A PUBLIC POLICY PRACTICE NOTE

Working With Auditors of Pension and OPEB Plans

December 2019

Developed by the Pension Committee of the American Academy of Actuaries

AMERICAN ACADEMY *of* ACTUARIES

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The American Academy of Actuaries is a 19,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

This practice note is not a promulgation of the Actuarial Standards Board, is not an actuarial standard of practice (ASOP), is not binding upon any actuary, and is not a statement as to what constitutes generally accepted practice in the area under discussion. Events occurring subsequent to the publication of this practice note may make the practices described in the practice note no longer relevant or otherwise obsolete. This practice note should also not be construed as an interpretation, pronouncement, or application of auditing standards.

A prior version of this practice note was initially prepared by the Pension Accounting Committee of the American Academy of Actuaries and has now been updated by the Academy's Pension Committee to offer information to actuaries on current practices relevant to the audit of pension and other post-employment benefit (OPEB) plan financial information that is subject to U.S. generally accepted accounting principles (U.S. GAAP). The note focuses on the information prepared for the financial statements of the employer sponsoring the plan, and not the financial statements of the plan itself (although many of the Q&A responses are equally applicable to both types of financial statement audits). It is intended to assist Responding Actuaries in working effectively with Auditors (and Reviewing Actuaries) throughout the course of an audit by providing a better understanding of:

- The information that is expected to complete the review of the year-end measurements for clients;
- Why Auditors ask the questions they do; and
- How Responding Actuaries, Reviewing Actuaries, Auditors and Companies work together to help the process go smoothly.

The note offers issues for consideration and is not intended to define practice, set standards, or be audit guidance. The note includes some commonly observed questions and answers. While this note does reflect experiences of both Responding and Reviewing Actuaries, it is not intended to provide definitive guidance or set practice. Rather, it is intended to help a Responding Actuary better appreciate the thought process and context in which a Reviewing Actuary approaches a year-end audit with an emphasis on general principles and not specific guidance. To the extent that any statements contained herein conflict with applicable laws, rules, or regulations, the relevant laws, rules, or regulations should be followed.

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The Committee thanks James Burke, Ellen Kleinstuber, Keith Panetta and Todd Peterson for their contributions.

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BACKGROUND

This practice note is written from the perspective of actuaries working with auditors under U.S. GAAP. The broad issues and thought processes illustrated may be useful for actuaries and auditors working under other accounting and auditing standards, although the standards will differ in their particular requirements, the specifics of which are beyond the scope of this practice note.

Generally speaking, when an auditor reviews a financial measurement, that auditor may use the work of a specialist "with special skill or knowledge in a particular field other than accounting or auditing" (AS 1210:01[1]) when performing an audit in accordance with the standards of the PCAOB. The auditor has a specific Audit Standard (AS 1210) that provides guidance on when it is appropriate to use the work of a specialist. Actuaries are among the professions specifically identified in AS 1210 as potential specialists that an auditor might use. The PCAOB guidance on "specialists" is clear that AS 1210 does not apply to situations in which a specialist employed by the auditor's firm participates in the audit, a situation covered by another Audit Standard (AS 1201) on "Supervision of the Audit Engagement." When that specialist is an actuary, an auditor will want to explore the support for the actuary's inputs, including assumptions and other decisions that are often products of an actuary's professional judgment.

If an auditor asks questions of the actuary, there could be a misperception by some that the auditor is challenging the actuary or attempting to supersede the actuary's judgment.[2] This is not typically the case. In most cases the auditor is applying "professional skepticism," seeking to get comfortable with the actuary's inputs in an effort to assure themselves that the special actuarial skill or knowledge that the auditor is seeking from an actuary exists and meets the requirements of AS 1210.[3] As described later in this practice note, the auditor also has responsibility with respect to the validation of processes and controls implemented by the Company. If an auditor asks questions, it is often to acquire adequate audit documentation to fulfill these requirements.

The actuary can take certain steps that might simplify an auditor's review and reduce the number of questions. One way is to have a planning meeting before the actuary begins work. The Auditor (with support from the Reviewing Actuary), Responding Actuary, and Company can discuss any potential issues or new developments and set expectations as to what the auditor will require for adequate audit documentation. For example, how and through what process were the key assumptions selected, and what are the significant

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[1] AS 1210, "Using the Work of a Specialist."

[2] The primary audience for this practice note is the Responding Actuary who prepares the actuarial valuation results and supports the plan sponsor in discussions with their auditor. References to "the actuary" that are not otherwise clarified to be a Reviewing Actuary should be assumed to be a Responding Actuary.

[3] Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence, taking into consideration the competency and sufficiency of the evidence (PCAOB Auditing Standard No. 1015, paragraphs 7 and 8). Further discussion is included later in this practice note in the section **Selected Guidance That May Influence an Auditor's Perspective.**

changes in results from last year to this year? Certain assumptions, like the discount rate and following year's expected return on assets assumption, can be reviewed by the auditor before the actuary begins work. To be in compliance with ASOPs, an actuarial report must include adequate support and justification for any key assumptions or inputs.[4] Keeping this in mind, another way to simplify an auditor's review is through enhanced documentation in the report including explanations for significant changes in results to assist the user of the report in understanding the results presented. Adequate documentation will help the auditor gain comfort with the actuary specialist's work, and the auditor may not have to ask as many questions to get comfortable with the final results.

Roles and Responsibilities

Understanding that Accounting Standards and Actuarial Standards of Practice may define words differently, the following descriptions are the meaning this practice note ascribes to these:

Company—The entity whose financial statements are being reviewed in the audit or examination. For purposes of this note, "Company" includes publicly traded companies, not-for-profit organizations, or any other entity that is subject to U.S. generally accepted accounting principles (GAAP). The Company is responsible for the accuracy and appropriateness of all of the information contained in its financial statements. As such, all of the assumptions and methods of calculation become the responsibility of the Company. In addition to auditing the information in the financial statements, auditors will also gain an understanding of the Company's internal controls—the collective processes that a Company uses to ensure the reliability of financial reporting and the preparation of financial statements for external reporting purposes.[5]

Responding Actuary—As defined in ASOP No. 21, a Responding Actuary is an

> "actuary who is authorized by the entity to respond to the auditor or examiner on behalf of the entity being audited, reviewed, or examined with respect to specified elements of the entity's financial audit, financial review, or financial examination that are based on actuarial considerations. Any given financial audit, financial review, or financial examination may involve one or more responding actuaries."

Typically, a Responding Actuary will ultimately prepare the financial measurements necessary for the financial statements. In the course of that process, the Company will often consult the Responding Actuary regarding the assumptions to use in the calculations; although the Responding Actuary provides input as part of the assumption

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[4] ASOP No. 27, Section 4.1.2 states "The actuary should disclose the information and analysis used in selecting each economic assumption that has a significant effect on the measurement." Section 4.1.2 of ASOP No. 35 contains identical language with respect to disclosing the rationale for selecting demographic assumptions.

[5] PCAOB Auditing Standard ("AS") No. 2201, paragraph 2; http://pcaobus.org/Standards/Auditing/Pages/AS2201.aspx#introduction.

setting process, the ultimate responsibility for selecting the assumption usually lies with the Company.[6]

Auditor—As defined in ASOP No. 21, an Auditor is the

> "external firm or professional engaged to conduct a financial audit or financial review in accordance with generally accepted auditing standards for the purpose of issuing an opinion on a financial statement."

Reviewing Actuary—As defined in ASOP No. 21, a Reviewing Actuary is an

> "actuary designated by the auditor or examiner to assist with the financial audit, financial review, or financial examination with respect to specified elements of the financial audit, financial review, or financial examination that are based on actuarial considerations. Any given financial audit, financial review, or financial examination may involve one or more reviewing actuaries."

Reviewing Actuaries are often, but not always, employees of audit firms. Employees of audit firms are covered under AS 1201, "Supervision of the Audit Engagement," while Reviewing Actuaries engaged by the audit firm are covered under AS 1210, "Work of a Specialist."

Specialist—As defined by the auditing standards,[7] a specialist[8] is a person or firm engaged by the Company who possesses specialized skill or knowledge in a field other than accounting or auditing. Auditors are directed by their own standards to evaluate the professional qualifications of specialists to determine if the specialist possesses the necessary skill or knowledge in a particular field in which the auditor is not expected to have expertise. Auditors are directed to consider "professional certification, license, or other recognition of the competence of the specialist in his or her field"; "the reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance"; and "the specialist's experience in the type of work under consideration" when thinking about using a specialist. Typically, if the actuaries are sufficiently qualified (generally satisfied by maintaining appropriate credentials and meeting any applicable qualification standards, including continuing education requirements), follow applicable ASOPs, and take responsibility for assumptions (or, in the case of a prescribed assumption selected by the Company, assess

[6] Section 302 of the Sarbanes-Oxley Act assigns direct responsibility for ensuring the accuracy, documentation, and submission of the entity's financial reports to the chief executive officer and chief financial officer. Auditors and Specialists support the company in preparing this reporting, but the company is ultimately responsible for the information contained in its financial statements.

[7] PCAOB AS 1210; http://pcaobus.org/Standards/Auditing/Pages/AS1210.aspx.

[8] IN 17 CFR § 230.436, the SEC describes a requirement that outside experts who provide information used in an SEC filing must have their consent to use the information included with the filing. However, our understanding is that specialists are not the same as experts. Experts are solely responsible for the selection of the underlying methods and assumptions and are commonly encountered in SEC filings when the situation requires a "fairness" opinion, such as mergers, buyouts, or initial public offerings (IPOs). For purposes of this practice note only, we are assuming that actuaries are acting as specialists and that the reporting company "owns" its reported financial results.

the assumptions and make the disclosures regarding reasonableness required by the ASOPs), they are viewed as possessing the necessary skill and knowledge, and auditors might reduce their normal procedures in evaluating the professional qualifications of the actuary (e.g., auditors gain a level of comfort with the assumptions and methods used by the specialist rather than reproducing all the results independently to verify their appropriateness).

Experts are commonly encountered in SEC filings when the situation requires a "fairness" opinion, such as mergers, buyouts or initial public offerings (IPOs). For purposes of this practice note only, we are assuming that actuaries are acting as specialists and that the reporting company "owns" its reported financial results.[9]

In the context of this practice note, we have assumed that auditors consider actuaries (most commonly Responding Actuaries, but sometimes Reviewing Actuaries) to be specialists when the Auditors are reviewing pension and OPEB accounting results. This is supported by AS 1210.07.c that notes "actuarial determinations for employee benefits obligations and disclosures" as an example of the type of matter an auditor "may decide require him or her to consider using the work of a specialist."

Accounting Standards

<u>FASB</u>—The Financial Accounting Standards Board establishes the standards of financial accounting in the U.S. These standards govern the preparation of financial reports by nongovernmental entities submitted to the SEC, as well as other organizations (such as not-for-profit organizations) that are required to prepare financial statements under U.S. GAAP.

<u>GASB</u>—The Governmental Accounting Standards Board establishes accounting standards for U.S. state and local governments that report under U.S. GAAP. GASB standards are recognized as authoritative by state and local governments, state Boards of Accountancy, and the American Institute of CPAs (AICPA).

<u>IASB</u>—The International Accounting Standards Board establishes accounting standards and interpretive guidance for employers operating in the global financial markets where other nation-specific reporting standards are not otherwise mandated (as in the U.S., where FASB requirements supersede those of the IASB).

<u>NAIC</u>—The National Association of Insurance Commissioners establishes statutory accounting principles to assist state insurance departments in the regulation of insurance companies.

[9] Section 302 of the Sarbanes-Oxley Act assigns direct responsibility for ensuring the accuracy, documentation, and submission of the entity's financial reports to the chief executive officer and chief financial officer. Auditors and Specialists support the company in preparing this reporting, but the company is ultimately responsible for the information contained in its financial statements.

Throughout the remainder of this practice note, references to accounting standards will generally address FASB requirements. In most instances, the concepts discussed will also apply to GASB, IASB, and NAIC reporting requirements, even if not expressly addressed. When applying the concepts discussed in this practice note to financial reporting governed by one of these other entities, actuaries typically need to take into consideration any specific differences that may apply between the FASB and non-FASB standards.

Auditors and Other Reviewing Bodies

Audit work is subject to scrutiny by many different parties. The following summarizes the entities that impact the Auditors' work. The Reviewing Actuary in the course of the audit seeks to gather supporting documentation from the Responding Actuary such that any questions regarding the financial statements asked by any one of the following bodies may be addressed.

SEC—The mission of the Securities and Exchange Commission is "…to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions."[10]

PCAOB—The Public Company Accounting Oversight Board was established by the Sarbanes-Oxley Act of 2002 to oversee the audits of public companies. The PCAOB is a private not-for-profit organization and is responsible for establishing "auditing and related professional practice standards for registered public accounting firms to follow in the preparation of and issuance of audit reports."[11] Each year, the PCAOB reviews the workpapers for selected clients of registered public accounting firms to assess a firm's work. The PCAOB inspects on an annual basis registered public accounting firms that audit more than 100 public companies, and inspects at least triennially firms that perform fewer than 100 audits. Over time, the examinations by the PCAOB have grown in sophistication and depth. The PCAOB issues a report of its findings to the public.[12]

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[10] Securities and Exchange Commission; "What We Do"; http://www.sec.gov/about/whatwedo.shtml.
[11] Public Company Accounting Oversight Board; "Standards"; http://pcaobus.org/Standards/Pages/default.aspx.
[12] PCAOB; "Firm Inspection Reports"; https://pcaobus.org/Inspections/Reports/Pages/default.aspx.

A key part of the PCAOB's review includes the audit documentation. The required documentation is discussed in Auditing Standard (AS) 1215,[13] which states that:

> "Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached." (Paragraph 4)

and

> "This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:
>
> 1. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
>
> 2. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review." (Paragraph 6)

Thus, many of the questions Auditors ask Responding Actuaries are directly related to the Auditor's professional obligation to provide "sufficient documentation" under the PCAOB's rules. This includes documenting the work of a specialist—including actuaries—as described under AS 1210 below. While the PCAOB's guidelines only apply directly to the audit of public companies, similar standards are promulgated by the AICPA that apply when auditing the financial statements of non-public companies and governmental entities. In practice, most audit firms establish a single set of auditing guidelines that apply across all of their engagements, reflecting the guidance in both the PCAOB and AICPA standards.

Many actuaries will recognize that the auditor's professional obligation to provide documentation under AS 1215 has parallels to the actuary's professional obligation to provide documentation under ASOP No. 41 and other applicable ASOPs.[14]

AICPA—The American Institute of CPAs is the national, professional body for Certified Public Accountants (CPAs) in the U.S. The AICPA develops standards for auditing (and

[13] PCAOB; AS 1215; "Audit Documentation Requirement"; http://pcaobus.org/Standards/Auditing/Pages/AS1215.aspx#auditdocumentationrequirement. *These quotations from AS 1215 are provided for background information only; nothing in this practice note should in any way be construed as an interpretation, pronouncement, or application of auditing standards.*

[14] See, for example, section 3.2 of ASOP No. 41: "In the actuarial report, the actuary should state the actuarial findings, and identify the methods, procedures, assumptions, and data used by the actuary with sufficient clarity that another actuary qualified in the same practice area could make an objective appraisal of the reasonableness of the actuary's work as presented in the actuarial report."

other services performed by CPAs) and monitors and enforces compliance with the profession's technical and ethical standards.

Selected Guidance That May Influence an Auditor's Perspective

The following list is intended solely to give actuaries a sense of the professional guidance under which auditors operate. It is illustrative only and should not in any way be interpreted as binding, exhaustive, or authoritative.

1. Professional Skepticism—Auditors are tasked with reviewing audit evidence in a critical manner with a questioning mind to ascertain the validity of such evidence under AS 1015. The balance between professionalism and skepticism may be explained as an approach where an auditor "trusts but verifies." When it comes to assumptions, judgments, and recommendations that a Responding Actuary makes in the course of preparing a financial measurement, the auditor first seeks to understand, not to challenge, the Responding Actuary's work. In situations that the auditor considers to be higher risk, more evidence may be requested from the Company or the Responding Actuary.

2. PCAOB AS 2601 sets forth the guidelines for reviewing the contracted internal controls of a service organization. It is commonly believed that AS 2601 applies to recordkeeping and other administrative functions rather than to pension actuarial valuation systems.

3. PCAOB AS 1210 provides guidance for auditors in using the work of a specialist. In using the work of a specialist, the guidance recognizes that:
    - Auditors are not expected to be experts in all areas;
    - Auditors may encounter material matters that are complex or subjective; and
    - An auditor may be using the work of a specialist engaged by management as evidential matter to evaluate financial statement assertions.

Selected Sources of Relevant Guidance for the Actuary

In the course of preparing the work product for purposes of the financial statement audit, the Responding Actuary may look to various sources of guidance and literature. The following provides a sample of some of the relevant guidance but is not an exhaustive list of all applicable materials.

The Code of Professional Conduct **adopted by the American Academy of Actuaries, the American Society of Pension Professionals and Actuaries,[15] the Casualty Actuarial Society, the Conference of Consulting Actuaries, and the Society of Actuaries.**

In general, the Code of Professional Conduct sets forth required standards of conduct for actuaries who are members of the aforementioned organizations, to support the actuarial

[15] The actuarial body within this organization is now known as the ASPPA College of Pension Actuaries.

profession and to help fulfill its responsibilities to the public. Precept 2 of the Code of Professional Conduct refers to the Qualification Standards and states that an actuary shall perform actuarial services only when the actuary is qualified to do so. Those qualifications include appropriate requirements for basic education, continuing education, and experience. Precept 3 of the Code of Professional Conduct requires actuaries to perform Actuarial Services that satisfy applicable actuarial standards of practice (ASOPs).

Qualification Standards (including Continuing Education Requirements) for Actuaries Issuing Statements of Actuarial Opinion in the United States **promulgated by the American Academy of Actuaries.**
The purpose of the Qualification Standards is to provide the framework for actuaries to assess whether or not they are qualified to issue a Statement of Actuarial Opinion. The Qualification Standards define a Statement of Actuarial Opinion to be "an opinion expressed by an actuary in the course of performing Actuarial Services and intended by that actuary to be relied upon by the person or organization to which the opinion is addressed."

ASOP No. 4—Measuring Pension Obligations and Determining Pension Plan Costs or Contributions.[16]
This standard applies to actuaries when performing professional services with respect to the following tasks:

- Measurement of pension obligations. Examples include determinations of funded status, assessments of solvency upon plan termination, market measurements, and measurements for use in pricing benefit provisions.
- Assignment of the value of plan obligations to time periods. Examples include actuarially determined contributions, periodic costs, and actuarially determined contributions or periodic cost estimates for potential plan changes.
- Development of a cost allocation procedure used to determine periodic costs for a plan.
- Development of a contribution allocation procedure used to determine actuarially determined contributions for a plan.
- Determination as to the types and levels of benefits supportable by specified cost or contribution levels.
- Projection of pension obligations, periodic costs or actuarially determined contributions, and other related measurements. Examples include cash flow projections and projections of a plan's funded status.

ASOP No. 6—Measuring Retiree Group Benefit Obligations and Determining Retiree Group Benefits Program Periodic Costs or Actuarially Determined Contributions. This

[16] The Actuarial Standards Board released an exposure draft of proposed revisions to ASOP No. 4 in April 2018. Those proposed revisions are not directly considered in developing this practice note.

standard applies to actuaries when measuring any type of retiree group benefit obligation. Included in the scope of this standard are measurements made for the following purposes:

- Measurement of obligations
- Assignment of the value of retiree group benefits program obligations to time periods
- Development of a cost allocation procedure used to determine periodic costs for a retiree group benefits program
- Development of a contribution allocation procedure used to determine actuarially determined contributions for a retiree group benefits program
- Determination as to the types and levels of benefits supportable by specific periodic cost or actuarially determined contribution levels
- Projection of retiree group benefit obligations, retiree benefits program periodic costs or actuarially determined contributions, and other related measurements.

ASOP No. 21—Responding to or Assisting Auditors or Examiners in Connection with Financial Statements, Financial Reviews, and Financial Examinations.
This ASOP provides guidance to actuaries when performing actuarial services while responding to or assisting auditors or examiners in connection with a financial audit, financial review, or financial examination. Actuaries are encouraged to read and understand the framework in ASOP No. 21. This practice note is intended to provide additional background for actuaries to illustrate how some actuaries apply the guidance provided by ASOP No. 21 to support financial audits, financial reviews, and financial examinations.

ASOP No. 23—Data Quality. This standard provides guidance to actuaries when selecting data, performing a review of data, using data, or relying on data supplied by others, in performing actuarial services. The ASOP also applies to actuaries who are selecting or preparing data, or are responsible for the selection or preparation of data, that the actuary believes will be used by other actuaries in performing actuarial services, or when making appropriate disclosures with regard to data quality. The standard does not require the actuary to perform an audit of the data, but rather outlines the level of review an actuary should undertake in evaluating the appropriateness of the data and identifying what disclosures should be made about the effect of any deficiencies or inaccuracies in the data on the results.

ASOP No. 25—Credibility Procedures. This standard provides guidance to actuaries when performing actuarial services that involve the selection or development of credibility procedures and the application of those procedures to data sets.

ASOP Nos. 27 and 35—Selection of Economic Assumptions for Measuring Pension Obligations, **and** ***Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations.***[17] These standards provide guidance on the factors and

[17] The Actuarial Standards Board released an exposure draft of proposed revisions to ASOP Nos. 27 and 35 in April 2018. Those proposed revisions were not directly considered in developing this practice note.

approaches to consider when the actuary is responsible for either selecting or evaluating the various assumptions used to measure benefit obligations, assets, contribution requirements, or plan costs.

ASOP No. 41—Actuarial Communications. This standard provides guidance with respect to written, electronic, and oral communications issued by an actuary with respect to actuarial service. The standard sets forth the framework for required disclosures; communicating the scope of the requested work; communicating the methods, assumptions, data, and other information required to complete the work; and the development of the actuarial communication of the actuarial findings.

***ASOP No. 44—Selection and Use of Asset Valuation Methods for Pension Valuations*.** This standard provides guidance to the actuary when performing professional services with respect to selecting or using an asset valuation method for purposes of a defined benefit pension plan that is not a social insurance program. Selecting an asset valuation method also includes giving advice on selecting an asset valuation method.

***ASOP No. 51—Assessment and Disclosure of Risk Associated with Measuring Pension Obligations and Determining Pension Plan Contributions*.** This standard provides guidance to actuaries with regard to the assessment and disclosure of the risk that actual future measurements may differ significantly from expected future measurements.

Each of the ASOPs related to pension and other postretirement benefit measurement issues (ASOP Nos. 4, 6, 27, 35, and 44) indicates that any reference to selecting assumptions, selecting a cost allocation policy, or to modeling also includes giving advice on those actions. For instance, the actuary may advise the plan sponsor on selecting assumptions for Accounting Standards Codification (ASC) 715-30 or 715-60 measurements, but the plan sponsor is ultimately responsible for selecting these assumptions. These standards apply to the actuarial advice given in such situations, within the constraints imposed by the relevant accounting standards.

Helping Responding and Reviewing Actuaries Understand Each Other

Commonly Asked Questions

1. *The process of completing a year-end Company audit involves a great deal of work in a short period of time. What information and analysis can be provided early in the course of the audit to ease this year-end time crunch?*

Having a schedule in place with the Auditor, Company, and Responding Actuary that sets forth a clear framework for the process goes a long way toward making the audit run smoothly. Some of the items that are considered may be provided early in the process so that procedures can be completed well in advance of the applicable filing date. Examples of those items include the following:

- Documentation of employment events or other significant changes in plan population (e.g., reduction in workforce, acquisition or divestiture of covered participants, terminated vested lump sum cash out, etc.) or plan changes that occurred during the year (or since the prior measurement date) along with the details of any midyear remeasurements;
- The process used to determine if a curtailment or settlement was triggered and the basis for that conclusion;
- Changes in pay practices or other employment policies that may affect future plan experience; and
- The selection process for market- or current data-sensitive assumptions. For example, while the discount rate needs to reflect year-end economic conditions, an assessment of the process that will be used to determine that rate (e.g., yield curve, bond portfolio) can be performed prior to year-end. Similarly, the process in place to determine claims costs for an OPEB valuation or the following year's expected return on assets assumption can also be assessed.

The selection and documentation of other assumptions that are not based on current market conditions or an analysis of current data, including turnover rates, retirement rates, mortality, medical trend rates, and expected increases in retiree contributions may also be completed prior to year-end. A planning meeting or call involving the Company, the Auditor (including the Reviewing Actuary), and the Responding Actuary shortly before year-end can often help identify any areas of concern and provides an opportunity for the Auditor or Reviewing Actuary to raise questions early rather than waiting until the Responding Actuary has completed the work that relies upon these assumptions.

An ongoing dialogue during the year between the Company and Auditor (with inclusion of the Responding Actuary and Reviewing Actuary as appropriate) may also help ensure that the Auditor is comfortable with any approach proposed to the Company by the Responding Actuary.

2. *Responding Actuaries work directly with the Company to develop the information the Company will need for its year-end audit. Why do Auditors still send an audit confirmation letter to the Responding Actuary requesting the same information?*

AS 2301 describes the confirmation process as an integral part of the audit. The letters provide the framework for what the Auditors need to begin the audit. Actuarial information received directly from the third-party specialist is likely regarded as stronger audit evidence than information received from the Company and, therefore, the Reviewing Actuary may likely request information directly from the Responding Actuary even if that information has already been provided by the Company. It also provides evidence in support of the accounting controls framework adopted by the Company. To the extent the letter requests duplicative information, the Responding Actuary, Company, and Auditor can work together to identify the information that has already been provided and what remains outstanding.

3. *Many of the items in the confirmation letter aren't the responsibility of the Responding Actuary to answer and would be better answered by the Company or another service provider—why are they included?*

The request serves two purposes. First, requesting the same data from multiple sources can provide corroboration of the information being provided. Second, requesting the information from the Responding Actuary (with the knowledge and approval of the Company that engaged the Responding Actuary) enables the Auditor to confirm what the Company and Responding Actuary have discussed and evaluate the accuracy of the information provided to the Responding Actuary as a basis on which to develop the actuarial measurements. Investment policy is a good example of this kind of information.

4. *Many of the answers to questions in the course of the audit seem really obvious. Why is this?*

"Obvious" is a subjective term. What is obvious to the Responding Actuary may not be obvious to an Auditor, Reviewing Actuary (or another member of the audit team performing internal review of the audit procedures), or PCAOB inspector. The literature may call for a specific method or process, but there may be situations where the method is applied incorrectly or with a different variation than would be considered usual. The question is asked so that the Auditor can better understand whether the method used is appropriate within the context of the guidance, especially in cases where the answer may not be so straightforward.

A good example of this situation is the method used to measure the benefit obligation, which is required under ASC 715 to be the projected unit credit method. Although the method is prescribed, in many cases just saying "projected unit credit" without providing further details on the specifics of the calculation may not unambiguously identify the particular variation of projected unit credit used or how benefits are attributed to periods of service. For example, complex or multiple formula plans, cash balance or other hybrid plans, or nonqualified plans often require significant interpretation of how to apply this method to a particular plan design. These interpretations—part of an employer's accounting policies—need to be sufficiently documented so that the Auditor can form an opinion as to their appropriateness.

And, in practical terms, the Auditor needs to document the response to the question, even if the Auditor (or Reviewing Actuary) is relatively confident of what the answer would be. Asking such questions may also reveal changes made since the prior audit that may not otherwise be apparent to the Auditor.

5. What do audit standards generally require for an actuarial report?

AS 1210 requires that auditors should consider whether specialists maintain the requisite licenses, credentials, and certifications required by their profession, and AS 1210.12 currently requires that the specialists take responsibility for "the appropriateness and reasonableness of methods and assumptions used and their application" in order to be considered a specialist. A Reviewing Actuary generally looks to see if that report conforms to ASOP No. 41 and includes any disclosures required by the other applicable ASOPs. As a result, both auditing and actuarial standards can be satisfied.

Some of the key items that a Reviewing Actuary usually looks for include the following:

- Identification of the actuary responsible for the measurements
- Acknowledgement of the purpose of the measurements
- Acknowledgement that the results presented are reasonable and appropriate for the purpose intended, and were prepared in accordance with the actuary's understanding of the applicable requirements
- The qualifications of the actuary, including relevant credentials and an acknowledgement of qualification as specified in the U.S. Qualification Standards
- Any relationships to the Company that may create or may appear to create a conflict of interest and need to be disclosed
- Summary of data, assumptions, methods, and plan provisions used in developing the measurements
- Assessment of reasonableness of assumptions with corresponding rationale

However, in December 2018 the PCAOB revised AS 1210 and eliminated the language in AS 1210.12 regarding the Specialist taking responsibility for the assumptions. The amendments to AS 1210 are effective for fiscal years ending on or after December 15, 2020. While current practice among auditors as of the date of publication of this practice note largely focuses on gaining an understanding of the assumptions used by the Specialist, audit procedures for the review of pension and OPEB plans may become more rigorous in the future as the focus shifts toward evaluating the assumptions in greater depth.

While it may not be possible to eliminate all possible questions that a Reviewing Actuary may raise, one approach to reduce the number of questions may be to discuss in the report any questions that the Responding Actuary raised (either with the Company or as part of its internal quality control review) while preparing the report and the resolution of those questions. For example, if the Responding Actuary questioned the total gain/loss for the year while preparing the report and subsequently identified several significant sources of gain/loss, a brief commentary on those sources might address a similar question from the Reviewing Actuary.

6. How does an Auditor evaluate census data?

Auditors typically employ sampling techniques to evaluate the quality and accuracy of the census data used for the valuation. Sometimes this involves preselecting sample participants and requesting data for those specific individuals; however, more recent practice has been observed to request a full census file and select samples for review after the data file is received.

The Auditor compares the valuation census data from the Responding Actuary to the payroll feed or other data sources that come directly from the Company. The Auditor also reconciles the current year valuation census with the prior year.

The disclosure requirements in ASOP No. 23 provide a list of the items an actuary should include in his or her report. Providing this information will likely answer most of the Auditor’s questions, but may also trigger a request for additional detail beyond what is necessary to meet the ASOP requirements—for example, if the Responding Actuary provides a summary of any assumptions or corrections made to the client’s data while preparing the valuation census data (e.g., disclosing an assumption regarding missing date of birth for 20 participants may trigger a request from the Auditor for a list of the specific people for whom this assumption was applied).

7. What does the Reviewing Actuary usually do with the summary of plan provisions?

As noted above, the summary included in the Responding Actuary’s report is used by the Reviewing Actuary to understand the interplay between the plan provisions and assumptions. For example, if a plan provides a heavily subsidized early retirement benefit but the actuary’s calculations assume all employees retire at normal retirement age, the Company may be asked to support how using a uniform retirement age produces a reasonable best estimate for the actuarial liability.

This summary is also used by the audit team to verify that the appropriate plan provisions have been reflected in the measurements in a manner consistent with the written plan document, and to identify and confirm plan provision changes reflected by the Responding Actuary.

8. What special information is usually required when a plan pays lump sums?

Accounting standards specify that each of the significant assumptions "reflect the best estimate solely with respect to that individual assumption."[18] Practice has been to include assumptions related to lump sum payments or other accelerated payouts.

Where a lump sum option is offered, Auditors examine the methodology and assumptions used to value this form of payment to evaluate the implications on the measurements. For example:

- Is the method used based on an "ongoing" or "settlement" approach?[19]
- What is the interest rate basis used to value lump sum benefits, and does it differ from the rate(s) used to value annuity benefits? Is this assumption consistent with the other economic assumptions selected (see Q&A 16)?
- Is the mortality assumption based on current prescribed tables in effect at the measurement date, a projection of the current prescribed basis with future mortality improvements through the benefit payment date, or a forecast of the prescribed table in effect at the assumed future payment date?
- How does the valuation reflect any plan-specific basis that may exceed the statutorily required calculations?
- What proportion of the plan participants are expected to take the lump sum option?

The Responding Actuary may be asked to support or provide the underlying rationale for these various methods and assumptions.

9. What information does a Reviewing Actuary usually consider in assessing the mortality assumptions?

The mortality assumption consists of two parts—the base mortality rates as of the measurement date and the improvement scale used to project the mortality rates beyond the measurement date. There is an accounting requirement that all relevant information be considered at the issuance date of the financial statements.[20] This requirement pertains mostly to the annual update of the mortality improvement scales. Specific mortality tables

[18] ASC 715-30-35-42.
[19] More information about the various approaches to valuing interest-sensitive lump sum benefits is included in the Pension Practice Council's practice note *Valuing Benefits Payable as a Lump Sum.*
[20] ASC 855-10-25-1 notes that information first available after the balance sheet date that provides additional evidence about conditions that existed at the balance sheet date should be recognized in developing the estimates used in the financial statements. An example of this is illustrated in Technical Q&A 3700.01 issued by the AICPA in February 2015 discussing the effect of the release of new mortality tables.

or improvement scales may not be mandated, but when the selected mortality assumption deviates from what the Auditors observe as common practice, they might ask the Reviewing Actuary or Responding Actuary for clear documentation of why the particular assumption selected provides a best estimate assumption with respect to the specific population covered by the plans. In certain cases, this documentation might include the quantification of the impact of using a different mortality assumption.[21]

10. What information does a Reviewing Actuary usually consider in assessing the other demographic assumptions?

No single answer covers every case. The Auditor will first want to identify the factors that the Company (and Responding Actuary) considered in selecting the assumptions as the Company's "best estimate." Section 4.1.2 of ASOP No. 35 requires actuaries to disclose the rationale for the selection of each significant non-prescribed demographic assumption used in the measurement. While this disclosure requirement does not address prescribed assumptions or methods set by another party (which would include assumptions selected by the Company under U.S. GAAP), Auditors and Reviewing Actuaries may look for such disclosures to assist in assessing the reasonableness of the assumptions selected.

In many cases, a plan's experience is credible enough to reflect in the selection of assumptions. In these situations, the Auditor may ask for a copy of the experience study report to better understand how the results of the study were reflected. In other cases, the Company may look to industry or national data to develop the assumption. Again, the Auditor will look to identify which factors the Company considered. Where these two approaches are blended—i.e., when the data does not have full credibility by itself, but sufficient partial credibility to still make an experience study useful—the Auditor or Reviewing Actuary may want to know how the results of the experience study were blended with industry data or outside studies to arrive at the final assumptions used.

Auditors also want to know how the Responding Actuary and Company monitor these assumptions to verify their continued reasonableness and identify when they may require revision. When assumptions are changed, the Auditor wants to identify the information that was considered as part of that process and understand why the new assumptions are now considered to be the best estimate.

11. What does a Reviewing Actuary typically look for as support of the discount rate? Is more support required if a hypothetical bond portfolio or bond matching model is being used?

[21] Additional guidance for actuaries on selecting and documenting mortality assumptions is available in the practice note *Selecting and Documenting Mortality Assumptions for Pensions*.

The U.S. GAAP standards and SEC guidance require that the discount rate will:

- Reflect yields available on high-quality fixed-income instruments;
- Reflect the plan population and plan provisions; and
- Be determined based on economic conditions as of the measurement date.[22]

While this accounting guidance provides some indication of the basis of the rate, alternative approaches/methods are sometimes used in practice. Thus, the support needed for the discount rate for any given situation depends on the approach taken.

- For a yield curve, considerations might include whether or not the curve is reflective of high-quality bond yields, whether the application of the curve to the cash flows is appropriate, and whether the comparison of the benefit obligation to the discounted cash flows is reasonable.
- For an index, documentation would generally include information illustrating why that particular index is appropriate for the population and any adjustments necessary to account for the difference between the duration of the index and the duration of the cash flows.
- If a hypothetical bond portfolio is used, the bond model, underlying bonds, and assumed reinvestment rates are typically reviewed. The individual bonds are likely to be more heavily scrutinized because of the very limited number of bonds typically used. A major focus on hypothetical bond portfolios is the reasonableness of the matching of benefit cash flows with the bond cash flows.

As the level of sophistication in selecting a discount rate has increased over the years, so has the scrutiny of the rate selected. Because of these developments, Auditors often request a detailed description of the method used to select the discount rate and the supporting analysis documenting the calculation of the discount rate selected. The more complex the method used to select the discount rate, the more supporting analysis and documentation the Auditor would expect to receive. For example, more documentation can be expected for a hypothetical bond portfolio or bond matching model due to the additional assumptions that must be made (such as reinvestment rates) and factors that must be considered in developing the model (such as liquidity of the bonds and quality of the fit to the plan's projected benefit payments).

In addition, if a Company has changed the procedure for estimating the discount rate, the Auditor and Reviewing Actuary may want to know how the new procedure improves the quality of the estimate and the facts and circumstances occurring in the current period that have made the new procedure more appropriate.

[22] Other accounting standards, such as GASB 67/68 (applicable to pension benefits) and 74/75 (applicable to OPEB benefits) have requirements for discount rate selection that differ from these criteria.

12. What is the purpose of providing separate documentation supporting the discount rate for each of the Company's plans when some of them are small?

ASC 715-30-55-170 states that: "Judgment shall be applied to determine what is significant for each pension plan (the unit of accounting) based on facts and circumstances." A similar standard applies for other postretirement benefit plans. Therefore, the requirement is that the discount rate is supportable for each plan individually. To the extent there are deviations from that practice, the impact of using a different discount rate may be considered an audit difference that must be considered in assessing whether the overall financial statements of the Company fairly represent its financial position. The Responding Actuary or Company is encouraged to provide the dollar impact (or a ceiling on the impact) on the benefit obligation and/or expense if the discount rate was determined separately for each plan, rather than in aggregate, so that the Auditor can assess whether the audit difference is material. (See Q&A 26 for a discussion of materiality.)

In certain cases, several plans may have similar demographics and the same discount rate could be supportable for each. The Reviewing Actuary may ask the Responding Actuary to provide documentation or reasoning to support the Company's conclusion that the plans have sufficiently similar demographics so that the same discount rate may be used. In other cases, the Company may elect to use one discount rate for all plans, perhaps based on the largest plan or an aggregation of the cash flows for all plans. This approach could be permissible, but not without a valid basis and articulation of the reasons as to why using a single, aggregate discount rate is reasonable. The Reviewing Actuary typically wants to receive additional information that may include the relevant facts and circumstances on which the conclusion was made, and whether the same rate was supportable for each plan. Such information would be based on demographic and economic conditions as of the measurement date, which may change over time. Providing solid support from the Responding Actuary that the aggregate discount rate is reasonable for each of the plans individually makes for an easier discussion.

13. What additional documentation should be provided if the "spot-rate approach" is used?

If a Company has elected to determine the service cost and/or interest cost components of pension expense using a more granular approach, referred to herein as the "spot-rate approach,"[23] the Auditor may request that the Responding Actuary provide additional information, including (but not limited to):

- Methodology and spot rates from the yield curve selected by the Company to determine the service and/or interest cost

[23] There are several variations on these more granular approaches that plan sponsors might consider. These are discussed in detail in the Pension Practice Council's August 2015 issue brief, *Alternatives for Pension Cost Recognition—Issues and Implications*.

- Service cost cash flows, in addition to the Projected Benefit Obligation (PBO) or Accumulated Postretirement Benefit Obligation (APBO) cash flows already typically provided, if the spot-rate approach is used to determine service cost
- In addition to the traditional disclosure of the weighted-average discount rate used to measure the benefit obligation, new weighted-average discount rates (or effective rates) used to develop the interest cost and service cost (and possibly interest on service cost, if significant enough to mandate separate disclosure) components of net periodic benefit cost
- In the year of the change to the spot-rate approach, the difference in expense under the new approach compared with the previous approach, in any interim financial statements (e.g., 10-Qs), and in the year-end financial statements
- If a roll-forward technique is used, a description of any adjustments made to the first-year cash flows to reflect actual annuity payments significantly different than expected annuity cash flows
- If a roll-forward technique is used, a description of any adjustments made to the entire stream of expected benefit cash flows to the extent actual lump sum payments made during the year are materially different than assumed
- Where annual actuarial valuations are not performed, additional information on how the expected benefit cash flows as of the measurement date were developed
- The portion of the total PBO or APBO actuarial loss (or gain) attributable to the use of the spot-rate approach

If the Company has more than one plan, the Auditor usually expects that the spot-rate approach is used for all plans, unless there are relevant facts and circumstances that would provide adequate rationale for a difference in approach for a particular plan or a plan in a particular jurisdiction, subject to materiality considerations. In some countries, credible high-quality bond yield curves may not be available, so other approaches are used by Companies in developing the discount rate in those countries. This is an example of a situation where it may be appropriate for a Company to change to the use of the spot-rate approach for certain plans but not for others (e.g., plans in countries where there are no viable yield curves).

The SEC has commented that it would not object to a filer's switch from use of a plan's single weighted-average discount rate based on a spot-rate yield curve to use of the spot-rate approach. Nor would it object to such a change being treated as an acceptable refinement that results in a change in estimate, with prospective impact only as of the measurement date when the change occurs.[24]

When a Company adopts the spot-rate approach, the Responding Actuary may want to engage in a dialogue with the Auditor and the Reviewing Actuary early in the process to

[24] The SEC has also commented that it would not object to such a change being treated as a change in accounting estimate inseparable from a change in accounting principle.

discuss how the expected benefit cash flows for the PBO/APBO, Interest Cost, and Service Cost calculations are determined, including any adjustments that are being made to reflect the interest-sensitive nature of any lump sum benefits that are to be reflected.[25]

14. What does the Auditor look for as support for the long-term rate of return on plan assets?

As discussed in accounting standards, the expected long-term rate of return on plan assets is the expected return on those assets currently invested or to be invested to provide for the benefits included in the benefit obligation. Accordingly, the rate has a long-term perspective and the methods, data sources, and other factors used to determine this assumption reflect this long-term perspective (rather than a short-term, single-investment-cycle perspective).

The Auditor usually first wants to know the Company's process (including the factors considered) in selecting a particular rate as its best estimate. The Auditor may also ask the Responding Actuary to discuss the factors considered in the Responding Actuary's assessment of the rate.

Further, the accounting standards and SEC guidance require that the Company provide a narrative (included in the footnotes to the financial statements) discussing the development of this assumption. While a Company might consider surveys in its selection process, the other companies included in such surveys may not have the same investment strategy or philosophy as the Company being audited. Accordingly, simply referencing survey information without adapting that information to the Company's specifics is not likely to be as helpful to the users of the financial statements as providing a more robust discussion or description of how much weight the Company places on survey information, actual historical asset returns for the Company's plans, the Company's future capital market expectations, any adjustments for active management and expenses paid from plan assets, etc.

If a Company makes adjustments to expected passive asset returns for active management, the Auditor might request additional documentation that supports an expectation of any net incremental asset return (net of active management expenses) on account of such active management, such as a comparison of actual asset returns by asset class versus the actual return of appropriate passive benchmark indices over an extended period of time. The Responding Actuary's assessment of whether any adjustments for active management are unduly optimistic or pessimistic in accordance with Section 3.8.3(d) of ASOP No. 27, along with any disclosures required by the Responding Actuary

[25] In September 2018, the Pension Committee of the Academy issued an exposure draft of the practice note *Valuing Benefits Payable as a Lump Sum* that provides detailed insights into the various alternative methods for valuing interest sensitive lump sum benefits for financial accounting purposes (http://www.actuary.org/files/publications/Valuing_Benefits_Payable_as_a_Lump_Sum_9212018.pdf).

under Section 4.3 of ASOP No. 41, provides the Auditor with audit evidence to evaluate the reasonableness of any such adjustment.

If a Company develops its expected return assumption using information from third-party expected return models, such as those that may be provided by the Company's investment adviser and/or the Responding Actuary, the Auditor/Reviewing Actuary may want documentation regarding the underlying capital market assumptions to better understand how the results of those models compare to each other or to other economic assumptions.

If administrative or other plan-related expenses are paid out of plan assets, and such expenses are not reflected elsewhere in the valuation, the Company could request that the Responding Actuary estimate plan-related expenses such as actuarial valuation fees and PBGC flat-rate and variable-rate premiums to support an adjustment to the expected return assumption. The Auditor/Reviewing Actuary will typically expect that any documentation of the development of the expected return on plan assets assumption will include a description of how any adjustment for plan-paid expenses was developed, or why an adjustment for plan-paid expenses was not reflected.

In some cases, the actuary may not be involved in the selection of this assumption at all, with the assumption developed exclusively by the Company and the plan's investment advisor. In this case, the actuary evaluates the assumption after it has been set and may have to make a disclosure about whether the assumption significantly conflicts with what the actuary believes is reasonable for the purpose of the measurement. If the actuary has not been involved in setting the assumption, the lack of a disclosure that the prescribed assumption is not reasonable (or that the actuary was unable to evaluate the assumption for reasonability) could be considered audit evidence supporting the reasonability and appropriateness of the assumption, but may not be sufficient to meet the requirements for support.[26] If the actuary's report states it is a prescribed assumption selected by the Company, the Auditor may still ask the Responding Actuary to provide documentation of how he or she concluded it is a reasonable assumption.

15. Is the long-term rate of return on assets being reviewed for the current year expense, the following year expense, or both?

The year-end disclosure shows the expense determination for the year just ended, so the assumption is reviewed for the year that just ended. Practically speaking, the Company is also planning for the next fiscal year and the assumption that will be used in the development of the pension expense for that year would typically be set at the same measurement date as the year-end balance sheet entries. As a result, a review of the rate for the coming fiscal year is often performed during the year-end disclosure review process to avoid any issues being raised as quarterly or other interim expense amounts are

[26] Section 4.2 of ASOP No. 27 requires certain disclosures when an actuary believes a prescribed assumption significantly conflicts with what would be reasonable for the purpose of the measurement, or when the actuary is unable to assess the reasonableness of such a prescribed assumption.

recorded during the next fiscal year. If an assumption change is proposed in anticipation of a modification to a plan's investment policy during the coming year, and that change does not actually occur, the Auditor may challenge the use of the revised assumption at a later date.

16. What are Auditors looking for when assessing consistency among the economic assumptions used to determine liabilities and the components of expense?

To develop the future expected benefit cash flows, the Company must select as its best estimate certain economic assumptions such as inflation, salary increases, Social Security Taxable Wage Base increases, National Average Wage increases, cash balance interest crediting rates, lump sum conversion rates, etc. The guidance under ASC 715-30-35-42 and ASC 715-30-35-44 suggests that with the exception of the discount rates, the other economic assumptions are intended to represent the Company's best long-term estimate of such assumptions at future dates.

Account-based defined benefit plans have become more prevalent and the liabilities of such plans have become more material to the audit. As such, and in part due to comments and inquiries made by the SEC, PCAOB, and other regulatory agencies, Auditors and Reviewing Actuaries are placing a greater emphasis on consistency among the economic assumptions used to determine the benefit obligations being disclosed and the components of pension expense, and are requesting additional documentation as to whether and how the economic assumptions are consistent.

For example, an Auditor/Reviewing Actuary might question the consistency of an expected return on plan assets assumption set in a low-interest-rate environment assuming future interest rates (or bond yields, for example) will increase over time to a more normative level, combined with a future interest crediting rate for an account-based defined benefit plan based on similar market-based securities that are assumed to remain at the rates in effect as of the measurement date. In this case, the Auditor/Reviewing Actuary might request an explanation of how the assumed future interest crediting rates are consistent with the capital market assumptions used to develop the expected return assumption.

Similarly, for traditional defined benefit plans that offer interest-sensitive lump sums, or account-based defined benefit plans that assume annuity payment forms, if the Company's best estimate is that future lump sum conversion interest rates remain unchanged from the rates in effect as of the measurement date, the Auditor/Reviewing Actuary might question the consistency of the lump sum conversion and expected return on plan assets assumptions.

As previously stated, a Company may develop its expected return assumption using information from third-party expected return models, such as those that may be provided by the Company's investment adviser. The Auditor/Responding Actuary may request support to document consistency between the capital market assumptions inherently being used by the Company and the other economic assumptions selected by the Company based on advice from the Responding Actuary. As such, the Responding Actuary may find it helpful to have conversations with the Company and the investment adviser as they assess the reasonableness of the prescribed economic assumptions or advise the Company on the selection of other economic assumptions that might not be consistent with assumptions based on such third-party information.

If the economic assumptions ultimately selected by the Company are not consistent, the Auditor/Reviewing Actuary typically expects the Responding Actuary to provide the disclosures as required under Sections 3.13 and 4.2 of ASOP No. 27, or ASOP No. 41, as applicable, and may require additional quantification of the impact on the measurement if an alternative set of consistent assumptions were used.

17. What process is used by the Reviewing Actuary to evaluate long-term medical trend rates for OPEB plans?

The Reviewing Actuary first works with the Auditor to learn the basis for the assumption (i.e., how trends were selected and what factors were considered in the selection process). Companies can help facilitate this review by having a well-documented selection process. Like other actuarial assumptions, the trend rate is intended to be a best estimate and the Auditor typically wants to know how the Company concluded that the selected rates were the best estimate of future trend.

18. What information is necessary to support the initial claims cost?

This parameter is the starting point for the application of trend rates to develop expected future claims costs. As per ASOP No. 6, initial claims might be based on a manual rate, or a blend of the two approaches.[27] The Reviewing Actuary typically wants to identify the process followed, including whether there were adjustments for large claims. Accordingly, an actuarial report that provides some detail regarding the development of the initial claims is more helpful than one that simply presents the initial claims amounts.

As with any change, if the approach to developing the initial claims cost is modified, the Reviewing Actuary and Auditor will look at the drivers of the change and in particular the current circumstances leading to the change. They typically want to understand whether the change is temporary to account for anomalous experience that is not expected to recur in the future, or a permanent change in the methodology to reflect a new or changed source of information or a more refined technique that is meant to improve the estimate.

[27] Section 3.7 of ASOP No. 6 provides guidance on Modeling Initial Per Capita Health Care Costs.

19. What other factors are considered in assessing the appropriateness of assumptions for an OPEB plan?

Credibility of the block of experience in the plan is key to setting assumptions in OPEB plans. For some Companies, plan experience may not be sufficiently credible and actuaries will rely on other data sources such as national surveys to develop assumptions. At other times, pre- and post-Medicare retiree experience may be blended, or active experience may be blended with retiree experience to develop a more credible data set. The Reviewing Actuary will want supporting documentation to ensure that the ultimate claims cost and age-related morbidity factors effectively reflect retiree-only rates that are appropriate for an OPEB measurement. This particular concern is frequently raised when considering early retirees who pay the same rate as actives (which might imply a "hidden" subsidy being paid by the employer).

20. In an instance where a Company has both an OPEB plan and pension plan, should there be consistency in assumptions used for each plan?

On the surface and to the extent the plans cover a similar participant group, the expectation is that the assumption sets would be the same. In some circumstances, however, the characteristics of each plan may support differences in assumptions, and documentation of those situations will likely be requested by the Auditor and Reviewing Actuary to assist in understanding the assumptions used.

For example, a pension plan valuation might not include an explicit disability decrement if the benefit provided is not significantly different from the withdrawal or retirement benefit. On the other hand, in an OPEB plan that provides retiree medical benefits to disabled participants, the absence of a disability decrement might result in an understatement of the benefit obligation. Another example often seen in practice is the marriage assumption. While there may not be actual differences between the pension and OPEB plan assumptions, the disclosure of the assumption in the OPEB plan often incorporates both the percent married and election percentage in a single assumption. In this situation, the Reviewing Actuary might ask a clarifying question to determine consistency. For example, the marriage assumption in an OPEB report may indicate 40 percent when in fact the percentage assumed to be married is 80 percent (consistent with a pension report) and the anticipated election percentage is 50 percent.

Another potential difference is the mortality assumption for pension and OPEB plans. The Pri-2012 and RP-2014 mortality tables were developed on a benefits-weighted basis and on a headcount-weighted basis. The benefits-weighted tables are generally viewed as appropriate for pension plans, because of a correlation between participants' benefit amounts and longevity; participants with larger benefits are more likely to live longer. However, for OPEB plans, this relationship may not be applicable. Therefore, headcount-weighted tables could be appropriate. It may seem inconsistent for two different mortality assumptions to apply to the same participant who is in both a pension plan (with benefits-weighted mortality) and an OPEB plan (with headcount-weighted mortality). However, the Reviewing Actuary might not necessarily consider this to be an inherent inconsistency, as long as the same family of tables is used for both plans. For example, if a Company is using the Pri-2012 white collar benefits-weighted table for pension and determines that headcount-weighted mortality be used for OPEB, it would typically use the Pri-2012 white collar headcount-weighted table for the OPEB valuation.

To the extent the pension and OPEB valuations cover different but partially overlapping participant populations, the Auditor/Reviewing Actuary will want to understand whether the assumptions used for the overlapping participant groups are consistent in the two valuations and how the overall assumption was developed to incorporate anticipated experience for each plan's unique demographics. For example, a Company may sponsor separate pension plans for its bargained and non-bargained employees, but only one OPEB plan covering both groups. If blue collar mortality is used for the bargained pension plan and white collar mortality is used for the non-bargained pension plan, the Auditor might question use of a single mortality table for the OPEB plan rather than separate tables applied to each subpopulation, and request support showing that the single mortality table being used is based on a blend of these two tables that reasonably estimates the relative proportion of bargained and non-bargained participants covered.

21. How does a Reviewing Actuary evaluate significant events?

The Company is responsible for assessing any particular event to determine whether or not it constitutes a significant event that calls for a remeasurement. Based on that analysis, the Auditor then assesses and audits the policies and procedures used in that determination and the consistent application of these policies and procedures to other such events. For example, in determining whether a curtailment has occurred due to a downsizing event, the Company must assess, with review by the Auditor, whether a significant reduction in headcount or future years of service has occurred. In addition to curtailments, the Company might also need to evaluate significance with respect to events such as plan amendments, settlements, and plan mergers or spin-offs. Discussing these types of events with the Auditor at the time they occur to gain acceptance of the accounting treatment instead of reviewing them at year-end can help avoid unnecessary surprises.

Given the subjective nature of "significance," one of the challenges is how to actually measure it. Consider, for example, a plan amendment. Is significance measured by just the change in the benefit obligation? Or does the Company also consider how much expense would change following the remeasurement? With no specific guidance in the literature, the role of the Reviewing Actuary is to assist the Auditor in understanding the Company's process and policy to evaluate the event, determine whether the Company has followed its stated process and policy, and express an opinion on the appropriateness of the policy in the measurement of the event.

Whether a significant event is material ultimately depends on the particular situation, but is considered in relation to the plan and/or the financial statements of the Company. It may be the case that a significant event which would otherwise call for a remeasurement might be exempted from that requirement because the effects are not considered material to the Company's financial statements. On the one hand, recognizing an otherwise immaterial event is always acceptable. On the other hand, setting a very low threshold in assessing significance (e.g., recognizing a curtailment when there has been a somewhat insignificant reduction in future years of service) may set an undesirable precedent for the future.

22. What information would be appropriate to evaluate settlements and curtailments? Are detailed calculations and support for assumptions as of the remeasurement date required?

The goal of the supporting documentation is to provide the Auditor evidence that the one-time charge or credit to the income statement is appropriate. To reach that conclusion, review of the actual calculation documenting the determination of the charge or credit could be warranted. The amount of information needed will vary based on facts and circumstances. To the extent that the event has more significant repercussions for a Company's financial results, more supporting information might be requested. Likewise, events whose impact is close to the recognition threshold might require documentation to support whether the threshold was breached.

23. Can interim remeasurements (for special events such as a settlement or curtailment) be reviewed during the year so that Companies can avoid year-end surprises? What information is required to be reviewed and how/when can it be provided to the Auditor?

Interim remeasurements that are significant are reported in quarterly financial statements for public companies. The Company would ordinarily be talking with the Auditor throughout the course of the year, and the same information required for a year-end review would typically be required for a review of an interim remeasurement. A Company that does not require quarterly reporting might engage with its Auditor and the Responding Actuary during the year to review the proposed interim remeasurement and obtain their views and identify any questions or supplemental documentation that will be requested as part of the year-end review.

An ongoing dialogue between the Company and Auditor (including the Responding Actuary and Reviewing Actuary as appropriate) regarding any nonstandard approaches can help the Auditor be comfortable with the approach proposed by the Company (or proposed to the Company by the Responding Actuary).

24. Do all measurements have to be performed as of the measurement date?

Generally, yes. ASC 715-30-35-62 provides that "the measurement of plan assets and benefit obligations required by this Subtopic shall be as of the date of the employer's fiscal year-end statement of financial position" with exceptions noted. Similar requirements also apply to other postretirement benefit plans. While pension and OPEB measurements are expected to be as of a particular date, it is not always necessary that all calculations actually be performed after that date. As with other financial statement items requiring estimates, much of the information could be prepared as of an earlier date and projected forward to account for subsequent events (for example, employee service). The Responding Actuary typically reflects all known information when adjusting the calculations, using best estimate assumptions. While the assumptions used in the broader calculations are long term, the roll-forward period assumptions are expected to reflect the short-term environment. Thus, the Responding Actuary typically seeks information to support the assumptions to be used in the roll-forward. This support is generally based on communications between the Responding Actuary and the Company intended to identify trends over the past year (including, for example, how actual pay increases and participant turnover have compared to expected). The Auditor or Reviewing Actuary might ask for this documentation to confirm that the data being used is as close as possible to what it would be if it were actually collected as of the measurement date.

25. When a current year's measurement of expense and year-end benefit obligations is based on a roll-forward from a prior fiscal year, is additional documentation required regarding how this roll-forward was calculated?

Yes, the Reviewing Actuary typically wants to know how the roll-forward was performed and what adjustments (if any) were made. At times, this roll-forward is relatively straightforward and little additional information is needed. In other cases, the Reviewing Actuary might ask for additional information and detail to assess the reasonability of the assumptions used for modeling the short-term changes in participant demographics and other factors affecting the measurement (such as claims costs for an OPEB plan) since the measurement date upon which the roll-forward is based.

26. What does "materiality" mean?

Some often use the term "material" loosely. For an Auditor, however, "materiality" is a very specific concept.[28] Auditors determine what is or is not material by looking at many items in different contexts; materiality is not simply a concept of significant digits but rather involves an accumulation of differences and may be measured over many years. This accumulation and cross-over creates a situation that sometimes results in seemingly small numbers being identified as material for financial statement purposes, while in other cases items that the actuary considers significant relative to the specific plan's results may not be material to the Company's financial statements. As a result, much time

[28] Section 2.6 of ASOP No. 1 includes a discussion of "materiality" with respect to an actuary's work. The concept of materiality from the perspective of compliance with the ASOPs is distinct from the concept of materiality in the context of an auditor's review of a Company's financial statements.

is spent by the Auditor reviewing the sources of what could be material differences when a possible issue arises.

Actuarial reports often state items “considered” but identified as having no material impact on results. It is possible that something may be “material” from the actuary’s perspective with respect to compliance with the applicable ASOPs but not “material” from an audit perspective, or vice versa. From an Auditor perspective, it is more helpful for the Responding Actuary to quantify (perhaps with an upper bound) the effect of the item when advising the Company regarding the impact of assumption changes or the use of alternative assumptions. While the impact of an assumption change might not be significant from an actuarial measurement standpoint, the impact might be material to the overall financial statements. Also, while the Responding Actuary might be indifferent to the use of alternative reasonable assumptions, the Auditor looks for evidence that the alternative selected by the Company represents the Company’s best estimate and typically wants to know whether the use of one equally appropriate alternative results in a material change to the measurement.

27. What may be considered to be “clearly trivial”?

As with materiality, no clear-cut definition for “clearly trivial” exists, but this threshold is much lower than the materiality threshold. The consequences of crossing the “clearly trivial” threshold are less severe in that, rather than requiring a revision of the Company’s financial statements, the item in question may merely be noted in the summary of unadjusted differences to the audit committee of the Company’s board of directors with an indication that there is a disagreement with management regarding certain items in the financial statements.[29] However, because of increasing scrutiny and oversight, management is often uncomfortable acknowledging disagreements with the Auditor and resolves these items before the financial statements are finalized.

As with materiality, for the Auditor to evaluate whether an item is clearly trivial, the difference needs to be quantified. This quantification allows the Auditor to accumulate these adjustments across the entire audit engagement to determine the point at which the adjustments may become relevant in the aggregate.

28. What is the concept of “preferability” in accounting methods?

This concept is also defined in the Auditor’s domain. When a Company wishes to change from one acceptable accounting method to a different acceptable accounting method, the Auditor must agree that the new method is “preferable” to the old one and must issue a Preferability Letter attached to the Company’s financial statements. Preferability involves comparing different but otherwise acceptable approaches and identifying any approach as

[29] An audit adjustment is a correction to the Company’s general ledger proposed by the Auditor. It indicates a disagreement between the Company and the Auditor. A passed adjustment is an adjusted difference that the Auditor considers to not be material to the financial statements.

having an advantage over other approaches that are available in the context of the Company's particular facts and circumstances. A common example seen in practice is the method of amortizing actuarial gains and losses. In most situations, faster amortization of gains and losses would be considered preferable to slower amortization.

While the Auditor ultimately determines whether the elected method is preferable, some considerations may be as follows:

- What effect will changing an approach have on the income statement or the balance sheet?
- Does the approach move the reporting toward or away from marking to market?

29. Responding Actuaries may present an idea to a Company that the Auditor indicates would be a change in accounting principle. What does this mean?

If a Company changes how it measures or recognizes benefit obligations, plan assets, or annual expense and the Auditor determines that change to be a change in accounting principle, the Company is required to disclose what the differences in the financial reporting would have been if the new method had been used since the inception of reporting. This is referred to as "retrospective application" of the change in accounting principle. Note that retrospective application is different from an actual restatement of the financial results for prior periods, which may occur when an error is discovered in those prior period results (see the following question). Clearly, performing retrospective application on an exact basis requires significant time and effort. In some situations, the Auditor may be open to discussing approximations or estimates (sometimes referred to as "computational shortcuts" in the accounting standards) as a possibility in lieu of exact calculations when retrospective application is required. In any case, it is important to have a dialogue with the Auditor so that all parties agree that the financial statements are providing appropriate information.

When a Responding Actuary proposes any change to process used to determine the financial statement information, it is useful to involve the Auditor early to evaluate whether the change will be considered a change in accounting principle or simply a change in process or estimate.

30. What is an "error in previously issued financial statements"?

In ASC 250-10-20, the accounting standards codification defines this term as, "An error in recognition, measurement, presentation, or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of generally accepted accounting principles (GAAP), or oversight or misuse of facts that existed at the time the financial statements were prepared."

A nonstandard, though acceptable, approach or estimate is not an error in previously issued financial statements (of course, a nonstandard approach may also warrant a deeper level of review). The use of the term "error" does not necessarily imply that the actuary made a mistake or did not comply with professional standards—the actuary may have followed the Company's instructions, but the instructions or data provided could have been inappropriate or insufficient.

Examples of errors in financial statements include issuing financial statements that are based on significantly incomplete or inaccurate census data or which otherwise do not reflect all relevant information that was known (or knowable) to the Company as of the measurement date.

In the case of a potential error in previously issued financial statements, the Auditor may ask questions such as:

- What was done this year and how was it done in the past?
- How long has it been done this way?
- What is the quantification of the difference?

If such an accounting error is identified and is determined by the Company or Auditor to be material, the Company's financials for the affected periods may need to be restated. Doing so could involve a significant amount of work and could negatively affect how the Company is viewed in the marketplace, particularly if financial statement users view the restatement as reducing the credibility of the Company's other published financial results.

Final Thoughts

The audit review process is designed with the goal of providing well-documented evidence that the information reported for a Company's retirement plans appropriately represents the value of those plans. Just as actuarial practice and the ASOPs evolve over time, so do the standards for the work done by Auditors in reviewing a Company's financial statements. Many Responding Actuaries have observed the changes and enhancements made to audit procedures in recent years through their interactions with Auditors and Reviewing Actuaries. By better understanding why Auditors and Reviewing Actuaries ask the questions they do, and what type of information they may expect to receive in response, Responding Actuaries are better able to prepare in advance and work with their principals to improve the year-end audit experience. Actuaries may also be better able to anticipate questions that could be asked in response to future changes in actuarial practice, and what information to consider, document, and communicate in actuarial reports when those changes are implemented.