# Employee Benefit Plan

## Hot Topics

How recent GASB statements will affect your next audit & pitfalls

### Topics to be discussed

1. **GASB 68**
   - High Level Overview of GASB 68
   - How it will affect local government financials
   - How it will affect your next audit

2. **EBP Shortfalls**
   - Administrative pitfalls of managing EBPs, including common issues we see on our EBP audits
TOPICS NOT DISCUSSED TODAY

1. Measurement Timing Intricacies
2. Deferred Inflows & Outflows Intricacies
3. Debit & Credit Intricacies

AVAILABLE RESOURCES

GASB’s “Implementation Toolkit for Governments”
- Videos
- Podcasts
- Articles
- Fact Sheets
- Frequently Asked Questions

AICPA’s State and Local Government Expert Panel (SLGEP)
- Whitepapers
STATEMENT NO. 68 FROM 30,000 FEET

- Liabilities related to providing a retirement benefit in the form of a pension will now be recognized (along with the related expense) in the financial statements of governments
- Effective for years beginning after June 15, 2014

30,000 FEET: OLD VS. NEW

Old:
- Pension costs are recognized as pensions are funded based on an actuary’s calculations, known as the actuarially required contribution (ARC) or contractually required contribution (CRC).
- No large or even massive liability!!
- Only a liability if: ARC(CRC) > $ Funded
- Pay-As-You-Go
New:

• Pension costs are recognized (either immediately as pension expense or as a deferred inflow/outflow of resources) as employees earn their pension benefits by providing services. If the calculated liability exceeds what the pension plan has as assets, a liability will be booked.

• Could result in a large or even massive liability!! (No affect on bond rating)
• Only a liability if: Liability>Assets
• ARC no longer important to financial reporting

BUT WHY?

Per GASB:

• Provide better decision-useful information
• Support assessments of accountability and inter-period equity
• Create additional transparency
30,000 FEET: WHO IS SUBJECT?

Employers that participate in any of these:
- Defined Benefit Pension Plan
- Agent Multiple-Employer
- Cost Sharing
- Defined Contribution Pension Plan
- Any Other Pension Trust Fund

GASB gives 3 characteristics:
1. Contributions from employers and non-employer contributing entities to the pension plan and earnings on those contributions are irrevocable.
2. Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.
3. Pension plan assets are legally protected from the creditors of employers, non-employer contributing entities, and the pension plan administrator. If the plan is a DB pension plan, plan assets also are legally protected from creditors of the plan members.
30,000 FEET: WHO IS SUBJECT?

- Defined Benefit Pension Plans
- Agent Multiple-Employer & Cost Sharing

Agent Multiple-Employer
- Assets are pooled for investment purposes, but still legally segregated for payments of benefits to individual employers

A Collection of Single Employer Plans
Cost Sharing

- Assets are pooled for investment and benefit payment purposes, and not legally segregated for payments of benefits to individual employers.

### Plan Assets Pay Benefits of Any Employer

**Employer A**  **Employer B**  **Employer C**  **Employer D**

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**Defined Contribution Plan**

- Stipulates the contributions a government must make to an active employee's account each year.

Helpful Hint!

- DB vs. DC is all about the risk!
  - DB Plan = Employer bears the market risk
  - DC Plan = Employee bears the market risk
3 Basic Steps

- **Project** future benefit payments for current and former employees
- **Discount** to present value
- **Attribute** the amount to the past, present and future

**OVERALL EFFECT ON YOUR FINANCIALS**

**Projection**

- Based on terms of the plan (i.e. plan document)
- Performed by an actuary, not the employer or the accountants
- Calculations based on:
  - Expected remaining service of employees
  - Current and future expected salaries
  - Length of benefit collection after retirement (death)
- Statement requires assumptions to confirm to actuarial standards
OVERALL EFFECT ON YOUR FINANCIALS

**Discounting**
- Use of a discount rate
  - Long term expected rate of return, or
  - Single rate based on combo of the above PLUS a municipal bond index rate
  - To determine which rate, project both plan assets and benefit payments and compare
    - If projected assets > projected payments, then use expected rate of return
    - If projected payments > projected assets, then use 20 year tax exempt municipal bond rated AA or Higher

OVERALL EFFECT ON YOUR FINANCIALS

**Attribution**
- Single actuarial cost method
  - Entry age, as a level percentage of payroll
  - 12 previous possibilities
EFFECT ON YOUR FINANCIALS

SINGLE EMPLOYER DB PLANS

Balance Sheet

- 100% of Net Pension Liability will be recognized
- Booked to government-wide statements
- Allocated between governmental and business-type

Disclosures

- Description of plan and benefits
- Assumptions and changes in assumptions
- Discount rate assumptions
- Impact on NPL if rate was one up or down
- Roll forward of NPL
- Schedules of deferred inflows/outflows and amounts charged as CY expense
- 10 year RSI schedules

INCOME STATEMENT IMPACT

<table>
<thead>
<tr>
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<th>Deferred Inflow/Outflow</th>
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<td>Employees work and earn benefits</td>
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<tr>
<td>3</td>
<td>Changes in benefit terms (i.e., plan amendments)</td>
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<td>4</td>
<td>Change in economic and demographic factors</td>
<td></td>
<td>Amortized Over Avg Remaining Service Period</td>
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<td>5</td>
<td>Experience gains and losses</td>
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<td>6</td>
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<td>Amortized Over 5 Year Period (Market Cycle)</td>
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<tr>
<td>7</td>
<td>Change in plan assets due to projected investment earnings</td>
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EFFECT ON YOUR FINANCIALS

AGENT MULTIPLE-EMPLOYER DB PLANS

Balance Sheet
- 100% of Net Pension Liability will be recognized
- Booked to government-wide statements
- Allocated between governmental and business-type

Disclosures
- Description of plan and benefits
- Assumptions and changes in assumptions
- Discount rate assumptions
- Impact on NPL if rate was one up or down
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- Schedules of deferred inflows/outflows and amounts charged as CY expense
- 10 year RSI schedules

Practically the same as single employer DB plan, with exception of SFS’s

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EFFECT ON YOUR FINANCIALS

COST-SHARING MULTIPLE-EMPLOYER DB PLANS

Balance Sheet
- Employer's proportionate share of cumulative net pension liability will be recognized
- Proportionate share calculated by taking expected long term contributions divided by same figure for all employers combined
- Booked to government-wide statements
- Allocated between governmental and business-type

Disclosures
- Description of plan and benefits
- Assumptions and changes in assumptions
- Discount rate assumptions
- Impact on NPL if rate was one up or down
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EFFECT ON YOUR FINANCIALS

DEFINED CONTRIBUTION PLANS

Balance Sheet

- Could have liability if employer contributes less than what was required per the terms of the plan
- Since a DC, no involvement of an actuary

Disclosures

- Description of plan and benefits
- Contribution rates
- Amounts of pension expense and forfeitures
- Amounts for any liabilities

Income Statement

- Recognize pension expense equal to the contributions that the terms of the plan require
- Recognize amounts paid by "non-employer contributing entities"
- Net of forfeitures

PARTICIPATION CHECK

WHICH ITEMS HAVE NOT BEEN BANNED IN NEW YORK CITY AT SOME POINT?

- PINBALL
- SELFIES WITH TIGERS
- FERRETS
- MMA FIGHTING
SPECIAL FUNDING SITUATIONS (SFS)

- Exists when another government is responsible for part of all of a government’s pension obligation
- Non-employer contributing entity (NECE)
- Key points
  - NPL in employer’s F/S will be bet of NECE’s share
  - Employer and NECE’s full pension expense will be recognized in employer’s F/S
  - Disclose full amount of NPL prior to assumption by the NECE
  - Revenue will be recognized for the amount of pension expense we recognize from the NECE

EFFECTS ON YOUR AUDIT

- State and Local Government Expert Panel (SLGEP)
- Whitepapers for Agent and Cost-Sharing DB Plans
- Key points
  - Stresses communication between employers and plans
  - Gives guidance on how auditors may achieve sufficient, appropriate audit evidence
  - Stresses that the calculations throughout the new Statement are “dependent on certain accounting records maintained by the plan”
TYPICAL ENTITY CONFIGURATION

- Actuary
- Plan
- Employer(s)
- Employer Auditor
TYPICAL ENTITY CONFIGURATION

SUFFICIENT, APPROPRIATE AUDIT EVIDENCE

BEST PRACTICES (AGENT PLANS)

1. Actuary issues separate valuations for each employer which includes a certification letter

2. Plan’s auditor is engaged to do one of two things
   - Issue SOC 1 Report
   - Examination engagement

Option chosen by TCRS
COST-SHARING PLAN SLGEP RECOMMENDATIONS

- Cost-Sharing plans, not employers, calculate their allocation percentage and collective pension amounts
- Plans will prepare a “Schedule of Employer Allocations”
- Plans will prepare a “Schedule of Pension Amounts by Employer”

CENSUS DATA TESTING

- Employer auditors will now test the following:
  - Employee demographic data such as:
    - Name and SSN
    - Date of Birth
    - Date of Hire
    - Salary
    - Gender
    - Other Items
  - Tests of Accuracy and Completeness
    - Payroll registers
    - Personnel files
    - Actuarial census data
ENTRIES AND ALLOCATIONS

Two main entries in year 1

• Prior period adjustment (bye-bye fund balance)
• Current year recording of pension expense and reclassifications in and out of deferred inflows/outflows
  • Will be allocated between governmental and business-type activities
    • Use materiality to determine whether component unit allocations are necessary
    • TN Division of Local Government Audit recommends allocating, if deemed necessary, based on “a rational basis” and report element on the component unit’s F/S. They recommend one year’s pension contributions as an allocation method

In Tennessee, governments participating in TCRS will receive journal entries from them

RAMIFICATIONS

Ramifications if Best Practice Solutions Not Adopted

If an agent plan issues audited financial statements, but does not implement the best practice solutions recommended by the AICPA SLGEP, it is unlikely that employer auditors will be able to accumulate sufficient appropriate audit evidence necessary to provide unmodified opinions on the opinion units of the government financial reporting entity that have material pension amounts. It is important to emphasize that unaudited information provided by the plan to its employers to support specific pension amounts that have not been subjected to further audit procedures would not constitute sufficient appropriate audit evidence upon which employer auditors could base their opinions. While the AICPA SLGEP acknowledges that the best practice solutions proposed in this whitepaper 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.
GROUP AUDIT?

AU-C 600 Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)

- Interpretation No. 1 – Auditor of Participating Employer in a Governmental Pension Plan
- **States that there is no need for the employer auditor to make reference to the audit report of the Plan’s auditor**
- Why? The Plan is not a component of the employer

OVERALL IMPLEMENTATION RECOMMENDATIONS

Communicate now

- Establish a clear channel between employer government and employer auditor to determine how and when schedules will be prepared

Develop internal “tiger team” or champion at your employer government (and CPA firm!)

- Become technically proficient with the standard

Go ahead and prepare template schedules based on information provided so far by the GASB

- Footnote disclosures and RSI (10 years)

Don’t be scared of the journal entries and any allocation calculations, as most items will be provided to you
EBP ADMINISTRATIVE PITFALLS – ALL PLANS

• Plan administrators at the local government level must be careful and watch out for the pitfalls we are seeing when conducting EBP audits
• Some of the tests required by SLGEP are similar to what we commonly perform on EBP audits
• Here are the things we see the most that you should watch out for

DEFINED BENEFIT PLAN FINDINGS

• David and Eric, Big City’s auditors arrive for their yearly audit and begin census data testing. Rita Rement is selected for testing, however David and Eric cannot find any documentation in Rita’s employee file of her hire date or birth date.
• Neither the auditors nor the plan administrator can identify that the information in the census is incorrect.
DEFINED BENEFIT PLAN FINDINGS

• Rita Rement was hired 7/1/1978, however she left her position in 1983 for another position, but returned to Big City in 1986. The census reflects the original hire date, but the original termination date and the rehire date are excluded on the census. Therefore, Rita has a break in service that is not reflected in the census.
• Rita employee will get credit for 4 more years than she should.

DEFINED BENEFIT PLAN FINDINGS - SOLUTIONS

• Reviewing personnel files to verify that documentation evidencing demographic data is in each employee’s file
• Maintaining each employee’s personnel file over the course of their employment to make sure that information relevant to their eligibility is placed in their personnel file.
• Periodic reviews by management. Tracing information in the census back to documentation in the employee file to verify the accuracy of the census.
DEFINED CONTRIBUTION PLAN FINDINGS

- Smith Company pays out quarterly bonuses to a number of employees. Smith’s payroll department does not withhold 401(k) contributions on these bonuses.
- The plan document defines compensation as “W2 wages plus Section 125 deductions.”
- These bonuses should be included in compensation for the purpose of calculating 401(k) contributions.

DEFINED CONTRIBUTION PLAN FINDINGS

- Rita Rement has accrued a large amount of vacation time. Her employer allows her to “cash out” a certain amount of this time and receive a check for the value of the time. The payroll department issues Rita a manual check net of the proper tax withholdings, however, the payroll department neglected to make the proper 401(k) deductions based on the percentage that Rita had elected.
- Had the vacation time been used by the employee, it would have been subject to 401(k) withholding.
DEFINED CONTRIBUTION PLAN FINDINGS - SOLUTIONS

• Plan management should review the definition of “compensation” in the plan document.

• The payroll department should verify that all proper pay codes set to be included in gross wages for the calculation of 401(k) contributions based on the plan document.

• All manual checks should be subject to 401(k) withholding based on the type of pay and the definition of compensation in the plan document.

THANK YOU

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