NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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MEMORANDUM# 2017-02

TO: Finance Officers of Local Governments

FROM: Sharon Edmundson, Director, Fiscal Management Section

SUBJECT: Accounting for Liabilities to LGERS/TSERS Resulting From Contribution Based Benefit Cap Legislation

DATE: August 15, 2016

As a result of contribution-based benefit cap legislation enacted by the General Assembly in 2014, participating employers (or in some instances the employee) in the North Carolina Retirement Systems may be required to bear the cost of unusually high unforeseen liabilities often associated with late-career compensation increases.

Statutory Authority and Description

Pursuant to Session Law 2014-88 (see G.S. §§ 128-27(a3) & 135-5(a3)), the General Assembly established the anti-pension spiking contribution-based benefit cap (CBBC). The CBBC protects all employers participating in the state retirement systems from absorbing certain unforeseen liabilities caused by compensation decisions made by certain individual employers. The benefit cap only applies to individuals with an average final compensation (AFC) of $100,000 or higher, adjusted annually for inflation, and will only directly impact a small number of those individuals. By statute, the CBBC may not impact more than three-quarters of one percent (0.75%) of retirements each year.

An individual who became a member of the Retirement Systems before January 1, 2015, cannot have his or her or retirement benefit reduced by the new law. The last employer of a member who retires on or after January 1, 2015, with an AFC of $100,000 or higher, is required to pay the additional contribution needed to fund the portion of the member's benefit in excess of the CBBC. The payment for a CBBC liability is required to be paid in a lump sum or an employer may pay the CBBC liability on an installment payment plan beginning no less than 90 days after the retirement of the member and ending no more than one year after the retirement of the member.

For members who enter the Retirement System from which they retire on or after January 1, 2015, the employer or employee may choose to pay the additional contribution, or the employee may choose to receive a reduced benefit.

Policy Rationale

The General Assembly and the Boards of Trustees, as advised by the Retirement Systems' actuaries, in October 2013 determined that the CBBC law would address the unfunded liabilities created as a result of compensation decisions made by individual employers by recouping funds to offset unforeseen costs to the retirement system. The CBBC ensures that the retirement system is made whole for outlying decisions without requiring employers to cross-subsidize each other to offset these costs.

Ultimately, without the CBBC, it would fall on the shoulders of all participating employers in the Retirement Systems to defray these costs, which means the costs would be passed along to all citizens in the state rather than the citizens directly served by the agency that made the compensation decision.

Planning for and Accounting For Potential Liabilities

In order to assist local governments in planning for the potential liabilities, the Retirement System Division (RSD) sends a monthly report to each employer, listing those active members (members for whom the employer made a contribution to the retirement system in the preceding month) that are most likely to require an additional employer contribution should they elect to retire in the following twelve months. This notice is not likely to trigger the recording of a liability since none of the employees listed on the notice have officially elected to retire. However, when the employee does officially elect to retire, a liability, as defined by GASB, probably is created. An invoice is sent from RSD to the unit detailing the amount(s) owed due to a retirement or multiple retirements. It is important to note that the invoice is not created until an employee that meets the criteria has officially notified RSD of his or her intent to retire.

This liability (assuming it is material) will be recorded in a governmental fund or a proprietary fund, or allocated across funds. Governmental funds will record the current portion of the liability that is expected to be paid from current available resources. Normally this will be the entire liability amount as it is due in the immediate future. GASB Codification 1500.118 states that matured liabilities should be reported as governmental fund liabilities; it goes on to define matured liabilities as "liabilities that are normally due and payable in full when incurred". At the government-wide level, both the current and long-term portions of the liability should be recorded. For proprietary funds both the current and long-term portion of the liability are shown on the net position statements at both the fund and government-wide levels of reporting.

If for whatever reason the liability is subsequently reduced or eliminated, the amount may be changed at that time and reported in the next annual financial report, with the appropriate disclosure as to why the amount was changed.

If you have any questions about the above issue please contact Melinda Canady at melinda.canady@nctreasurer.com or by phone at 919-814-4302.