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A Review of Government Oversight of Multi-Employer Public Sector Pension Plans in British Columbia

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OFFICE OF THE
Auditor General
of British Columbia

LOCATION:

8 Bastion Square
Victoria, British Columbia
V8V 1X4

OFFICE HOURS:

Monday to Friday
8:30 a.m. – 4:30 p.m.

TELEPHONE:

250 387–6803
Toll free through Enquiry BC at: 1 800 663–7867
In Vancouver dial 604 660–2421

FAX: 250 387–1230

E–MAIL: bcauditor@bcauditor.com

WEBSITE:

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OFFICE OF THE

Auditor General

of British Columbia

The Honourable Claude Richmond
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
V8V 1X4

Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2002/2003 Report 9: A Review of Government Oversight of Multi-Employer Public Sector Pension Plans in British Columbia.

Wayne Strelioff, CA
Auditor General

Victoria, British Columbia
February 2003

copy: Mr. E. George MacMinn, Q.C.
Clerk of the Legislative Assembly

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Project team:

Senior Principal: *Endre Dolhai*

Project Leader: *Owen Trist*

Project Leader: *Deborah Law*

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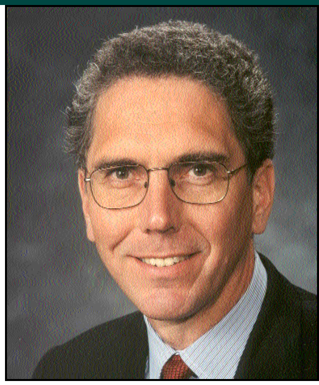


Wayne Strelioff, CA
Auditor General

Until recently public sector pension plans in British Columbia were managed wholly by the provincial government. In July 1999, however, the government passed the Public Sector Pension Plans Act. This legislation transformed the College Pension Plan into a joint management model and set out a process for negotiating other joint management agreements for the Municipal, Public Service, and Teachers' pension plans—agreements that were subsequently concluded.

Joint management of the plans took effect on the following dates: College Pension Plan on April 1, 2000; Public Service Pension Plan on January 1, 2001; and the Municipal and Teachers' pension plans on April 5, 2001. About 360,000 people are members of these plans.

Under these new arrangements, governance of the plans has changed significantly. Government now has less responsibility for, and less control over, the four pension plans than it had previously. Nevertheless, it continues to be a major contributor to each plan and is also responsible for half of any unfunded liability that occurs within any of the plans. It, as well as the Legislative Assembly, therefore must be assured that the pension plans are well managed and will continue to provide effective and efficient services to plan members.

We carried out this review to assess whether the government has identified the risks associated with the new public sector pension plan arrangements and whether it is managing such risks adequately. In our review we sought answers to the following questions:

- Did the government clearly set out what it wanted to achieve from the Public Sector Pension Plans Act and have those results been achieved?
- Did the government adequately identify and manage the risks associated with the new public sector pension plan arrangements?
- Has the government established an appropriate oversight process with which to monitor pension plan management?
- Is the government adequately fulfilling its accountability obligations to the Legislative Assembly in reporting on public sector pension plans?

We did not assess:

- governance and administration of the pension plans themselves, including whether current contribution rates are actuarially sound;
- operations of the British Columbia Pension Corporation and the British Columbia Investment Management Corporation; or
- the consultation process with plan members that preceded the joint management agreements, and whether plan members achieved their goals related to the new pension plan arrangements.

Overall Conclusion

We concluded that the government set out what it wanted to achieve from the Public Sector Pension Plans Act and it has generally achieved what it set out to. It is adequately managing the risks associated with the new arrangements and recognizes the importance of ongoing monitoring of the plans. However, it needs to develop its capacity to do so and to secure access to the information it requires to discharge its oversight responsibilities. As well, it has to determine what it should report to the Legislative Assembly, in addition to information provided in the Public Accounts, about how it is fulfilling its oversight responsibilities.

Key Findings

The government has generally achieved the results it wanted to achieve by devolving management of the four public sector pension plans

The government hoped to achieve a number of goals by entering into joint management agreements for its public sector pension plans.

- It wanted to reduce the conflicts related to pension plan governance and management by providing increased participation by employees and employee representatives in plan administration.
- It wanted to reduce its exposure to the risk of future increases in pension contribution rates. Under the previous arrangements, government and other public sector employers were responsible for all unfunded liabilities associated with the pension plans.

Although government was in a position to control the contribution rates of both employees and employers, any increase in employee contribution rates would likely have been contentious.

- It wanted to reduce employer contribution rates. The nominal contribution rates were greater for employers than employees in all four pension plans.

By negotiating the agreements, the government ensured that the risks between public sector employers and their employees were shared, and it also removed several points of ambiguity and contention that existed under previous pension plan arrangements.

When they entered into joint management agreements with employee representatives (mostly trade unions and professional associations), the government and other public sector employers gave up exclusive ownership of current and future surpluses in pension plans. In return they secured agreement to share equally with plan members any future unfunded liabilities of the pension plans. As well, they secured agreement to balance the contribution rates of employers and plan members to the pension funds. The government also stopped making direct payment of Medical Services Plan premiums, extended health, and life insurance benefits for retired members under the Public Service Pension Plan. Under the new arrangements, these benefits will be paid out of employer contributions to the inflation adjustment account.

The risks associated with the current public sector pension plan arrangements are essentially the same in nature, but reduced in magnitude, as those under the previous arrangements

The fundamental risk associated with a defined benefit pension plan is that insufficient money will be available in the pension fund to pay the basic pensions that plan members have been promised. This risk was present before the four pension plans were transformed to joint management, and it remains present under the current joint management model. However, under the new arrangements, the obligation to eliminate any unfunded liability arising during the period of joint management, by increasing the rates of contribution to the plans, will be shared equally between employers and employees.

An unfunded liability can occur for a number of reasons, but the most likely reason is lower than expected real investment returns. The level of investment return is not within government control. However, this and other sources that might contribute to unfunded liabilities can be monitored with a view to developing appropriate strategies to mitigate their effects.

One risk that the government recognized was that the boards of trustees of the public sector pension plan, many of whom are plan members themselves, might elect to enhance pension plan benefits and thereby be creating additional obligations for the government. To preclude such an event, each joint management agreement (as well as Schedule A of the Public Sector Pension Plans Act for the College Pension Plan) requires that certain changes to plan rules first receive approval of the plan partners including, in each case, the government.

Board appointments are not well coordinated or planned

The government and other pension plan partners are responsible for appointing trustees to the pension boards. The partners have generally been making these appointments without consulting each other or the pension plan boards to ensure that people with the appropriate knowledge and skills required to discharge the board's governance responsibilities are appointed. I think it is important for all the plan partners to develop a common approach to board appointments to ensure that the trustees selected best meet the needs of the boards.

An independent oversight process is necessary to monitor pension plan management

A pension plan is a trust and the trustees of the plan have an obligation to keep plan members' interests uppermost in their minds. In the case of public sector pension plans, the responsibility for protecting the public interest lies with government.

The Public Sector Employers' Council Secretariat (PSEC) is responsible for oversight of public sector pension plans, as well as for supporting government in its role as a plan partner under the joint trust agreements. A number of staff members within PSEC, as well as employees in other branches of government, serve as trustees for one or more of the plans. Some staff members with oversight responsibilities also serve as trustees. This creates the potential for conflict between responsibilities that should be avoided. Government needs to ensure that it has sufficient capacity to effectively monitor the pension plans, and to discharge its plan partner responsibilities, without putting individuals into conflicts between their oversight and trustee responsibilities.

In order to provide effective oversight of the pension plans, the government must be informed about all matters that can affect its obligations with respect to the plans. These matters concern unfunded liabilities identified in periodic actuarial valuations, proposed changes to pension plan rules and plan investment policies. The government has identified what information it needs to monitor the results and risks associated with devolution of pension plan control to joint management, and is in the process of making arrangements to gather the information from appropriate sources.

The Legislative Assembly should be provided with accountability information about how the government is fulfilling its oversight responsibilities of the four public sector pension plans

Now that the four public sector pension plans are operating at arm's length from the government, the Legislative Assembly's need for information about the plans and the administrative structures that support them is different than when the government fully controlled the plans. However, the government is still accountable to the Legislative Assembly and the public for its oversight of the plans.

We found that the government is providing the required pension related financial information in the Public Accounts of the Province. However, it has not yet determined what information it should report on how it is fulfilling its oversight responsibilities of the four pension plans.

Auditor General's Comments

The findings and conclusions presented in this report are based on evidence gathered during the summer and fall of 2002.

Our examination was carried out in accordance with the standards for assurance engagements recommended by the Canadian Institute of Chartered Accountants and, accordingly, included such tests and other procedures as we considered necessary in the circumstances.

I acknowledge and thank all the individuals who provided us with information and explanations we required to complete this review.

Our Recommendations

We recommend that the government:

1. **Work with other plan partners to establish processes for dealing with pension plan governance or administration issues, such as the appointment of trustees, that need consultation between plan partners.**

2. **Ask the boards to provide information on the knowledge, skills and experience they need as a whole and to identify their specific needs when vacancies occur. The government should then work with the other plan partners to determine how best to fill those vacancies.**

3. **Ensure that it has sufficient resources familiar with pension plan issues and capable of effectively monitoring the plans.**

4. **Arrange to obtain the information it needs, to monitor the management of the public sector pension plans, on a timely basis.**

5. **Determine what information, in addition to that presented in the Public Accounts of the Province, it should report to the Legislative Assembly and the public about how it fulfills its oversight responsibilities relating to the public sector pension plans; and it should provide that information on a timely basis.**

Detailed Report

Background

Pension plans can be set up as defined benefit plans, defined contribution plans or a mix of both. A defined benefit plan provides a pension based on a benefit formula that is tied to the plan member's salary, age and years of service. A defined contribution plan provides a pension based on the contributions made by the plan member and / or the employer, plus the investment earnings on the contributed funds.

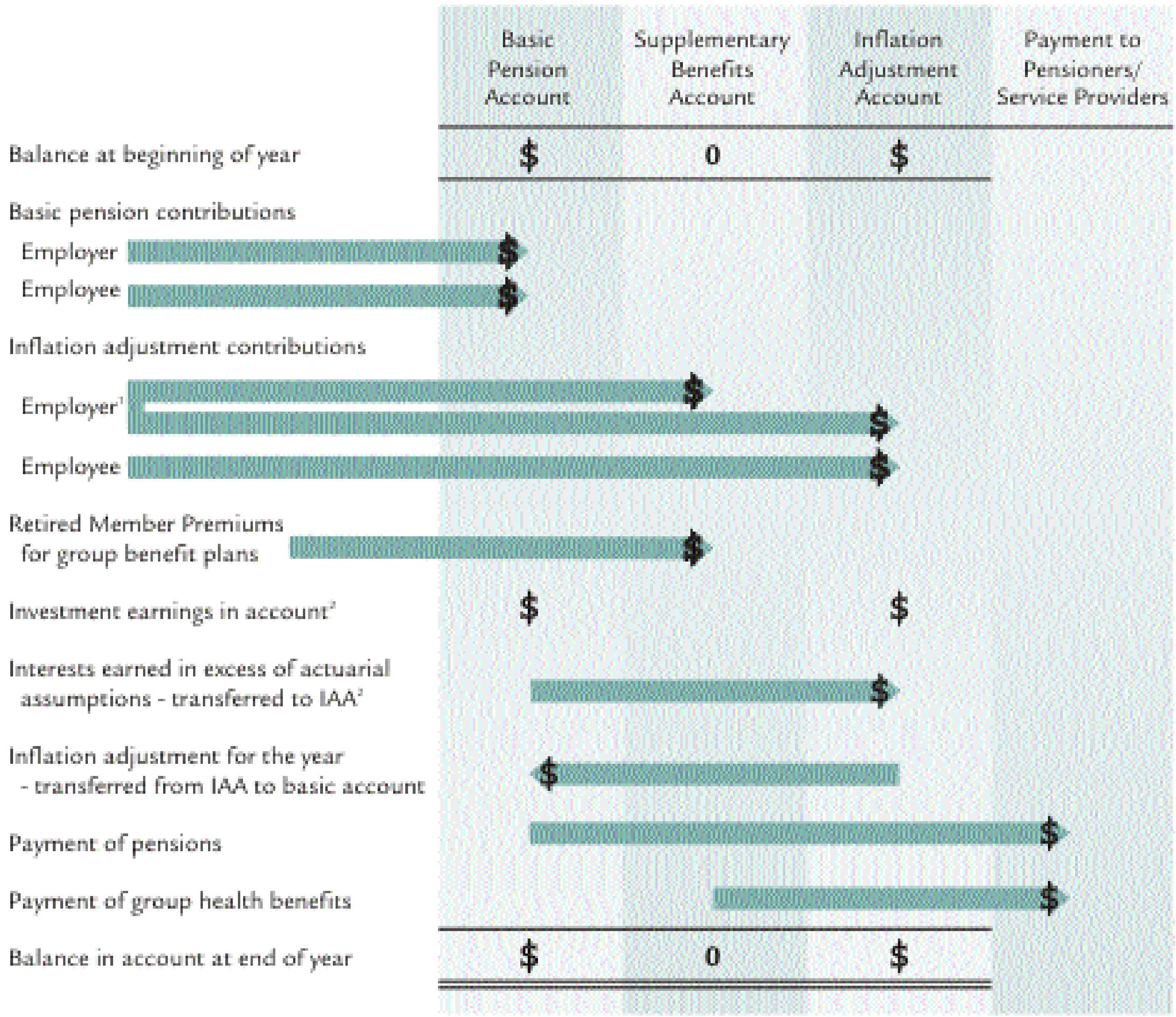
Pensions are one of the significant benefits associated with public sector employment. Most public sector pension plans are described as defined benefit plans. However, the four pension plans devolved to joint management by the British Columbia government—the College, Municipal, Public Service, and Teachers' pension plans—might be described as a combination of defined benefit and defined contribution plans.

The *basic pension benefit* for all four pension plans is a defined benefit, derived mostly from years of service and salary level (adjusted, in some cases, by age at retirement). This benefit is funded by employee and employer contributions made to the basic account of each plan's pension fund, plus investment earnings. The basic account of each pension fund is subject to an actuarial valuation every three years, which determines whether the fund has a surplus or an unfunded liability. The results of the actuarial valuation, along with the advice of the plan actuary, determine the level of contributions required in the future to restore the fund to equilibrium. All pension payments are made from this account.

The *indexation benefit*—which provides for increases to the basic benefits of retired plan members to compensate for the effects of inflation—has been described as a defined contribution promise of the pension plan. The inflation adjustment account of each plan is funded in several ways: by employee contributions to the inflation adjustment account, by employer contributions to the inflation adjustment account (except what is required to pay for pensioner group health benefits), by investment earnings on the portion of the basic account held for the benefit of already-retired members that exceed the rate of return assumed by the actuary; and by investment earnings on the inflation adjustment account balance for the year. (See Exhibit 1 for an illustration of funding of pension and group health benefits).

Exhibit 1

Funding of the pension and non-pension funds



[1] The employer inflation adjustment contribution is used to pay for supplementary pension benefits with the residual amount going to the inflation adjustment account.

[2] Investment earnings of the Inflation Adjustment Account are retained in the account. Investment earnings of the Basic Account (up to actuarial assumptions) are retained in the Basic Account with excess (above actuarial assumptions) investment earnings, on assets held to offset liabilities to already retired members are transferred to the Inflation Adjustment Account.

Indexing is contingent on funds being in the inflation adjustment account of the pension fund. Indexation benefits are permanent increases to the basic benefits that retired plan members receive. The full present value of the cost of an inflation adjustment is transferred from a pension plan's inflation adjustment account to the basic account when the decision to grant an inflation adjustment is made. The result is that each year's increase is fully funded at the time it is granted.

Pensioner *group benefits* are supplemental benefits that are not part of the registered pension plans. Health benefits for retired employees (medical services plan, extended health and dental plans) are paid from a supplementary benefits account that is funded partially from premiums paid by retired plan members who choose to participate in the group benefit plans, and partially from the employers' portion of contributions that would otherwise go into the inflation adjustment account. The amount in health benefits available annually is limited to the amount collected during the year in premiums and contributions.

Before devolution of public sector pension plan management, the government was responsible for the plans

Up until the last couple of years, the four public sector pension plans were controlled and administered exclusively by the government. The basic elements of the pension plans were set out in legislation and the administrative rules were set out in regulations. This meant that the government controlled both the content and the timing of any changes to the pension plans—notably determining what pension benefits were available, and what contributions had to be made by employees and employers to the pension funds. The government also determined how pension funds were to be invested until needed to pay pension benefits to plan members.

Investments for all four pension funds were managed by the Office of the Chief Investment Officer, and the Superannuation Commission was responsible for the administration of the plans —the collection of contributions and the payment of benefits. Both organizations were formerly part of the Ministry of Finance and Corporate Relations.

The government initiated pension reforms in 1994

In 1994, the government passed legislation that created pension advisory boards for each of the four main public sector pension plans. The boards were responsible for directing the application of pension plan rules, recommending changes to benefits and funding policies, reviewing and making recommendations about pension fund investment policy, and hearing appeals. The boards were required to make an annual report on the operation of each pension plan, fund and board, as well as to perform certain other administrative duties.

The boards were also intended to provide a forum in which pension plan reform could be discussed by the plans' members and sponsors, including the government. Once consensus was reached, each board would recommend, to the minister responsible for pension plans, changes to benefits and funding policies.

The advisory boards were seen to be a tool in the transition to joint governance—a transition that would lead to pension plans eventually being independently governed at arm's length from the provincial government.

In 1999, the Public Sector Pension Plans Act was passed

In July 1999, the Public Sector Pension Plans Act was passed. At that time, the four pension plans affected by the Act were described as covering over 220,000 public sector employees working for approximately 800 public sector employers, plus approximately 71,000 retired plan members receiving a monthly pension. The assets of the four plans exceeded $30 billion.

When the legislation was introduced, it was described as being "the culmination of a lengthy dialogue and consensus reached among the boards of the four statutory pension plans, the provincial and municipal governments and the major public sector unions." According to the government, the new reforms would fulfill its 1994 commitment to modernize pension statutes.

The Act provided for the continuation of the four pension plans—College, Municipal, Public Service, and Teachers'—each under the management of a board of trustees appointed by the stakeholders of each plan. Stakeholders included the provincial government, trade unions, and active and retired plan members.

The terms of joint management for the College Pension Plan were set out in the Act. A similar arrangement was also available as an option for the other three plans if the government and other stakeholders could agree on terms.

In the two-year period following passage of the Act, joint management agreements, (also known as joint trust agreements) were subsequently concluded for the Municipal, Public Service and Teachers' pensions plans, and various sections of the Act were brought into force.

Joint management of the four plans thus took effect as follows: College Pension Plan, April 1, 2000; Public Service Pension Plan, January 1, 2001; and Municipal and Teachers' pension plans, April 5, 2001.

The Act established joint management of the College Pension Plan

The Public Sector Pension Plans Act continued the College Pension Plan and the College Pension Fund that existed under the Pension (College) Act. The legislation also established the College Pension Board of Trustees, with half the board members being appointed by plan employers and half being appointed by the unions representing plan members.

The members of the board are the trustees of the pension plan and the pension fund. They are responsible for:

- administering the pension plan;
- managing the pension fund;
- establishing investment policy and the asset mix of the fund; and
- monitoring the performance of the plan administrator (the British Columbia Pension Corporation) and the investment manager (initially, the British Columbia Investment Management Corporation).

The College Pension fund is described as being "for the sole benefit of plan members," with government having no claim on the assets of the fund, except where it is agreed that government can use surplus assets identified in an actuarial valuation report to reduce or eliminate employer contributions for a period of time.

The Act authorizes the College Pension Board of Trustees to make regulations prescribing the pension plan rules.This the board has already done. The regulations describe entitlement to participate in the plan, contribution rates for both employees and employers, eligibility for benefits, calculation of benefits, administration of the pension fund (including the sources and applications of accounts within the fund), and general administrative requirements.

The plan rules can be amended: some amendments must be made in order to ensure that plan rules comply with legislation, some amendments must be made if the plan partners direct the board to do so, some amendments may be made if the partners approve, and some amendments may be made on the board's authority alone.

Joint management agreements have since been established for the other pension plans

The Public Sector Pension Plans Act provided for the continuation of the Municipal, Public Service and the Teachers' pension plans, each under the management of a board made up of persons nominated by the stakeholders of each plan and appointed by the Lieutenant Governor in Council.

Unlike it did for the College Pension Plan, the Act did not set out the actual terms of a joint management arrangement for the other three pension plans. It simply provided the plan partners with an opportunity to enter into a unanimous agreement concerning governance of each plan and deal with the issues set out in the schedules of the Public Sector Pension Plans Act.

Since the Act was passed, such agreements have been reached for each of the three plans. All of the agreements are very much like the statutory arrangements that established the College Pension Plan, except they are established by contract, rather than by legislation.

Background

For each of the plans, the Public Sector Pension Plans Act identified the plan partners who were authorized to negotiate joint management agreements which provide for:

- continuation of the pension plans and pension funds for the benefit of plan members;
- joint management of the pension plans and the pension funds;
- establishing who will manage the agreements;
- establishment of an arrangement to hold and invest the pension funds;
- composition of the boards of trustees of the pension plan, including the appointment of trustees and the delineation of their powers, functions and duties;
- sharing by employers and plan members of gains or surplus and of liability for deficiencies in the pension funds;
- a method for amending the pension plans by the agreement of the partners; and
- resolution of disputes.

The partners for the four public sector pension plans are identified in Exhibit 2. The employer partners are the government and employers' associations and the plan member partners are unions and professional associations. In some cases the plan partners were re-defined in the joint management agreements, and are therefore slightly different than those defined in the Public Sector Pension Plans Act.

The plan partners are responsible for approving changes to pension plan rules that result in increases to contribution rates or the creation of, or increase in, an unfunded liability. The partners can direct the board of trustees to amend pension plan rules in certain circumstances.

The partners can also amend or terminate the agreements, but only after consulting with the board of trustees or receiving a recommendation from them.

Exhibit 2

Partners in British Columbia pension plans

Pension Plan	Employer Partners	Member Partners
College	Government of British Columbia Post Secondary Employers' Association	College Institute Educators' Association British Columbia Government and Service Employees' Union
Municipal	Government of British Columbia Union of British Columbia Municipalities	Municipal Employees' Pension Committee, representing: ■ British Columbia Nurses Union ■ Canadian Union of Public Employees (BC Division) ■ Health Sciences Association of British Columbia ■ Health Employees' Union ■ British Columbia Federation of Police Officers ■ British Columbia Professional Firefighters' Association ■ Council of Joint Organizations and Unions
Public Service	Government of British Columbia	British Columbia Government and Services Employees' Union
Teachers'	Government of British Columbia	British Columbia Teachers' Federation

Source: Public Sector Pension Plans Act and Public Service, Municipal and Teachers' joint trust agreements

Each pension plan is governed by a board of trustees

Each of the four pension plans has a board of trustees with a specified number of members (Exhibit 3). Trustees are appointed by the plan partners and major stakeholders.

Board members are the trustees of the pension plans and the pension funds. In that capacity they are responsible for the administration of the pension plans and the management of the funds. Their duties therefore include:

- investing and managing the pension fund in a prudent manner;
- establishing pension plan rules;

- contracting with, and directing, the plan administrator, the Pension Corporation;
- appointing investment managers, the Investment Management Corporation or other investment managers;
- establishing investment policy and monitoring investment performance; and
- appointing an actuary, an auditor and other professionals in order to ensure proper financial reporting and accountability.

Boards of trustees also have authority to allocate available actuarial gains to one or more of four specified options. If an actuarial valuation report indicates that a pension plan has surplus assets, the board may elect to: transfer some or all of the surplus to a reserve established for the purpose of stabilizing contribution rates; transfer some or all of the surplus to the inflation adjustment account; apply some or all of the surplus to reduce, equally, employee and employer contributions to the basic account; or apply some or all of the surplus to make changes to pension benefits.

Exhibit 3

Membership of the boards of trustees of British Columbia public sector pension plans

Pension Plan	Board Members Appointed by Employer Partners and Stakeholders	Board Members Appointed by Member Partners and Stakeholders	Total Board Members*
College	5	5	10
Municipal	8	8	16
Public Service	7	7	14
Teachers'	5	5	10

*Each board has the option of designating one of the existing members as the chair of the board, or appointing an additional board member as the chair. All of the initial boards of trustees have chosen the latter option.

Source: Public Sector Pension Plans Act and Public Service, Municipal and Teachers' joint trust agreements

The Act created the British Columbia Pension Corporation and the British Columbia Investment Management Corporation

The role of the British Columbia Pension Corporation is to provide pension plan administration services to the boards of the four public sector pension plans and to any other clients that retain the corporation's services. Legislation and the agreements state that boards of the four pension plans are required to retain the services of the Pension Corporation.

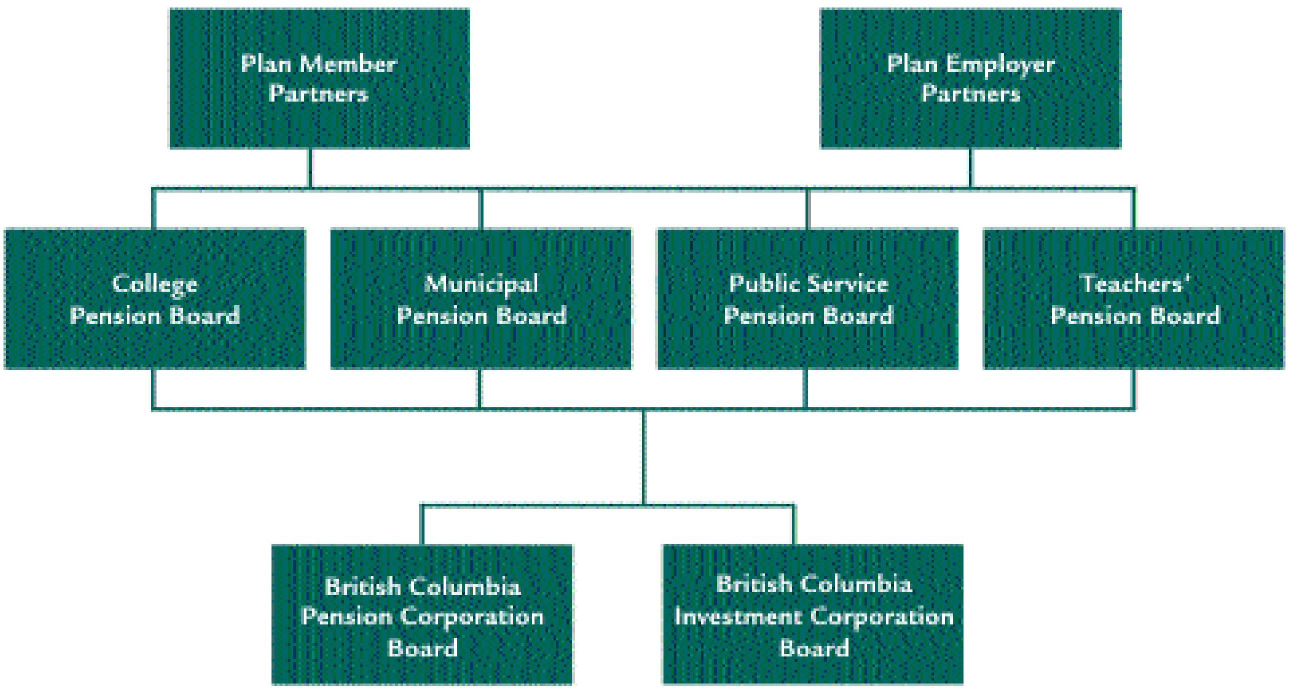
The role of the British Columbia Investment Management Corporation is to provide funds management services for client funds placed with it. None of the pension plans are obligated to use the services of the Investment Management Corporation beyond a short initial period (one year after the first post-devolution actuarial valuation report has been prepared).

Both the Pension Corporation and the Investment Management Corporation are wholly-owned by the government, with the single share of each corporation being held by the Minister of Finance. Each of the boards of the four pension plans appoints two directors of the Pension Corporation; those directors can either designate one of themselves to serve as chair of the board, or appoint an additional director to serve as chair. Of the seven members on the management board of the Investment Management Corporation, four are appointed by the boards of trustees of the pension plans and three are appointed by the Minister of Finance (two of whom to represent clients other than the pension plans). The third appointee of the Minister is designated as the chair of the board.

Exhibit 4 illustrates the relationship between plan partners, boards of trustees, and the two corporations.

Exhibit 4

Accountability relationship between plan partners, boards of trustees, and the British Columbia Pension Corporation and Investment Management Corporations



All pension plans have reported surpluses after devolution

As the Exhibit 5 shows, before devolution to joint management, the College and Public Service pension plans had surpluses, and the Municipal and Teachers pension plans had unfunded liabilities. Exhibits 5 and 6 summarize pertinent financial and other information for each pension plan before and after the change to joint management arrangements.

Exhibit 5

Pension plans as they existed before the Public Sector Pension Plans Act

(based on closest fiscal year-end information, not date of joint management)

	College Plan	Municipal Plan	Public Service Plan	Teachers' Plan
Members	August 31, 2000	December 31, 2000	March 31, 2001	December 31, 2000
Active	7,962	120,048	58,572	48,888
Retired	1,788	34,269	23,950	16,319
Inactive, or Vested and Deferred	1,561	15,668	10,506	9,326
	August 31, 2000	December 31, 2000	March 31, 2001	December 31, 2000
Market value of investment of the plan	$1.34 billion	$15.2 billion	$11.7 billion	$11.1 billion
	August 31, 1997	December 31, 1997	March 31, 1999	December 31, 1999
Actuarial Valuation (for funding purposes)[1]	$57 million surplus	$548 million unfunded liability	$929 million surplus	$454 million unfunded liability
	Year ended August 31, 2000	Year ended December 31, 2000	Year ended March 31, 2001	Year ended December 31, 2000
Member Contributions	$21.7 million	$289 million	$141 million	$140 million
	Year ended August 31, 2000	Year ended December 31, 2000	Year ended March 31, 2001	Year ended December 31, 2000
Employer Contributions	$17.4 million	$328 million	$127 million[2]	$206 million
Date of Devolution	April 1, 2000	April 5, 2001	January 1, 2001	April 5, 2001

[1] There are several types of actuarial valuation of pension plans. One approach, an accrued basis valuation, is used for accounting purposes. This valuation assesses the actuarial value of the fund at the date of valuation, and the liabilities that have been accrued for service up to that date. For funding purposes, plans use an entry-age basis valuation that assumes the plan will continue indefinitely. This valuation includes, in its analysis, the value of future contributions and investment returns, and additional liabilities arising from future service, future expenses, and salary growth. The results of this valuation are used by an actuary to make recommendations for appropriate contribution rates for the next period.

[2] During the year ended March 31, 2001, employer contributions were reduced because the employer claimed a partial contribution holiday based on the 1999 actuarial surplus.

Source: Pension plan annual reports

Exhibit 6

Pension plans after implementation of the Public Sector Pension Plans Act

(based on closest fiscal year-end information, not date of joint management)

	College Plan	Municipal Plan	Public Service Plan	Teachers' Plan
Members	August 31, 2001	December 31, 2001	March 31, 2002	December 31, 2001
Active	8,670	124,855	56,342	49,435
Retired	1,924	36,278	24,615	17,293
Inactive, or Vested and Deferred	1,677	16,447	12,055	9,573
	August 31, 2001	December 31, 2001	March 31, 2002	December 31, 2001
Market value of investment of the plan	$1.25 billion	$15.1 billion	$12.1 billion	$10.8 billion
	August 31, 2000	December 31, 2000	March 31, 2001	December 31, 2000
Actuarial Valuation (for funding purposes)	$120 million surplus	$436 million surplus	$777 million surplus[1]	$216 million surplus[1]
	Year ended August 31, 2001	Year ended December 31, 2001	Year ended March 31, 2002	Year ended December 31, 2001
Member Contributions	$24 million	$308 million	$151 million	$159 million
	Year ended August 31, 2001	Year ended December 31, 2001	Year ended March 31, 2002	Year ended December 31, 2001
Employer Contributions	$24 million	$345 million	$182 million	$225 million[2]

[1] Extrapolated from previous actuarial valuation.

[2] Excludes a $10.5 million government contribution for period January 1 to May 31, 2001 that was required by the Joint Trust Agreement

Source: Pension plan annual reports.

In the following sections of the report we examine whether the government:

- clearly set out what it wanted to achieve from the Public Sector Pension Plans Act and whether those results have been achieved;
- adequately identified and managed the risks associated with the new public sector pension plan arrangements;

- established an appropriate oversight process with which to monitor pension plan management; and
- is adequately fulfilling its accountability obligations to the Legislative Assembly in reporting on public sector pension plans.

Did the government clearly set out what it wanted to achieve from the Public Sector Pension Plans Act and have those results been achieved?

The decision to negotiate joint management of the pension plans was a significant one, involving the transfer of billions of dollars to organizations intended to be at arm's length from the government. We therefore expected the government to have identified, in advance of the legislative change, the benefits that it expected would result from entering into joint management agreements.

We concluded that the Public Sector Pension Plans Act and the joint management arrangements for the four public sector pension plans covered by the Act have achieved the results the government wanted.

The government clearly identified the results it wanted to achieve from sharing management of the pension plans

On June 11, 1998, the Minister of Finance and Corporate Relations wrote to the president of the British Columbia Government and Service Employees' Union asking the Public Service Pension Advisory Board to outline a joint trusteeship structure for its pension plan that reflected:

- equal sharing of responsibility for management of the pension asset in the best interest of the beneficiaries;
- agreed to sharing of contributions;
- equal sharing of responsibility for any unfunded liabilities generated during the period of joint trusteeship;
- equal ownership of any surpluses generated during the period of joint trusteeship; and
- protection of the plan from unilateral actions by plan sponsors or principals.

The Minister asked that the Public Service Pension Advisory Board to work in collaboration with a governance committee established jointly with the other three statutory pension boards because the governance model developed for the Public Service Pension Plan would have implications for the others.

Over the next two years, the government's negotiators reached agreement with the Government and Service Employees' Union, the Professional Employees Association and the Union of Psychiatric Nurses on the elements of a joint management agreement for the Public Service Pension Plan.

The government recognized the benefits and risks of sharing management of pension plans

The Public Sector Pension Plans Act, passed in July 1999, provided for joint management of the College Pension Plan. The Act also anticipated joint management agreements for the other three public sector pension plans.

When the legislation was introduced, the Minister stated that the changes in pension management provided for in the Public Sector Pension Plans Act were "progressive advances in the way the pension plans and their funds [would be] managed on behalf of plan members and [would] bring this legislation into line with legislation that exists all across the country."

Joint trusteeship, stated a Ministry of Finance and Corporate Relations briefing document, would afford several advantages:

- Reduction of downside risk associated with unfunded liabilities resulting from a changing economic climate. According to the Ministry, if a series of "bad news" actuarial valuations were to occur, each one might drive the employer contribution rate up, and any new unfunded liability would have to appear in the government's income statements. A joint trusteeship agreement, said the Ministry, would halve the risk of those adverse circumstances.
- Positive human resources management implications. The existing pension governance relationships were seen to be very paternalistic. The new arrangement would respond to members' growing expectations of consultation and meaningful participation in the affairs of their pension plans.

- The possibility of the employer being able to reduce the balances of unfunded liabilities that were recorded in the financial statements of the Province.

The major disadvantage of joint trusteeship was that the employer would have to give up half its claim on any future surpluses generated by a pension plan, and unilateral control of management of the plan. However, it was recognized that this theoretical discretion was already fettered by the realities of public sector collective bargaining (although pensions were not formally negotiated) and had become a growing source of friction with employees.

The government clearly established its negotiating objectives

The Ministry of Finance and Corporate Relations proposed that a mandate for negotiating joint trusteeship for the Public Service Pension Plan include:

- allocation of plan surpluses;
- adjustment of employer contribution rates;
- establishment of workable and sustainable governance arrangements (similar to those already established and set out in the Public Sector Pension Plans Act for the College Pension Plan); and
- establishment of pensioner group benefits as a contingent benefit funded from the inflation adjustment account (benefits were, at that time, mostly paid for directly by the government).

The government's negotiating objectives for a joint management agreement for the Public Service Pension Plan were:

- to reduce the employer contribution rate to match employee contributions (a change that was estimated to save Public Service Pension Plan employers $52 million per year); and,
- to move pensioner benefits funding to the inflation adjustment account.

The government generally achieved the results it wanted

Transition of the Public Service Pension Plan

The joint management agreement that provides for the Public Service Pension Plan illustrates how the government achieved the results it wanted from devolution of the four public sector pension plans. The agreement, which was consistent with the principles originally set out in the Minister's 1998 letter proposing restructuring, provides for:

- equal sharing of future unfunded liabilities, with allocation of future surpluses to be determined by the board of trustees;
- a governance model that incorporates a decision rule so that the support of at least two Government and Service Employees' Union-appointed trustees and two government-appointed trustees is required to pass a board resolution;
- a reduction in the employer contribution rate to the basic account from 9.25% to 5.75% (to match the employee rate); and
- an increase in the employer contribution rate to the inflation adjustment account from 1.25% to 2.25%, plus a one-time transfer to that account of $100 million from the surplus in the basic account, in return for transferring responsibility for funding pensioner group benefits from the consolidated revenue fund to employers' contributions to the inflation adjustment account of the Public Service Pension Fund.

The government also negotiated similar joint management agreements for the other three public sector pension plans. Although it has not achieved equal contribution rates for the Municipal and Teachers' plans, because these plans did not have surpluses at the time joint management agreements were being negotiated, government has secured agreement on the financial circumstances and courses of action that is expected to lead to roughly equal contribution rates for each plan.

Transition of the Teachers' Pension Plan

The government knew that it would likely be unable to enter into a joint management agreement for the Teachers' Pension Plan unless it was willing to increase employer contribution rates to a level that would eliminate the large unfunded liability for the plan.

The proposed strategy was therefore to avoid the risk of government being solely responsible for any future increases in the plan's unfunded liability.

Arrangements for transition of the Teachers' Pension Plan to joint management include commitments to use surplus assets and actuarial gains to eliminate any unfunded liability, and then to rebalance employer contribution rates relative to member contribution rates.

A series of steps set out in an appendix to the joint management agreement illustrates how contributions will be rebalanced over time (Exhibit 7). The initial step in the transition arrangements included a 1% increase in employer contributions to the basic account and a 1% increase in member contributions to the inflation adjustment account. No dates have been set for when further steps will take place. Implementation of the commitment requires that there be an actuarial surplus in the plan.

Exhibit 7

Future changes to contribution rates for the Teachers' Pension Plan

	Employer Contribution Rates %		Plan Member Contribution Rates %	
	Basic Account*	Inflation Adjustment Account	Basic Account*	Inflation Adjustment Account
Previous	9.5	1.13	6.5	1.0
Current	10.5	1.13	6.5	2.0
Step 2	9.5	1.63	6.5	2.0
Step 3	8.5	2.13	6.5	2.0
Step 4	7.5	2.13	6.5	2.0
Final	6.5	2.13	6.5	2.0

*Contribution rates are shown at maximum rates. Actual contribution rates are reduced by 1.5% on earnings below the year's maximum pensionable earnings as determined by the Canada Pension Plan.

Source: Teachers' Pension Plan joint trust agreement

Transition of the Municipal Pension Plan

Arrangements for transition of the Municipal Pension Plan to joint management include commitments to use surplus assets and actuarial gains to first eliminate any unfunded liability. After that any surplus will be used to improve pension plan benefits and rebalance employer contribution rates relative to member contribution rates. Any additional surpluses will be allocated to a contribution rate stabilization reserve and to the inflation adjustment account.

Transition of the College Pension Plan

Arrangements for the transition of the College Pension Plan to joint management included a requirement to enter into an agreement for the distribution of a $30 million surplus in the College Pension Fund. The surplus was distributed as follows:

- $10 million used to reduce the employer contribution rate to the basic account to match the employee contribution rate;
- $10 million transferred from the basic account to the inflation adjustment account; and
- $10 million retained in the basic account as a contribution rate stabilization reserve.

Balancing employer and employee contribution rates

In January 2000, at the time negotiations for the other three plans were beginning, the employer contribution rates for the College Pension Plan had been reduced to the same level as member contribution rates as part of the statutory joint management arrangement established for the plan. The government hoped, during the negotiation of other joint management agreements, to use the opportunity to reduce the gap between employer and employee contribution rates in other plans.

Exhibit 7 shows the rates resulting from the negotiations. Payment of public sector pension benefits is integrated with payment of Canada Pension Plan (CPP) benefits. As a result, contribution rates to public sector pension plans are reduced for the portion of earnings that qualify for CPP benefits—$39,100 in 2002. Contribution rates to the basic accounts for earnings above $39,100 (the “year’s maximum pensionable earnings”) are at the rates shown in the table. Contributions to the inflation adjustment account are based on all earnings.

The post-joint management contribution rates shown in Exhibit 8 are the result of negotiations between the plan partners at the time that joint management agreements were concluded. In the future, contribution rates to the basic accounts of each plan will be determined on the basis of actuarial valuations and the relevant agreements.

Exhibit 8

Employer and plan member contribution rates for the four public sector pension plans

Pension Plan	Employer Rates (%)		Plan Member Rates (%)	
	Pre-Joint Management	Post-Joint Management	Pre-Joint Management	Post-Joint Management
College				
Basic Account*	6.3	6.0	6.0	6.0
Inflation Adjustment Account	1.0	1.0	1.0	1.0
Municipal				
Basic Account*	Rates vary from 4.9 to 17	Rates vary from 4.9 to 17	6.5	6.5
Inflation Adjustment Account	1.0	1.0	1.0	1.0
Public Service				
Basic Account*	9.25	5.75	5.75	5.75
Inflation Adjustment Account	1.25	2.25	1.25	1.25
Teachers				
Basic Account*	9.5	10.5	6.5	6.5
Inflation Adjustment Account	1.13	1.13	1.0	2.0

*Contribution rates are shown at maximum rates. Actual contribution rates are reduced by 1.5% on earnings below the year’s maximum pensionable earnings as determined by the Canada Pension Plan.

Source: Public Sector Pension Plans Act and Public Service, Municipal and Teachers’ pension plans’ joint trust agreements.

Disposition of the Public Service Pension Plan surplus

The Public Service Pension Plan had, at the time of negotiation of the joint management agreement for that plan, an actuarial surplus of approximately $1.5 billion. The government was, under arrangements at the time, entitled to use that surplus to reduce its contribution rates, and was taking a partial contribution holiday funded from the surplus. The government agreed to waive its right to access the surplus in return for agreement that the employer contribution rate for the basic account would be equal to the member rate on an ongoing basis. The government also agreed to transfer $100 million from the basic account to the inflation adjustment account, and to increase the employer contribution rate to the inflation adjustment account by 1 percent, in return for transferring responsibility for funding pensioner group benefits from the consolidated revenue fund to employers' contributions to the inflation adjustment account of the Public Service Pension Fund.

Impact on the Public Accounts of the Province

The settlement of the plans resulted in a write-off of $52 million when the joint management agreement for the Public Service Pension Plan came into effect in the March 31, 2001 fiscal year and a credit to government of $1,464 million as a result of the early realization, in the March 31, 2002 fiscal year, of past actuarial gains that existed in the Teachers and Municipal plans at the time the joint trusteeship took effect.

Did the government adequately identify and manage the risks associated with the new public sector pension plan arrangements?

The decision to negotiate joint management of the pension plans led to government ceding control over pension plans to boards of trustees that would operate at arm's length from the government. We expected the government to have assessed the risks associated with such devolution of responsibility and authority, and to have determined how those risks could be managed.

We concluded that the government identified the major risks inherent in the new arrangement and is managing the risks appropriately. However, past practices may have created expectations which could result in claims by retired pension plan members. This is a risk the government needs to monitor.

We also found that the partners have no forum for consultation and cooperation on issues of common interest. Such a forum would help partners to identify potential risks relating to the plans and to plan for how those risks should be dealt with.

The government identified the risks inherent in moving to new public sector pension plan arrangements

The fundamental risk associated with a defined benefit pension plan (such as the basic pension benefits for each of the province's four public sector plans) is that there may, in the future, be insufficient money in the pension fund to pay the pensions that plan members have been promised. This risk was present before devolution of the pension plans to joint management, and it remains present under the current arrangements. The main difference is that, under the new joint management model, the obligation to eliminate any unfunded liability arising during the period of joint management will be shared equally between employers and employees.

Although we saw no document specifically described as a "risk assessment" or "risk management strategy," we found evidence in briefing notes and requests for decision that showed the government's negotiators were aware of risks and aware of opportunities to shift risks from the government to pension plan members.

Government now shares pension plan related risks

Although the Public Sector Pension Plans Act has resulted in control of four public sector pension plans being shared between the government and unions that represent most of the plan members, the government still has pension plan-related risks that it must manage and for which it remains accountable to the Legislative Assembly. Because the Legislative Assembly authorizes the government to provide several hundred million dollars each year in contributions to public sector pension plans, it needs to be assured that these contributions are being well managed. Additionally—because pensions represent an obligation (the full extent of which cannot be determined until some time into the future) and pension funds represent an asset intended to match that obligation (the adequacy of which cannot be determined until some time in the future)—the Legislative Assembly needs to be assured that the government is properly managing both short, and long-term risks associated with public sector pension plans. We discuss the government's accountability obligations in the last section of this report.

The major source of risk to government is that if pension plans are not managed well, unfunded liabilities could arise, requiring government to make increased contributions to the plans to reduce or eliminate the liability. It is therefore important that the government monitor the factors that affect its obligation to contribute to a pension fund. These factors include plan rules that define contribution rates, pension fund investment strategies that carry different levels of risk and reward, actual performance of pension found investments, inflation rates, and the impact that all of these factors have on the viability of the pension plans. We discuss the monitoring, or oversight, role of government in more detail in the next section of this report.

Government has several means with which to minimize its risks

Generally speaking, the most likely source of an unfunded liability is lower-than-expected investment returns. With the devolution of pension plan management, the government no longer controls the investment strategies of the pension funds. It must now rely on the boards of trustees to set investment policy and to establish risk parameters for investment managers. As trustees, members of the boards are required to discharge their responsibilities prudently and in the best interests of plan members. Although government ability to control or influence plan trustees is limited, government can provide research and advisory support to the plan trustees that it appoints (and to other trustees, to the extent that other trustees are open to such inputs).

As well, the government can manage the risks related to pension plans by working with other plan partners to ensure that the boards of trustees are made up of competent people committed to fulfilling the obligations of a trustee.

Government has already acted to control some risks

One risk that the government recognized was that the boards of trustees of the public sector pension plan, many of whom are plan members themselves, might elect to enhance pension plan benefits, thereby creating additional obligations for the government.

To preclude such an event, each joint management agreement (as well as Schedule A of the Public Sector Pension Plans Act for the College Pension Plan) requires that certain changes to plan rules receive approval of the plan partners including, in each case, the government. Those changes are any that would result in:

- an increase in the contribution rates for providing non-indexed basic benefits;
- an increase in the contribution rates for providing for the indexing of benefits; or
- the creation of, or increase in, an unfunded liability.

Good governance is critical to successful management of the pension plans

One of the ways the partners can manage their risks relating to the pension plans is by ensuring that the plans have good governance. Governance refers to the roles, relationships, powers and accountability of those who have responsibility for the management, oversight and administration of an organization. It is defined by who is in charge, who sets direction, who makes decisions, who monitors progress, and who is accountable for the performance of the entity. In terms of pension plan management, good governance is essential for ensuring that the plans deliver the benefits that members are entitled to.

For each of the four pension plans, both the plan partners and the boards of trustees play significant roles in the plan's governance. The partners appoint the trustees and initiate and approve significant changes to the plan. The members of the board are the trustees of the pension plan and the pension fund, and are responsible for the administration of the plans and the management of the funds. They also make appointments to the boards of the British Columbia Investment Management Corporation and the British Columbia Pension Corporation.

The plan partners have a common interest in ensuring that each board of trustees fulfills its responsibilities. The boards of the two corporations are responsible for ensuring that management of the corporations are fulfilling their responsibilities.

Plan partners have no forum for consultation

We found that although a number of issues require, or would benefit from, consultation and cooperation between plan partners, no mechanism is currently set up to allow this. There are no formal arrangements for discussion of issues of common interest or for review of how the plans are doing. We believe that it would be useful to formalize the working arrangement between the partners.

Recommendation:

We recommend that the government work with other plan partners to establish processes for dealing with pension plan governance or administration issues, such as the appointment of trustees, that need consultation between plan partners.

Planning and coordination of board appointments are lacking

A key responsibility of the plan partners is to ensure they appoint competent people to the plan's board of trustees. To be able to do that effectively, the partners must have a clear understanding about what knowledge, skills and experience are needed by the board as a whole and by individual board members to enable the board to fulfill its responsibilities. Gaining such an understanding requires that a board first evaluate its needs. It should then provide the information to the partners, as well as stipulating what is needed on the boards when vacancies occur.

We found the government has not received sufficient information from the boards about what expertise they need, nor have plan partners developed a common approach to making appointments to ensure that the needs of the boards are being adequately addressed.

We found that the government has established a process for appointing members to the boards. It has identified the desired attributes of board members and developed a list of individuals who it feels are capable to serve on the boards. It also has developed a plan for reappointing members currently serving and for dealing with vacancies as they occur. When a seat becomes open, the Deputy Minister and Chief Executive Officer of the Public Sector Employers' Council Secretariat makes the appointment to the various boards on the government's behalf.

Recommendation:

We recommend that the government ask the boards to provide information on the knowledge, skills and experience they need as a whole and to identify their specific needs when vacancies occur. The government should then work with the other plan partners to determine how best to fill those vacancies.

Plan member expectations may create additional risks to government

Public sector pension plans are complex. They are integrated with Canada Pension Plan benefits and provide for a number of options on when and how pensions can be collected. They also include access to optional non-pension benefits that are partially funded from the employer's contributions that could otherwise be available for inflation protection. Practices that have been in place for many years—such as some of the group benefit plan premium subsidies and full inflation protection—may have created plan member expectations that such practices will be carried on in the future.

Pension plan members are eligible to participate in group health and dental benefit programs established pursuant to the Public Service Benefit Plan Act. In the past, member premiums for each group benefit—Medical Services Plan, extended health, and dental care—have been subsidized, with the amount of subsidy based on length of service prior to retirement. Premiums for members with at least ten years of employment were 100 percent subsidized. However, as costs of health and dental care increase, it has become difficult to meet the demands of these benefit programs. The government's decision to increase Medical Service Plan premiums, effective May 1, 2002, meant that an increased portion of the employer's contribution, earmarked for pensioner group benefits and inflation adjustment, needed to be diverted to pay for premium subsidies. In 2002, three of the pension plans announced changes in group health plans that result in less coverage and/or greater cost to retired plan members.

Retired plan members have also benefited, in past, from having pension benefits increased each year to compensate for increases in the cost of living. Funding for such increases comes from the inflation adjustment account of each pension plan. Plan members and employers both make contributions to the inflation adjustment accounts. However, as noted in Exhibit 1, the employers' contributions to the accounts are used first to pay health benefits and what remains, after the benefits have been paid, is retained in the inflation adjustment accounts. This means that less than the full amount of employers' contributions is available to fund cost of living increases.

Another limiting factor on the ability to fund cost of living increases is that contribution rates to inflation adjustment accounts are not based on actuarial valuations. There is no assurance that there will be sufficient funds in the inflation adjustment accounts to provide for paying inflation adjustments equal to the annual increase in the consumer price index in the future. The government has, in past, described the cost of living benefits provisions of the pension plans as an "intergenerational transfer." However, active plan members are required to make contributions that are earmarked for inflation protection purposes and have expectations that they will eventually benefit from such contributions.

The government, and pension plan trustees, have consistently advised that cost of living benefits are contingent on there being sufficient funds in the inflation adjustment accounts. Current projections indicate that the plans will be able to provide full cost of living increases for many years if inflation rates remain low. However if inflation picks up again, the pension board of trustees would eventually have to start restricting inflation adjustments to less than the consumer price index.

The government may have no obligation to meet plan member expectations. However, it needs to monitor the possibility of claims based on unfulfilled expectations.

Has the government established an appropriate oversight process with which to monitor pension plan management?

As already noted in this report, government's role with respect to public sector pension plans has changed from full control to oversight. Nevertheless, the need remains for government to ensure that its and taxpayers' interests are protected. We expected the government to have:

- clearly defined and articulated responsibilities for oversight of the management of the four pension plans;
- assigned those responsibilities;
- identified the information needed to monitor the results and risks associated with devolution of control of public sector pension plans to joint management arrangements; and
- secured access to the information it needs to discharge its oversight responsibilities, and ensured that it receives appropriate reporting on a timely basis.

We concluded that the government needs to develop its capacity to monitor the pension plans, and to discharge its plan partner responsibility to appoint competent trustees for the plans without putting individuals into situations in which their oversight responsibilities may conflict with their trustee responsibilities.

We found that the government has identified the information it needs to oversee the plans, and is in the process of securing access to that information.

Pension plan trustees are protecting the interest of members

A pension plan is a trust and the plan's trustees have the obligations to keep pension plan members'—not the public—interests uppermost in their mind. In carrying out their duties, trustees over-arching responsibility is to meet their fiduciary obligations to the pension plan's members.

The government protects the public interest with respect to public sector pension plans

Responsibility for safeguarding the public, and taxpayers' interest, lies with the government. To do this job effectively, the government must identify and monitor all the factors that affect its obligations to contribute to pension funds. These factors include plan rules that define contribution rates, pension fund investment strategies that carry different levels of risk and reward, actual performance of pension fund investments, inflation rates, and the impact that all the factors have on the viability of the pension plans.

Despite the devolution to joint management of the plans, the government is continuing to provide several hundred million dollars each year in the form of employers' contributions. As well, the government is still responsible for half of any unfunded liability of the pension plans. For these reasons the Legislative Assembly must be assured that the government is properly managing the risks associated with public sector pension plans.

The government needs to appropriately assign responsibilities for independent pension plan monitoring

Government has assigned responsibility for oversight of public sector pension plans, as well as responsibility for supporting government in its role as a plan partner under the joint trust agreements, to the Public Sector Employers' Council Secretariat (PSEC). The Deputy Minister and Chief Executive Officer (CEO) of PSEC represents the government in its capacity as a pension plan partner. In discharging these responsibilities, the CEO is supported by several staff within PSEC, as well as employees in other areas of government (including the Treasury Board Staff and the Office of the Comptroller General).

Government needs to ensure that it has sufficient resources with pension expertise to effectively monitor the pension plans and to discharge its plan partner responsibilities. We found that most of government's current capacity to monitor the public sector pension plans currently resides in one person. That person previously served as the government's lead negotiator of the joint management agreements. If he were to leave the government, he would take a significant portion of the corporate memory and expertise with him. Within the last year the government has moved to address the need for back-up and successorship by training other government employees in pension matters.

The government also has responsibilities as a plan partner, including responsibility to make appointments to each pension plan's board of trustees. A number of staff members within PSEC, as well as employees in other branches of government, serve as trustees for one or more of the plans. Some individuals with oversight responsibilities also serve as trustees. This practice creates the potential for conflict between responsibilities because trustees are, with limited exceptions, required to put the interests of pension plan members ahead of the interests of the government. Government needs to ensure that it can effectively monitor the pension plans, and discharge its plan partner responsibility to appoint trustees for the plans without putting individuals into situations in which their oversight responsibilities may conflict with their trustee responsibilities.

Recommendation:

We recommend that the government ensure that it has sufficient resources familiar with pension plan issues and capable of effectively monitoring the plans.

The information needed to monitor the results and ongoing risks of devolution of public sector pension plans to joint management has been defined

To provide effective oversight of the public sector pension plans, the government must be aware of any issues that can affect its obligations in this regard. Such issues include the identification of unfunded liabilities in periodic actuarial valuations, the assumptions used in the actuarial valuations, proposed changes to pension plan rules, and extraordinary claims made by pension plan members. Being aware means regularly receiving relevant, reliable and timely information. We found that the government has determined what information it needs for oversight purposes but has not yet secured access to that information.

The only information that the government is currently entitled to, as a matter of course, is each pension plan's annual report (including audited financial statements). At present, other information the government needs to support the oversight function has been made available through informal means. Except for annual reports, government has no right to information produced by or for the pension boards. Clearly this seriously weakens government's ability to provide effective oversight.

Has the government established an appropriate oversight process with which to monitor pension plan management?

A critical source of information concerning pension plan risk is the actuarial valuation performed by an independent actuary. As a point-in-time assessment of the financial strength of a pension plan the valuation is an indicator of the need or opportunity to modify member or employer contribution rates. An actuarial valuation is required for each of the four public sector pension plans at least once every three years. It determines whether a plan has sufficient assets to meet future pension obligations. The valuation is a complex process involving calculations based on the age, service and salary of plan members, plus assumptions related to the future expected experience of salary increases, rate of return on the fund, mortality, retirement ages and other factors. For oversight purposes, the government should know how conservative or aggressive the assumptions are for any valuations carried out.

We believe that the government should also be interested in the investment policies of the pension plans. An overly aggressive policy could create unacceptable risks to the plan in question whereas an overly conservative policy might not generate the return needed to provide the benefits in the future.

Recommendation:

We recommend that the government arrange to obtain the information it needs, to monitor the management of the public sector pension plans, on a timely basis.

Government should monitor employee satisfaction with the new pension plan arrangements

The government, in addition to its financial interest in the health of the pension plans, should also recognize that, as an employer, it can be affected by the perceptions that current employees and prospective employees have about pension plans as a component of compensation. Public sector pension plans have long been held up, by both critics and supporters of the plans, as one of the significant distinguishing characteristics of public sector employment. To the extent that the pension plans are viewed as adequate and secure, they represent incentives that make public sector employment attractive.

Historically, the perception that public sector pensions plans were backed by the government provided comfort to employees. The new arrangements make it clear that government obligations to plan members are limited. There are both opportunities and risks associated with these arrangements but, until there is a demonstrated history of performance on the part of pension plan boards of trustees, public sector employees are likely to be concerned about how their pension plans will perform. These concerns have been exacerbated by the poor investment climate that has prevailed during the recent past.

Government, and other public sector employers, need to monitor the extent to which employees are satisfied with the new pension plan arrangements.

Is the government adequately fulfilling its accountability obligations to the Legislative Assembly in reporting on public sector pension plans?

Although its responsibilities for managing the four pension plans have changed, government is still accountable to the Legislative Assembly and the public for its oversight of the four pension plans. We expected the government to identify the information that should be reported to the Legislative Assembly and the public, and to report it on a yearly basis.

We concluded that the government is providing the required pension-related financial information in the Public Accounts. It has, however, not yet identified what it needs to report to the Legislative Assembly on how it fulfills its oversight responsibilities.

Pension-related financial information is appropriately reported in the public accounts of the Province

We found that the government is reporting pension-related financial information as required by professional standards. The following information is included in the Public Accounts of the Province for the fiscal year ended March 31, 2002, under the notes to the Summary Financial Statements:

- Note 1, describing how the Province accounts for employee pension plans.
- Note 17, showing the financial status of the plans and providing information about the joint trusteeship arrangements and the results of the most recent actuarial evaluations of the plans.
- Note 34, explaining that joint trusteeship agreements were entered into on April 5, 2001 for the Municipal and Teachers Pension Plans. The settlements of these plans resulted in a one-time credit to operations of $1,464 million.

The Government has not yet identified what it should report to the Legislative Assembly on how it fulfills its oversight responsibilities of the four pension plans

Now that the four public sector pension plans are operating at arm's length from the government, the Legislative Assembly's need for information about the plans and the administrative structures that support them is different than before, because the government is no longer directly responsible for the administrative and investment management processes that support the pension plans. However, the government still makes annual contributions of several hundred million dollars to the plans, and is directly or indirectly liable for a portion of any unfunded liability in the plans. The Legislative Assembly therefore needs information to determine how the government is monitoring the pension plans.

We found that the government has not yet determined what information it should report to the Legislative Assembly on how it fulfills its oversight responsibilities of the four pension plans.

Recommendation

We recommend that the government determine what information, in addition to that presented in the Public Accounts of the Province, it should report to the Legislative Assembly and the public about how it fulfills its oversight responsibilities relating to the public sector pension plans; and it should provide that information on a timely basis.

The Pension Corporation provides information to pension plan members and the public

The British Columbia Pension Corporation provides considerable information to pension plan members and employers about the plans on its website at http://pensionsbc.ca/. The information includes the annual report summaries, annual reports of the plans, which contain audited financial statements, as well as information about how the plans were managed during the year.

There is good guidance on performance reporting

One source of guidance on what constitutes good performance reporting is a document recently released by the CCAF-FCVI Inc. (a national, non-profit research and education foundation. Previously, the Canadian Comprehensive Auditing Foundation) entitled Reporting Principles, Taking Public Performance Reporting to a New Level. The document sets out nine principles for public sector performance reporting.

The reporting principles proposed by the CCAF describe, in general terms, what type of performance information should be reported and how such information can best be presented. The principles respond to the belief that good performance information supports informed decision-making which, in turn, leads to better performance. Also, effectively reported performance information helps maintain and build confidence in the organization.

The nine principles recommended by the CCAF are as follows:

- focus on a few, critical aspects of performance—core objectives and commitments;
- look forward as well as back, tracking achievements against previously established goals and indicating how past achievements affect longer-term prospects;
- explain key risks identified by management, how those risks influence decision-making, and relate achievements to acceptable levels of risk;
- describe capacity factors that affect ability to sustain or improve results, and plans to match expectations and the capacity to achieve those expectations;
- provide information about the context of a program—economic, social or demographic factors that can affect performance;
- integrate financial and non-financial information, showing the link between activities and results and how changes in spending affect results;
- provide comparative information—trend information that shows whether performance is stable, improving or deteriorating or information about the results of comparable organizations;
- present credible information, including the basis for interpretations or conclusions about performance; and
- describe judgements that shape performance reporting, such as: the definition of the reporting unit, the rationale for choice of critical performance measures, decisions to change the way performance is measured or reported, and the extent to which reliability of the information is validated.

Response from Public Sector Employers' Council Secretariat

Thank you for your report "A Review of Government Oversight of Multi-Employer Public Sector Pension Plans in British Columbia." Please be advised that the report has been reviewed and the following constitutes the government's response to the report.

The pension governance provisions reviewed in this report were negotiated, legislated, and implemented by the previous government. After coming into office in 2001, the current government performed a review of these pension governance arrangements as part of its Core Review process. Government concluded at that time that the new arrangements were balanced and would provide a reasonable framework for the governance of the four multi-employer public sector pension plans. It therefore supported their continuance.

Government welcomed the review by the Office of the Auditor General as an independent assessment of the new pension governance arrangements. The Office of the Auditor General has conducted a thorough review, lasting over a year. The resulting report comments favourably that the government is adequately managing the risks associated with the new governance arrangements and recognizes the importance of on-going monitoring of the pension plans. The report did make six management-Ievel recommendations. The recommendations are all helpful, and government intends to make some changes in response to them.

Overall the report increases government's confidence in its prior conclusions that the new governance arrangements strike a reasonable balance between the interests of the plan members and those of the taxpayers, and that they will provide a solid framework for the future governance of these pension plans.

Appendices

Appendix A: Office of the Auditor General: Risk Auditing Objectives and Methodology

The Office has four lines of business:

- Attesting to the reliability of government financial statements;
- Assessing the quality of government service plan and reports;
- Assessing the management of risk within government programs and services; and
- Providing strong support to the standing committees of the Legislative Assembly.

Each of these lines of business have certain objectives that are expected to be achieved, and each employs a particular methodology to reach those objectives. The following is a brief outline of the objectives and methodology applied by the Office for assessing the management of risk within government programs and services, that is, risk auditing.

Risk Auditing

What are Risk Audits?

Risk audits (also known as performance or value-for-money audits) examine whether money is being spent wisely by government—whether value is received for the money spent. Specifically, they look at the organizational and program elements of government performance, whether government is achieving something that needs doing at a reasonable cost, and consider whether government managers are:

- making the best use of public funds; and
- adequately accounting for the prudent and effective management of the resources entrusted to them.

The aim of these audits is to provide the Legislature with independent assessments about whether government programs are implemented and administered economically, efficiently and effectively, and whether Members of the Legislative Assembly and the public are being provided with fair, reliable accountability information with respect to organizational and program performance.

Appendix A: Office of the Auditor General: Risk Auditing Objectives and Methodology

In completing these audits, we collect and analyze information about how resources are managed; that is, how they are acquired and how they are used. We also assess whether legislators and the public have been given an adequate explanation of what has been accomplished with the resources provided to government managers.

Focus of Our Work

A risk audit has been described as:

> *...the independent, objective assessment of the fairness of management's representations on organizational and program performance, or the assessment of management performance, against criteria, reported to a governing body or others with similar responsibilities.*

This definition recognizes that there are two forms of reporting used in risk auditing. The first—referred to as attestation reporting—is the provision of audit opinions as to the fairness of management's publicly reported accountability information on matters of economy, efficiency and effectiveness. This approach has been used to a very limited degree in British Columbia because the organizations we audit do not yet provide comprehensive accountability reports on their organizational and program performance.

We believe that government reporting along with independent audit is the best way of meeting accountability responsibilities. Consequently, we have been encouraging the use of this model in the British Columbia public sector, and will apply it where comprehensive accountability information on performance is made available by management.

As the risk audits conducted in British Columbia use the second form of reporting—direct reporting—the description that follows explains that model.

Our "direct reporting" risk audits are not designed to question whether government policies are appropriate and effective (that is achieve their intended outcomes). Rather, as directed by the Auditor General Act, these audits assess whether the programs implemented to achieve government policies are being administered economically and efficiently. They also evaluate whether Members of the Legislative Assembly and the public are being provided with appropriate accountability information about government programs.

When undertaking risk audits, we look for information about results to determine whether government organizations and programs actually provide value for money. If they do not, or if we are unable to assess results directly, we then examine management's processes to determine what problems exist or whether the processes are capable of ensuring that value is received for money spent.

Selecting Audits

All of government, including Crown corporations and other government organizations, are included in the universe we consider when selecting audits. We also may undertake reviews of provincial participation in organizations outside of government if they carry on significant government programs and receive substantial provincial funding.

When selecting the audit subjects we will examine, we base our decision on the significance and interest of an area or topic to our primary clients, the Members of the Legislative Assembly and the public. We consider both the significance and risk in our evaluation. We aim to provide fair, independent assessments of the quality of government administration and to identify opportunities to improve the performance of government. Therefore, we do not focus exclusively on areas of high risk or known problems.

We select for audit either programs or functions administered by a specific ministry or government organization, or cross-government programs or functions that apply to many government entities. A large number of such programs and functions exist throughout government. We examine the larger and more significant of these on a cyclical basis.

Our view is that, in the absence of comprehensive accountability information being made available by government, risk audits using the direct reporting approach should be undertaken on a five- to six- year cycle so that Members of the Legislative Assembly and the public receive assessments of all significant government operations over a reasonable time period. We strive to achieve this schedule, but it is affected by the availability of time and resources.

Appendix A: Office of the Auditor General: Risk Auditing Objectives and Methodology

Planning and Conducting Audits

A risk audit comprises four phases—preliminary study, planning, conducting and reporting. The core values of the Office—independence, due care and public trust—are inherent in all aspects of the audit work.

Preliminary Study

Before an audit starts, we undertake a preliminary study to identify issues and gather sufficient information to decide whether an audit is warranted.

At this time, we also determine the audit team. The audit team must be made up of individuals who have the knowledge and competence necessary to carry out the particular audit. In most cases, we use our own professionals, who have training and experience in a variety of fields. As well, we often supplement the knowledge and competence of our staff by engaging one or more consultants to be part of the audit team.

In examining a particular aspect of an organization to audit, auditors can look either at results, to assess whether value for money is actually achieved, or at management's processes, to determine whether those processes should ensure that value is received for money spent. Neither approach alone can answer all the questions of legislators and the public, particularly if problems are found during the audit. We therefore try to combine both approaches wherever we can. However, because acceptable results-oriented information and criteria are often not available, our risk audits frequently concentrate on management's processes for achieving value for money.

If a preliminary study does not lead to an audit, the results of the study may still be reported to the Legislature.

Planning

In the planning phase, the key tasks are to develop audit criteria—"standards of performance"—and an audit plan outlining how the audit team will obtain the information necessary to assess the organization's performance against the criteria. In establishing the criteria, we do not expect theoretical perfection from public sector managers; rather, we reflect what we believe to be the reasonable expectations of legislators and the public.

Conducting

The conducting phase of the audit involves gathering, analyzing and synthesizing information to assess the organization's performance against the audit criteria. We use a variety of techniques to obtain such information, including surveys, and questionnaires, interviews and document reviews.

Reporting Audits

We discuss the draft report with the organization's representatives and consider their comments before the report is formally issued to the Legislative Assembly. In writing the audit report, we ensure that recommendations are significant, practical and specific, but not so specific as to infringe on management's responsibility for managing. The final report is tabled in the Legislative Assembly and referred to the Public Accounts Committee, where it serves as a basis for the Committee's deliberations.

Reports on risk audits are published throughout the year as they are completed, and tabled in the Legislature at the earliest opportunity. We report our audit findings in two parts: an Auditor General's Comments section and a more detailed report. The overall conclusion constitutes the Auditor General's independent assessment of how well the organization has met performance expectations. The more detailed report provides background information and a description of what we found. When appropriate, we also make recommendations as to how the issues identified may be remedied.

It takes time to implement the recommendations that arise from risk audits. Consequently, when management first responds to an audit report, it is often only able to indicate its intention to resolve the matters raised, rather than to describe exactly what it plans to do.

Without further information, however, legislators and the public would not be aware of the nature, extent, and results of management's remedial actions. Therefore, we publish updates of management's responses to the risk audits. In addition, when it is useful to do so, we will conduct follow-up audits. The results of these are also reported to the Legislature.

Appendix B: Office of the Auditor General: 2002/03 Reports Issued to Date

Report 1

Building a Strong Work Environment in British Columbia's Public Service: A Key to Delivering Quality Service

Report 2

Follow-up of Performance Reports, June 2002

Report 3

A Review of Financial Management Issues
in the Office of the Police Complaint Commissioner

Report 4

Monitoring the Government's Finances

Report 5

Managing Contaminated Sites on Provincial Lands

Report 6

Review of Estimates Related to Vancouver's Bid to Stage the 2010 Olympic Winter Games and Paralympics Winter Games

Report 7

Building Better Reports:
Our Review of the 2001/02 Reports of Government

Report 8

Follow-up of Performance Reports, January 2003

Report 9

A Review of Government Oversight of Multi-Employer Public Sector Pension Plans in British Columbia

These reports and others are available on our website at http://bcauditor.com

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