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Pensions

Main points

In this chapter, we describe our audit of the annual reports of the Government's 14 pension plans. The objective of our audit was to assess whether the annual reports contained sufficient information. We concluded that the plans need to improve their annual reports. The annual reports did not always describe how the plans were progressing toward meeting their expectations. Nor did they consistently help plan members look forward by describing plan risks and capacity.

Some of the government pension plans need to develop and document their strategic direction and improve their governance processes. They must take these first steps before they will be able to report on their progress in achieving their goals.

We recommend the Government's pension plans improve their annual reports by describing their:

- key goals and objectives;
- future directions and risks; and
- strategies to build capacity.

We also describe the work we plan to do to assess how the Superintendent of Pensions supervises pension plans in Saskatchewan.

Glossary

Beneficiary – a person who receives or is entitled to receive benefits.

Defined benefit pension plan – a pension plan that specifies the pension that members of the plan receive on retirement or the method of determining the pension.

Defined contribution pension plan – a pension plan in which the members' contributions are fixed, usually as a percentage of pay (except for the Saskatchewan Pension Plan, whose members can contribute up to $600 each per year). A member's pension is based on the member's and the employer's contributions made on behalf of the member and investment earnings on those contributions.

Fiduciary responsibility – under common law, board members owe a duty of loyalty to those persons whose interests they are protecting. Board members cannot be in a conflict of interest with their board duties or profit from their board duties because of personal interests. Board members must deal fairly with the members of the plan.

Pension liability – the present value of pension benefits earned as determined by an actuary using the pension plan's best estimates about future events and an appropriate actuarial method as recommended by The Canadian Institute of Chartered Accountants for accounting purposes.

Pension plan board – is the oversight body identified in the pension plan's act or plan document that acts as the administrator and is the body to which plan management reports. The pension plan board may be referred to as a committee, commission, or trustees in some cases.

Unfunded liability – the amount by which the pension liability exceeds the assets of the pension plan.

Introduction

When a pension promise is made, this is the first step in the creation of a complex arrangement known as a pension plan. Appropriate management and oversight of this complex arrangement is critical to keeping the pension promise for both defined contribution and defined benefit plans. To ensure pension plans are well managed, the Government must properly manage its own pension plans and supervise the other pension plans, which are mostly private sector pension plans.

The Government's pension plans are significant to the Legislative Assembly, members of the pension plans, and the public. The Government incurs significant costs to provide pension benefits. In addition, the Government manages a significant amount of assets and pension liabilities in the plans. During 2002-2003, the Government's pension plans had assets totalling $7.2 billion. Significantly, the Government's defined benefit pension plans had a total unfunded liability of $3.8 billion.

Also, under *The Pension Benefits Act, 1992*, the Superintendent of Pensions (Superintendent) mostly supervises private sector pension plans. In 2002, the Superintendent supervised pension plans with a market value of assets of $13.6 billion.[1]

In this chapter, we describe our audit of the annual reports of the Government's 14 pension plans. We also describe the work we plan to do to assess how the Superintendent of Pensions supervises pension plans in Saskatchewan.

Pension plan annual report assessment

Background

Providing relevant and timely information to the pension plan members, the Legislative Assembly, and the public is one element of good

[1] Source: Financial Services Commission. *A Statistical Perspective on Pension Plans Registered in Saskatchewan*, p.5.

governance. Pension plans use their annual reports to provide much of this information.

In 1997, we examined the consistency and adequacy of the information contained in the annual reports of the Government's 14 pension plans (see Exhibit 2, page 263). We concluded the pension plans needed to improve their annual reports. In 2003, we again examined those pension plans' annual reports. We wanted to see how the pension plans had improved their annual reports. In this chapter, we report our assessment.

Audit objective

The objective of our audit was to assess whether the annual reports of the Government's 14 pension plans contained sufficient information. We examined those annual reports for pension plans with year-ends falling in the period December 31, 2002 to June 30, 2003.

Our audit was limited to examining whether the annual reports contained sufficient information. We did not assess the accuracy or reliability of the performance information provided. Nor did we examine the underlying information systems or the data used to prepare the performance information.

Criteria

Auditors use criteria to evaluate the matters that they examine. Criteria are reasonable and attainable standards of performance and control. We used the CCAF's[2] *Reporting Principles-Taking Public Performance Reporting to a New Level* (CCAF Reporting Principles) (Exhibit 1) to carry out this assessment. The Department of Finance supports the CCAF's Reporting Principles for public reporting of government agencies.

We followed *The Standards for Assurance Engagements* established by The Canadian Institute of Chartered Accountants.

[2] The CCAF-FCVI is a non-profit research and education foundation that supports capacity development for the public sector in the areas of governance, accountability, management, and audit.

Exhibit 1 – Audit criteria

1. **Focus on the few critical aspects of performance**
2. **Look forward as well as back**
3. **Explain key risk considerations**
4. **Explain key capacity considerations**
5. **Explain other factors critical to performance**
6. **Integrate financial and non-financial information**
7. **Provide comparative information**
8. **Present credible information, fairly interpreted**
9. **Disclose the basis for reporting**

Source: CCAF's Reporting Principles.

Conclusion and recommendation

We concluded that the Government's pension plans need to continue to improve their annual reports.

We recognize that preparing annual reports that meet the CCAF's Reporting Principles will take time and resources. Some government pension plans need to develop and document their strategic direction and improve their governance processes. They must take these first steps before they can report their progress in achieving their goals and meeting their governance standards.

The majority of pension plan annual reports included their investment goals and targets and indicated how well they achieved those targets. However, the annual reports did not always show a clear link between a mission statement and plan strategic goals, objectives, performance measures, and targets. None of the annuals reports we examined described how well the plans were progressing towards achieving their goals and objectives.

All annual reports identified the pension plans' investment risks and investment performance factors, but most did not describe other strategic risks or significant factors affecting performance (e.g., impact of demographic changes). Also, the annual reports did not provide any information on plan risk beyond investment risk.

Most of the annual reports provided information about who was responsible for the administration and governance of plans. They provided some information about processes to safeguard plan assets. However, the annual reports did not identify the plans' key capacity considerations (i.e., information systems, knowledge, and communication gaps) or strategies to build the necessary capacity to meet their goals.

1. We recommend that the Government's pension plans improve their annual reports by describing their:

- **progress towards key goals and objectives;**
- **future direction and risks; and**
- **strategies to build capacity.**

Our detailed findings

We describe below our detailed findings for each criterion. For each criterion, we set what we expected (in italics) and what we found.

Focus on the few critical aspects of performance

We expect pension plan annual reports to:

- *focus selectively and meaningfully on a limited number of performance goals; and*
- *centre on core objectives and commitments.*

To be useful, a pension plan's annual report should include adequate information for the stakeholders to understand the plan's purposes and core objectives. When stakeholders receive this information, they are better able to assess plan performance.

Pension plan annual reports should tell their stakeholders (i.e., plan members, Legislative Assembly, and the public) about their mission, vision, and strategic goals.

We found that the pension plan annual reports provided a description of the plan either in their financial statements or elsewhere in their annual report. Only three plans provided mission statements. Only one of those three plans provided a vision statement.

Most pension plans outlined their investment goals and targets and reported actual performance. However, the plans should provide targets and actual performance for all their goals. This should include investment performance, and performance related to other areas, such as governance, member education, and service to members.

All plans need to improve their annual reports by clearly outlining their mission and vision, and by describing their broad strategic goals, objectives, performance measures, and targets. They should also report their progress towards meeting their goals and objectives. Such information allows stakeholders to better assess plan performance.

Look forward as well as back

We expect pension plan annual reports to:

- ♦ *provide information on the prior year's performance;*
- ♦ *set out the goals and how activities contribute to the goals; and*
- ♦ *track achievements against expectations.*

All pension plans included audited financial statements in their annual reports. However, the annual reports included little or no information on what goals the pension plans intended to achieve during the year and their progress towards those goals.

About half of the defined benefit plans also included cash flow projections. Such information helps plan stakeholders assess cash requirements to meet pension benefits. Also, all pension plans included yearly investment benchmarks and three or four year benchmarks compared to actual results.

One plan had outlined broad goals in its annual report but then did not have specific targets for these goals. Providing goals with specific targets helps stakeholders better assess plan performance.

Government pension plans need to improve their annual reports by including all of their strategic goals and targets and describing their progress towards meeting those goals and targets. Plans need to expand their communication of specific short-term targets beyond investment targets. They should explain how these short-term targets contribute to achievement of long-term goals.

Few plans addressed the importance of, or responsibility for, governance in their annual reports. Those that did, did not state if they had met goals related to governance, nor did they describe what they planned to do to meet those goals.

None of the annual reports described what they intended to achieve in the long term. Long-term plans help stakeholders assess what the plans intend to do to meet their pension promises.

Explain key risk considerations

We expect all pension plan annual reports to:

- *discuss key strategic risks; and*
- *communicate their key strategies to manage these risks and if these strategies were effective.*

All annual reports described investment risks. The reports provided some information on how the plans mitigated those risks. Pension plans also included information related to actual investment returns compared to planned returns.

Pension plans, however, need to describe all their risks (e.g., governance, member education, service levels) and their strategies to mitigate those risks. When stakeholders do not know all the risks that the plans face and the strategies to mitigate those risks, they cannot assess whether the risks are properly managed.

Explain key capacity considerations

We expect pension plan annual reports to:

- *disclose key considerations affecting capacity to sustain or improve results to meet expectations; and*
- *describe strategies to align expectations and capacity.*

Twelve of the pension plan annual reports discussed the responsibilities of the board and management to govern and administer the plan. The plans described how they safeguard assets to meet pension promises. In addition, all defined benefit plans identified who was responsible for covering shortfalls if the plans were in deficit.

In addition, some plans discussed how they used specialists to gain needed expertise to help meet pension promises. One plan noted that it had completed an upgrade of its computer system, although it had not identified why that was necessary, nor the benefits to be achieved from the upgrade.

All plans need to better disclose key factors affecting their capacity. They should describe how those key factors relate to their ability to meet pension promises. For example, plans may need to improve information systems, staff competencies, education, communication, or service levels to meet their long-term goals or members' expectations. Plans need to explain their strategies to build capacity to address these areas.

Explain other factors critical to performance

We expect pension plan annual reports to:

- *explain their operating environment and reporting structure;*
- *identify core values and explain how they are applied in operations; and*
- *discuss and explain the impact of significant factors on performance.*

One pension plan included only financial statements and a management responsibility report in its annual report. Another plan included only financial statements. The notes that accompanied the financial statements provided a brief description of the plans. Annual reports of other pension plans provided better operational information, such as organizational charts, lists of fund managers and plan administrators, and general descriptions of the responsibilities of the board and management.

Only one plan identified its core values, but did not discuss how it applied these values in practice. All pension plans should identify and describe their core values in their annual reports. To ensure these core values are followed, pension plans should set out a code of conduct for board members, plan management and employees, and consultants.

Five plans described poor financial market conditions and explained how this affected investment returns. In addition, the plans explained how they managed this risk by diversifying their investment portfolios.

All plans should describe in their annual reports additional factors that they consider important to their performance, such as significant political, social, or demographic factors. The plans should describe how they intend to manage or respond to these factors.

Integrate financial and non-financial information

We expect pension plan annual reports to:

- *explain the link between activities and desired results; and*
- *show spending on key strategies and explain how changes in spending affect results.*

Two of the 14 annual reports we examined provided only financial statements. These reports did not integrate financial and non-financial information to show how resources and strategies contribute to results. All annual reports described how their investment strategy influenced results.

The pension plans need to link financial and non-financial information. For example, an important aspect of pension plan performance is member satisfaction. Pension plans could provide information showing how money spent to improve member satisfaction is achieving results.

Provide comparative information

We expect pension plan annual reports to:

- *provide comparative information about past performance to show whether performance is stable, improving, or deteriorating; and*
- *provide comparative information to the industry where reliable comparative information is available.*

All annual reports included plan financial statements with comparative information for the prior year. Providing comparisons of current year financial performance with the prior year helps stakeholders to assess if performance is stable, improving, or deteriorating. However, comparing financial results for only two years is usually not adequate to fully assess performance.

All annual reports compared actual investment returns to benchmark returns. One annual report included investment return information compared to other pension plans. Some annual reports provided actual returns for all investments by asset classes compared to market indices. Such information allows stakeholders to assess if the plan's investment strategy is adequate to meet the plan's overall investment goals.

Present credible information, fairly interpreted

We expect pension plan annual reports to:

- *provide performance information on a timely basis; and*
- *present performance information in language and format that avoids excessive detail and overly technical descriptions.*

All pension plans tabled their annual reports on a timely basis.

All but two of the annual reports provided information in an appropriate way. Generally, for the information provided, the annual reports used appropriate format, avoided excessive detail, and did not use overly technical language. The other two annual reports included only financial statements. Financial statements alone are not enough to assess the plans' overall performance.

Pension plan members have significant life savings invested in the pension plans and need information to know how their money is being managed. Some plans provided better access to their annual reports than others. Four pension plans mailed out copies of their annual reports to their members. The majority of the other plans had their annual reports on their web sites but most did not specifically inform members that they could access the annual reports on the web site.

Disclose the basis for reporting

We expect pension plan annual reports to:

- *explain the basis for selecting the few critical aspects of performance;*
- *describe changes in the way performance is measured or presented; and*
- *set out who is responsible for the report and the reliability of information being reported.*

Most pension plans explained in their annual reports the performance measures they used for their investment goals. The annual reports described the pension plans' goals for investments returns and provided actual results to show how well they met those goals. However, annual reports should describe all their goals, their performance measures, and provide information to show progress towards those goals.

None of the plans we assessed described any changes in their performance measures. However, when plans develop performance measures for all their goals they will need to reassess on a regular basis if the measures are still adequate. The annual reports should outline any changes in the performance measures.

Almost all of the annual reports described management's responsibility, stating that the Board was responsible for the governance and administration of the plan. One annual report did not identify who was responsible for the administration of the plan.

Most annual reports described how independent specialists helped manage investments and assist with segregation of duties. To improve public and member confidence, all pension plans should provide in their annual reports assurance about the adequacy of their controls including plan governance processes.

Exhibit 2 – Government pension plans

This chapter reports on 14 of the Government's pension plans. There are nine defined benefit plans and five defined contribution plans.

In **defined benefit plans**, the Government promises to pay each member a pension based on the member's salary and years of service. For the Municipal Employees' Pension Plan, the municipal employers and school boards promise to pay the pensions. In 1978 (1980 for the Teachers' Superannuation Plan), the Government reduced its risk that its pension costs would be greater than expected, by closing its defined benefit pension plans to new members, except for the Judges of the Provincial Court Superannuation Plan and the Municipal Employees' Pension Plan. Since 1978 (1980 for the Teachers' Superannuation Plan), new Government employees become members of defined contribution plans.

The nine defined benefit plans included in this chapter are:

- Judges of the Provincial Court Superannuation Plan-March 31, 2003;
- Liquor Board Superannuation Plan-December 31, 2002;
- Municipal Employees' Pension Plan-December 31, 2002;
- Public Service Superannuation Plan-March 31, 2003;
- Power Corporation Superannuation Plan-December 31, 2002;
- Saskatchewan Government Insurance Superannuation Plan-December 31, 2002;
- Saskatchewan Telecommunications Pension Plan-December 31, 2002;
- Teachers' Superannuation Plan-June 30, 2003; and
- Workers' Compensation Board Superannuation Plan-December 31, 2002.

In **defined contribution plans**, the Government and the plan member each pay a fixed percentage of the member's salary into a fund (the Government no longer contributes for the Saskatchewan Pension Plan and members do not contribute for Saskatchewan Research Council Employees' Pension Plan). The member's pension is based on the accumulated contributions (i.e., total contributions made by the member and the Government over the member's career) and the investment earnings on these contributions.

The five defined contribution plans included in this chapter are:

- Capital Pension Plan Inc.-December 31, 2002 (this plan includes employees of the Saskatchewan Gaming Corporation, Saskatchewan Government Insurance, Saskatchewan Transportation Company, Saskatchewan Water Corporation, and certain other agencies);
- Public Employees Pension Plan-March 31, 2003 (this plan includes employees hired by the Public Service Commission, Saskatchewan Telecommunications, and Saskatchewan Power Corporation);
- Saskatchewan Pension Plan-December 31, 2002;
- Saskatchewan Research Council Employees' Pension Plan-December 31, 2002; and
- Staff Pension Plan for Employees of the Saskatchewan Legal Aid Commission-December 31, 2002.

Superintendent of Pensions

Background

In our 2003 Report – Volume 1, we said that we planned to study and report best practices followed by pension plan regulators in Canada so that we can assess the adequacy of processes for regulating pension plans in Saskatchewan. We have now completed the first phase of our work. We have developed criteria to assess the adequacy of the processes used by the Superintendent to supervise pension plans in Saskatchewan. In this chapter, we describe the general audit criteria that we will use to study the systems and practices that the Superintendent uses to supervise pension plans.

To maintain the confidence of the public and plan members, pension plans must meet pension promises. Because of recent failures, funding issues, and legal actions, pension plan supervision and governance have become highly visible and sensitive issues. Plan members are more likely to make demands on public resources if pension plans fail to meet pension promises. The Government's regulatory and supervisory framework helps ensure pension plans meet their pension promises.

Under *The Pensions Benefits Act,* 1992, (Act) the Minister of Justice appointed a Superintendent of Pensions (Superintendent) to administer and enforce the Act. The Superintendent is responsible to reduce the risk of financial loss or inequities to pension plan members. Without an adequate system to supervise pension plans, situations that require intervention by the Superintendent may go unnoticed.

The intent of the Act is to protect the pension benefits that members have earned. The Act does not guarantee that pension payments will be made, because no government guarantee or insurance scheme is in place to cover a loss in a terminated pension plan. Furthermore, the Act does not influence the nature or generosity of pension plan benefits. The Act promotes fair and equitable treatment of all plan members, but does not guarantee that pensions will meet the retirement income needs of members.

The Act generally applies to pension plans in Saskatchewan, other than pension plans established by statute for Government of Saskatchewan employees. The Act also applies to some of the Government's plans, such as the Saskatchewan Research Council Employees' Pension Plan, Capital Pension Plan, and Saskatchewan Telecommunications Pension Plan. The Superintendent of Pensions supervises over 360 plans in Saskatchewan.

The Act does not apply to registered retirement savings plans, employee profit sharing plans, and deferred profit sharing plans. In addition, the Act does not apply to arrangements for retiring allowances, supplemental plans, or plans that provide benefits insured under a contract issued pursuant to the *Government Annuities Act* (Canada)[3]. Federally regulated pension plans and pension plans for Federal Government employees are also not subject to the Act.

Audit objective

The objective of our audit is to determine whether the Superintendent of Pensions has adequate systems and practices to supervise pension plans.

Our audit does not include the Superintendent's reciprocal arrangements with other pension regulators in Canada.

Criteria

Auditors use criteria to evaluate the matters that they examine. Criteria are reasonable and attainable standards of performance and control against which auditors can assess the adequacy of systems and practices.

We developed criteria based upon our review of relevant literature and reports of other auditors. We provided our general criteria to the Superintendent of Pensions for comments and suggestions. The Superintendent agreed with our general audit criteria.

[3] *The Pension Benefits Regulations,* 1993, Saskatchewan, p 5.

To adequately supervise pensions, the Superintendent of Pensions should have the following processes.

Register, amend, and deregister pension plans

We expect the Superintendent would have established processes for registering, amending, and deregistering pension plans on a timely basis. We expect the Superintendent's processes would establish minimum standards, set out administrative steps, and require necessary documentation. The Superintendent would have processes to examine proposed pension plan registrations and any proposed changes to pension plans to ensure that proposals meet the established minimum standards.

Identify and evaluate risks of pension plans

We expect the Superintendent would have processes to identify and evaluate the risks that Saskatchewan pension plans face. The Superintendent would have processes to gather information about risks through examination of plan documents, strategic plans, governance practices, annual reports, valuation reports, investment management and compliance reports, and board minutes. The Superintendent would also have processes to analyze information received and document the key risks faced by pension plans and their members.

Align work processes with risk assessment

We expect the Superintendent would have processes to use the identified risks to develop a work plan. We expect the work plan would identify those plans that have the highest levels of risk. Also, the work plan would describe actions the Superintendent will take (e.g., review, analysis, and testing) to respond to mitigate those risks.

Evaluate pension plan information

We expect the Superintendent would have processes to evaluate pension plan information in relation to the identified risks. We expect the Superintendent would have processes to examine pension plans with greater levels of risk. In addition, the Superintendent would have processes to ensure it covers other pension plans on a random basis. We also expect the Superintendent would have processes to ensure that pension plans comply with *The Pensions Benefits Act, 1992.*

Provide sound direction

We expect the Superintendent would have processes to consider the results of evaluations in making supervisory decisions. The Superintendent would have processes to properly document and communicate all actions and guidance necessary to improve plan administration, meet expectations set out in plan documents, and comply with *The Pensions Benefits Act, 1992.*

Follow up and enforce compliance

We expect the Superintendent would have processes to follow up and enforce compliance with supervisory decisions. The Superintendent would have processes to ensure pension plans carry out the Superintendent's directions. Also, we expect the Superintendent would have processes to change the work plans and practices when required due to changes to legislation or industry standards.

Our future work plans

We plan to complete our work on assessing the Superintendent's processes to supervise pension plans. We plan to report the result of our work in our 2004 Report – Volume 3.

Next year, we plan to examine the Government's plan to address its future cash requirements for pensions promised. We will also assess and report on pension plan progress in implementing our past recommendations to improve their governance processes.

In the future, we plan to reassess pension plan annual reports and their progress in addressing the recommendation in this chapter.

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