

# Pensions-Making the Number Our Own

By Bob Scott, CPA

## Forward into the Future

With the implementation of GASB 68 "Accounting and Financial Reporting for Pensions" about a year away it is time to focus on what it will require us, as preparers of employer financial statements, to implement this complex and to some, intimidating standard. It is "intimidating" because for many of us, we know very little about this huge number that we are about to record in our financial statements. This brief will discuss the best practice solutions published by the AICPA's Government Audit Quality Center (GAQC) that we, as preparers, can also utilize to gain understanding and assurance regarding what could be the largest number in our government's financial statements.

## The Employer Dilemma

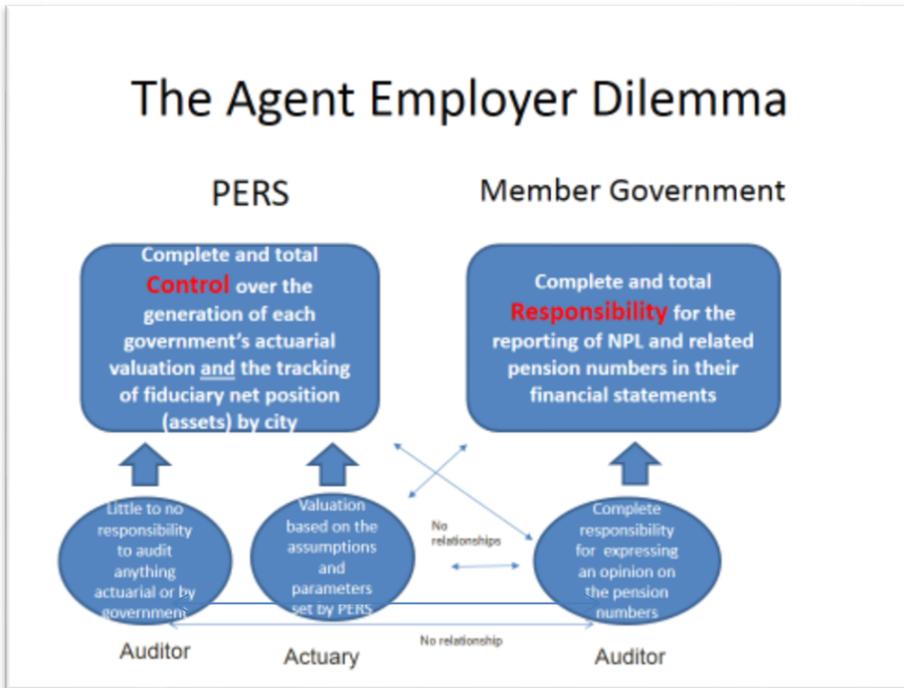
Under GASB 27, the focus of financial reporting related to pensions is the Annual Required Contribution (ARC) or pension expense which is typically relatively small compared to other items in the financial statements. GASB 27 also allows a huge degree of flexibility in terms of how the ARC is determined including extensive use of "smoothing" techniques. Under GASB 68, however, employers will be required to report a strictly defined Net Pension Liability (NPL) which GASB explains as the Total Pension Liability (TPL) less Fiduciary Net Position. Pension expense will now be the change in the NPL from beginning to end of the year adjusted for certain deferred inflows and outflows.

The NPL will often be one of the largest and volatile numbers in an employer's financial statements which, combined with the recent media, investor and SEC scrutiny of pensions

and the affect they could have on an employer's financial position, create a significant dilemma for many employers that have created independently governed and managed Public Employees' Retirement Systems (PERS). These PERS typically have their own staff as well as accounting and internal control systems. PERS are the sole keeper of the census data, hire the actuary, approve all assumptions that will drive the NPL, and often hire a different auditor than the employer. In other words, GASB is now asking preparers to record and stand behind a very material and volatile number for which they may not have any direct control or first-hand knowledge. This dilemma becomes even greater for employers who are members of agent plans because unlike cost-sharing and single-employer PERS, under GASB 67 "Financial Reporting for Pension Plans," the agent PERS will not be required disclose any actuarial based amounts, such as the NPL in the notes to their basic financial statements and accordingly, the PERS auditor will not need to audit anything actuarial to render an opinion on those financial statements. The agent PERS will also not be required to report in their basic financial statements, fiduciary net position by individual member government so again there will be no audit coverage for agent employers at the PERS level. (See Illustration on the next page).

Given the huge financial implications that pensions can have on an employer's financial operations, it is not unreasonable for GASB and others to expect government employers to have a firm grasp on these numbers and yet for many governments this will require a significant change in both mindset and in relationships with their PERS.

Illustration



**Creating a Conductor for the Orchestra**

The employer dilemma is an even greater problem for the employer’s auditor since it is virtually impossible to audit a number that the client cannot directly support or document. This situation is similar to a group of musicians who each have their own music to play but currently don’t function as a unit. Without a conductor to coordinate the effort, the end product is unlikely to please anyone. Accordingly, the AICPA’s State and Local Governments Expert Panel (SLGEP) has provided best practice recommendations to help conduct the orchestra. These best practice recommendations in the form of “Whitepapers” <http://www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Resources/gasbmatters/Pages/GASBPensionsIssues.aspx> are also reinforced with auditing standards interpretations and the development of a forthcoming pension chapter in the AICPA Audit and Accounting Guide, *State and Local Governments*.

Whitepapers have been issued to address issues associated with governments that participate in multiple-employer cost-sharing and multiple-employer agent plans as well as a whitepaper that addresses the testing of census data for cost-sharing and single employer plans. These whitepapers provide a common sense approach of having the PERS prepare certain information relevant to participating

employers and having the PERS auditor perform procedures for information or processes that are maintained at the PERS with the remainder of the audit procedures performed by the employer’s auditor. It should be noted that the SLGEP whitepapers are best practice solutions and the schedules the SLGEP suggests the PERS prepare are considered supplementary information. In order to provide sufficient information for participating employers and their auditors to rely upon, the PERS will have to engage its auditor to opine on the recommended schedules. While the SLGEP acknowledges that the best practice solutions it proposed are recommendations, it believes there are few other alternatives employers and their auditors could efficiently and effectively utilize to obtain

sufficient appropriate evidence on which to base their specific pension amounts or the auditor’s opinions, respectively.

A key principal throughout the whitepaper is that even though the employer auditor will be utilizing audit evidence provided by the PERS auditor, ultimately the opinion on whether the employer’s pension numbers are fairly stated rest solely with the employer auditor. The logical extension of this principal is that the employer is also solely responsible for the fair statement of their pension amounts.

The whitepapers make the following recommendations:

**Cost-Sharing Plans & Employers:**

The whitepaper titled, [Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting](#), addresses issues related to how employers participating in cost-sharing plans obtain all necessary information to properly recognize and disclose pension amounts in their financial statements and how their auditors obtain sufficient appropriate evidence to support their opinions on the employer financial statements.



- Plan prepares a schedule of employer allocations for which PERS auditor is engaged to provide an opinion.
- Plan prepares a schedule of pension amounts by employer for which the PERS auditor is engaged to provide an opinion.

The whitepaper also describe the responsibilities of cost-sharing employers and their auditors.

The whitepaper titled, [Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements](#), addresses the role of census data in single-employer and cost-sharing plan financial statements and the plan auditor's responsibility for such census data. This whitepaper addresses the responsibility of the cost-sharing plan to obtain all necessary information and the plan auditors to obtain sufficient appropriate evidence regarding the completeness and accuracy of all census data underlying certain financial statement elements of the plan.

#### **Agent Employers:**

As discussed above, agent employers are the most difficult to audit. The whitepaper titled, [Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting](#), addresses issues related to how employers participating in agent plans obtain all necessary information to properly recognize and disclose pension amounts in their financial statements and how their auditors obtain sufficient appropriate evidence to support their opinions on employer financial statements. Accordingly the whitepaper recommends breaking down the NPL into its two component parts of TPL less Fiduciary Net Position and provides guidance for each component separately. In addition, the whitepaper introduces the concept of using a certain service organization control report known as a SOC 1 Type 2 as an efficient way to gain assurance regarding internal controls thereby reducing the level of substantive testing by the PERS auditor.

#### **Total Pension Liability and Pension Expense/Deferred Inflows of Resources/Deferred Outflows of Resources**

- Plan actuary issues separate actuarial report for each participating employer addressed to each employer which includes NPL, deferred inflows and outflows by type and year, pension expense and discount rate calculation, and.
- The plan engages its auditor to issue either:

- Option 1: A service organization controls 1 (SOC 1) Type 2 report on controls over census data maintained by the plan, or
  - Option 2: An examination engagement over selected management's assertions related to census data maintained by the plan.
- Employer auditor tests census data of active employees and confirms census data used by the actuary.
  - Employer auditor performs various other tests and analytical review of the TPL, deferred amounts and pension expense

#### **Fiduciary Net Position**

The whitepapers provide two alternatives:

- PERS prepares a Schedule of Changes in Fiduciary Net Position by Employer and
- PERS engages its auditor to opine on the Schedule of Changes in Fiduciary Net Position by Employer either through:
  - An opinion on the schedule as a whole accompanied by a SOC 1 Type 2 report on allocations of additions and deductions to employer accounts **or**
  - An opinion on the schedule by individual employer.

#### **Implications of the Agent Recommendations**

Many who have been following the formation of the audit strategies believe that ultimately SOC 1 Type 2 reports offer the most efficient and common sense approach for providing some of the PERS level audit evidence to the employer auditor. Unfortunately, SOC 1 Type 2 by their nature must be performed during the reporting period for which they apply and it is very doubtful that most agent plans will be in a position to have these procedures done in time for their employer members first year of reporting under GASB 68. Accordingly, the whitepapers offer alternatives but these alternatives will require substantially greater effort possibly delaying the issuance of the financial statements and in all likelihood increasing audit costs. PERS and their employer members will have to evaluate the alternatives available to them and if a SOC 1 Type 2 approach is not feasible in the first year determine whether it would be better to accept and explain a modified opinion on the pension numbers or incur the greater cost and time necessary for the alternative procedures.



## Single Employer PERS

With the exception of testing of census data, the whitepapers do not address single employer plans as the SLGEP felt that the unique and complex nature of multiple-employer plans must be addressed first. Auditors however, will inevitably look for parallels that can be applied. Preparers for example may want to consider the desirability of having the actuarial certification letter addressed to them as the employer rather than just the PERS as this creates a relationship between the actuary that performed the valuation and the employer that must report the numbers.

### **Making the Number Our Own**

The tremendous financial impact of pensions on employer finances combined with media, investor and SEC scrutiny and the new reporting requirements of GASB 68 make the development of employer due diligence procedures an absolute necessity. This employer due diligence when combined with the additional procedures in the SLGEP best practices recommendations should provide preparers adequate substantive evidence regarding the fair statement of their pension amounts. Possible due diligence and implementation procedures should include:

- Develop an understanding of all pension plans sponsored by the employer
- Perform an annual review of PERS financial results
- Discuss implementation in advance with the plan
- Discuss implementation in advance with your auditor

### **Brave New World**

The days of an employer simply accepting the pension reporting package numbers the PERS provides and inserting them into their financial statements without question are going away. Employers need to understand their responsibilities for objective, unbiased reporting of their pension commitments. GASB 68 is but one indicator of how the world of public pensions is changing and the need for government employers to make the pension number their own.

### **Additional Resources**

If you need additional resources in advance of the implementation of the new standards, there are numerous resources available which are highlighted below.

- [GASB Pronouncements](#). The GASB has made available the following pronouncements on its website: Statements of Governmental Accounting Standards (including GASB

Statement Nos. 67 and 68); Concepts Statements; GASB Interpretations; and GASB Technical Bulletins

- [GASB Educational Resources](#). The GASB has made available numerous resources on its website that include podcasts, fact sheets, articles, and more which are all available to the public.
- [AICPA Governmental Audit Quality Center \(GAQC\)](#). The GAQC has developed a public section of its web site titled, GASB Matters which is dedicated to GASB issues and resources developed by the SLGEP to address pension issues.
- [AICPA Governmental Conferences](#). Anticipating the significant effect the new GASB pension standards will have on plans, employers, and their auditors, the AICPA will provide extensive coverage of these matters in the 2014 governmental conference agendas. Consider attending.
- [Government Accounting and Auditing Conference \(GAAC\)](#). The GAAC is offered in two locations. GAAC East will be held in Washington, DC August 11-12, 2014. GAAC West will be held in Denver, CO September 23-24, 2014.
- [Governmental and Not-for-Profit Training Program](#). This conference will be held in Las Vegas, NV October 22-24, 2014.

#### **Author's Bio**

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Bob Scott is Chief Financial Officer/Assistant City Manager for the City of Carrollton, Texas. Mr. Scott, a CPA, began his career in public accounting, ultimately serving as an audit manager with responsibility for a large number of governmental clients. He has served on various GASB review committees and taskforces, been a reviewer for the last three editions of GFOA's "Governmental Accounting, Auditing, and Financial Reporting" (known as the "Blue Book") and various other GFOA publications and is a past chair for GFOA's Committee for Accounting, Auditing and Financial Reporting (CAAFR). Active with the AICPA, he currently serves on the State and Local Government Expert Panel. While in public accounting, he served as a Practice Fellow for the Governmental Accounting Standards Board (GASB) and later as representative to the Governmental Accounting Standards Advisory Committee. In 2008 the AICPA named him the outstanding CPA in local government.

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