**September 22, 2016**

**MEMORANDUM**

**TO:** CPA Firms Who Audit TCRS Employer Pension Information



**FROM:** Jerry E. Durham, CPA, CGFM, CFE

Assistant Director

Division of Local Government Audit

**SUBJECT:** 2016 TCRS Pension Audit Update

This memo is intended to provide information and instructions you should find useful when auditing pension information at the employer level under GASB 68, GASB 71, GASB 73, GASB 78, and GASB 82. I have waited to provide this information because we only received word from TCRS this past week that all the required data from TCRS is complete. **Please forward this memo to those in your office who may be directly interested.**

1. This is the first memo to be sent for the fiscal year ended June 30, 2016. However, the memos that were sent out last year relating to census data testing are still accurate for the current year. Current year memos will be posted and prior year pension memos can be found on our website at [www.comptroller.tn.gov/la/Pensions.asp](http://www.comptroller.tn.gov/la/Pensions.asp) .
2. The question I am asked most often is, “when will we receive the necessary opinions from State Audit to complete our workpapers?” The short answer is, we do not know. State Audit is waiting on information from TCRS that will allow them to finish their work. We believe the timeframe will be within the next three weeks. We realize you are holding audits waiting for these opinions and other information. Our office is waiting as well. The information includes:
   1. State Audit’s workpapers related to the Work of a Specialist for TCRS’s Actuary **(Available now, see number 4 below.)**
   2. Examination Engagement for Inactive and Retiree Census Data (i.e. Census Data maintained by the Plan) **(Available now, see number 5 below.)**
   3. Opinion on the Schedule of Changes in Fiduciary Net Position by Employer for Agent Employers.
   4. Opinion on Schedule of Employer Allocations for Cost-Sharing Employers.
   5. Opinion of Schedule of Pension Amounts for Cost-Sharing Employers.
3. While the above information is not yet available, no matters have surfaced that would indicate specific problems with the overall conclusions about these matters. This knowledge may allow you to proceed with financial statement preparation if you are at that stage of completion. However, auditors should ***not*** issue opinions on financial statements until the opinions from State Audit are issued and other information is available in final form. In addition, your workpapers should ***not*** be considered complete unless the above information has been considered and related to the employer financial statement opinions. Auditors should include the above information in their audit documentation and internally reference these documents to financial reports. The information provided by the Actuary in the Actuarial Report should be traced to the Notes, Journal Entries, and RSI provided by TCRS. It would be very easy for TCRS to have made errors when transferring information from the Actuarial Report to the Notes, Journal Entries, and RSI. Each government covered under an agent plan will have its own unique Actuarial Report for each separate plan. Governments covered under the Cost-Sharing plans will only have one collective Actuarial Report.
4. State Audit’s workpaper conclusion related to the Work of a Specialist will be posted on Local Government Audit’s website next week. **It is attached with this memo for your convenience.**
5. State Audit’s Opinion on Census Data for Political Subdivisions and State Government is already on the TCRS website at <https://publicreports.treasury.tn.gov/> . This opinion dated August 19, 2016, relates to the census data for the plans including inactive and retirees. The same report was dated September 22, 2015 last year.
6. The Employer Responsibilities Memo that deals with employer responsibilities under the AICPA Whitepapers is complete. The template memo should be posted on Local Government Audit’s website next week. **It is also attached with this memo for your convenience**.
7. The necessary Actuary/TCRS financial statement information (Journal Entries, Notes to Financial Statements, and RSI) is currently available on the TCRS website [www.treasury.state.tn.us/tcrs](http://www.treasury.state.tn.us/tcrs) for most entities under the description “GASB 68 Information” on the left side of the page. When this site is opened, click on Public Reports. You can search for your particular entity by name or account number. The large searchable PDF files utilized by TCRS last year ***no*** longer exist.
8. Information is provided for individual Charter Schools this year. Information for the Achievement School District (ASD), as a whole, is presented on TCRS’s website at <https://publicreports.treasury.tn.gov/Home/LEA> . Detailed information for individual ASD Schools is currently ***not*** available. However, TCRS has prepared a breakdown of contributions for the individual ASD Schools. The ASD contributions information will be available on Local Government Audit’s website next week. **It is also attached with this memo for your convenience.**  CPAs may use this breakdown to prepare Journal Entries, Notes to Financial Statements, and RSI for the individual schools.

If you have questions about Actuary/TCRS reported entries or entities you should contact TCRS directly. The best contact at TCRS is Mary Collins, Manager of Employer Pension Accounting, at [Mary.Collins@tn.gov](mailto:Mary.Collins@tn.gov) or 615.770.1744.

***Please Note:*** **The Division of Local Government Audit did not prepare the Journal Entries, Notes to Financial Statements, RSI, etc. and in most cases does not have answers about missing entries or entities.**

1. The Actuary/TCRS information should include the following. This information should be located at each entity’s account site except for the Actuarial Certification and Actuarial Report for the LEA Cost-sharing Plans which is located at accounts 90000 and 90001.
2. Actuary Certification Letter
3. Actuarial Report
4. Journal Entries for recording Net Pension Asset/Liability, Deferrals, and Pension Expense.
5. Notes to Financial Statements
6. RSI and Notes to RSI

Auditors should include the above information in their audit documentation and internally reference these documents to financial reports and other workpapers.

1. There is a new state mandated hybrid pension plan for all LEA’s in existence for the year ended June 30, 2016. There could be hybrid pension plans for Agency Plans as well, but these are not mandatory. Notes to the financial statements should be provided separately for all pension plans. The TCRS information for the LEA Hybrid Plan was placed on TCRS’s website for use by CPA firms, but was subsequently revised on September 13, 2016. The main thing that changed was the RSI relating to Contributions. **So, if you finished audit work before September 13, 2016** for a given school, you should make sure the information has not changed. In addition, TCRS has informed us that the 2016 Contractually Required Contribution amount for the Teacher Hybrid Plan can be calculated by multiplying the Covered (i.e. Pensionable) Payroll by 2.5%. The Contribution in Relation to the Contractually Required Contribution is 4.0% of Covered (i.e. Pensionable) Payroll. The 2016 “Contribution as a Percentage of the Covered Payroll” is 4.0%. You will need this information to complete the RSI schedules for contributions for the LEA Hybrid Plan.
2. Remember, for most LEA pension plans, there is a cost-sharing component for teachers and agency component for non-teacher employees.
3. Several governments will have a net pension **asset** rather than a net pension **liability**. Also, several governments will have the equivalent of “**pension income”** rather than **pension expense**. Even though GASB has not addressed this in Statement 68 or subsequent amendments to 68, GASB has informally advised that using the description “*Pension Income*” is not correct. The description that should be used is “*Negative Pension Expense*”. Negative Pension Expense should be reported with expenses rather than income. **Please note**, this is different from the advice I included in this memo last year. GASB has clarified its guidance. Some governments that had Negative Pension Expense (i.e. Pension Income) last year may have a Pension Expense this year.This is mainly because of a lower rate of return on TCRS investments during the current fiscal year.
4. TCRS has grouped individual plans for each government differently in many cases. For example, one plan, let’s say plan account 80777, may include, employees of a discretely presented component unit, nonprofessional employees of the School Department, employees of an enterprise fund, and employees of the general government. Therefore, TCRS would report combined Census Data for all the employees under plan 80777. This creates various allocation and census data testing problems for Auditors. If different Auditors are performing the audits of the primary government and the component unit included in plan 80777, they will need to communicate about the allocations similar to the methods described for Counties in **Number 14** below.
5. **IMPORTANT NOTE:** In a situation such as described in **Number 13** above, the Division of Local Government Audit will continue to provide CPA Firms that audit stand-alone financial statements of Component Units or Enterprise Funds (e.g. Utilities) related to **County Governments** with an allocation of Net Pension Asset/Liability, Deferrals, and Pension Income/Expense. This way our numbers will agree between the Primary Government, Enterprise Funds, and Component Units. This year we plan on using contributions to allocate pension costs. Obviously, this only applies to the 89 counties that are audited by the Division of Local Government Audit. If you are involved with an entity that meets the criteria in **Number 13** above, and you are preparing stand-alone financial statements for a Component Unit or Enterprise Fund of a **County Government**, please contact your Regional Office of the Division of Local Government Audit so we can forward the necessary allocations. Unfortunately, there may be a situation, whereby the Division of Local Government Audit is unaware of an entity that is included in with census data of the general government. This would skew the allocations. We will deal with those situations if and when they occur.
6. **IMPORTANT CHANGE FROM LAST YEAR:** Last year, the RSI ten year tables used the terminology “Covered-Employee Payroll”. This is not the same as “Covered Payroll” (sometimes known as “Pensionable Payroll”). See GASB’s *Guide to Implementation of GASB Statement 68 on Accounting and Financial Reporting for Pensions,* **Question 106**. However, GASB has now issued Statement 82 to further clarify its intentions. Statement 82, paragraphs 5 and 6 address the use of the term “covered payroll” and paragraphs B4-B6 explain the difference between “covered-employee payroll” and “covered payroll.” The effective date for Statement 82 for paragraphs 5 and 6 is for periods beginning after June 15, 2016. **The Division of Local Government audit intends to encourage our clients to early implement paragraphs 5 and 6 and use “covered payroll” as a measure for the ratios presented in RSI. We encourage CPA firms to do the same with their clients.**
7. When testing census data, I would encourage CPA Firms to select the Accuracy Sample, and then provide the sample to the government. Ask the government to provide the required Census Data evidence for each employee in the Accuracy Sample. This will save Auditors considerable time. Remember, we are testing data from July 1, 2014 through June 30, 2015. In addition, only salaries for that one year and service credits for that one year are required to be examined.
8. **IMPORTANT CHANGE FROM LAST YEAR:** TCRS intends to provide a list of contributions after the measurement date for each TCRS account. However, this information is currently **not** available. Therefore, until TCRS provides information for contributions after the measurement date, auditors will need to manually obtain the amount of contributions made between the measurement date of June 30, 2015 and the report date of June 30, 2016 just as we did last year. Contributions will more than likely be presented in one account even though the contributions may apply to more than one type of pension plan. For example, contributions at a Local Education Agency (LEA) may include contributions for the non-professional employees (Agent Plan) and the professional employees (Teachers – Cost-Sharing Legacy and Hybrid Plans). The different types of contributions should be segregated by plan for reporting purposes. We recommend asking the employer to provide the segregated amounts. Going forward, it would probably be good for employers to have different contribution accounts for each plan.

On a different but related matter, employers that have other than June 30 year-ends will only include contributions between the measurement date and their year-end date. For example, for an entity with a December 31, 2015 year-end, auditors would only include six months of contributions after the measurement date of June 30, 2015.

1. As a follow-up to number 17 above, it may be the case that TCRS provides contribution numbers that do not agree with client records. This will normally be because of the way TCRS accrues contribution payments. For example, contribution payments made during the first month of any fiscal year (i.e. July) represent payments from the prior year’s billings for purposes of TCRS accounting. Adjustments may have to be made by auditors to reconcile client contributions and TCRS contributions. This is also true for contributions reported during the measurement year (i.e. July 1, 2014 to June 30, 2015). Contributions you calculated after the measurement date of June 30, 2014 may not agree with TCRS reported contributions.
2. Employers will need to decide whether or not pension expense should be booked for each department (Enterprise Funds). In addition, on the Statement of Activities at the government-wide level, pension expense should be allocated between functions using some logical approach.
3. The Division of Local Government Audit is not aware of any “Special Funding Situations” as defined by GASB 68. However, if a Primary Government is making contributions to TCRS for a Component Unit, the Component Unit likely should record an “On-Behalf Payment” transaction as described in GASB 24.
4. CPA Firms are again encouraged to read GASB 68, paragraph 18, and related Implementation Guide Questions 33, 34, and 35 for Agent Plans. Stand-alone financial statements of a component unit that is included in the primary government’s agent plan, should present Cost-Sharing notes rather than agent notes. This will cause considerable effort for CPA Firms reporting on the stand-alone financial statements of a component unit. If possible, the component unit needs to ask TCRS to set up its own account to avoid this situation in the future.
5. Census data testing workpapers for **Agent Plans** should be maintained by the CPA Firm in its workpapers in support of the Pension Asset/Liability, Deferrals, and Pension Income/Expense.
6. ***However*, the Census Data testing workpapers for the Cost-Sharing Plans should be forwarded to the Division of Local Government Audit in support of the Division of State Audit’s Opinion on the overall Cost-Sharing plans. The Division of Local Government Audit will collect these workpapers; form an overall purpose, source, and conclusion; and provide this information to the Division of State Audit. *The entities selected for testing this rotation are Gibson County School District, Lenoir City Schools, and Metropolitan Davidson/Nashville Schools.* If you are auditing these schools you have extra responsibility. All other auditors have no responsibility to test census data for the Cost-Sharing Plans.**
7. **IMPORTANT CONTINUING ISSUE:** Certain Component Units and Utilities have fiscal year end dates that are not June 30(e.g. September 30). The TCRS valuation and measurement date for local government employers is June 30. GASB 68 requires that the measurement date be **no more than one year** from the reporting date. This works perfectly for entities that report on a June 30, 2016, year-end. Unfortunately, because of this one year requirement, there is no ideal solution for reporting pension costs for entities that have a fiscal year end **other** than June 30. These entities will, at a minimum, experience long delays in publishing their financial statements. Auditors should also keep in mind the nine-month deadline for filing Single Audit reports. Some thoughts and suggestions that might be relevant are as follows:
8. The actuarial valuation and measurement date will always be June 30. This cannot be changed for employers under TCRS plans. If the employer has a year-end of July 31, August 31, or September 30, 2015 or 2016, there will be no way for this entity to utilize June 30, 2014 or June 30, 2015 actuarial measurements because of GASB’s one year requirement.
9. **Entities with other than a June 30 year-end should consider changing their year-end.**
10. An opinion could be issued as of June 30 regardless of the normal year-end.
11. The difference between September 30, 2015 or 2016 pension reporting and June 30, 2014 or 2015 measurement date reporting **might** not be **material**. Auditors will need to consider materiality and whether or not a modified opinion is required. Auditors must have a documented and reasonable basis for determining materiality. In our judgment, this is difficult if not impossible to do. The only way that seems plausible to us is to hire an actuary to perform additional work based on the June 30 TCRS information.
12. **FIDUCIARY RESPONSIBILITY:** Questions frequently arise about whether or not Pension Plan Financial Statements should be included in the Financial Statements of a particular government or component unit. The entire issue hinges on the concept of **Fiduciary Responsibility**. In our judgment, the best explanation of Fiduciary Responsibility can be found in a **GASB Exposure Draft** that is currently outstanding titled ***Fiduciary Activities***. While this document is not GAAP yet, it does give CPAs more guidance than is currently available anywhere else.Based on our conversations with GASB, the Exposure Draft describes what should already be current practice. The Division of Local Government Audit is in the process of writing a memo to explain how we view the concept of Fiduciary Responsibility. The memo should be finished sometime in October.

The Exposure Draft can be obtained at GASB’s website: <http://www.gasb.org/jsp/GASB/Document_C/GASBDocumentPage?cid=1176167745133&acceptedDisclaimer=true>

1. Even if a Fiduciary Responsibility exists, nothing in the previous paragraph is intended to prevent separate reporting for a Government and its Pension Plan (i.e. Trust Fund) provided adequate reporting and disclosures are made.
2. **IMPORTANT CONTINUING ISSUE:** We have received several questions about how Net Pension Assets should be presented in the Net Position Section of our Statement of Net Position. We have been in contact with GASB about this matter and have received the following, somewhat ambiguous, response. I should preface GASB’s response by saying that Local Government Audit views a Net Pension Asset as a restricted asset. GASB advised us to follow GASB 63.10 which requires netting of restricted assets and deferred **“inflows”** of resources. Deferred “outflows” would ***not*** be included. We then asked GASB about contributions after the measurement date and were again advised to follow GASB 63.10. We later received an unsolicited call back from GASB advising that GASB intends to address this issue in an Implementation Guide, at which time, GASB intends to recommend that a Net Pension Asset should be presented without netting either deferred inflows or deferred outflows. **Accordingly, Local Government Audit is presenting Net Pension Assets as a separate line (Restricted for Other Purposes) in the Restricted Net Position section without any adjustment for deferred inflows or deferred outflows.**
3. This memo only addresses employers who participate in TCRS pension plans.
4. Auditors should be aware of new GASB pronouncements. GASB Statements 73, 78, and 82 have been issued. Paragraph 4 of Statement 73 as it relates to *Assets Accumulated For Purposes Of Providing Pensions Through Defined Benefit Pension Plans That Are Not Administered Through Trusts,* is effective for years beginning after **June 15, 2015**. GASB Statement 78 is effective for calendar year entities for the **2016 calendar year**.
5. For your convenience, I have included excerpts of the December 16, 2014 memo related to testing census data beneath our contact information.

I have attempted to answer some of your questions in this memo. The best way to contact me about pension questions is by telephone. Please keep trying if I am not in. You may also contact Rachelle Cabading if I am not in. Feel free to contact us by email as well, but realize it takes a long time to communicate about pension questions by email because of the complexity of the subject matter.

Thanks to each CPA Firm for your continuing cooperation as we deal with this difficult implementation process. A new implementation issue surfaces almost daily. I apologize for the length of this memo, but given the complexity of the pension standards, I did not believe I had any other alternative. Our contact information is as follows:

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**From the December 16, 2014 Memo:**

***Audit Plan - Step 3***

*Testing of Census Data* - The Division of State Audit (State Audit), for purposes of local government employers, will utilize Option 2 in the Whitepaper. State Audit will perform an Examination Engagement on Census Data Maintained by the Plan. This Examination Engagement will cover TCRS assertions related to Census Data for **Inactive** and **Retired** TCRS members. The Examination Engagement will be made available to Contract CPA firms via Local Government Audit’s website. This means that CPA firms **will not** need to test Census Data for **Inactive** or **Retired** Employees.

CPA firms who audit local government employers **will be** involved in testing census data for **Active** TCRSemployees. This will involve a test for accuracy and a test for completeness. The Whitepaper mentions tests that auditors “may” perform, but the following tests are considered mandatory by Local Government Audit. These tests are designed to ensure that the employer’s Census Data, upon which the actuarial reports are based, is reliable for obtaining sufficient appropriate audit evidence about each element of Pension Costs. TCRS will provide Actuarial Census Data to each local government employer. This data should be utilized to select a sample for testing. CPA firms may also request their client’s to access the TCRS Concord System to obtain the Census Data that will be tested for accuracy. This is possible because State Audit will perform audit procedures to determine that the data agrees with Census Data submitted to the Actuary. So effectively, by using the actuarial census data provided or the Concord System, we are testing Actuarial Data to the employer’s accounting records. The census data will be tested for the period July 1, 2013 to June 30, 2014.

*Accuracy Test -*

1. Test the accuracy of following data elements for **Active** Employees: Name and Social Security Number (or other ID); Date of Birth, Salary reported for the one-year period; Service Credit reported for the one-year period; Retirement Code, Department Code, and whether the member is Male or Female. We believe these will provide a sufficient amount of audit evidence.
2. A sample of employees should be selected using a random or systematic approach. Employees hired after June 30, 2014, should be excluded from the sample.
3. Government Employers should be asked to locate and provide physical audit evidence to support the data reported for each employee selected for testing.
4. The sample should be selected in accordance with the AICPA’s March 2014 edition of the Audit Sampling Guide. In other words, this is a true sample not a test performed using auditor judgment.
5. The purpose, scope, source, and conclusion of the sample should be included in the audit documentation. The reason for all discrepancies should be documented if possible. If the **overall** test reveals that the Census Data is not accurate, CPA firms should notify Local Government Audit, write a detailed finding, and determine whether or not an Unmodified Opinion can be issued.

*Completeness Test –*

1. Another sample should be selected directly from the employer’s payroll records. Each employee selected should be tested back to the Actuarial Census Data provided by TCRS or to the TCRS Concord System through access provided by the employer. If any employee does not show up, the CPA firm should determine the reason (e.g. part-time, not eligible for TCRS).
2. The purpose, scope, source, and conclusion of the sample should be included in the audit documentation. If the **overall** test reveals that the Actuarial Census Data or the TCRS Concord System does not include all eligible employees, CPA Firms should notify Local Government Audit, write a detailed finding, and determine whether or not an Unmodified Opinion can be issued.