This document reflects the result of analyses, discussions and review by UCOP staff and PricewaterhouseCoopers (PwC) to date. The document is subject to change pending additional discussions with PwC; however, it represents the best information available to date.

University of California

GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*

Issues Resolution Memo No. 27.1

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Financial Reporting Approach for the University's Consolidated Financial Statements, the Separately Audited "Carve Out" Financial Statements, the National Laboratories' Financial Statements and The Hastings College of the Law

Background

In November 1994, the GASB published Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The Statement outlined changes to the information that the University is required to record in its financial statements and report in its footnotes regarding pension costs. These changes were required for fiscal year 1997-98, with restatements for fiscal year 1996-97. However, at the implementation date, the University had no transitional liability and no ARC due to the funded status of the plan. Both employer and employee contributions have been suspended since 1990, with the employee portion redirected to the Defined Contribution Plan. Therefore, at the time the Statement became effective, and until present, the University has made only the footnote disclosures required by Statement No. 27.

The University currently provides pension benefits to its retirees, including lifetime retirement income, disability protection, death benefits, and pre-retirement survivor benefits through the University of California Retirement Plan (UCRP), a defined benefit pension plan. Benefits provided by the UCRP exclude those described in GASB Statement No. 45 as other postemployment benefits, such as medical and dental benefits. The GASB has taken the position that pension benefits are a part of the compensation that employees earn each year, even though these benefits are not received until after employment has ended. Therefore, the cost of these future benefits is a part of the cost of providing services today. Among other matters, the Statement requires the University to record as an operating expense the actuarially determined, accrued annual cost of providing pension benefits to its employees (APC). It also requires the University to record and report the accrued liability, or net pension obligation (NPO), to the UCRP. The University must identify the APC and NPO for the University and develop a financial reporting approach for each separate reporting segment and affiliated entity that participate in the UCRP. Financial reporting requirements prescribed by the GASB require the effect of providing pension benefits to be reported in any reporting segment or entity that

has audited financial statements. The University's consolidated financial statements as well as the "carve out" financial statements for each medical center (MC), UC Press, Continuing Education of the Bar (CEB), Associated Students – UCLA (ASUCLA), national laboratories (NL) and Hastings College of Law (HCL) are audited by certified public accountants.

It is clear that the pension reporting requirements, including the APC and NPO, fully apply to the University's consolidated financial statements. The University has one plan. Within the context of the consolidated University statements, the DOE's continuing obligation to fund the laboratory portion of the UCRP benefits must also be addressed in the financial reporting approach.

The financial reporting requirements are also not entirely clear for the separately audited "carve out" financial statements. In order to develop a financial reporting approach to these situations, it is necessary to demonstrate that the University has a pension plan where all facets of the University community, including the laboratories, share the risks, rewards and costs of the plan.

Authoritative Guidance

For the consolidated financial statements of the University of California, the relevant authoritative guidance is as follows:

- Paragraph 26 of GASB Statement No. 35 permits the University to report as a special purpose government engaged in business-type activities (BTA's).

- Paragraph 138 of GASB Statement No. 34 states that governments engaged only in business-type activities should present only the financial statements required for enterprise funds.

- Paragraph 63b of GASB Statement No. 34 includes enterprise funds under proprietary funds.

- The plan meets the definition of a single-employer plan as outlined in the GASB Statement No. 27 specifically…."A plan that covers the current and former employees, including beneficiaries, of only one employer." The inclusion of The Hastings College of the Law employees in UC's plan is not significant to either the plan or to UC.

- Paragraph 8 of GASB Statement No. 27…"For employers with single-employer or agent multiple-employer (agent) plans (sole and agent employers), annual pension cost should be equal to the annual required contributions of the employer (ARC) to the plan for that year, calculated in accordance with paragraphs 9 and 10 (the parameters), unless the employer has a net pension obligation to the plan at the beginning of the year."

- The University has one plan, therefore the provisions of paragraphs 14 and 15 of GASB Statement No. 27 do not apply.

- Paragraph 17 of GASB Statement No. 27 states, "Pension expense of proprietary and similar trust funds and all other entities that apply proprietary fund accounting should be recognized on the accrual basis. The employer should report pension expense for the year equal to annual pension cost. The net pension obligation should be adjusted for any difference between contributions made and pension expense. A positive (negative) year-end balance in the net pension obligation should be recognized as the year-end liability (asset) in relation to the ARC."…

- With respect to the relationship with the DOE for the University to provide pension benefits for retired employees who formerly worked at the national laboratories and for whom UC retains the pension benefit liability, paragraph 28 of GASB Statement No. 27 states, "Some governmental entities are legally responsible for contributions to pension plans that cover the employees of another governmental entity or entities. For example, a state government may be legally responsible for the annual "employer" contributions to a pension plan that covers employees of school districts within the state. In those cases, the entity that is legally responsible for the contributions should comply with all applicable provisions of this Statement for measurement and recognition of expenditures/expense, liabilities, assets, note disclosures, and required supplementary information. If the plan is a defined benefit pension plan and the entity with legal responsibility for contributions is the only contributing entity, the requirements of this Statement for sole employers apply, regardless of the number of entities whose employees are covered by the plan."

For the University's separately audited "carve out" entities, the relevant authoritative guidance follows:

The GASB generally avoids any conclusions on "carve out" financial statements; therefore, the following information is relevant in documenting an approach that complies with the GASB requirements.

- Paragraph 19 of GASB Statement No. 27…"Employers that participate in cost-sharing multiple-employer plans (cost-sharing employers) should recognize annual pension expense equal to their contractually required contributions to the plan. Recognition should be on the modified accrual or accrual basis, whichever applies to the type of employer or for the fund type(s) used to report the employer's contributions. Pension liabilities and assets result from the difference between contributions required and contributions made. Pension liabilities and assets to different plans should not be offset in the financial statements."

- Paragraph 174 of GASB Statement No. 27..."The Board recognizes that the obligations of employers participating in cost-sharing plans differ significantly from those participating in single-employer or agent plans. For sole and agent employers, the cost of each employer's commitment to provide benefits is directly attributable to that

employer. An actuarial valuation is performed for each employer, and each employer's contribution rate is based on the projected benefits of that employer's employees. Because the cost of future benefits is attributable to each employer, this Statement requires all sole and agent employers to measure and report that cost in accordance with the parameters and related provisions of this Statement. Those measurement requirements apply, even if the contributions assessed by the plan differ from the ARC and are legally required."

- Paragraph 175 of GASB Statement No. 27…"A cost-sharing plan is a single plan. All assets and benefit obligations are pooled, all risks and costs are shared, one actuarial valuation is performed, and the same contribution rate(s) applies to all participating employers. The contribution rate or amount charged to an individual employer may be higher or lower than the amounts that would result from a calculation based upon the projected benefits of only that employer's employees. The obligation or commitment for benefits is not directly attributable to any individual participating employer; any attribution would be arbitrary. For example, if an employee changes employers and both employers participate in the same plan, there is no change in either employer's obligation; the obligation for that employee's benefits is not attributable to any particular employer. For these reasons, the obligation of cost-sharing employers generally is limited to payment of their contractually required contributions, and the employers have little or no control over the amount of required contributions or how they are determined."

- Paragraph 177 of GASB Statement No. 27…"The Board believes that, for most cost-sharing plans, there will be little or no difference between the ARC and the sum of the required contributions assessed to the participating employers, but there may be differences in some cases. The Board has concluded that an accounting requirement to allocate these differences to individual participating employers would be inconsistent with the nature of a cost-sharing plan and of the employer's obligations. The allocations would be arbitrary and the resulting liabilities or assets would not provide useful information for users of the employer's financial statements. Therefore, this Statement requires cost-sharing employers to recognize pension expenditures/expense equal to their contractually required contributions and a liability to the plan for contributions due and unpaid…."

Finally, due to the lack of guidance by the GASB on "carve out" financial statements, there is guidance from the Securities and Exchange Commission (SEC) that is not binding, but relevant:

> From SEC 4220.43 – Corporate-Overhead-Allocations..."Regardless of a consolidated entity's organizational structure (which may comprise subsidiaries, divisions or other operating units), it is not unusual for certain services benefiting multiple units within the entity to be performed by the parent company or "corporate headquarters" group. Such services could include, for example, accounting, legal, insurance, advertising and tax services, centralized purchasing and marketing functions and executive management. In addition, certain costs such as pension, OPEB, and other employee benefit costs which pertain to all operating units of the entity may be recorded on the parent company or headquarters level. Although such

> services and costs are common to many entities, the internal methods of allocating such costs vary widely. For example, some entities do not allocate any of the corporate costs incurred, others allocate on a percentage of revenue or other basis deemed to be "reasonable," while others allocate on a specific identification basis.
>
> Generally, although each situation is unique and requires separate consideration based on its particular facts and circumstances, carve-outs should reflect a "reasonable" basis of allocation of corporate overhead costs from the parent or other unit within the organization providing the services. In such situations, SEC staff has required an explanation in the footnotes of the allocation method used, together with management's assertion that the method used is reasonable and management's estimate of what the expenses would have been on a stand-alone basis, if materially different. In the staff's view, this allocation would be necessary in Generally Accepted Accounting Principles (GAAP) financial statements used in initial public offerings regardless of whether the allocation had been made on an historical basis. Staff Accounting Bulletin (SAB) Topic 1-B emphasizes the importance of presenting operating results that reflect all of the "costs of doing business," notwithstanding that some of the costs may not have historically been allocated to the carve-out entity. What constitutes "reasonable" is, in part, a matter of judgment. However, the allocation should reflect consideration by management of incremental overhead costs incurred as a result of servicing the carve-out. If material amounts of allocable costs are not reflected in the carve-out financial statements, it is doubtful that such financial statements could purport to fairly present financial position and results of operations in accordance with GAAP. A non-GAAP audit report would be unacceptable.

Recommended Approach

See Attachment 1 for a pictorial overview of the University's approach at the Plan level, the UC consolidated financial statement level and the separately audited financial statement level.

For the consolidated financial statements of the University of California:

See IRM No. 27.3 for a full discussion of the financial reporting for the campus and medical center (non-laboratory) and DOE laboratory segments of the UCRP. In summary:

For the University's separately audited "carve out" entities:

Based upon the above, the University will consider the separate "carve out" financial statements to be based upon the premise that they fall within the spirit of "cost sharing employers" who participate in "cost sharing multiple-employer plans," therefore the annual expense on their statement of revenues, expenses and changes in net assets will be based upon the common contractually required assessment rate and there will not be any net pension obligation or asset on their statement of net assets. The APC and net pension obligation will not be "pushed down" to the separately audited financial statements. The appropriate disclosures for cost-sharing employers will be made in accordance with paragraph 20 of GASB Statement No. 27. Separate actuarial valuations will not be necessary for these "carve out" entities, at least for the specific purpose of implementing GASB Statement No. 27.

For the National Laboratories:

The DOE contracts require the University to prepare separate actuarial valuations for each laboratory so they may comply with the FAFASB accounting standards that state they must apply the provisions of FASB Statement No. 87 in their separate financial statements and financial reporting to the DOE.

Note however that the DOE contracts require pension actuarial valuations using FASB standards, not GASB standards. The pension actuarial calculations for the University will need to be done using GASB standards, if different from the FASB standards. Therefore, there will be a need for the University's actuaries to prepare two separate actuarial valuations for each laboratory, one under FASB and one under GASB standards.

For the Hastings College of the Law:

Hastings College of the Law is an affiliate of the University but is not included in the University's reporting entity. Therefore the annual pension cost and net pension obligation associated with this entity will be excluded from the University's financial statements and actuarial calculations.

IRM 27.1

Attachment 1: UC Retirement Plan (UCRP) - Financial Reporting by UC (not the Plan)

Approach as of July 24, 2008

UCRP Financial Statement Level

	LANL**	LLNL**	LBNL	Campuses	ASUCLA	Med Cntrs	UC Press	CEB	Hastings*	Comments
	University of California Retirement Plan - Single-employer plan*, with multiple cost-sharing participants									
	Cost Sharing Plan "Employers"									
	DOE Laboratories				UC Carve Outs					
One plan and one trust fund	LANL**	LLNL**	LBNL	Campuses	ASUCLA	Med Cntrs	UC Press	CEB	Hastings*	
Shared risks, rewards and costs?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	
Separate actuarial valuations?	Yes, individual lab, per DOE contract; although combined for UC financial statement purposes.			No, common assessment rate	No, common assessment rate	No, common assessment rate	No, common assessment rate	No, common assessment rate	No, common assessment rate	Requires 4 separate valuations
Contractual/common assessment rate?	Contractual	Contractual	Contributions are all based upon the UC common "contractual" assessment rate GASB 27 ¶175							
Separate fiduciary plan?	Yes, fund is a trust with only one account. Separate audit required.									
UC employees?	No	No	Yes	Yes	Yes	Yes	Yes	Yes	No	

UC Financial Statement Level

	LANL**	LLNL**	LBNL	Campuses	ASUCLA	Med Cntrs	UC Press	CEB	Hastings*
Included in UC statements?	Yes**	Yes**	Yes, UC employees via DOE contract	Yes, UC employees	Yes, blended component unit	Yes, UC employees	Yes, UC employees	Yes, UC employees	No, not UC employees
Include APC and NPO in UC statements?	Yes, combined DOE. They have a continuing financial obligation. Record APC as a DOE Lab Expense, not in the UC APC Expense. GASB 27 ¶ 28			Yes, UC APC as UC expense; NPO includes DOE. GASB 27 ¶ 8, 17					No, not UC employees
Record a receivable/deferred revenue from the DOE if MV of assets is less than AAL?	Yes, combined DOE. They have a continuing financial obligation. Record as DOE Lab Revenue.			Not Applicable					Not Applicable

"Carve Out" Financial Statement Level

	LANL**	LLNL**	LBNL	Campuses	ASUCLA	Med Cntrs	UC Press	CEB	Hastings*
	Cost Sharing Plan - "Multiple Employers" GASB 25 ¶64, 127; GASB 27 ¶19, 175								
Record APC and net pension obligation?	Yes, FASB basis for DOE			No, only record "contractual" assessment as an expense Do not "push down" of APC and NPO GASB 27 ¶19					No No "push down" GASB 27 ¶19

* Hastings not significant to UC

** Only retirees and inactives in plan