



CITY NUMBER:

MEMORANDUM

TO: TMRS participating municipality **FINANCE DIRECTORS** and your municipality's **EXTERNAL FINANCIAL AUDITOR**

RE: GASB Pension Standards and audit implications, including User Entity Controls

Executive Summary

- It is important that your city's Finance Director review and share this memo with your city's external auditor. This memo will also be posted on the TMRS "Eye on GASB" website page.**
- GASB Statement No. 68 (GASB 68), effective for fiscal years beginning after June 15, 2014, will now require your city to record a net pension liability (NPL) on your financial statements; additionally, your city will include disclosures as a participant in an agent, multiple-employer plan. For some cities, this liability will likely be a significant dollar amount and could be material for financial statement audit considerations.
- Many of the records and calculations necessary for your auditor to opine on the NPL and related disclosures are maintained only by TMRS, thereby requiring a coordinated approach in which TMRS' external auditor performs certain procedures and your auditor performs others. However, it will be your external auditor that will have the ultimate responsibility for expressing an opinion on the NPL for your city.

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[Executive Summary, cont.]

- Although auditing requirements have not been finalized, the AICPA is currently proposing that a Plan (TMRS) auditor be engaged to issue a Service Organization Control Report (SOC-1 report) that provides assurance that the appropriate internal controls were both in place and operating effectively during the reporting period.
- TMRS has been working with KPMG, LLP, and we are scheduled to begin our SOC testing for the 2014 calendar year. As part of this audit, TMRS will receive and share a report on our internal control processes, which the user entities (i.e., TMRS participating municipalities) will need to understand. Additionally, for the report to be of value to your city and your city's financial audit, you will need to ensure that certain user entity controls related to TMRS are in place and operating effectively at your entity. Your external auditor will be reviewing this SOC report to gain an understanding of TMRS' controls and processes. To enable your city's external auditor to place reliance on this report and the NPL ultimately recorded in your financial statements, your auditor will also assess the user entity controls in place at your city.
- As TMRS learns of any further developments by GASB and the AICPA relating to audit implications, we will continue to share them through our "Eye on GASB" section of the website.

GASB Pension Standards and Audit Implications, including User Entity Controls

Background:

In June 2012, the Governmental Accounting Standards Board (GASB) issued new pension accounting standards that will have a significant impact on TMRS and our participating municipalities. GASB Statement No. 67 *“Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25”* only impacts TMRS as a Plan or System. However, GASB Statement No. 68 (GASB 68) *“Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27”* will impact the financial reporting requirements for all TMRS participating municipalities.

To comply with GASB 68, cities will now be required to record a net pension liability (NPL) and pension expense in their financial statements. This liability will be calculated very differently from the current net pension obligation (NPO) that cities may currently record; the expense amount is also significantly different from the current calculation, which basically records the contributions amount remitted to TMRS. The expense number will likely be very volatile and could be significantly higher or lower than many cities have seen in the past. For more details about the calculations, please review GASB Statement No. 68 on the GASB website, www.gasb.org. In addition, TMRS provided some highlights of the liability and expense in the “Update on GASB Changes” presentation during the TMRS Annual Training Seminar (see “Eye on GASB” in the City Services section of the TMRS website to review this presentation).

Due to the recording of the liability and its likely significant dollar-amount, auditors have been studying and interpreting GASB 67 and 68 to determine proposed audit procedures. The American Institute of Certified Public Accountants (AICPA) is drafting recommended audit procedures that CPAs/external auditors will need to adhere to in order to meet the requirements needed to issue an audit opinion. With GASB 68, your city/external auditor will likely spend more time reviewing and understanding the pension liability and expense that you are recording in your financial statements.

TMRS has engaged KPMG LLP (KPMG) as the System’s external auditor. Over the past year, we have been working with KPMG to determine the audit implications of these new GASB pension standards. Through these efforts and under current interpretations of the AICPA, TMRS has determined that as a System, we need to provide assurances to your city/external auditors about the processes and controls in place at TMRS. As such, TMRS will be undergoing a detailed process and controls audit during 2014, resulting in a SOC-1 Type 2 report that you can provide to your auditor.

What is a SOC-1 Type 2 (“SOC-1”) report?

A SOC-1 Report (Service Organization Controls Report) is a report on the controls at a service organization (i.e., at TMRS, which services your city pension plan) which are relevant to user entities’ (i.e., TMRS participating municipalities) internal controls over financial reporting.

Statement on Standards for Attestation Engagements No. 16 (SSAE 16) is the authoritative guidance developed by the AICPA, which allows service organizations like TMRS to disclose our control activities and processes to our customers/cities in a uniform reporting format. The issuance of a report prepared in accordance with SSAE-16 indicates that the service organization has had its controls examined by an independent accounting firm; the report (SOC-1 report) which includes the auditor’s opinion, is issued to the service organization at the conclusion of the examination. TMRS has engaged KPMG LLP as the independent auditor to conduct an in-depth audit of our control objectives and control activities, which include controls over information technology and operational processes. **TMRS is planning to make our annual SOC-1 report available to participating municipalities via the TMRS City Portal.** If you are not currently using the City Portal, we strongly encourage you to do so. See the TMRS website or contact TMRS for information on signing up.

See the Appendix at the end of this letter for more details on SOC-1 engagements.

How does this SOC-1 report affect my city?

As part of this audit, TMRS will be required to provide KPMG with written descriptions of our systems, processes, and controls. KPMG will then attest to the fairness of the descriptions, indicate whether TMRS designed suitable controls to achieve the objectives stated, and determine the operating effectiveness of those controls.

Part of the controls identified by TMRS include certain additional controls that must occur first at the city level, called user entity controls. Many aspects of the pension processes here at TMRS are dependent on the processes that occur at your city. TMRS will need to provide these user entity controls in the narrative to KPMG, which will become a part of the SOC-1 report. For you and your respective city auditor to place reliance on the SOC-1 report, your city will need to ensure that you have these user entity controls in place during your fiscal year.

User Entity Controls (City Responsibilities)

The first TMRS cities to be affected by GASB 68 will be those cities with fiscal years ending June 30, 2015 (i.e., July 1, 2014 through June 30, 2015). TMRS plans to issue its first SOC-1 report in May, 2015, which will cover the 15-month period of January 1, 2014 through March 31, 2015.

TMRS has identified several control objectives to be included in the audit (so these control objectives are the responsibility of TMRS). More importantly, however, **within the control objectives listed below, we have identified key user entity controls that need to be in place at your city during your fiscal year** (these controls are the responsibility of the city), **to ensure that your city can rely on the conclusions/opinion issued in the final SOC-1 report.**

Control Objective 1 – Controls provide reasonable assurance that reporting of participant census to the TMRS outside actuary is complete and accurate.

User Entity Controls:

- a. Controls should be established to ensure city representatives (city correspondents) are authorized to create TMRS-16 forms for new member enrollment data.
- b. Controls should be established to ensure city representatives are responsible for determining if workers are “employees” under the TMRS Act and for providing employee eligibility data to TMRS.
- c. Controls should be established to ensure municipal representatives are responsible for maintaining plan documents.
- d. Controls should be established to ensure municipal representatives are responsible for ensuring all plan amendments (i.e., ordinances) are forwarded to TMRS in a timely manner.
- e. Controls should be established to ensure municipal representatives are responsible for providing TMRS with information that is accurate, complete, properly authorized (if applicable), and in accordance with plan guidelines.

Control Objective 2 – Controls provide reasonable assurance that contributions received from employers are completely and accurately posted to the employee and employer accounts in the proper period.

User Entity Controls:

- f. Controls should be established to ensure payroll amounts included in the TMRS-3 forms submitted to TMRS are complete and accurate.
- g. Controls should be established to ensure only appropriate municipal representatives are authorized to certify the Summary of Monthly Payroll Report (TMRS-3).
- h. Controls should be established to ensure that municipal representatives are responsible for the timely remittance of contributions to TMRS (by the 15th of the month).
- i. Controls should be established to ensure municipal representatives are responsible for providing TMRS updated personnel and payroll files as needed for the operation and maintenance of the plan.

- j. Controls should be established to ensure municipal representatives are responsible for notifying TMRS of any manual adjustments needed to the payroll files/TMRS-3 form.

Control Objective 3 – Controls provide reasonable assurance that distributions (i.e., partial lump sum distributions, refunds, and service retirements) are authorized and processed accurately, completely, and in a timely manner in accordance with employer plan provisions.

User Entity Controls:

- k. Controls should be established to ensure that only appropriate municipal representatives are authorized to certify the Application for Occupational Disability Retirement form (TMRS-150).
- l. Controls should be established to ensure that only appropriate municipal representatives are authorized to certify the Application for Retirement form (TMRS-15).
- m. Controls should be established to ensure that only appropriate municipal representatives are authorized to certify the Refund Application (TMRS-5).

Control Objective 4 – Controls provide reasonable assurance that logical access to programs and data is granted to appropriately authorized individuals.

User Entity Controls:

- n. Controls should be established to ensure access to PCs/terminals (containing payroll and TMRS-related information) is limited to authorized and appropriate individuals.

What should my city do now?

As soon as reasonably possible, your city should share this letter/information with your external auditor. GASB 68 will ultimately place more responsibility on your external auditor to gain comfort with your internal processes as they relate to information/data that is sent to TMRS (i.e., the user entity controls). The city's external auditor will likely review TMRS' SOC-1 report once it is completed, to gain an understanding of TMRS' processes and ultimately ensure that TMRS has appropriate controls in place to determine the city's pension assets and liabilities.

In conjunction with your auditor, we also encourage your city to study and become familiar with GASB Statement No. 68. Many resources are available on the GASB website (www.GASB.org).

TMRS will continue to provide GASB 68 information on the “Eye on GASB” section of our website, so please visit the TMRS website on a regular basis.

Questions can be emailed to pensionaccounting@TMRS.com.

APPENDIX:

What’s the difference between SOC 1 Type 1 and SOC 1 Type 2 reports?

SOC 1 audits examine a service organization’s controls relevant to a user organization’s internal controls over financial reporting.

- SOC 1 Type 1 reports cover the suitability of design of controls on a specific date.
- SOC 1 Type 2 reports cover suitability of control design as well as the effectiveness of those controls over a period of months.

User entities (i.e., TMRS municipalities) require SOC 1 audits to be performed on IT systems of service organizations (i.e., TMRS) when their information technology (IT) infrastructure is a part of the user entity’s IT system and the user entity needs to verify that the service organization controls relevant to the user entity’s own internal control over financial reporting are adequate. There are two types of reports that can be written as a result of a complete SOC 1 engagement.

In a SOC 1 Type 1 report, the service auditor expresses an opinion on the fairness of the description of the system and the assertion about the system written by the service organization’s management. A Type 1 report only covers the suitability of the design of the controls to achieve specific control objectives; it does not discuss the effectiveness of those controls, which are described in Type 2 report. Additionally, a SOC 1 Type 1 reports on controls as of a specified date.

A SOC 1 Type 2 report covers both the suitability and the effectiveness of the controls. A SOC 1 Type 2 audit includes the information in a Type 1 report as well as the service auditor’s opinion on the effectiveness of controls in meeting control objectives over a period of months.