

An Audit of

**The Basic Financial Statements of the
Office of the Fire Fighters' Pension
Commissioner for the Fiscal Year
Ended August 31, 2002**

March 2003

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The Basic Financial Statements of the Office of the Fire Fighters' Pension Commissioner for the Fiscal Year Ended August 31, 2002

Overall Conclusion

In our audit report dated February 19, 2003, we issued a qualified opinion regarding whether the basic financial statements of the Office of the Fire Fighters' Pension Commissioner (Commission) for the fiscal year ended August 31, 2002, were materially correct in accordance with accounting principles generally accepted in the United States of America.

The Texas Statewide Emergency Services Personnel Retirement Fund Board of Trustees (Board) did not approve the actuarial report that an actuary issued for the Texas Statewide Emergency Services Personnel Retirement Fund (Fund) for fiscal year 2002 because that report contained incorrect actuarial calculations and estimates.

We issued a qualified opinion because, without an approved actuarial report specifying whether the Fund was sound, it would have been impractical for us to determine the exact amount (if any) that the State might have been statutorily required to contribute to the Fund. In addition, the absence of an approved actuarial report prevented us from making any conclusions regarding the accuracy or reasonableness of (1) the basic financial statement disclosures related to the actuarial estimates and (2) other required supplementary information for the Texas Statewide Emergency Services Retirement Act (TSESRA).

In addition to issues involving the actuarial report, the Commission faces other serious issues that could negatively affect the Fund:

- The Fund's investment income has consistently decreased during the last three years from \$5,020,684 in fiscal year 2000 to negative \$3,584,035 in fiscal year 2002. If stock market conditions do not improve and contributions from the governing bodies of participating fire departments remain the same, the Fund may not be able to meet future benefit payments.

Background Information Regarding Texas Statewide Emergency Services Personnel Retirement Fund Benefit Payments and Contributions

- Created in 1937, the Commission provides retirement, death, and disability benefits to firefighters. At the end of fiscal year 2002, the Commission's Texas Statewide Emergency Services Personnel Retirement Fund (Fund) had 7,683 members.
- The amount of retirement benefits the Fund paid to eligible participants in fiscal year 2002 ranged from \$8 to \$574 per month.
- Unlike most pension plans, the amount of member contributions to the Fund is not determined by actuarial analysis. Instead, statute requires the governing bodies of participating fire departments to contribute at least \$12 for each member for each month of service.
- Statute requires the State to contribute the sum necessary to make the Fund actuarially sound each year. However, statute requires that this contribution may not exceed one-third of the total of all contributions by governing bodies in one year.



- If the Fund is not able to meet future benefit payments, it would be deemed actuarially unsound. If this is the case, the maximum amount that the State would be required to contribute to the Fund, under statute, could be as high as \$605,956 for fiscal year 2002.

Without an approved actuarial report, it is not possible to know whether the Fund was actuarially sound at the end of fiscal year 2002. However, it is important to note that if an actuary ultimately deems the Fund unsound, the maximum state contribution required by statute still may not be enough to make the Fund actuarially sound.

- Total net assets of the Fund have been decreasing for the past three years. Total net assets were \$35,877,664 at the end of fiscal year 2000 but decreased to \$29,815,693 by the end of fiscal year 2002.
- Total member contributions to the Fund from participating governing bodies have increased 8.5 percent in the last two years. However, Fund benefit payments and administrative expenses increased by 15 percent in the last two years.

Summary of Information Technology Review

As part of obtaining an understanding of internal controls relevant to our audit of the Commission's basic financial statements, we performed the following technology-related procedures:

- Identified and risk-assessed the Commission's key information systems for accounting and reporting revenues, investments, benefit contributions and payments, and other financial information
- Analyzed member benefit payments and participant data to identify higher risk transactions for detailed, transaction-level testing
- Recalculated and compared the amount of benefit payments for selected eligible participants and performed other procedures deemed necessary

Detailed Results

Chapter 1

If Stock Market Conditions Do Not Improve and Member Contribution Rates Set in Statute Remain the Same, the State May Be Required to Contribute \$605,956 to the Texas Statewide Emergency Services Personnel Retirement Fund

Statute Could Require the State to Contribute Up to One-Third of Annual Contributions to the Texas Statewide Emergency Services Personnel Retirement Fund

Texas Civil Statutes, Article 6243e.3, Section 2(d), specifies that:

"The state shall contribute the sum necessary to make the [Fund] actuarially sound each year. The state's contribution may not exceed the amount of one-third of the total of all contributions by governing bodies in one year. If the state contributes one-third of the total contributions of the governing bodies in one year, the [Fund] shall be presumed actuarially sound."

Member Contributions to the Texas Statewide Emergency Services Personnel Retirement Fund Are Established in Statute

Texas Civil Statutes, Article 6243e.3, Section 2(c), specifies that:

"Every governing body of a department that is eligible to participate in the pension system ... shall contribute for each member at least \$12 for each month of service beginning on the date the member enters the pension system...."

Total investment income of the Office of the Fire Fighters' Pension Commissioner's (Commission) Texas Statewide Emergency Services Personnel Retirement Fund (Fund) has consistently decreased during the last three years, from \$5,020,684 in fiscal year 2000 to negative \$3,584,035 in fiscal year 2002. If stock market conditions do not improve and contributions from participating fire departments remain the same, the Fund may not be able to meet future benefit payments or accrued liabilities.

Without an approved actuarial report, whether the Fund is currently actuarially unsound is unknown. However, it is important to note that if an actuary ultimately deems the Fund unsound as of the end of fiscal year 2002, statute would require the State to contribute up to one-third of the total amount that fire department governing bodies contributed to the Fund in fiscal year 2002.

Based on fire department governing bodies' contributions of \$1,817,869 in fiscal year 2002, the maximum state contribution could be as high as \$605,956. Even then, this amount may not be enough to make the Fund actuarially sound. The statute specifies that if the State makes the maximum contribution required, "the [Fund] shall be presumed actuarially sound." Unfortunately, investment income could have decreased so significantly that the State's maximum contribution still will not make the Fund actuarially sound.

As Table 1 shows, both the investment income and the net assets of the Fund have been decreasing for the past three fiscal years.

Table 1 - Fund investment income and net assets have decreased during the past three fiscal years.

| Summary of Decreases in the Texas Statewide Emergency Services Personnel Retirement Fund Investment Income and Net Assets | | | |
|---|------------------|------------------|------------------|
| Primary Source of Fund and Net Assets | Fiscal Year 2000 | Fiscal Year 2001 | Fiscal Year 2002 |
| Investment Income | \$ 5,020,684 | \$ (1,949,407) | \$ (3,584,035) |
| Net Assets | \$ 35,877,482 | \$ 33,795,469 | \$ 29,815,693 |

Source: Commission Annual Financial Statements for fiscal years 2000 through 2002.

As Table 2 shows, Fund member contributions from participating governing bodies have increased 8.5 percent in the last two years. However, benefit payments and administrative expenses increased by 15 percent.

Table 2 - Fund member contributions increased 8.5 percent and benefit payments and administrative expenses increased 15 percent during the past two fiscal years.

| Summary of Texas Statewide Emergency Services Personnel Retirement Fund Member Contributions and Benefit Payments and Administrative Expenses | | | |
|--|------------------|------------------|------------------|
| Other Sources/Uses of Fund | Fiscal Year 2000 | Fiscal Year 2001 | Fiscal Year 2002 |
| Member Contributions | \$ 1,675,379 | \$ 1,891,628 | \$ 1,817,869 |
| Benefit Payments and Administrative Expenses | \$ 1,916,661 | \$ 2,024,234 | \$ 2,202,484 |

Source: Commission Annual Financial Statements for fiscal years 2000 through 2002.

Recommendations

The Commission should:

- Continue its efforts to hire a new actuary.
- Promptly communicate the results of the new actuary's report to the Legislature and the Texas Statewide Emergency Services Personnel Retirement Fund Board of Trustees.

Management's Response

The Office of the Fire Fighters' Pension Commissioner will continue to work with the TSESRA Board of Trustees to hire a new actuary for the TSRRA Fund. At their February meeting the TSESRA Board of Trustees voted to issue a Request For Proposal for Actuarial Services. A RFP will be issued in accordance with the Texas Building and Procurement Commission purchasing guidelines and finalists will make presentations to the Board at their quarterly May Board meeting in Austin. It is the goal of the Board of Trustees to have a contract executed with the chosen actuary by June 1, 2003.

Assuming that the Office of the Commissioner and the Board of Trustees will execute a contract with the new actuary by June 1, 2003, the expectation is that the new actuary will need more than the usual 90 days to complete the actuarial valuation report of August 31, 2002. The Board has determined that 120 days should be sufficient time to complete this report and therefore, it is expected that the report will be completed by October 1, 2002. Upon receipt of the report and acceptance by the Board of Trustees, the Office of the Commissioner will forward all necessary copies to the Legislature and to each required agency.

Other Information

Objective, Scope, and Methodology

Objective

Our objective was to express an opinion on the Commission's basic financial statements for the fiscal year ended August 31, 2002.

Scope

The scope of this audit included expressing an opinion on the Commission's basic financial statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits in *Government Auditing Standards* issued by the Comptroller General of the United States.

Methodology

We gained an understanding of the Commission's overall internal control structure (control environment, control procedures, and accounting systems) to determine the extent of our audit plan. We tested internal controls and significant accounts as deemed necessary to support our opinion.

Tests of significant account balances and classes of transactions included tests of detailed supporting transactions and confirmations of investments and contributions. In addition, we performed analytical procedures, interviewed Commission personnel, and reviewed the annual financial statements. We also tested compliance with applicable laws and regulations relating to investments, maximum cash balance at the State Treasury, and benefit payments. We administered questionnaires, reviewed documents, recalculated balances, and compared current-year financial information with that of prior years for reasonableness.

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