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GFOA BEST PRACTICE
ACTUARIAL AUDITS (2014) (CORBA) (NEW)

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BACKGROUND

Due diligence requires that pension plan fiduciaries and plan sponsors exercise prudence in selecting service providers such as actuaries, and monitor the quality of their work. An *actuarial audit* is a valuable tool for monitoring the quality of actuarial services performed on behalf of the pension plan.

An actuarial audit involves engaging the services of an outside actuary (*reviewing actuary*) to scrutinize the work of the plan's consulting actuary.[1] Actuarial audits are helpful for several reasons:

1. They enhance the credibility of the actuarial valuation process by providing independent assurance that it was performed in accordance with actuarial standards of practice;

2. They increase public trust in how the pension plan is being governed;

3. They help plan fiduciaries to assess whether the pension plan is meeting its funding objectives;

4. They can lead to the remediation of errors that might otherwise go undiscovered; and

5. They can provide recommendations for improving the actuarial valuation process, including how information is presented in the actuarial valuation report and in other communications.

Actuarial audits are not all the same. Various levels of actuarial audits are distinguished from one another by the types of services performed by the reviewing actuary.

1. In a *level one*, or "full-scope," actuarial audit, the reviewing actuary fully replicates the original actuarial valuation, based on the same census data, assumptions, and actuarial methods used by the plan's consulting actuary. In addition, the reviewing actuary examines the consulting actuary's methods and assumptions for reasonableness and internal consistency.

2. In a *level two* actuarial audit, the reviewing actuary does *not* fully replicate the consulting actuary's valuation, but instead uses a sampling of the plan's participant data to test the results of the valuation. The reviewing actuary also examines the consulting actuary's methods and assumptions for reasonableness and internal consistency.

3. In a *level three* actuarial audit, the reviewing actuary examines the consulting actuary's methods and assumptions for reasonableness and internal consistency, but does not perform actuarial calculations.

RECOMMENDATION

The GFOA recommends that public pension plan fiduciaries:

1. Gain an understanding of the types of actuarial audits;

2. Provide for actuarial audits at least once every five years[2] and when a "red flag" appears, such as

   a. Significant and unanticipated changes in asset or liability trends or funded ratio

   b. Computed contribution rates change without adequate explanation.

c. The actuarial methods and assumptions used are not consistent with those approved by the plan's board

d. The actuarial methods and assumptions are not consistent with plan objectives

3. Determine the level of actuarial audit most appropriate to their circumstance.

Often when a new consulting actuary is engaged the new consulting actuary performs a full replication of the previous actuarial valuation to establish a baseline. This practice, when feasible,[3] is highly encouraged. ■

ENDNOTES

1 When procuring services for a reviewing actuary, plan fiduciaries and plan sponsors are encouraged to use the same RFP process as for a consulting actuary. Recommendations for procuring these services can be found in the GFOA best practice, "Procuring Actuarial Services" (CORBA 2012).

2 This recommendation is designed to ensure that more than one actuary has performed or replicated the actuarial valuation during any five-year period. Therefore, an actuarial audit would not be necessary if the consulting actuary had changed during that time.

3 A full replication may not be practical, for example, for an agent multiple-employer plan.