State of North Carolina
Office of the State Controller

LINDA COMBS
STATE CONTROLLER

December 4, 2018

Ms. Naomi Tamashiro
Branch Chief - State & Local Governments, Grants Finance and Administration Services Program Support Center
U.S. Department of Health and Human Services
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Dear Ms. Tamashiro:

This letter responds to your September 9, 2018 email requesting support for the 2016 contribution and cost recovery rate for the Teachers' and State Employees' Retirement System of North Carolina ("TSERS"). We look forward to working with you to provide additional information and resolving this matter.

For the 2016 fiscal year, TSERS reported an actuarially determined contribution equal to 8.69 percent of covered payroll. However, during that year, the employers under the system contributed 9.15 percent of covered payroll to the system as established under North Carolina law. Below we detail two distinct reasons that explain why the allowable cost for reimbursement purposes under federal awards or contracts should include all amounts contributed to TSERS in fiscal 2016 and thus no refund is due.

I. Relevant Guidance from the Regulatory Cost Recovery Framework

As is generally true with all costs, when a pension cost is not paid in a particular year, it needs to be paid in a future year. The applicable regulations governing federal reimbursements for pension costs are fully consistent with this principle. Specifically, 2 C.F.R. 200.431(g)(6)(ii) provides that:

> Pension costs calculated using an actuarial cost-based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six-month period (or a later period agreed to by the cognizant agency for indirect costs) are allowable in the year funded.

II. Why All 2016 Contributions to TSERS Are Fully Allowable for Reimbursement

First, consistent with 2 C.F.R. 200.431(g)(6)(ii), the portion of the fiscal 2016 contribution to TSERS in excess of the reported actuarially determined contribution is fully allowable because it funds unpaid pension costs incurred in a prior year.

In the 2011 fiscal year, employers contributed 4.93 percent of covered payroll to TSERS, which was considerably less than the reported actuarially determined contribution rate of 6.71 percent. The contributions in fiscal 2016 that were above the reported actuarially determined contribution represent the portion of the pension costs that were incurred in 2011, but not funded until fiscal year 2016. 2 C.F.R. 200.431(g)(6)(ii) specifically addresses this situation and provides that reimbursement for these contributions is allowable.

Second, 2 C.F.R. 200.431(g)(6)(ii) does not act as a cap on the reimbursable contribution at the actuarially determined contribution amount reported by TSERS. Rather, the regulation permits the 9.15 percent of covered payroll contribution rate because it is a reasonable contribution amount that is consistent with the applicable accounting guidance and actuarial standards of actuarial practice.

An actuarially determined contribution represents a reasonable contribution amount to a pension plan that is calculated in accordance with the actuarial standards of practice. Adopting a position that a reported actuarially determined contribution is a maximum contribution amount is not supported by GASB or other actuarial standards and directly contravenes the public policy underlying relevant funding guidance, as public pension plan sponsors should be encouraged to fund their plans more conservatively (i.e., with a higher rate of contributions) when directed by lawmakers and other fiduciaries, rather than merely at a level that an actuary determines is minimally reasonable.

In the valuation document for the year in question, the ARC was described as “the amount needed to pay for the cost of the benefits accruing and to pay off the pension debt over 12 years.” The actuary further characterized the ARC as the amount necessary to keep the funding sufficient and noted that North Carolina’s viewing the ARC as a minimum funding requirement had been a successful public policy. The actuary has also determined that the maximum ARC that would have been considered reasonable under the GASB statements and actuarial standards of practice was 30.48 percent of payroll, which was the amount needed to pay off the unfunded liability in a single year.

The actuarial standards of practice (“ASOP”) provide broad guidance on the calculation of an actuarially determined contribution, while not prescribing any particular assumptions, methods, or amortization periods. In fact, paragraph 2.8 of ASOP No. 4 explicitly contemplates that an actuarially determined contribution may “produce a single value, such as normal cost plus an amortization payment of the unfunded actuarial accrued liability, or a range of values, such as the range from the ERISA minimum required contribution to the maximum tax-deductible amount.”

Based on this authority, the actual contribution rate of 9.15 percent of payroll for the 2016 fiscal year falls well within the range of appropriate actuarially determined contributions under the actuarial standards of practice. Thus, the entire contribution amount paid in fiscal 2016 is eligible for reimbursement.

We appreciate your consideration of this matter and look forward to working with you toward resolution.

Sincerely yours,

DocuSigned by:
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CC: Mr. Gilbert Tran, U.S. Office of Management and Budget; Mr. Nelson Clugston, Vice President, Maximus

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