 11, and Statement No. 59, Financial Instruments Omnibus, paragraph 5.)

If the districts do not participate in the investment income (or the possibility of loss) of the pooled investments, the districts do not have a position in a governmental external investment pool. This could be the case if, for example, the districts’ moneys are invested for the benefit of the county’s general fund in an assignment of income and the districts are protected from loss. From the perspective of the districts, this structure more closely resembles a demand account. The county should follow the assignment-of-income provisions of Statement 31, paragraphs 14 and 15, as amended.

6.35 Colleges and Universities

6.35.1. [Not used in GASBIG 2015-1]

6.35.2. [Not used in GASBIG 2015-1]

6.36 Joint Ventures

6.36.1. Q—A governmental joint venture is established to construct and operate a sewage treatment plant. In its initial design and construction phase, the joint venture realizes significant income from the investment of unspent construction money. Is this joint venture an external investment pool?

A—No. Statement 31 indicates that an external investment pool is organized to commingle the moneys of participants in an investment portfolio. The joint venture described was not
established to operate as an investment vehicle; the investment function is incidental to the purposes of the organization. The accounting provisions of Statement 14, as amended, should be followed. However, the joint venture should apply the provisions of Statement 31 when reporting its investments.

6.37 Public Entity Risk Pools

6.37.1. Q—A risk management pool is established among local governments to manage liability exposures. The pool holds substantial investments. Is this risk pool also an external investment pool?

A—No. The risk pool was not organized to be an investment vehicle and should not be considered an external investment pool. Risk pools should follow the investment requirements of Statement 10.

6.38 Venture Capital Limited Partnerships

6.38.1. [Not used in GASBIG 2015-1]

6.39 2a7-Like Pools

6.39.1. [Not used in GASBIG 2015-1]

6.39.2. [Not used in GASBIG 2015-1]

6.40 Valuation of Governmental External Investment Pool Investments

6.40.1. Q—Should a governmental external investment pool that is not 2a7-like measure its debt investments using fair value or amortized cost?

A—Most investments should be reported using fair value (paragraph 7 of Statement 31, as amended). Nonparticipating interest-earning investment contracts should be reported using cost-based measures. (See Question 6.17.3.) Debt securities with a remaining maturity of 90 days or less at the date of the financial statements may be reported at amortized cost (paragraph 16 of Statement 31). Fully benefit-responsive synthetic guaranteed investment contracts—the combination of the underlying investments and the wrap contract—should be reported at contract value based on the guidance provided in paragraph 67 of Statement 53.

6.40.2. Q—A governmental external investment pool has held a U.S. Treasury bond for several years and has reported it at fair value. At the pool’s current year-end, that bond has only 75 days remaining to maturity, and the pool reports short-term debt investments with a remaining maturity of 90 days or less at amortized cost. What is the value of that bond for determining its cost basis at the current reporting date?

A—The fair value of the investment on the date it becomes short term (for example, when it has 90 days remaining to maturity) becomes its new cost basis. Any difference between that new cost basis and the face value of the investment is amortized over the remaining 90 days to maturity.

6.40.3. Q—Statement 31 provides different accounting requirements for money market investments and participating interest-earning investment contracts that are held by governmental entities
other than external investment pools. If a governmental external investment pool includes internal moneys belonging to the pool’s sponsor, should the accounting guidance applicable to governmental external investment pools be followed for the entire pool?

A—Yes. This pool should follow the governmental external investment pool guidance for money market investments and participating interest-earning investment contracts. Short-term debt investments with remaining maturities of up to 90 days at the date of the financial statements may be reported at amortized cost, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. (See Statement 31, paragraph 16.) The pool is not permitted to follow the cost-based standards for money market investments and participating interest-earning investment contracts, even though a portion of the pool represents internal moneys. (See Statement 31, footnote 3.)

6.41 Reporting Governmental External Investment Pools

6.42 Separate or Stand-Alone Financial Reports

6.42.1. [Not used in GASBIG 2015-1]

6.42.2. [Not used in GASBIG 2015-1]

6.42.3. [Not used in GASBIG 2015-1]

6.42.4. Q—A governmental external investment pool includes moneys of external entities as well as moneys of the sponsoring government. For the separate or stand-alone financial reports of the pool, should only those positions belonging to the external entities be reported?

A—No. The separate or stand-alone financial report should include all assets under management, including those that represent positions that belong to the sponsoring government.

6.42.5. Q—Statement 31 requires governmental external investment pools to disclose information about regulatory oversight and the frequency of determining the fair value of pool investments. What are examples of this type of information?

A—Examples are the existence of state agency oversight, the existence of a board of directors, and the frequency of marking-to-market. Research for this project revealed that the nature of a pool’s operations and portfolio was not always evident in materials that were distributed to participants, including financial reports. These disclosures will provide that information to pool participants and other users of pool financial statements, permitting them to make more informed decisions about the pool.

6.42.6. Q—Statement 31, paragraph 17, as amended, requires governmental external investment pools to disclose, among other information, a summary of the fair value and carrying amount (if different from fair value) of each major investment classification. Does this disclosure requirement apply to 2a7-like pools?

A—Yes. Such information is as important for the financial reports of 2a7-like pools as it is for non-2a7-like pools.

6.43 Sponsor Reporting
6.43.1. Q—A state government sponsors an investment pool for its own moneys and moneys of legally separate entities that are not component units. What are the requirements for presenting this pool in the state’s annual financial report?

A—The state should report the external portion of the pool (that is, the portion belonging to the non-component-unit participants) as an investment trust fund in the fiduciary fund financial statements. (See Exhibits 41 and 42 in nonauthoritative Appendix B7-1.)

6.43.2. Q—A governmental external investment pool is included in the statement of fiduciary net position of the sponsoring government. How should the equity account net position held in trust for pool participants be reported?

A—In the statement of fiduciary net position, this account should be presented in net position as, for example, held for external investment pool participants.

6.43.3. Q—What are the disclosure requirements for the financial statements of a government that sponsors an external investment pool?

A—If a separate financial report is issued for the pool, the financial statements of the sponsoring government need only disclose how to obtain that report. If a separate report is not issued, the sponsor’s financial statements should include the disclosures required by Statement 31, paragraph 17, as amended, for such a separate report. Those disclosures include the frequency of determining the fair value of investments, the method used to determine the participants’ share sold and redeemed, and other disclosures. In addition, the sponsoring government’s financial statements should make the disclosures required by Statements 3 and 28, as amended, and other cash and investment standards separately for the pool. (See Question 6.43.4.) Finally, the sponsor’s financial statements should disclose condensed statements of fiduciary net position and changes in fiduciary net position for the pool. If the pool includes both internal and external investors (a “mixed pool”), those condensed financial statements should include, in total, the net position held in trust for all pool participants, and the equity of participants should distinguish between internal and external portions. If the government sponsors more than one external investment pool, the disclosures are required for each pool. (See Statement 31, paragraph 19, as amended.)

6.43.4. Q—Statement 40, paragraphs 8 and 9, requires governments to disclose information about custodial credit risk of deposits and investments. How is a sponsoring government’s disclosure of deposits and investments under Statement 40 affected by whether the sponsoring government issues a separate report for its external investment pool?

A—If the sponsoring government issues a separate report for its external investment pool, the custodial credit risk disclosure in the sponsoring government’s report could aggregate all deposits and investments into a single disclosure, including those of the pool. (Such aggregation is subject to the provisions of Statements 3 and 40 for disaggregation in certain situations—see paragraph 65 of Statement 3, as amended, and paragraph 5 of Statement 40.) However, disaggregation is acceptable.

If the sponsoring government does not issue a separate report for its external investment pool, Statement 31 requires a separate custodial credit risk disclosure in the sponsoring government’s report for the deposits and investments of the pool as a whole. This is the same disclosure as would have been presented under the requirement of paragraph 19 of Statement
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31 if the pool had issued a separate report. In this situation, Statement 31 does not specify whether the sponsoring government’s “general” custodial credit risk disclosure should include all, some, or none of the pool’s deposits and investments. Sponsoring governments should select the presentation that they believe best presents the required information and should disclose what is included in the presentation. Any presentation should consider the provisions of Statement 3, paragraph 65, as amended, and Statement 40, paragraph 5, for disaggregation.

6.43.5. Q—Can individual investment accounts be combined with a governmental external investment pool for reporting purposes?

A—No. The individual investment accounts should be reported as one or more separate investment trust funds. (See Questions 6.45.1–6.45.3.) Combining individual investment accounts with the investment pool might obscure information that is needed by users of the pool’s financial statements.

6.44 Pool Reporting Compared to Pool Management

6.44.1. Q—Does Statement 31 require governmental external investment pools to use the same accounting method for valuing participant shares as is used for financial reporting?

A—No. Statement 31 addresses external financial reporting. It does not provide standards for the management of an external investment pool. The valuation of participant shares is the determination of the pool sponsor. Regardless of the method the pool sponsor uses to value shares, participants should report their positions either at fair value or, if the pool is a 2a7-like pool, at the pool’s net asset value per share.

6.44.2. Q—Does Statement 31 mandate the manner, method, or frequency of the distribution of investment income?

A—No. The distribution of investment income is the determination of the pool sponsor in conjunction with pool participants. Regardless of the distribution of investment income, however, pool participants should value their position in the pool using fair value. The only exceptions are investment positions in open-end mutual funds and in 2a7-like pools, which are reported using the fund’s share price or pool’s net asset value per share because it approximates fair value.

6.44.3. Q—A governmental external investment pool distributes investment income on an amortized cost basis. Amortized discounts and premiums, accrued interest, and realized gains and losses, net of expenses, are paid in cash to participants on a quarterly basis. The pool is not a 2a7-like pool. How does the pool sponsor report fair value information and participants’ equity in the pool’s financial statements?

A—Statement 31, as amended, applies to the valuation of investments and does not apply to the method the pool uses to value the participants’ equity. Pool investments should be reported at fair value. Participants’ equity in the pool is determined by the amount of participant deposits, adjusted for withdrawals and distributed income. Undistributed and unrealized gains
and losses can be captioned as such in the net position portion of the statement of fiduciary net position. See Illustration 2 in nonauthoritative Appendix B6-3. See Illustration 1 in nonauthoritative Appendix B6-3 for participants’ reporting of their position in an external investment pool.

6.44.4.  Q—In Question 6.44.3, what disclosures would be appropriate about the difference between the fair value of the pool’s investments and the amortized cost share value?

A—Note disclosures should indicate that distributions to participants are made on an amortized cost basis, which differs from a fair value basis, and that the difference between the two methods is reported in the net position section on the statement of fiduciary net position as undistributed and unrealized gains (losses). See Illustration 2 in nonauthoritative Appendix B6-3.

6.45  Individual Investment Accounts

6.45.1.  Q—Statement 31, paragraph 20, requires governments to report as separate investment trust funds the individual investment accounts that they manage for legally separate entities that are not component units. What are individual investment accounts?

A—Some governmental entities provide investment services to other entities on other than a pooled basis. For example, a state treasurer may maintain individual investment accounts for the municipal governments in the state. Specific investments are acquired for the individual municipalities, and the income from and changes in the value of those investments affect only the municipality for which they were acquired. Sometimes, such individual accounts are offered as an alternative to the sponsoring government’s external investment pool; in other cases, only individual investment accounts are provided.

6.45.2.  Q—Does Statement 31 require separate annual financial reports or special disclosure by governments sponsoring individual investment accounts?

A—No. An individual investor’s position is not affected by all investments in individual accounts, but only by those investments in its own account. Therefore, separate reports and disclosures are not required from the sponsor.

6.45.3.  Q—A county government provides individual investment accounts to other, legally separate special-purpose governments. Those governments are not part of the county’s reporting entity. In the combining and individual fund financial statements, can the county aggregate all individual investment accounts for these governments?

A—Yes. In the combining and individual fund financial statements, all individual investment accounts may be aggregated as a single investment trust fund and be presented as one column.
6.46 Transition

6.46.1. [Not included in GASBIG 2015-1]

6.46.2. [Not included in GASBIG 2015-1]

6.46.3. [Not included in GASBIG 2015-1]

Glossary

12. This paragraph contains definitions of certain terms as they are used in paragraph 11. The terms may have different meanings in other contexts.

Amortized cost
A method of calculating an investment’s value by adjusting its acquisition cost for the amortization of discount or premium over the period from purchase to maturity.

Flex repurchase agreement (flex repo)
A term repurchase agreement that permits the investor to sell a portion of the collateral securities back to the counterparty before the stated, final maturity date of the transaction. (That is, it is “flexible.”)

Impairment
When an investment is reported using cost-based measures, events or changes in circumstances that indicate the carrying amount of the investment may not be recoverable. An investment is impaired when a decline in its fair value below the amortized cost basis is other than temporary.

Mixed pool
An investment pool that commingles moneys of a fund or component unit of a reporting entity, and legally separate entities that are not part of the same reporting entity.

Money market fund
An open-end mutual fund that complies with the SEC’s Rule 2a7 of the Investment Company Act of 1940 (17 Code of Federal Regulations §270.2a7).