Check it Out! The Audit Implications of the GASB’s New Pension Standards

Jeff Markert, KPMG LLP
Bob Scott, City of Carrolton, TX

May 19, 2014
Your Speakers Today

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Agenda

Classification of Defined Benefit Pension Plans

New GASB Pension Standards

Issues Related to Cost-Sharing Multiple-Employer Plans

Issues Related to Agent Multiple-Employer Plans
Classification of Defined Benefit Pension Plans
Classification of Defined Benefit Pension Plans

Classification of the type of defined benefit (DB) pension plan is based on the number of employers and whether pension obligations and pension plan assets are shared:

- Single-employer DB pension plan:
  - Provides pensions to employees of one employer

- Agent multiple-employer DB pension plan:
  - Provides pensions to employees of more than one employer
  - Assets are pooled for investment purposes, but separate accounts maintained for each employer
  - Employer’s share of pooled assets is legally available only for its employees

- Cost-sharing multiple-employer DB pension plan:
  - Provides pensions to employees of more than one employer
  - Employers pool or share obligations
  - Plan assets can be used to pay the benefits of retirees from any employer
New GASB Pension Standards
New GASB Pension Standards

GASB Statement No. 67
Accounting and Financial Reporting For Pension Plans (Plan Reporting)

Effective for fiscal years beginning after **June 15, 2013**

GASB Statement No. 68
Accounting and Financial Reporting for Pensions (Employer Reporting)

Effective for fiscal years beginning after **June 15, 2014**
Summary of Employer Reporting

● The following amounts for a defined benefit pension plan must be determined as of a date no earlier than the end of the employer’s prior fiscal year (i.e., measurement date):
  – Net pension liability (asset)
  – Pension expense
  – Pension deferred outflows of resources and deferred inflows of resources

● Employers participating in single-employer or agent multiple-employer plans recognize 100 percent of the above amounts for each plan

● Employers participating in cost-sharing multiple-employer plans recognize their proportionate share of the collective amounts for the plan as a whole
Net pension liability (asset) equals the total pension liability for the pension plan, less the fiduciary net position:

- Total pension liability is the actuarial present value of projected benefit payments attributed to past employee service

- Fiduciary net position is determined using same valuation methods as used for plan’s GAAP financial reporting
Net Pension Liability and Pension Expense

- Changes in net pension liability will be immediately recognized as pension expense or reported as deferred outflows/inflows of resources depending on nature of change.

- Approach results in reporting of pension liability and expense as employees earn their pension benefits by providing services instead of being based on funding requirements.

- No significant changes to accounting for pensions in governmental funds.
Issues Related to Cost-Sharing Multiple-Employer Plans
Cost-Sharing Plans—Current Status of AICPA Recommendations

Whitepapers

- Government Employer Participation in Cost-Sharing Multiple Employer Plans: Issues Related to Information for Employer Reporting
- Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data

Auditing Interpretations

- Issued interpretations to 3 AU-C sections
  - AU-C 500
  - AU-C 600
  - AU-C 805

Links to Papers & Interpretations on GAQC “GASB Matters” website: www.aicpa.org/GAQC
Cost-Sharing Plan Issues

- Audited financial statements of the plan only include disclosure of the collective net pension liability for the plan as a whole. They do NOT include:
  - Deferred outflows/inflows of resources by category
  - Pension expense
  - Each participating employer’s share of collective pension amounts
- Standard is silent on who (plan or each individual participating employer) should calculate allocation percentages
- Audited financial statements of the plan may not include necessary information to calculate allocation percentages
- Standard provides flexibility in approach to determining allocations
- Standard encourages an allocation method would be extremely difficult to audit as it is based on projected future contributions
Cost-Sharing Plan Issues

- GAAP financial statements of the plan and additional unaudited information from the plan will NOT provide sufficient appropriate audit evidence for the governmental employer auditor.
  - Absent additional audit evidence from the cost-sharing plan, the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence.
  - If unable to accumulate sufficient appropriate evidence, the employer auditor should modify the audit opinion.

(AU-C section 9500, Question 2)
Cost-Sharing Plans—AICPA Recommendations

- Plan prepares “schedule of employer allocations” for which plan auditor is engaged to provide opinion
  - Use allocation method based on covered payroll or required (actual) contributions depending on whether there are different classes of benefits and whether resulting allocations are expected to be representative of future contributions
  - Projected future contributions could be used if necessary
# Example Schedule of Employer Allocations

**EXAMPLE COST SHARING PENSION PLAN**

Schedule of Employer Allocations

6/30/20X5

<table>
<thead>
<tr>
<th>Employer</th>
<th>20X5 Actual Employer Contributions</th>
<th>Employer Allocation Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer 1</td>
<td>$2,143,842</td>
<td>36.376%</td>
</tr>
<tr>
<td>Employer 2</td>
<td>268,425</td>
<td>4.554</td>
</tr>
<tr>
<td>Employer 3</td>
<td>322,142</td>
<td>5.466</td>
</tr>
<tr>
<td>Employer 4</td>
<td>483,255</td>
<td>8.199</td>
</tr>
<tr>
<td>Employer 5</td>
<td>633,125</td>
<td>10.742</td>
</tr>
<tr>
<td>Employer 6</td>
<td>144,288</td>
<td>2.448</td>
</tr>
<tr>
<td>Employer 7</td>
<td>95,365</td>
<td>1.618</td>
</tr>
<tr>
<td>Employer 8</td>
<td>94,238</td>
<td>1.599</td>
</tr>
<tr>
<td>Employer 9</td>
<td>795,365</td>
<td>13.495</td>
</tr>
<tr>
<td>Employer 10</td>
<td>267,468</td>
<td>4.538</td>
</tr>
<tr>
<td>Employer 11</td>
<td>403,527</td>
<td>6.847</td>
</tr>
<tr>
<td>Employer 12</td>
<td>165,886</td>
<td>2.815</td>
</tr>
<tr>
<td>Employer 13</td>
<td>68,454</td>
<td>1.161</td>
</tr>
<tr>
<td>Employer 14</td>
<td>6,240</td>
<td>0.106</td>
</tr>
<tr>
<td>Employer 15</td>
<td>2,144</td>
<td>0.036</td>
</tr>
</tbody>
</table>

Total  $5,893,764  100.000%
Cost-Sharing Plans—AICPA Recommendations

- Plan prepares “schedule of pension amounts by employer” for which plan auditor engaged to provide opinion
  - Schedule includes the following elements for each employer:
    - Net pension liability
    - Deferred outflows of resources by category
    - Deferred inflows of resources by category
    - Pension expense
- An alternative could be to prepare a “schedule of collective pension amounts” (excluding employer specific deferrals) for the plan as a whole
### Example Schedule of Pension Amounts by Employer

#### Example Cost Sharing Pension Plan

**Schedule of Pension Amounts by Employer**

As of and for the year ended 6/30/20X5

<table>
<thead>
<tr>
<th>Entity</th>
<th>Net Pension Liability</th>
<th>Expected Experience</th>
<th>Net Amortization of Deferred Amounts from Changes in Proportion and Differences Between Projected and Actual Investments</th>
<th>Deferred Outflows of Resources</th>
<th>Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions</th>
<th>Total Deferred Outflows of Resources</th>
<th>Deferred Inflows of Resources</th>
<th>Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions</th>
<th>Total Deferred Inflows of Resources</th>
<th>Pension Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer 1</td>
<td>$45,224,620</td>
<td>438,859</td>
<td>1,569,847</td>
<td>1,404,206</td>
<td>695,426</td>
<td>4,808,338</td>
<td></td>
<td>355,917</td>
<td>726,425</td>
<td>1,082,342</td>
</tr>
<tr>
<td>Employer 2</td>
<td>5,667,870</td>
<td>54,942</td>
<td>196,553</td>
<td>175,796</td>
<td>84,231</td>
<td>501,502</td>
<td></td>
<td>44,558</td>
<td>74,326</td>
<td>118,844</td>
</tr>
<tr>
<td>Employer 3</td>
<td>6,795,628</td>
<td>65,945</td>
<td>235,892</td>
<td>211,001</td>
<td>117,394</td>
<td>630,192</td>
<td></td>
<td>53,481</td>
<td>98,465</td>
<td>151,946</td>
</tr>
<tr>
<td>Employer 4</td>
<td>10,933,442</td>
<td>98,917</td>
<td>353,838</td>
<td>316,502</td>
<td>161,215</td>
<td>930,472</td>
<td></td>
<td>80,222</td>
<td>165,433</td>
<td>245,675</td>
</tr>
<tr>
<td>Employer 5</td>
<td>12,355,038</td>
<td>129,597</td>
<td>463,584</td>
<td>418,668</td>
<td>199,845</td>
<td>1,207,694</td>
<td></td>
<td>105,303</td>
<td>197,645</td>
<td>302,748</td>
</tr>
<tr>
<td>Employer 6</td>
<td>3,043,487</td>
<td>29,534</td>
<td>105,646</td>
<td>94,499</td>
<td>53,453</td>
<td>283,132</td>
<td></td>
<td>23,952</td>
<td>48,453</td>
<td>72,405</td>
</tr>
<tr>
<td>Employer 7</td>
<td>2,015,585</td>
<td>19,529</td>
<td>69,827</td>
<td>62,459</td>
<td>33,458</td>
<td>185,264</td>
<td></td>
<td>15,831</td>
<td>35,345</td>
<td>51,176</td>
</tr>
<tr>
<td>Employer 8</td>
<td>1,987,964</td>
<td>19,291</td>
<td>69,007</td>
<td>61,725</td>
<td>35,425</td>
<td>185,448</td>
<td></td>
<td>15,645</td>
<td>46,453</td>
<td>83,294</td>
</tr>
<tr>
<td>Employer 9</td>
<td>16,777,717</td>
<td>162,811</td>
<td>582,393</td>
<td>520,941</td>
<td>248,356</td>
<td>1,534,501</td>
<td></td>
<td>152,040</td>
<td>284,543</td>
<td>46,583</td>
</tr>
<tr>
<td>Employer 10</td>
<td>5,644,888</td>
<td>54,749</td>
<td>195,843</td>
<td>175,178</td>
<td>95,465</td>
<td>512,235</td>
<td></td>
<td>44,401</td>
<td>44,256</td>
<td>88,757</td>
</tr>
<tr>
<td>Employer 12</td>
<td>3,499,761</td>
<td>33,962</td>
<td>12,148</td>
<td>108,666</td>
<td>52,145</td>
<td>316,258</td>
<td></td>
<td>27,543</td>
<td>64,254</td>
<td>91,897</td>
</tr>
<tr>
<td>Employer 13</td>
<td>1,443,418</td>
<td>14,007</td>
<td>50,104</td>
<td>44,818</td>
<td>23,156</td>
<td>132,085</td>
<td></td>
<td>11,360</td>
<td>33,453</td>
<td>44,813</td>
</tr>
<tr>
<td>Employer 14</td>
<td>13,178,85</td>
<td>1,279</td>
<td>4,575</td>
<td>4,092</td>
<td>1,968</td>
<td>11,914</td>
<td></td>
<td>1,037</td>
<td>894</td>
<td>1,931</td>
</tr>
<tr>
<td>Employer 15</td>
<td>44,757</td>
<td>434</td>
<td>1,554</td>
<td>1,390</td>
<td>1,456</td>
<td>4,834</td>
<td></td>
<td>352</td>
<td>698</td>
<td>1,050</td>
</tr>
<tr>
<td><strong>Total for All Entities</strong></td>
<td><strong>$124,325,432</strong></td>
<td><strong>1,206,453</strong></td>
<td><strong>4,315,618</strong></td>
<td><strong>3,860,253</strong></td>
<td><strong>1,939,406</strong></td>
<td><strong>11,217,330</strong></td>
<td><strong>978,435</strong></td>
<td><strong>1,939,406</strong></td>
<td><strong>2,917,841</strong></td>
<td><strong>5,243,245</strong></td>
</tr>
</tbody>
</table>

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Cost-Sharing Plans—AICPA Recommendations

- Plan auditor issues opinion on the employer allocations and on the total of each of the four “elements” in accordance with AU-C 805
  - Net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the sum of all participating entities
    - Materiality calculated separately for each element
  - Plan auditor needs to consider the appropriateness of the materiality used in the audit of plan financial statements
    - For audit of a public employee retirement system (PERS) plan financial statements, the audit opinion is provided on the system as a whole (which often includes more than one plan)
    - Audit of plan financial statements effectively has to be performed at a lower level consistent with the “allocation” pool
Cost-Sharing Plan
Illustrative Auditor’s Report

Report on Schedules

We have audited the accompanying schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the total for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense (specified column totals) included in the accompanying schedule of pension amounts by employer of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.

Opinions

In our opinion, the schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the total of all participating entities for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.
## Cost-Sharing Plans: Employer Responsibilities

<table>
<thead>
<tr>
<th>Report</th>
<th>Evaluate</th>
<th>Verify &amp; Recalculate</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Complete and accurate data to plan</td>
<td>• Appropriateness of information used to record financial statement amounts</td>
<td>• Amounts in schedules specific to employer</td>
</tr>
<tr>
<td></td>
<td>• Whether plan auditor’s report on schedules are adequate and appropriate for employer purposes</td>
<td>• employer amount used in allocation percentage (numerator)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• recalculate allocation percentage of employer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• recalculate allocation of pension amounts based on allocation percentage of employer</td>
</tr>
</tbody>
</table>
# Cost-Sharing Plans: Employer Auditor Responsibilities

<table>
<thead>
<tr>
<th>Determine</th>
<th>Evaluate</th>
<th>Verify &amp; Recalculate</th>
<th>Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Sufficiency and appropriateness of audit evidence</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| - Whether plan auditor’s report on schedules are adequate and appropriate for auditor purposes (e.g., evidence)  
  - Review plan auditor’s report and any related modifications  
  - Evaluate whether plan auditor has necessary competence and independence  
  - Determine whether named as specified user |
| - Amounts in schedules specific to employer  
  - Employer amount used in allocation percentage (numerator)  
  - Recalculate allocation percentage of employer  
  - Recalculate allocation of pension amounts based on allocation percentage of employer |
| - Census data submitted to plan |
Cost-Sharing Plans — Testing Underlying Census Data of Active Employees

- Risk-based approach by plan auditor to select employers to test
  - Individually important employers (e.g. > 20% of plan) tested annually
  - Plan auditor performs risk assessment on remaining employers using tiered approach
    - For example:
      - Employers between 5 and 20% tested to approximate a 5-year cycle
      - Employers less than 5% tested to approximate a 10-year cycle
      - Many small employers will never be tested (e.g. 400 employers represent 2% in aggregate of plan)
Example risk factors to consider for selecting employers to test:

- Size of employer in relation to plan
- Past errors or control deficiencies of an employer
- Length of time since procedures last performed for employer
- Whether there have been significant changes in workforce
- Results of internal analysis (analytical procedures) of employer information
- New or terminating employer
- Whether employer financial statements are audited and have received unmodified opinions

Absence of effective management procedures and controls by plan to verify census data is considered a control deficiency and will impact the level of auditor testing.
Consider a plan with 3,000 participating employers for which the auditor has determined that plan management has effective processes and controls to determine the completeness and accuracy of census data. Based on the number and relative size of the participating employers, as well as a low assessed risk of material misstatement, the auditor determines that one employer constitutes more than 20 percent of covered payroll and is individually important. Accordingly, this employer will be tested on an annual basis. Six employers are at least five percent of covered payroll and will be tested to approximate a five year cycle. The auditor then determines there are 400 very small employers that will never be tested because they represent less than two percent in the aggregate of the total covered payroll. The remaining employers (that is, 2,593) that represent less than five percent of covered payroll will be tested to approximate a ten year cycle.
Cost-Sharing Plans — Testing Underlying Census Data of Active Employees

- Employer auditor may perform procedures under examination engagement in accordance with AT (Attest) Section 101
  - Employer auditor engaged to provide opinion on relevant assertions related to census data reported to plan during period
  - Consider the actuarial valuation date in determining which period to be covered by opinion
    - Most plans will likely be using beginning of year actuarial valuation date
    - Relevant census data for actuarial valuation will be prior year information reported to plan
    - Relevant census data for contributions and benefit payments will be current year information reported to the plan
Issues Related to Agent Multiple-Employer Plans
Agent Plans —Current Status of AICPA Proposed Recommendations

Whitepaper

- Government Employer Participation in Agent Multiple Employer Plans: Issues Related to Information for Employer Reporting
  - Issues and potential recommendations are more complex
  - Recently discussed at AICPA Audit Issues Task Force (AITF) meeting on May 14th
  - Expected to be issued May 30th

Auditing Interpretations

- Expected to be issued in June
Agent Plan Issues

- Audited financial statements of the plan do not include actuarial information or each employer’s “interest” in the fiduciary net position
- Allocation of fiduciary net position reported by plan to employer is unaudited
- Employers need the following elements to record as of the measurement date:
  - Net pension liability
  - Deferred outflows/inflows of resources by category
  - Pension expense
• Plan actuary issues separate actuarial report for each participating employer which includes net pension liability, deferred outflows/inflows by category and year, pension expense, and discount rate calculation
  • Individual actuarial certification letters addressed to each employer
  • Employer management and employer auditor rely on actuary as management specialist for total pension liability for individual employer
Total Pension Liability, Deferred Outflows/Inflows, and Pension Expense—AICPA Proposed Recommendations

**Option 1:**
- Plan auditor engaged to issue a SOC 1 (type 2) report on census data controlled by the plan
  - Internal controls are suitably designed and operating effectively

**Option 2:**
- Plan auditor engaged to issue examination report on plan management’s assertions related to census data controlled by the plan in accordance with AT (Attest) section 101
  - Completeness and accuracy of census data for inactive and retired members
  - Plan’s responsibilities regarding accumulation and adjustment to census data
Example Assertions:

- The census data provided to the actuary as of June 30, 201X is complete and accurate based on the accumulation of census data reported by participating employers for the period from July 1, 201W to June 30, 201X. Census data includes [(list relevant attributes) for example, date of birth; date of hire; years of service; marital status; eligible compensation; class of employee; gender; date of termination or retirement; spouse date of birth; employment status; and annual benefit payments for retirees] as set forth in [(name plan document), for example Chapter X of Example State Compiled Statutes].
Example Assertions, continued:

- The census data provided to the actuary as of July 1, 201X properly reflects the benefit provisions in effect as of July 1, 201X included in [(name plan document), for example, Chapter X of Example State Compiled Statutes].

- The census data provided to the actuary as of July 1, 201X properly excluded deceased members based on the plan’s validation of the existence of inactive and retired members by cross matching social security numbers of inactive and retired members with the Social Security Administration as of [insert date].
Total Pension Liability, Deferred Outflows/Inflows, and Pension Expense—AICPA Proposed Recommendations

- Employer and employer auditor responsible for validating deferred outflows/inflows and pension expense related to individual employer
  - Deferred outflows/inflows resulting from current year can be recalculated from condensed statement of changes in fiduciary net position (by employer) included as supplemental information in plan financial statements
  - Rely on actuarial report for deferred outflows/inflows related to actuarial experience
**Fiduciary Net Position—AICPA Proposed Recommendations**

**Option 1:**

- Plan prepares “schedule of changes in fiduciary net position by employer” for which plan auditor is engaged to provide opinion on schedule as a whole (and an in-relation-to opinion on each individual employer column)

- Plan auditor engaged to issue SOC 1 (type 2) report on allocation of inflows (i.e., contributions, investment income, etc.) and outflows (i.e., benefit payments, administrative expenses, etc.) of plan to individual employer accounts
### Example Schedule of Changes in Fiduciary Net Position by Employer

**Example Agent Multiple-Employer PERS**

Schedule of Changes in Fiduciary Net Position by Employer

As of and for the year ended June 30, 20X5

<table>
<thead>
<tr>
<th></th>
<th>Employer 1</th>
<th>Employer 2</th>
<th>Employer 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Additions:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer</td>
<td>86,252,000</td>
<td>34,500,000</td>
<td>51,751,000</td>
<td>172,503,000</td>
</tr>
<tr>
<td>Plan Member</td>
<td>32,662,000</td>
<td>13,065,000</td>
<td>19,597,000</td>
<td>65,324,000</td>
</tr>
<tr>
<td>Investment income:</td>
<td>80,965,000</td>
<td>20,347,000</td>
<td>37,112,000</td>
<td>138,424,000</td>
</tr>
<tr>
<td><strong>Total additions</strong></td>
<td>199,879,000</td>
<td>67,912,000</td>
<td>108,460,000</td>
<td>376,251,000</td>
</tr>
<tr>
<td><strong>Deductions:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pension benefits, including refunds</td>
<td>384,635,000</td>
<td>184,352,000</td>
<td>228,356,000</td>
<td>797,343,000</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>4,716,000</td>
<td>1,886,000</td>
<td>2,829,000</td>
<td>9,431,000</td>
</tr>
<tr>
<td><strong>Total deductions</strong></td>
<td>389,351,000</td>
<td>186,238,000</td>
<td>231,185,000</td>
<td>806,774,000</td>
</tr>
<tr>
<td><strong>Net increase (decrease)</strong></td>
<td>(189,472,000)</td>
<td>(118,326,000)</td>
<td>(122,725,000)</td>
<td>(430,523,000)</td>
</tr>
</tbody>
</table>

Net position restricted for pension benefits:

<table>
<thead>
<tr>
<th></th>
<th>Employer 1</th>
<th>Employer 2</th>
<th>Employer 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning of year</td>
<td>5,843,645,000</td>
<td>1,468,538,000</td>
<td>2,678,595,000</td>
<td>9,990,778,000</td>
</tr>
<tr>
<td>End of year</td>
<td>$ 5,654,173,000</td>
<td>1,350,212,000</td>
<td>2,555,870,000</td>
<td>9,560,255,000</td>
</tr>
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</table>
Report on Schedule

We have audited the fiduciary net position as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, included in the accompanying Schedule of Changes in Fiduciary Net Position by Employer (“Schedule”) of ABC Pension Plan, and the related notes.

Opinions

In our opinion, the Schedule referred to above presents fairly, in all material respects, the fiduciary net position of ABC Pension Plan as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.
Option 2:

Plan prepares “schedule of changes in fiduciary net position by employer” for which plan auditor is engaged to provide opinion on schedule as a whole and on each individual employer column.
Agent Plan Example Auditor Opinion on Schedule as a Whole and on Each Individual Employer

Report on Schedule

We have audited the fiduciary net position as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, included in the accompanying Schedule of Changes in Fiduciary Net Position by Employer (Schedule) of ABC Pension Plan, and the related notes. We have also audited the fiduciary net position of each individual employer as of June 30, 20X5, and the changes in fiduciary net position of each individual employer for the year then ended, included in the accompanying Schedule, and the related notes.

Opinions

In our opinion, the schedule referred to above presents fairly, in all material respects, the fiduciary net position of ABC Pension Plan as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the schedule referred to above presents fairly, in all material respects, the fiduciary net position of each individual employer as of June 30, 20X5 and the changes in fiduciary net position of each individual employer for the year then ended, in accordance with accounting principles generally accepted in the United States of America.
Agent Plans: Employer Responsibilities

- Complete and accurate data to plan
- Appropriateness of information used to record financial statement amounts
- Whether plan auditor’s report on schedules are adequate and appropriate for employer purposes
- Amounts in schedules specific to employer
  - employer amount used in allocation percentage (numerator)
  - recalculate allocation percentage of employer
  - recalculate allocation of pension amounts based on allocation percentage of employer
<table>
<thead>
<tr>
<th>Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Actuarial assumptions with appropriate, reliable, and verifiable information</td>
</tr>
<tr>
<td>• Underlying census data used by the actuary</td>
</tr>
<tr>
<td>• Obtain census data file to determine accurate and complete</td>
</tr>
<tr>
<td>• Compare information to underlying payroll records and prior year census data file</td>
</tr>
<tr>
<td>• Obtain roll forward of from one year to the next and review reconciliation</td>
</tr>
</tbody>
</table>
Agent Plans: Employer Auditor Responsibilities

**Determine**
- Sufficiency and appropriateness of audit evidence

**Evaluate**
- Whether plan auditor’s report on schedule and SOC 1 (Type 2) report are adequate and appropriate for auditor purposes (e.g., evidence)
  - Review plan auditor’s report and any related modifications
  - Evaluate whether plan auditor has necessary competence and independence
  - Determine whether named as specified user
  - Competence, capabilities, and objectivity of the actuary
  - Appropriateness of the actuary’s work as audit evidence
  - Whether underlying census data is sufficiently reliable

**Test**
- Census Data (See next 2 slides)
Agent Plans—Employer Auditor Responsibilities

- Procedures related to active, inactive, and retired members
  - Obtain the underlying census data file
  - Obtain and review a reconciliation of aggregate census data to amounts shown in the actuarial valuation report
  - Obtain and review a roll forward of the census data from one year to the next and review a reconciliation of any differences
  - Perform substantive analytic procedures comparing the number of members for the current year versus the prior year, as well as the number of members versus the number of employees
Agent Plans—Employer Auditor Responsibilities

- Additional procedures related to active members
  - Obtain underlying census data file
  - Select sample of new active members from census data file
    - Determine participants are eligible
    - Agree participant information with employer personnel files
  - Select sample of active members from the census data to verify census data reported to the plan during the year is correct
  - Select sample of employees from the employer’s payroll system to determine whether census data file is complete
Thank you for joining us.
Implementing GASB 68 from a Preparer’s Perspective

Making the Number Our Own

Although a member of the AICPA’s State and Local Government Expert Panel, Mr. Scott’s views do not necessarily represent that of the SLGEP or the AICPA.
Session Outline

• Public Sector plans are different!
• The Dilemma-Recording a financial statement number that we may not have any direct control or first hand knowledge
• Building the knowledge base-Employer Due Diligence
• Creating an “Implementation Triangle” to ensure a successful implementation
• Case Study-Texas Municipal Retirement System
Public Pensions are Different!
Public Pensions Are Different!

- Even though GASB 68 resembles an almost 30 year old private sector approach (FASB 87), public pensions differ from private pensions:
  - More Material
    - Personnel generally higher percentage of operations
    - Often a substitute for, not a supplement to Social Security
    - Earlier retirement ages for public safety employees
    - Employee contributions
Public Pensions Are Different!

- No Public Sector ERISA or PBGC
- Independent PERS Governance and Management
  - Independently elected Board of Trustees
  - Independent staff
  - Independent accounting and audit
- Multi-Employer PERS
  - Cost-sharing
  - Agent
The Preparer Dilemma
The Preparer Dilemma

• GASB is now asking us to book and stand behind a very material number when we:
  • may not have had any role in generating it
  • may not even have any input in the generation process
  • may not understand it
  • have no first hand knowledge of either the census data used or the internal control systems in place at the plan

• Unreasonable?—probably not, given the potential impact on our government’s finances but it will require significant changes in practice
The Agent Employer Dilemma

**PERS**

Complete and total **Control** over the generation of each government’s actuarial valuation and the tracking of fiduciary net position (assets) by city.

Complete and total **Responsibility** for the reporting of NPL and related pension numbers in their financial statements.

**Member Government**

No responsibility to audit anything actuarial or by varans.

Valuation based on the assumptions and parameters set by PERS.

Complete responsibility for expressing an opinion on the pension numbers.

No relationship.
Implementation Spectrum

- **Piece of Cake** - government administers the plan, maintains the books, significant influence with Board, same auditor
- **Not too Bad** - single employer plan with history of strong cooperation with government, same auditor
- **I’m Sweating Now** - single employer plan but very independent, little communication with employer, different auditor
- **Where Do I Even Start?** - each type of multi-employer plans have challenges but Agent plans are most difficult
Employer Due Diligence
Employer Due Diligence

• Pensions - the Original Government Outsourcing
  • Private Sector - tight control over their Plans
  • Public Sector - independently governed, managed plans but still retain most financial risk

• Whether you are outsourcing garbage collection, IT, Pensions or anything else...
YOU CAN OUTSOURCE THE TASK BUT NOT THE RESPONSIBILITY
Why can’t we outsource the responsibility for pensions?

• Won’t Let Us
  • GASB 68/Auditors
  • The Bondholders/SEC
    • Quote from SEC news release 2013-37: Elaine Greenberg, Chief of the SEC’s Municipal Securities and Public Pensions Unit, added, “Regardless of the funding methodology they choose, municipal issuers must provide accurate and complete pension disclosures including the effects of material changes to their pension plans. Public pension disclosure by municipal issuers continues to be a top priority of the unit.”

• Fiduciary Responsibility to:
  • The Taxpayers
  • Beneficiaries and Future Beneficiaries
  • Future Employees
Understanding Your Plan(s)

• Start with understanding pensions in general and your pension specifically

• Plan Design
  • Defined Benefit, Contribution or Hybrid
  • Benefit Formula
  • Retirement Eligibility
  • Automatic or Ad Hoc COLAS
  • Special Provisions
    • Buy Back Reciprocity DROP Payments
  • How susceptible to spiking? (No I’m not talking volleyball)
Understanding Your Plan(s)

- When in the context of their year end and your reporting cycle are financial statements issued?
  - Basic Financial Statements or
  - CAFR
- Frequency of actuarial valuations
- Outside investment managers or internal
- Tradeoff between risk and return on LTRoR
- How conservative is the amortization?
  - Beware of “open” amortization of unfunded liabilities
  - Realize that any Level Percent of Payroll amortization over twenty years is probably negative
Plan Monitoring

• In most cases, your largest financial asset and liability are managed by the PERS

• Employers should review:
  • Annual Financial Statements
    • Audit opinion
    • Financial Statements or footnotes for anything unusual
    • Did PERS receive a management letter
      • Material Weakness
      • Significant Deficiency
      • Other matters
Plan Monitoring-Actuarial Information

• Ideally the PERS will prepare a CAFR but if not, there should be independently issued actuarial report containing:
  • Certification letter
    • Addressed to the Plan or the Employer?
    • Signed by an ASA or FSA
    • Objectives of the valuation
    • Within the parameters of ...
    • Assumptions are reasonable
  • Discussion of Assumptions
  • Various Schedules of Trend Information
Plan Monitoring-Actuarial Information

• Trend Information
  • Current 3 years employer and six years PERS
  • GASB 67/68-ten years for both
  • Ten years is desirable due to the long term nature of pensions and that it is guaranteed to cover boom/bust of investment cycles and at least one actuarial experience study
Plan Monitoring-Actuarial Information

- Key Schedules
  - Retiree and beneficiary information
  - Schedule of Funding Progress
  - Solvency Test
  - Reconciliation of the Unfunded
    - Not always provided but very useful
    - A ten year schedule of changes in the NPL will be required by GASB 68
Plan Monitoring-Actuarial Information

<table>
<thead>
<tr>
<th>Year Ended</th>
<th>Added to Rolls</th>
<th>Removed From Rolls</th>
<th>Rolls at End of Year</th>
<th>Percentage Increase in Annual Allowances</th>
<th>Average Annual Allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number*</td>
<td>Annual Allowances</td>
<td>Number*</td>
<td>Annual Allowances</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>10,607</td>
<td>$278,758,820</td>
<td>4,041</td>
<td>$59,271,884</td>
<td>173,235</td>
</tr>
<tr>
<td>2009</td>
<td>10,839</td>
<td>289,793,503</td>
<td>5,542</td>
<td>78,808,830</td>
<td>166,669</td>
</tr>
<tr>
<td>2008</td>
<td>9,240</td>
<td>225,548,983</td>
<td>4,124</td>
<td>56,416,940</td>
<td>161,372</td>
</tr>
<tr>
<td>2007</td>
<td>9,733</td>
<td>230,401,061</td>
<td>5,576</td>
<td>82,605,482</td>
<td>156,256</td>
</tr>
<tr>
<td>2006</td>
<td>8,969</td>
<td>204,875,766</td>
<td>3,973</td>
<td>55,836,612</td>
<td>152,099</td>
</tr>
<tr>
<td>2005</td>
<td>9,394</td>
<td>217,934,811</td>
<td>5,047</td>
<td>65,360,194</td>
<td>147,103</td>
</tr>
</tbody>
</table>

* Represents a count of the retired members' accounts under which either the member or the member's beneficiaries are receiving benefits.
Plan Monitoring-Actuarial Information

Summary of Actuarial Liabilities & Funding Progress
(Pension Trust Fund)

(Amounts in Millions of Dollars)

<table>
<thead>
<tr>
<th>Annual Report Year</th>
<th>Actuarial Value of Assets</th>
<th>Actuarial Accrued Liability (AAL)</th>
<th>Funded Ratio (1) / (2)</th>
<th>Unfunded AAL (UAAL) (2) - (1)</th>
<th>Covered Payroll (5)</th>
<th>UAAL as a Percentage of Covered Payroll (4) / (5)</th>
<th>City Contributions (7)</th>
<th>Average City Rate (7) / (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$14,203.3</td>
<td>$19,278.8</td>
<td>73.7 %</td>
<td>$5,075.5</td>
<td>$4,221.3</td>
<td>120.2 %</td>
<td>$512.9</td>
<td>12.2 %</td>
</tr>
<tr>
<td>2008</td>
<td>15,149.7</td>
<td>20,360.8</td>
<td>74.4</td>
<td>5,211.1</td>
<td>4,530.0</td>
<td>115.0</td>
<td>567.2</td>
<td>12.5</td>
</tr>
<tr>
<td>2009</td>
<td>16,305.7</td>
<td>21,525.1</td>
<td>75.8</td>
<td>5,219.4</td>
<td>4,769.0</td>
<td>109.4</td>
<td>641.7</td>
<td>13.5</td>
</tr>
<tr>
<td>2010*</td>
<td>16,986.0</td>
<td>20,481.5</td>
<td>82.9</td>
<td>3,495.5</td>
<td>4,797.9</td>
<td>72.9</td>
<td>679.3</td>
<td>14.2</td>
</tr>
<tr>
<td>2011</td>
<td>18,347.0</td>
<td>21,563.3</td>
<td>85.1</td>
<td>3,216.4</td>
<td>4,853.3</td>
<td>66.3</td>
<td>703.8</td>
<td>14.5</td>
</tr>
<tr>
<td>2012</td>
<td>19,784.8</td>
<td>22,683.8</td>
<td>87.2</td>
<td>2,899.0</td>
<td>4,961.7</td>
<td>58.4</td>
<td>664.4</td>
<td>13.4</td>
</tr>
</tbody>
</table>
# Plan Monitoring-Actuarial Information

<table>
<thead>
<tr>
<th>Valuation Date</th>
<th>(1) Current Member Deposits</th>
<th>(2) Retirees and Beneficiaries</th>
<th>(3) Current Members (Employer-Financed Portion)</th>
<th>Actuarial Value of Assets</th>
<th>Portion of Actuarial Accrued Liabilities Covered by Net Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/06</td>
<td>$3,534.6</td>
<td>$4,244.8</td>
<td>$6,255.8</td>
<td>$13,229.8</td>
<td>100% 100% 87.1%</td>
</tr>
<tr>
<td>12/31/07</td>
<td>3,835.4</td>
<td>4,684.8</td>
<td>6,844.3</td>
<td>14,483.0</td>
<td>100 100 87.1</td>
</tr>
<tr>
<td>12/31/08</td>
<td>4,145.6</td>
<td>5,209.5</td>
<td>7,412.9</td>
<td>14,861.8</td>
<td>100 100 74.3</td>
</tr>
<tr>
<td>12/31/09</td>
<td>4,518.3</td>
<td>5,710.5</td>
<td>8,219.3</td>
<td>16,564.2</td>
<td>100 100 77.1</td>
</tr>
<tr>
<td>12/31/10</td>
<td>4,810.3</td>
<td>6,459.3</td>
<td>8,661.6</td>
<td>17,808.6</td>
<td>100 100 75.5</td>
</tr>
<tr>
<td>12/31/11</td>
<td>5,090.7</td>
<td>7,202.8</td>
<td>9,116.0</td>
<td>19,016.4</td>
<td>100 100 73.7</td>
</tr>
</tbody>
</table>
Plan Monitoring-Actuarial Information

Analysis of Financial Experience (Pension Trust Fund)

<table>
<thead>
<tr>
<th>Changes in the Unfunded Actuarial Accrued Liability</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>$ 226.0</td>
<td>$ 259.5</td>
</tr>
<tr>
<td>Amortization payments</td>
<td>(208.7)</td>
<td>(233.3)</td>
</tr>
<tr>
<td>Asset experience</td>
<td>(78.4)</td>
<td>(24.9)</td>
</tr>
<tr>
<td>Liability experience</td>
<td>(275.8)</td>
<td>(198.5)</td>
</tr>
<tr>
<td>Benefit modifications</td>
<td>12.1</td>
<td>(36.1)</td>
</tr>
<tr>
<td>Contributions different than actuarially calculated</td>
<td>7.4</td>
<td>(45.9)</td>
</tr>
<tr>
<td>Total</td>
<td>$(317.4)</td>
<td>$(279.2)</td>
</tr>
</tbody>
</table>
Plan monitoring-investment results

- Ideally the PERS will prepare a CAFR but if not, there should also be some type of report or information on:
  - investment strategies
  - investment allocation
  - investment results
- Remember LTRoR is one of the most likely assumptions to be challenged by the auditor so be familiar with the basic strategies and results.
Know What You Know and Don’t Know

• Your auditors will want you to make major representations about the fair statement of the NPL:
  • Familiarity with the plan and their officials does not necessarily equate to first hand knowledge on a specific number
  • Lack of concerns does not necessarily justify positive assurance
  • Think carefully about what you can positively assert and for the rest consider either
    • negative assurance
    • or getting enough additional information for positive assertion
    • This is a great item to discuss with your auditor at interim
Implementation Triangle

- PERS
- Employer
- Employer Auditor
Planning the Implementation

• Successful implementation will require extensive communication and cooperation between:
  • PERS
    • PERS actuary
    • PERS auditor
  • Employer
  • Employer’s auditor
Planning the Implementation

• Key Steps
  • Start early
  • Designate a project champion
    • Single employer plan
    • Cost Sharing Plan
    • Agent Plan

  Employer Group

Employer

PERS

PERS
Employer Sandwich

• Regardless of who the project champion is, employers must remember:
  • They are ultimately responsible for their GASB 68 numbers in their financials
  • They must act as the “go between” for their auditors and the PERS
  • In addition to financial reporting, they also need to adequately fund the plan, remember:

    Even though GASB has “divorced” funding from reporting, without adequate funding there will be nothing good to report.
Planning the Implementation

- **Key Steps** (continued)
  - Develop Clear Objectives
    - Adequate information and audit evidence for a unmodified opinion by a certain date
    - Pre-established protocols for communications between employer auditor and:
      - PERS
      - PERS auditor
      - PERS actuary
Planning the Implementation

• **Key Steps** (continued)
  • Develop Clear Objectives
    • Certain Plan level decisions should be made early
      • Valuation and measurement dates to be used (beginning and ending)
      • Changes to the valuation approach to facilitate transition
        • Tighter amortization for funding valuation to avoid blended rate
        • Definition of a “substantively automatic” to project ad hoc COLAs (GASB 68 par. 24)
      • Development of a funding policy if previous funding policy was simply: “We follow GASB 25”
Planning the Implementation

• Develop Clear Objectives
  • Identify potential problem areas early and develop a strategy for either eliminating or explaining
    • Is the employer auditor comfortable with an actuarial certification letter addressed only to the plan?
    • How likely is the employer auditor to challenge the reasonableness of both asset and liability assumptions?
    • If required, can a SOC 1 Type 2 report be completed in a timely manner?
    • For single employer plans, have previous years audits identified significant deficiencies or material weakness and have they been addressed?
Case Study-
Texas Municipal Retirement System
TMRS AT A GLANCE (as of 12/31/12)

• Statewide Agent Plan governed by state statute
• 849 member cities representing 11 FY ends
• 143,000 actives and in-actives
• 43,000 retirees
• Annual benefit payment of $865 million
• Fiduciary Net Position of $20.5 billion
• Currently 87.2% funded
## Timeline of GASB 68 Implementation-To-Date

<table>
<thead>
<tr>
<th>Date/Event</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2012</td>
<td>GASB issues Statements 67 &amp; 68</td>
</tr>
<tr>
<td>August 2012</td>
<td>AICPA SLGEP begins circulating possible audit approach for auditing employer’s NPL and related amounts</td>
</tr>
<tr>
<td>November 2012</td>
<td>TMRS and various audit firms hosted by GFOA-Texas to discuss impacts of and preparation needed for an employer auditor’s clean opinion</td>
</tr>
<tr>
<td>2013</td>
<td>TMRS begins preparing for SOC 1 Type 2 by documenting IC assertions and having a “gap” analysis performed</td>
</tr>
<tr>
<td>2013</td>
<td>Created GASB implementation team of TMRS CFO, internal staff actuary external actuary and key staff, internal auditor, assistant director and other key staff to coordinate implementation and communication strategy</td>
</tr>
<tr>
<td>2013</td>
<td>“Eye on GASB” page created on website to inform member governments of progress and issues</td>
</tr>
</tbody>
</table>
# Timeline of GASB 68 Implementation-To-Date

<table>
<thead>
<tr>
<th>Date/Event</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2103</td>
<td>TMRS Board approves change in actuarial cost methods to EAN to minimize difference in funding vs. reporting and to create a more stable contribution.</td>
</tr>
<tr>
<td>December 2013</td>
<td>TMRS Board approves the SOC 1 Type 2 audit as part of the 2014 budget and authorizes it to proceed for a 2014 completion date.</td>
</tr>
<tr>
<td>February 2014</td>
<td>AICPA SLGEP issues whitepapers for Cost Sharing and testing census data</td>
</tr>
<tr>
<td>March 2014</td>
<td>TMRS mails a “SOC” letter to all member cities informing them of the process, encouraging them to provide the letter to their auditors and informing them of employer responsibilities over identified user controls</td>
</tr>
</tbody>
</table>
Timeline of GASB 68 Implementation-To-Date

<table>
<thead>
<tr>
<th>Date/Event</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2014</td>
<td>TMRS outside actuary hosts a meeting with TMRS and GFOAT liaison to TMRS to discuss content of GASB 67 (2014) CAFR as well as key implementation and communication strategies</td>
</tr>
<tr>
<td>March 2014</td>
<td>GFOA requests/GASB declines a one year implementation delay</td>
</tr>
<tr>
<td>Spring 2014</td>
<td>TMRS and GFOAT coordinate education and training to provide members the tools and information needed for a smooth implementation.</td>
</tr>
<tr>
<td>April/May 2014</td>
<td>AICPA Audit Guidance for Agent Plans to be finalized</td>
</tr>
</tbody>
</table>
# Timeline of GASB 68 Implementation-To-Come

<table>
<thead>
<tr>
<th>Date/Event</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fall 2014-Spring 2015</td>
<td>Decisions regarding reporting packages, on-line resources and audit support finalized. TMRS begins first GASB 67/68 valuation. Contents of 2014 CAFR using GASB 67 to be finalized.</td>
</tr>
<tr>
<td>November 2014</td>
<td>TMRS Annual Conference- GASB implementation sessions</td>
</tr>
<tr>
<td>GFOAT Spring 2015 Conference</td>
<td>Multiple pension sessions on topics including GASB 68 basics, understanding and using TMRS reporting package, anticipating audit requests, required implementation JE’s, adjusting the MD&amp;A discussion, providing additional supplementary information on funding in your CAFR, etc.</td>
</tr>
<tr>
<td>GFOAT Fall 2015 Conference</td>
<td>Possible repeat of some spring sessions dependent on feedback, a session on explaining GASB 68 to elected officials and others</td>
</tr>
</tbody>
</table>
TMRS Key Objectives

• Provide member cities adequate pension information and related documentation in order to:
  • Allow for unmodified audit opinions on pension numbers
  • Allow for timely reporting that should not delay members normal reporting cycle
  • Instill confidence in TMRS internal controls and financial reporting process
• Create an efficient process that minimizes impact on both TMRS staff and the outside actuary
  • Decision to move forward with SOC 1 Type 2 report before AICPA guidance was finalized
  • Use of website to share information (Eye on GASB)
  • Goal is to use password protected city portals for proprietary information such as SOC report, census data and individual certification letters
  • TMRS staff actuary to act as first point of contact for actuarial related inquiries
TMRS Key Objectives

- Minimize as much as practical the difference between funding methodology and GASB 68 reporting methodology to increase confidence and understanding of both numbers
  - Primary difference in valuations will be MVA vs. AVA
  - Measurement date will be the same as valuation date
  - EAN also preferred for funding so good time to move from PUC
- With GASB 25/27 being replaced, develop a funding policy that continues to maintain and improve the funded status of its member cities
- Work closely with GFOA-Texas to coordinate communication and training efforts
  - TMRS will be presenting at GFOAT conference sessions
  - Close coordination and review of communications
Questions?