

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: State of Rhode Island DATE: December 6, 1976
Audit Control No. 40022-01
Docket No. 75-19
Decision No. 29

DECISION

Statement of the Case

This is an appeal from a decision of the Regional Director, Region I, refusing to approve the treatment of certain retirement costs in Rhode Island's State-Wide Cost Allocation Plan for fiscal years 1971, 1972 and 1973. The facts are not in dispute; they are reflected in the records and documentation of the State's plan. There appears to be only a single issue in this appeal: Whether contributions to the State's retirement fund for state employees engaged in Federal grant activities are justified.

The facts giving rise to this dispute are as follows:

The State employees' pension fund is financed by contributions from both employees and the State. Employees pay a fixed percentage of wages, excluding overtime, to the pension fund while the State's share is determined actuarially. In computing the State contribution to the retirement system the actuary develops two rates, a fully funded rate and a partially funded rate. The fully funded rate represents the rate of annual contribution to be paid to the retirement system, from the dates of entry of employees into the system to the dates of retirement, to fully fund the prescribed benefits. Under a partially funded concept, however, the State only contributes to the system the amount necessary to meet the current annual payouts of the system plus a small reserve. The rates computed by the actuary for fiscal years 1970 through 1973 and the actual partially funded rate applied by the State are shown below:

| Fiscal Year | Per Actuary | | Actual Partially-Funded Rate Applied |
|----------------|----------------------|--------------------------|--|
| | Fully-Funded Rate | Partially-Funded Rate | |
| 1970 | 8.5% | 5.55% | 5.18% |
| 1971 | 9.2% | 5.55% | 4.42% |
| 1972 | 9.9% | 5.55% | 4.71% |
| 1973 | 9.9% | 6.5 % | -- |

Our review disclosed that the State, in its billings to the Federal government and in the pension costs claimed on the SWCAP used the fully funded rate. These contributions are deposited, in full, into the retirement system. Pension fund contributions are also made at the full funded rate for State employees of self supporting activities, such as the data processing section, whose costs are recovered through billing to user agencies. In addition, the State makes a fully funded contribution to a separate retirement system for teachers in the State colleges and university. For the remaining State employees (approximately 70 percent of the total State employees covered by a retirement system) state contributions to the retirement system are, by state law, limited to the partially funded rate.

Attachment A, Section C(1) of OMB Circular A-87 states that to be allowable costs must "...be consistent with policies, regulations, and procedures that apply uniformly to both Federally assisted and other activities of the unit of government of which the grantee is a part..."

The amounts at issue are \$2,020,623 for each of fiscal years 1970, 1971, and 1972, and \$2,656,033 for fiscal year 1973.

In its appeal dated October 28, 1975, appellant lists its several retirement programs available to state employees and the contributions by which the respective funds are financed. It states that "The State of Rhode Island does pay fully-funded rates to the Retirement System for all special funds of the state and all Restricted Revenue Accounts within the General Fund which is the same rate charged to Federal Accounts." ^{1/} (Emphasis original). The list of retirement programs and contributions scheme follows:

1. State Police

Employee Rate -- Non-Contributory until July 1, 1974.
5% contribution of new members from
July 1, 1974.

Employer Rate -- Appropriations for current pension
costs.

1. See appeal letter dated October 28, 1975, p.1.

2. Judicial
Employee Rate -- Non-Contributory -- Justices only.
Employer Rate -- Appropriation for current pension costs.
3. U.S. Civil Service Commission
Employee Rate 7% -- Cooperative Extension Service,
Univ. of R.I.
Employer Rate 7%
4. Teachers' Insurance and Annuity Association
Employee Rate 5% (Employees of Higher Education
Institutions)
Employer Rate 9% (Fully Funded)
5. Employees' Retirement System (all other employees)
Employee Rate 5%.

Employer rate until 7/1/72 financed on a partial funded basis. The contribution by the state for any fiscal year consisted of an amount equal to the computed average annual expenditures for the several benefits provided by the Retirement System, for a period of five years next succeeding the fiscal year in question. A uniform rate of contribution is maintained for such five (5) year period, after which a computation is to be made to establish the contribution rate for the ensuing five-year period.

From July 1, 1967, the computed rate was 5.55% for the five-year ensuing period.

From July 1, 1972, the uniform rate was dropped and a rate which increased each year by a .33 of 1% was adopted:

| | |
|------|-------|
| 1973 | 5.88% |
| 1974 | 6.21% |
| 1975 | 6.54% |
| 1976 | 6.87% |
| 1977 | 7.2% |

These computations and rates were applied only to the General Fund -- General Revenue Appropriation Accounts.

The rates for:

1. Restricted Revenue Accounts (Dedicated Revenues)
2. Special Funds (Dedicated Revenues)
3. Federal Grant Accounts are on a fully-funded basis:

| | |
|------|------|
| 1970 | 8.5% |
| 1971 | 8.5% |
| 1972 | 9.2% |
| 1973 | 9.9% |

Thus, it is observed that Rhode Island has computed a fully-funded contribution rate that is equally applicable to Restricted Revenue Accounts, Special Funds and Federal Grant Accounts. However, the State's contribution to the general retirement system is based upon a partially-funded rate, "an actuarially computed sum determined by application of the General Law that provides for appropriations for the Retirement System and should provide an equitable charge."²⁷

Discussion

Upon a full consideration of the appeal file, the Board has concluded that the appeal should be and is hereby denied.

We address first the requirement contained in OMB Circular A-87³ which states, in pertinent part:

"The cost must be consistent with policies, regulations and procedures that apply both to Federally assisted and other activities. The cost must be accorded consistent treatment. The cost must be distributed equitably to grant programs and to other activities."

As noted above, appellant has made contributions to certain of the Restricted Revenue and Special Fund Accounts, including the Teachers' Insurance and Annuity Association, on a fully-funded basis. It claims that such contributions reflect its compliance with the OMB Circular requirement for consistent

² Appeal letter, p. 6.

³ Now identified as FMC 74-4.

cost treatment applicable to both Federally assisted and other activities. However, this is only part of the picture; the major share of the State's obligation toward the 70% of its employees is purportedly met by partially funding. In justification of this variation, appellant relies upon two arguments: (1) The provisions of state law prescribing a contribution system^{4/} and the "guaranty" by the state set out in Sec. 7 of that Chapter.^{5/}

We do not read the former section as prescribing a partial funding of the system; if anything, it implies full funding of the projected average annual expenditures for a period of five (5) years. Appellant has undertaken to discharge this obligation by partial funding. Whatever may be the merits or advantages of partial over full funding, it is clear that the state contributes to the retirement fund on a partially funded basis, while fully-funding other activities, and charging the Federal Government with full funding costs is not in compliance with A-87 requirements for consistent cost treatment.^{6/} As was said by Assistant Secretary/Comptroller, John D. Young^{6/} in reviewing the decision of this Board in the Appeal of the State of Connecticut, Docket No. 9, involving the same issue presented here for decision, "This Department only insists that the Federal Government's contributions to the Retirement Fund not be in excess of the State's contributions to that Fund...This Department is not objecting to a contribution by it to the Retirement Fund of the full 22.3%, but is only objecting to paying such a rate at the same time that the State is contributing to the Retirement Fund at a lesser rate." To the extent that Rhode Island contributed to the Retirement Fund a lesser rate than charged the Federal Government, such contribution by the Federal Government represents discriminatory treatment at odds with the requirement of OMB Circular A-87.

4. Sec. 2, Title 36, Chapter 10, General Laws of Rhode Island, amended.

5. Sec. 7, Title 36, Chapter 10, General Laws of Rhode Island, amended.

6. Letter dated July 15, 1975 from Assistant Secretary John D. Young to Mr. Wendell S. Gates, Assistant Attorney General, State of Connecticut.

The unfairness of the situation is compounded by the circumstance that the retirement fund does not receive the benefit of interest income on the larger amount of what would otherwise be the State's contributions to the Fund if fully funded. This serves to create an imbalance in the charge to the United States.⁷

As to the contention of appellant that its laws set forth a guaranty by the state to make the required payments to the employees, we refer again to the Board's decision in the Appeal of the State of Connecticut, supra. We there said:

"The State has not incurred a legal obligation for the excess rates. The State contends that the retirement costs which it fails to fund, and elects to accrue, represent a 'legal liability of the State' (appeal document, page 27). An entitlement to retirement benefits which an employee may accrue over the years does not represent a legal liability of the State. The State is free to reduce or terminate such benefits as it sees fit. To the extent that the State could be liable for such future benefits, its liability is, at best, a contingent one."

That such liability is only a contingent one finds support in recent action of the Connecticut State Legislature increasing the minimum retirement age for State employees beginning in 1980. Similar or other restrictive action could be taken by Rhode Island limiting the State's "Liability" for retirement benefits.

The reasonableness of the computed rates does not, ipso facto, justify their acceptance. Reasonableness is required of the contribution rates in addition to meeting the standards of consistency and equity. Here, the plain and simple fact

7. See letter of A.A. Weinberg, Actuary, submitted by appellant in support of its appeal, and his discussion, on p.2, of the consequences of interest income loss under partial funding. We also note, but only as a matter of interest, his recommendation for full funding as the most economical form of funding pension cost.

is that the Federal Government is asked to contribute for the retirement benefits of State employees at a rate in excess of that which the State contributes.

By letter dated October 29, 1976, the State submitted a copy of the Legislative Act passed by the Rhode Island General Assembly establishing a new procedure, effective July 1, 1976, for estimating and computing retirement costs. This legislation, being effective subsequent to the period in question, does not alter the conclusion above expressed.

For the foregoing reasons it is the decision of this Board that the appeal of the State of Rhode Island be denied.

/s/ Francis D. DeGeorge

/s/ Thomas Malone

/s/ Manuel B. Hiller, Panel Chairman