


# Employee Benefit Plan Audit Quality Center



## Understanding Actuarial Reports and Valuation Assumptions Live Forum

**August 27, 2009**

# Presenters



- **Marilee Lau**, Chair, EBPAQC
- **Raymond Berry**, Grant Thornton LLP
- **Dennis Polisner**, KPMG LLP
- **Heidi LaMarca**, Windham Brannon PC
- **Susan Peirce**, Apple Growth Partners

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# Moderator



**Marilee Lau**  
**Chair**  
**EBPAQC Executive**  
**Committee**

# Objectives

- 
- **Benefit obligations & valuation assumptions**
  - **Health and welfare plan issues**
  - **Post employment benefits**
  - **Mergers/terminations**
  - **Multiemployer issues**
  - **Ask the actuary**

# Speakers



**Raymond Berry, ASA, EA**  
**Senior Manager and**  
**Consulting Actuary**  
**Grant Thornton LLP**



**Dennis Polisner, FSA,**  
**MAAA, FCA**  
**Director, Actuarial Services**  
**KPMG LLP**

# Speakers



**Heidi LaMarca**  
**Partner**  
**Windham Brannon**



**Susan Peirce**  
**Partner**  
**Apple Growth Partners**

# Benefit Obligations



- **Benefit Obligations represent**
  - Benefits accrued to date
  - Probability that they will be paid
  - A present value
- **Referred to as the Present Value of Accumulated Plan Benefits**

# Benefit Obligations



- **Accumulated Plan Benefits**
  - Benefits accrued to date
  - Based on service to date
  - Based on salary to date
  - No projection of future salary
- **Present Value reflects amount and timing of benefits and time value of money**

# Benefit Obligation



- **Presented in the financial statements or in the notes**
- **Determined on first or last day of plan year**
- **Presented as of end of current or prior year**

# Benefit Obligation



- **Change in benefit obligation presented for one or two years**
- **Key items affecting changes**
  - **Benefits accumulated**
  - **Interest**
  - **Benefits paid**
  - **Assumption changes**
  - **Plan amendments**

# Benefit Obligations



- **Vested**
  - Based on plan's vesting schedule
- **Non-Vested**
  - Accumulated benefits not yet vested
  - Ancillary benefits
    - Death
    - Disability

# Assumptions for Obligations



- **Mortality**
- **Retirement**
- **Turnover**
- **Interest (discount)**
  - **Including lump sum and cash balance crediting rate**

# Mortality Tables



- **Current**
  - **RP 2000 (including variations and projections)**
  - **1994 UP**
  - **1994 GAM**
  - **1994 GAR**

# Mortality Tables



- **Generally considered out of date**
  - **1983 GAM**
  - **UP 1984**
  - **1971 GAM**

# Retirement Assumptions



- **Decrements generally from ages 55 to 65**
  - “Bumps” at 62 and 65
  - Or single age such as 65
- **Should reflect plan provisions**
- **Should reflect plan experience**

# Turnover Assumptions



- **For accrued benefits used to value non-vested benefits**
- **Usually reflects age**
  - **Often recognizes years of service**
  - **Or both age and service**

# Interest Rates



- **Lump sum rates-**
  - Percentage electing lump sum
  - Interest rate(s) used to calculate lump sum
- **Cash balance crediting rate**
  - Projection or most recent crediting rate

# Discount Rate (FAS 35)



- **Used to calculate present value of accumulated benefits**
- **FAS 35 has two options:**
  - **Expected return on assets (Paragraph 20)**
  - **Settlement of obligation (Paragraph 21)**

# Discount Rate – Expected Return



- Usually the funding rate prior to PPA
- PPA three-tiered rates not appropriate
- Usually FAS 87 long-term expected return on plan assets (not discount rate used to determine pension obligations)
- Generally, should not change frequently

# Discount Rate – Settlement



- **Reflects rate used to settle obligations**
- **Usually FAS 87 discount rate**
- **Generally should change every year**

# Discount Rate Basis (FAS 35)



- **Should select either “long-term” or “settlement” approach consistently**
- **A change from one basis to another is a change in accounting**
- **Preferability required to change**

# Health & Welfare Plans



- **Subject to SOP 92-6 and SOP 01-2**
- **Postretirement benefit plans – FAS 106 (with adjustments)**
- **Postemployment benefit plans – FAS 112**

# Health & Welfare Plan Assumptions



- **In addition to those already mentioned:**
  - **Per capita claim costs**
  - **Trend rates for claim costs**
  - **Retiree contribution trend rates**
  - **Medicare Part D subsidy**

# Postretirement Discount Rate



- **Based on high quality corporate bond rates (Paragraph 31A of FAS 106)**
- **FAS 158 requires measurement at corporate fiscal year end**

# Difference in Reporting with FAS 106



- **Employer report obligation net of Part D subsidy (plans are not entitled to Part D subsidy)**
- **Plans report obligation gross of subsidy and this requires a separate calculation**
- **For Multiemployer plans, obligation is net of Part D subsidy**
- **COBRA subsidy will have similar impact next year**

# Postemployment Benefits (FAS 112)



- **Accumulating benefits based on FAS 43**
  - **Short term disability**
  - **Extended sick leave**
- **Non-accumulating benefits based on FAS 5**
  - **Long term disability**
  - **Medical benefits**

# Post Employment Discounting



- **Not required under FAS 112**
- **SOP 01-2 does require discounting and should reflect high quality corporate based rates**
- **Not clear regarding FAS 5 type benefits although it appears that a high quality bond rate should be used**

# Post Employment Discounting



- **Employer benefits under FAS 5 use risk-free rate which will be different from the plan rate**

# Benefit Information Date



- **Beginning of year or end of year**
- **End of year preferred**
- **January 1 valuation presented as of December 31 (one day earlier)**

# Benefit Information Date



- **Beginning of Year Information**
  - Two years of net assets
  - Two years of changes in net assets
  - One year of benefit obligations
  - One year of changes in obligations

# Benefit Information Date



- **End of year Information**
  - **Two years of net assets**
  - **One year of changes in net assets**
  - **Two years of benefit obligations**
  - **One year of changes in obligations**

# Minimum Presentation Requirements

Financial Statements	Beginning of Year Benefit Information Date	End of Year Benefit Information Date
Statement of net assets available for benefits	Comparative	Comparative
Statement of changes in net assets available for benefits	Comparative	Single
Accumulated plan benefits (in the notes or in separate financial statements)	Single	Comparative
Changes in accumulated plan benefits	Single	Single

# Plan Amendments

- **Benefit obligations are affected by amendments affecting accrued benefits**
- **Amendments affecting future benefits are not recorded currently**
- **Amendments are recognized when adopted even if effective date is in the future**

# Matrix for Recognition of Plan Amendments



Effective Date	Amendments Adopted Within Reporting Year	Amendments Adopted After the Reporting Year
Effective date within the reporting year	Effect of amendment should be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year	Effect of amendment should not be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year
Effective date after the reporting year	Effect of amendment should be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year	Effect of amendment should not be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year

# Polling Question: Plan Amendments

## Situation 1:

**Plan adopted an amendment on 11/30/08, which increased all past benefits effective 6/30/09**

**Which financial statements would this amendment first effect?**

- a. 12/31/08**
- b. 12/31/09**

# Plan Amendments



## Situation 2:

**Plan adopts an amendment which increases all past benefits on 1/1/09, with an effective date of 1/1/09**

- **Recognized in 12/31/09 financial statements**
- **If included in 1/1/09 valuation, effect must be removed**


# Mergers/Spinoffs

- **IRC 414(I) – each participant’s benefit at least as great as before merger or spinoff**
- **Must generally report event within 30 days to PBGC**
- **Outstanding PPA issues relating to amortization bases and credit balances**


# Plan Merger

- **Permitted to maintain separate plans during transition period for coverage (410(b))**
- **Transition period: from date of merger/acquisition to last day of first plan year beginning after merger/acquisition.**


# Plan Termination

- 
- **Date of termination critical**
  - **Accumulated plan benefits measured on liquidation basis**
  - **Benefit information date should move to end of year**
  - **100% vesting for all participants**

# Types of Plan Terminations

- 
- **Standard** – must have sufficient assets
  - **Distress** – must prove business hardship
  - **Involuntary** – PBGC takeover to protect plan participants (and PBGC).

# Plan Terminations

- 
- **Many forms and notices required**
  - **204(h) notice before effective (45 days/15days)**
  - **Minimum funding applies through plan termination date.**

# Partial Plan Terminations



- **Legal determination, usually 20% of participants involuntarily terminated**
- **Can be over several plan years**
- **Affected participants must be 100% vested.**

# Partial Plan Terminations

- For DB plans, may only apply if increases reversion to plan sponsor. Consult with attorney and actuary.
- Often determined after many terminations and payouts have been processed. Sooner determination saves time and expense.

# Health and Welfare Plan Terminations




- **IBNR issues**
- **COBRA issues**

# Frozen Plans




- **Hard freeze – no additional accruals**
- **Soft freeze – no additional plan participants**
- **Perform accrued benefit calculations as soon as possible**

# Frozen Plans

- 
- **Financial statement issues (SFAS 87/88)**
  - **Still ongoing expenses: actuarial, accounting, legal, PBGC**
  - **Eventually compare present value of the expense of maintaining plan to the cost to terminate.**

# PPA Funding

- 
- **Required minimum contribution is Target Normal Cost plus amortization of Unfunded Target Liability over 7 years**
  - **Prescribed interest and mortality tables**
    - **Interest is either 3-tiered rate structure or full yield curve**
    - **Various outstanding issues**

# PPA Benefit Restrictions



- **Funded percentage below 80%**
  - No plan amendment benefit increases allowed
  - Limit on payouts of 50% of lump sums
- **Funded percentage below 60%**
  - All future benefit accruals frozen
  - No lump sums payable
- **Funding percentages determined by Enrolled Actuary**

# PPA Multiemployer Funding



- **Basically ERISA rules with adjustments**
- **Schedule MB looks similar to Schedule B**
- **Plans now have funding zones**

# PPA Multiemployer Zones



- **Green - o.k. – none of following**
- **Yellow – endangered – less than 80% funded or projected deficiency**
- **Orange – seriously endangered –less than 80% funded and projected deficiency**
- **Red – critical –less than 65% funded or other conditions such as solvency**

# PPA Multiemployer Funding Requirements



- **Yellow and orange zones**
  - Funding must be improved
- **Red zone**
  - Rehabilitation period which may reduce future accruals
  - Restrictions include
    - No lump sums
    - No reduction in contribution rates

# Data Issues



- **Trace data from plan sponsor to actuary**
- **Be certain actuarial confirmation is complete and all items confirmed.**

# Data Testing



- **Test individuals**
  - Basics
  - Definition of compensation
- **Test aggregate or totals**
  - Number of participants
  - Total payroll

# Data Testing



- **Still need to test frozen plans**
  - **Soft freeze – still need same data for continuing participants**
  - **Hard freeze – still need to test other than determination of accrued benefit (assuming already reviewed).**

# Data Issuer




- **Missing data**
  - What assumptions used to calculate obligations
- **Data only with actuary**
  - What if plan sponsor changes actuary

# Miscellaneous Issues

- **Starting with 2008 Form 5500:**
  - Schedule SB – single employer plans
  - Schedule MB – multiemployer plans
- **SFAS 157 applies to corporate audits starting with fiscal years ending on and after December 15, 2009.**

# Health and Welfare

- 
- **Incurred but not reported claims (IBNR)**
  - **Who calculates these claims?**
  - **How are they calculated?**
  - **Are they included for retirees in the postretirement benefit obligation?**
  - **Are they counted twice for retirees?**

# Claims IBNR



- **Calculated by**
  - **Actuaries**
  - **Insurance company underwriters**
  - **TPA staff**
  - **Client personnel**

# Claims IBNR




- **Calculation methods**
  - **Claims lag analyses**
  - **Completion factor method**
  - **Percentage of paid claims**
  - **Margins**
  - **Fully developed claims**

# Claims IBNR



- **IBNR for retirees**
  - **Post retirement benefit obligation may include IBNR**
  - **Post retirement benefit obligation may not include IBNR**
  - **Claims currently payable may or may not include IBNR for retirees**

# Claims IBNR

- 
- **Need to verify how post retirement benefit obligation is determined**
  - **Must avoid**
    - **Duplication of IBNR for retirees**
    - **Omission of IBNR for retirees**

# Actuarial Credentials

- **Fellow of the Society of Actuaries (FSA)**
- **Associate of the Society of Actuaries (ASA)**
- **Enrolled Actuary (EA)**
- **Fellow of the Conference of Consulting Actuaries (FCA)**
- **Associate of the Conference of Consulting Actuaries (ACA)**
- **Member of the American Academy of Actuaries (MAAA)**
- **Fellow of the American Society of Pension Professionals and Actuaries (FSPA)**
- **Member of the American Society of Pension Professionals and Actuaries (MSPA)**
- **Fellow of the Canadian Institute of Actuaries (FCIA)**

# Question & Answer Session



**Please submit questions**



# EBPAQC Upcoming Events



- **November 12 – *403(b) Plan Audits Update Live Forum***

# AICPA Upcoming Events



- **December 7 - 8, AICPA *Employee Benefit Plans Accounting, Auditing and Regulatory Update Conference*, Washington, DC**

# Evaluation



**We welcome your feedback on today's live forum**

**Please complete the online evaluation**

**<http://www.zoomerang.com/Survey/survey.zgi?p=WEB229H3HMPPD3G>**

**Thank you!!!**

# Employee Benefit Plan Audit Quality Center

**Thanks for Participating!**