Chapter 3
Pension Plans

Contents

Pension Plans

Background

3.1 The Province of New Brunswick sponsors several pension plans for its employees and for members of the Legislative Assembly. There are over 35,000 active contributors to the plans and approximately 14,500 pensioners. As well, over seven hundred persons entered the various early retirement programs in the year ended 31 March 1997.

3.2 Pension benefits are currently being provided through eleven pension plans and one early retirement/workforce adjustment program. Pension fund investments exist for each of the pension plans, except for the Members' Plans and the Ombudsman Plan. All pension fund investments are kept separate from the finances of the Province.

3.3 All pension plans which hold investments issue audited financial statements on an annual basis, except for the Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals and the Pension Plan for Part-time and Seasonal Employees.

3.4 Pension plans are classified as either defined benefit or defined contribution plans. The classification depends on the terms and conditions of the plan. A defined benefit plan specifies either the benefit to be received by employees or the method for determining those benefits. A defined contribution plan specifies how contributions are determined. Contributions, under a defined contribution plan, are allocated to the specific individuals making the contribution.

3.5 When the Province of New Brunswick provides benefits under a defined benefit plan, it is at risk with respect to the amount of the benefit that each employee will receive. There is a risk because the total amount of the liability is not known with certainty until the benefits have all been paid. Any shortfall between the fund revenues (amounts contributed to the funds by employees and the employer plus investment earnings) and the benefits paid must be funded by the Province. The exception is the Hospitals-Certain plan where any shortfall is the responsibility of the employees.

3.6 Under a defined contribution plan the Province and the employees contribute a specified amount to the fund in connection with services rendered by the employee. The Province has no responsibility to make any further contributions. With a defined contribution plan, it is the employee who is at risk because the amount of the benefit that will be payable to an individual employee is entirely dependent upon the amount of funds accumulated in the employee's account and the investment earnings on the accumulated funds.

3.7 All the Province's sponsored pension plans are defined benefit except for the part-time and seasonal employees.

Scope

3.8 The Auditor General Act states that the Auditor General shall audit on behalf of the Legislative Assembly and in such a manner that he considers necessary the accounts of the Province relating to:

- the Consolidated Fund
- all public property, and
- all trust or special purpose funds.

3.9 The audits of pension plans fall within our responsibilities in two ways.

- As mentioned earlier in the Report, the Auditor General Act requires us to examine the financial statements of the Province of New Brunswick (referred to above as the Consolidated Fund) and express an opinion as to whether they fairly present the information in accordance with the stated accounting policies of the Province. In conducting the associated audit work it is necessary to examine many aspects of the operations of the pension plans. Evidence of this can be seen by examining the level of detail supplied in Note 13 to the Province's audited financial statements.

- The Province holds the pension plans in trust. As trust funds of the Province, we have determined that it is necessary to perform audit work on each of these plans.

3.10 We have comments and observations arising from our responsibilities as auditor of both the Province's financial statements and the pension plans. This chapter includes our comments on the pension information included in the Province's financial statements and our comments to the Department of Finance arising out of the pension plans audits.

Results in brief

3.11 The pension liability for accounting purposes has declined from $1,645.7 million in 1993 to $1,251.8 million in 1997.

3.12 The actuarial liability for the Province's pension plans has declined from $1,292.5 million in 1993 to $189.7 million in 1997.

3.13 In the past five years the pension expense recorded by the Province has fallen from $154 million to $18.2 million.

3.14 The Province's pension valuation committee decided the period between actuarial valuations for pension plans will not exceed three years.

3.15 The pension plans may not be in accordance with the Income Tax Act.

3.16 The Department agreed to improve disclosure practices for pension plan administration expenses.

3.17 The Department has agreed that budgets should be prepared for administration costs charged to the pension plans.

3.18 There should be improvements to the accounting for administration costs and how they are charged to the pension plans.

Actuarial valuations

3.19 The Province's pension obligation results from a promise to provide pensions to employees in return for services. The employees' entitlement to pensions is earned over the term of their employment. When the assets of a pension plan do not equal pension obligations, the difference is called the pension liability or pension surplus and it is calculated through an actuarial valuation.

3.20 The Canadian Institute of Chartered Accountants defines an actuarial valuation as follows:

> *... an assessment of the financial status of a pension plan. It consists of the valuation of assets held by the fund and the calculation of the actuarial present value of benefits to be paid under the plan. The valuation results in a calculation of the required future contributions and the determination of any gains or losses since the last valuation.*

3.21 The valuation provides the information needed to determine the pension liability or surplus and related pension expenditures.

3.22 Actuaries utilize several sources of information in arriving at the estimated surplus or liability at the valuation date. Included are historical government payroll records, government assumptions affecting the future revenue and expenditure of the funds and information available to the actuaries, for example the life expectancy estimates of contributors.

3.23 Each time a valuation is conducted, a new estimate of the plan's liability or surplus is prepared. There are a number of key assumptions which can result in major changes to the liability or surplus. The Province's financial statements list four of the assumptions: rate of return on fund assets, annual wage and salary increases, inflation and rate of pension payment escalation. There are other assumptions that are considered such as mortality rates, retirement ages, percent of members married and rates of employment terminations.

Understanding the liability

3.24 Readers of the financial statements are faced with some rather complex concepts in the area of accounting for pensions. One that is worthy of discussion is the difference between the actuarial pension liability and the pension liability for accounting purposes.

3.25 In the financial statements the focus is primarily on the liability for accounting purposes. However, if the reader is interested in the funding plans for the liability, the focus would be on the actuarial liability since it represents the shortfall in the value of pension fund assets below accrued pension benefits at a point in time.

3.26 Both liability figures are based on results of actuarial valuations and they are very much interrelated. It is important, however, to use them in the proper context. As auditors we refer most often to the liability for accounting purposes. What makes this value different from the actuarial liability is that there is a delay before the liability for accounting purposes recognizes any increase or decrease in the amount of the actuarial liability.

3.27 For example, if a new actuarial valuation is completed and it indicates that the liability is only one half of what was originally estimated, the liability for actuarial purposes falls immediately to the revised level. For accounting purposes, however, such a treatment is not correct. By their nature, pension liabilities, as estimates, are prone to upward and downward adjustments. Because of this tendency, adjustments are not recognized all at once. Rather, they are recorded over a reasonable period of time. If this was not the case then it would be possible to have a huge increase or decrease in expenditure in the year of the new estimate of the liability. This could confuse and mislead users of the financial statements.

3.28 The end result of applying the accepted accounting practice for pension liabilities is to smooth the recognition of the adjustments. This considers the fact that the amounts are estimates, not certainties.

Changes in the year

3.29 The pension liability for accounting purposes has fallen from $1,386.4 million at the beginning of the 1996-97 year to $1,251.8 million at year end.

3.30 The 1997 financial statements disclose the pension liability for accounting purposes in two components. One component represents the adjustments to be recognized in the future ($1,062.1 million). The other component ($189.7 million) is the excess of the accrued pension benefits over the value of the assets held in the funds at year end (also known as the actuarial pension liability).

Declining pension liabilities

3.31 Increases and decreases to the pension liability for accounting purposes are the result of the combined impact of the pension expense and the employers' contributions each year. Pension expense, which represents the current service cost and any amortization of prior years' adjustments, will increase the liability for accounting purposes. Any contribution by the Province will reduce the liability. In 1996-97 the pension expense was $18.2 million. Employer contributions were $152.8 million resulting in a reduction of $134.6 million in the pension liability for accounting purposes.

3.32 The following exhibit shows the declining pension liability for accounting purposes recorded in the financial statements for each of the past five years. It also shows the components of the liability at each year end. The figures used are those previously published for the respective years. They have not been restated for subsequent changes due to new valuations or changes in accounting policies.

Exhibit 3.1
Components of pension liability
(millions of dollars)

	1997	**1996**	**1995**	**1994**	**1993**
Estimated accrued benefits	4,918.7	4,679.7	4,374.3	4,339.0	4,137.3
Less: Value of assets	(4,729.0)	(4,257.0)	(3,701.5)	(3,403.1)	(2,844.8)
Actuarial pension liability	189.7	422.7	672.8	935.9	1,292.5
Plus: Unamortized adjustments	1,062.1	963.7	794.9	650.2	353.2
Pension liability for accounting purposes	**1,251.8**	**1,386.4**	**1,467.7**	**1,586.1**	**1,645.7**

3.33 There has been a steady decline in the pension liability for accounting purposes from $1,645.7 million in 1993 to $1,251.8 million in 1997. During this time, the value of assets increased by 66.2% while the estimated accrued benefits rose by only 18.9%.

3.34 A continuation of special contributions by the Province to the Public Service and Teachers' Pension Plans have accelerated the increase in the value of assets.

3.35 The adjustments made to actuarial assumptions adopted in previous actuarial valuations have reduced pension expense recorded today and into the future. Adjustments to the estimated accrued benefits are being amortized over periods of up to twenty-one years. Despite the fact the adjustments are amortized each year, the level of the unamortized balance (the amount to be amortized in future years) has increased in each of the past five years. It has risen from a zero balance in 1992 to $1,062.1 million at the end of the 1996-97 year. The following exhibit shows how the balance has grown.

Exhibit 3.2
Unamortized pension adjustments
(millions of dollars)

	1997	1996	1995	1994	1993
Opening balance	963.7	794.9	650.2	353.2	-
Adjustments for the year					
Plan amendments	-	(30.5)	(13.9)	-	-
Experience gains	172.4	274.1	-	258.3	377.8
Actuarial assumptions	4.0	-	215.6	85.7	-
Less: Amortization for the year	(78.0)	(74.8)	(57.0)	(47.0)	(24.6)
Changes in the year	98.4	168.8	144.7	297.0	353.2
Closing balance	**1,062.1**	**963.7**	**794.9**	**650.2**	**353.2**

3.36 Annual amortization has gone from $24.6 million in 1993 to $78.0 million in 1997. The cause of this increase can be seen clearly in the adjustments for each year.

3.37 The majority of the adjustments result from experience gains. Experience gains or losses result when the planned performance and the actual results differ. As demonstrated by the experience gains shown in Exhibit 3.2, the recent results have been much more favourable than anticipated in the actuarial assumptions. The other major component in the adjustments is the impact of changes in actuarial assumptions from those used in previous periods.

Pension expense is declining

3.38 Changes to the actuarial pension liability are ultimately reflected in the pension expense through the amortization of the adjustments. The following exhibit shows the pension expense for the past five years. The amounts for 1993 and 1994 have been restated on a basis consistent with that used from 1995 to 1997.

Exhibit 3.3
Pension expense
(millions of dollars)

	1997	1996	1995	1994	1993
Employer's share of pension benefits earned	78.7	82.2	57.8	66.8	85.3
Plus: Pension interest cost	25.3	41.0	45.6	73.8	100.0
Less: Amortization of adjustments	(78.0)	(74.8)	(57.0)	(47.0)	(24.6)
Less: Crown agency special payments	(7.8)	(7.5)	(7.3)	(7.1)	(6.7)
Pension expense	**18.2**	**40.9**	**39.1**	**86.5**	**154.0**

3.39 This exhibit shows the components of the pension expense recorded in the Province's financial statements. It is composed of the employer's cost for the year using the actuarial assumptions, the interest on unfunded amounts, the amortization of adjustments and a reduction for special payments by certain Crown agencies.

3.40 Significant amortization adjustments were recorded in the past four years. Dramatic decreases in pension expense resulted during this period, falling from a level of $154 million in 1993 to $18.2 million in 1997.

3.41 Pension expense has decreased by $22.7 million from last year. This is primarily because of the decrease in the expenses of the Teachers' Plan by $13.6 million and the early retirement program by $7.5 million.

Timing of future actuarial valuations

3.42 The Canadian Institute of Chartered Accountants (CICA) recommends that "actuarial valuations of pension obligations for accounting purposes should be done at least once every three years."

3.43 Last year we were informed that the pension valuation committee composed of senior government officials was addressing the issue. We have since been notified that the valuation committee passed a motion which states that the period between actuarial valuations will not exceed three years.

3.44 Department of Finance officials have informed our Office that a full actuarial valuation will soon be completed for each of the following funds:

- Public Service Superannuation Plan
- Teachers' Pension Plan
- Pension Plan for CUPE Employees of New Brunswick Hospitals
- Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Boards
- Pension Plan for Secretarial and Clerical Employees of New Brunswick School Boards
- Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals

Disclosure of surpluses and liabilities in the Province's financial statements

3.45 The Province's financial statements report the total actuarial pension liability to be $189.7 million. This balance is a net amount made up of actuarial surpluses and deficits. Three plans and the early retirement/workforce adjustment program have an accumulated pension liability of $307.2 million. The remaining five plans have an accumulated pension surplus of $117.5 million.

3.46 There is currently no CICA standard dealing specifically with the netting of the surpluses and the deficits. A recent CICA proposal states "unless an entity clearly has the right to use the assets of one plan to pay benefits of another, a liability required to be recognized for one plan would not be reduced or eliminated because another plan has assets in excess of its accrued benefit liability."

Observations arising from our audits of pension plans

3.47 During the 1996-97 year a number of issues were raised with the Department of Finance. These issues resulted from the completion of the pension plan audits relating to the Province's year end of 31 March 1996.

Purchase of prior years' service

3.48 Records for the purchase of prior service are maintained with a local administrator. We tested six clients for purchase of prior years' service; three where purchase of service was made directly through the administrator and three through payroll deduction.

3.49 One case was noted where the wrong historical salary figure was used which resulted in an incorrect calculation being performed.

3.50 One case was noted where there was no salary figure in the file to support the contribution calculation.

3.51 There was no evidence of a properly approved application in any of the three cases involving payroll deductions.

Recommendation

3.52 The Department should implement procedures to ensure the administrator is keeping sufficient appropriate audit evidence to support the calculation of prior service purchase costs.

Departmental response

3.53 *The two plans which the administrator handles will be repatriated to the Public Service Employee Benefits Branch (PSEBB) in 1998. As a result, this branch will be in a position to administer these plans in accordance with the procedures now in place for the other plans.*

Compliance with the Income Tax Act

3.54 Board of Management approved amendments to the following pension plans:

- Pension Plan for CUPE Employees of New Brunswick Hospitals;
- Pension Plan for Management Employees of New Brunswick School Boards;
- Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Boards; and
- Pension Plan for Secretarial and Clerical Employees of New Brunswick School Boards.

3.55 This was subject to approval by pension committees or collective bargaining. The amendments were designed to ensure the plans comply with the Income Tax Act. The plan amendments covered the following major areas:

- maximum pension for post 1991 pensionable service;

- maximum employee contribution;
- periods of reduced pay and temporary absences;
- permissible employer contributions;
- reciprocal transfer agreements;
- unreduced early retirement; and
- superseding of the Income Tax Act.

3.56 Our concern is whether the plans are in compliance with the Income Tax Act in all respects. According to documentation provided by the Department, failure to comply with the Income Tax Act could result in the revocation of the federal registration of these pension plans.

3.57 During the audit we were not able to obtain the current plan documents for all the pension plans and thus were unable to ensure the necessary changes were made to the plan documents.

Recommendations

3.58 The Department should review the pension plans to ensure all the plan documents are in compliance with the Income Tax Act.

3.59 The Department should ensure the administration of the pension plans is in accordance with the Income Tax Act.

Departmental response

3.60 *Plan documents are currently being reviewed to reflect many changes, including those required as a result of the Income Tax Act. Non-legislated plans will all be updated by December 1997, pending pension committee's approval. Legislated plans will be modified as per the schedule of the Legislature.*

Refunds

Interest on refunds – Public Service Superannuation Plan and Teachers' Pension Plan

3.61 Test results indicated an error in the program logic that caused interest to be understated for certain individuals receiving refunds for the Public Service Superannuation and Teachers' Pension Plans.

3.62 We notified the Benefits Branch of the error. It is our understanding they have since identified the individuals affected and rectified the problem. We have performed no further work to identify the contributors involved or to ensure the error in the program logic was changed.

Recommendation

3.63 There should be procedures in place to ensure systems updates are not being made before they are properly tested.

Departmental response

3.64 *As noted in your letter, PSEBB has rectified the error in the program logic which caused interest to be understated for certain individuals receiving refunds for the Public Service Superannuation and Teachers' Pension Plans. In addition to the correction, the branch is taking measures to prevent the reoccurrence of such an error in the future, including the purchase of new software which will enhance the ability to conduct testing on the program logic. Due diligence will be used in the meantime.*

Update on comments from last year

3.65 Last year we reported a number of errors found in the refunds tested in the Public Service, Teachers'and Judges' Pension Plans. We are pleased to report that in the testing conducted this year pertaining to all the plans, we did not discover any errors of the same type.

Administration expenses

3.66 Exhibit 3.4 summarizes the disclosure of expenses appearing on the financial statements of the pension plans. For the purpose of this section these costs have been collectively referred to as administration expenses.

Exhibit 3.4
Pension plan financial statement disclosure
Administration expenses
Years ending 31 December 1995 and 31 March 1996
(thousands of dollars)

	Public Service	Teachers'	Judges'	Hospitals CUPE	Schools Management	Schools G.L.T. & S.	Schools S & C	Total
General administrative expenses	2,022.5	1,278.1	-	555.7	21.7	166.8	51.4	4,096.2
Custodial fees				80.8				80.8
Performance measurement fees				14.0				14.0
Investment management fees				280.9				280.9
Investment management and custodial fees					45.1	217.6	48.7	311.4
Total	**2,022.5**	**1,278.1**	**-**	**931.4**	**66.8**	**384.4**	**100.1**	**4,783.3**

Financial statement disclosure

3.67 Administration expenses were recorded in a number of ways in the financial statements of the pension plans. For example in the Public Service Superannuation Plan there was a one-line disclosure for all of the administration expenses, which includes fees for custodial, performance measurement and investment counsel as well as an allocation of Benefits Branch expenses, Pensions and Insured Benefits Administration system (PIBA) expenses and Department of Finance (now New Brunswick Investment Management Corporation) expenses.

3.68 The Pension Plan for CUPE Employees of New Brunswick Hospitals, on the other hand, provided separate financial statement disclosure for custodial fees, performance measurement fees, investment counsel fees and other administration fees.

3.69 Exhibit 3.4 indicates the inconsistency in the disclosure of similar types of expenses.

3.70 The CICA suggests disclosure of the details of administration expenses showing actuarial fees, trustee and custodial fees and investment management fees.

Recommendation

3.71 The Department should review the disclosure practices for the administration expenses. In our opinion expenses should be disclosed by major expenditure types on a consistent basis for all plans.

Departmental response

3.72 *As suggested by the CICA, more detailed disclosure for administration expenses will be provided for the statements. The disclosure will be consistent among all the plan financial statements.*

Charging out the costs of running the PSEBB

3.73 Not all expenditures of the Public Service Employees Benefits Branch are recoverable from the pension plans. There are some expenditures which, because of their nature, are only partly recoverable. For example, the salary of the director and some of the managers of the Branch are two thirds recoverable from the pension plans with the remaining one third absorbed by the Branch.

3.74 It is our understanding that this arrangement has been in existence for a number of years. During these years there have been changes at the Benefits Branch. It has come to our attention that the Branch is in the process of reviewing these allocations as a result of these changes. It is our opinion that such a review is very timely.

Recommendation

3.75 The Department should conduct a review of expenses being allocated to the pension plans to ensure that the costs which are charged are reasonable for the services being provided.

Departmental response

3.76 *Public Service Employee Benefits Branch is in the process of reviewing the allocation of expenses to the pension funds with the idea of implementing an approach that will provide additional structure to the charge-back process.*

3.77 Benefits Branch expenses and expenses relating to the PIBA computer system are being allocated to the plans based on the total number of contributors and pensioners. For the plans with 31 March 1996 year ends the allocation was based on data at 31 March 1994 and for 31 December 1995 year ends the allocation was based on data at 31 December 1993.

Recommendation

3.78 The Department should be using up-to-date and accurate information as a basis to allocate the expenses to the pension plans.

Departmental response

3.79 *The rates used will be based on the number of contributors and pensioners in each plan at the beginning of our fiscal year. We are currently improving our computer system to provide this information as accurately and timely as practical.*

Administration expense - accountability

3.80 Accountability has been defined as the obligation to answer for authority and responsibility that has been conferred. Accountability relates to two main functions, namely financial stewardship and performance reporting. An important part of the financial stewardship function is the process of monitoring expenditures.

3.81 One method of monitoring expenditures is to compare budget and actual expenditures. Currently the area of monitoring administration expenditures is weak. The main reason for the weakness is the fact there is no budget prepared to outline the administration expenditures expected for each of the pension plans. This weakness is compounded by the fact that the financial system does not report the types of administration expenses incurred.

Recommendation

3.82 A budget should be prepared for the administration costs charged to each pension plan. The Department should be prepared to explain differences between planned and actual charges to the plans.

Departmental response

3.83 *PSEBB will be implementing a system of global budgeting by pension plan for the budget year 1998-99. These budgets will be presented to the respective pension committees. We are proposing that we also report actual expenses compared to budgeted to these committees.*

Accounting records for administration costs

3.84 It is normal practice for the Benefits Branch to incur expenditures on behalf of the pension plans. Expenditures are first paid by the Branch and then allocated to the various pension plans. For example, for non-payroll expenditures, staff at Benefits Branch code each expenditure and staff in accounting calculate the charges to each individual pension plan. Discussions with both parties indicate that this practice of coding and calculating takes a great deal of time and effort.

3.85 From an audit perspective this system presents a challenge as it is extremely difficult to determine if all expenditures initially recorded as being that of the Benefits Branch have been charged to the pension plans. This problem is compounded by the fact that the pension plans have either a 31 December or a 31 March year end.

Recommendation

3.86 The Department should prepare a reconciliation between PSEBB gross expenditures and the amount charged to pension plans at 31 March and 31 December to ensure that the financial statements for the pension plans accurately reflect the expenditures.

Departmental response

3.87 *PSEBB will advise the appropriate parties of the coding required in order to achieve accurate reporting in a more efficient manner. A reconciliation between PSEBB gross expenditures and amounts charged to the pension plans is difficult given the two different pension plan year ends. However, a reconciliation will be attempted for 1997-98.*

Results of testing administration expenses

3.88 There were a number of errors discovered during the audit of administration expenses of the Public Service and Teachers' Plans. Adjustments of approximately $142,000 (net understatement $14,600) for the Public Service Plan and $199,800 (net understatement $199,800) for the Teachers' Plan were made to the financial statements.

3.89 There were several causes of the errors:

- Expenses were recorded in the wrong year. Not all the expenses associated with the Special Operating Agency (SOA), which later became the New Brunswick Investment Management Corporation, were accumulated at 31 March 1996. This resulted in an understatement of approximately $26,900 for the Public Service Plan and $28,300 for the Teachers' Plan.

- Salaries of staff transferred to the Special Operating Agency for the period 1 April 1995 to 31 July 1995 were not allocated to the plans. The result was an understatement of approximately $51,400 for the Public Service Plan and $39,500 for the Teachers' Plan.

- PIBA expenditures for the month of February 1996 were not set up in the Teachers' Plan. This caused an understatement of $68,300.

- Expenses were charged to the wrong plan. There was an overstatement error of approximately $63,700 caused by expenses being charged to the Public Service Plan when they belonged to the Teachers' Plan.

Recommendation

3.90 The Department should take the necessary steps to ensure administration costs are recorded in the correct year and properly charged to pension plans.

Departmental response

3.91 *A number of the errors noted were related to expenses of the SOA during 1995-96. The transfer of the assets for the Public Service and Teachers' Plans to New Brunswick Investment Management Corporation has been completed and these errors will not reoccur. The other errors detailed have been noted and steps have been taken to ensure administration costs are properly recorded.*

Agreement for custodial charges

3.92 On a monthly basis the custodian for the Pension Plan for Secretarial and Clerical Employees charges the plan with custodial fees. The Department could not provide us with a signed copy of the agreement with the custodian outlining the charges. The Department does not obtain invoices or receive details outlining charges to the plan.

Recommendation

3.93 The Department should have a signed agreement with the custodian concerning the custodial charges. The Department should request supporting documentation for invoices detailing the monthly charges.

Departmental response

3.94 *Presently a new agreement and fee schedule are being negotiated with this custodian for the Plan for Secretarial and Clerical Employees. In* *the meantime the fund was being billed using the fee schedule for the Plan for CUPE Employees of New Brunswick Hospitals as agreed by the custodian and the Department of Finance.*

3.95 *For 1997, custodial billing responsibilities will be transferred from the New Brunswick office to an out-of-Province office. The custodian will be billing on an actual basis for each quarter and will be providing improved supporting documentation for departmental and audit purposes.*