3 Public Service Superannuation Plan

Summary

Two of the largest employers who contribute to the Public Service Superannuation Plan do not have any means by which to verify that pension benefits paid to retirees are accurate. We were unable to verify the accuracy of benefit payments at either the Province of Nova Scotia or Capital Health. We have recommended that the Provincial Public Service Commission and Capital Health ensure that appropriate support is available to allow subsequent verification of benefits. Support should be maintained until the pension is no longer being paid. We further recommended that the Public Service Commission establish controls to determine whether it has received and properly stored all retiree files from departments, and that Capital Health review and improve controls to ensure employment information is received and filed in employee files.

Recent changes to the Public Service Superannuation Plan's governance structure and funding strategies were made following stakeholder and consultant input. As a result of changes to the Plan, and limits in the Auditor General Act, the Office of the Auditor General is no longer able to conduct independent audits of any aspect of the Plan, including such matters as governance and investment performance of the Plan. We recommended that the new Board of Trustees undertake nonfinancial statement audits for the Plan. Auditors should be engaged and results reported directly to the Board or its Audit and Actuarial Committee.

The Nova Scotia Pension Services Corporation is responsible for administering the Public Service Superannuation Plan. The Corporation should prepare an operational risk assessment for the Plan to help ensure risks have been considered. In addition, the Plan's Statement of Investment Policies and Goals is noted as being confidential and we have recommended this Statement be made available to Plan members. We also recommended that the new Board of Trustees of the Plan establish the timing of a periodic review of the Plan's asset mix. We tested the Corporation's processes for monitoring investment performance and concluded these were adequate. We also found that the Corporation has adequate processes to hire investment managers and assess their performance on a regular basis.

3 Public Service Superannuation Plan

Background

3.1 The Public Service Superannuation Plan is a defined benefit pension plan which provides retirement benefits for individuals working in the Nova Scotia public sector. It is jointly funded with matching contributions from employees and employers. Employers in the Plan include the Province of Nova Scotia, district health authorities, and other agencies, boards and commissions.

3.2 As at December 31, 2012, the Plan provided benefits to 13,787 pensioners and survivors, and received contributions from 16,409 members.

3.3 The Plan's March 31, 2013 audited financial statements disclose a fair value of net assets available for benefits of $4.7 billion (March 31, 2012 – $4.4 billion). The accrued pension benefit obligation was $4.7 billion (2012 – $4.5 billion), leaving a funding surplus of $23 million (2012 – $171.8 million deficiency). Plan assets are composed of fixed income securities, real assets, equity investments, hedge funds and commodities.

Audit Objectives and Scope

3.4 In winter 2013, we completed a performance audit of the Public Service Superannuation Plan. We wanted to determine whether pension assets are adequately managed to meet Plan objectives and whether service accruing to current members and benefit payments made to retired members are accurate. The audit was conducted in accordance with Sections 18 and 21 of the Auditor General Act and auditing standards adopted by the Chartered Professional Accountants of Canada.

3.5 Our audit objectives were to determine whether:

- benefits paid have been calculated accurately;
- the pension system includes accurate information on current members;
- investment performance is monitored and reported on a regular basis;
- investment manager performance is monitored on a regular basis, including monitoring compliance with investment manager contracts; and
- changes to the Public Service Superannuation Plan were made as a result of due process.

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3.6 Criteria were developed specifically for this engagement. Criteria related to investment and investment manager monitoring are similar to those used during our 2004 audit of the Plan. The objectives and criteria were discussed with, and considered appropriate by, senior management of the Nova Scotia Pension Services Corporation.

3.7 Our audit approach included interviews with management and staff of the Nova Scotia Pension Services Corporation, and testing of investment performance reports to source documents. In addition, we tested benefit payments and contributions for a sample of current contributors and retirees, and tested the processes to monitor investment managers' performance and compliance with contracts. We also examined documentation and meeting notes related to changes to the Plan. Our work covered the period January to December 2012.

3.8 On April 1, 2013, the Nova Scotia Pension Agency became the Nova Scotia Pension Services Corporation. We refer to the entity by its new name throughout this chapter.

Significant Audit Observations

Contributions and Benefits Testing

Conclusions and summary of observations

Two of the largest employers who contribute to the Public Service Superannuation Plan do not have any means by which to verify that pension benefits paid to retirees are accurate. We were only able to verify the accuracy of benefit payments for eight percent of retirees from Capital Health and the Province of Nova Scotia. We recommended that the Public Service Commission define how pay information is maintained in employee personnel records to ensure that information can be verified in the future. We also recommended that the Public Service Commission establish controls to determine whether it has received all retiree files from departments, and that files have been correctly labelled and sent to storage as required. And we recommended that Capital Health review and improve controls to ensure employment information is received and filed in employee files. Finally, we recommended that both the Public Service Commission and Capital Health revise their file retention policy to maintain retiree files as long as related pensions are being paid.

3.9 *Introduction* – The Nova Scotia Pension Services Corporation receives information from employers on current contributors and enters this into the pension administration system (PENFAX). PENFAX is intended to accurately record and store each plan member's employment history, including pension contributions, salary and service history, and to calculate the pension, and other information as required. Corporation management told us that it is the recipient of all information but is not responsible for its completeness and accuracy; that is the responsibility of the employer.

3.10 The Province pays pension benefits monthly and the Corporation is invoiced for these amounts.

3.11 *Reconciliations* – During each pay cycle, employers upload information to PENFAX on all new employees as well as any changes to current employees. The Corporation reconciles this information and ensures all discrepancies are cleared, providing explanations for any variances. The reconciliation confirms that PENFAX employee information is correct and ensures funds transferred from employers to the Corporation reconcile to the amount owing per PENFAX.

3.12 *Reconciliation testing* – We examined uploads from six employers to determine whether discrepancies were cleared with sufficient support. We also tested ten reconciliations to determine if employer contributions agreed to PENFAX anticipated contributions.

- All samples had adequate documentation to clear PENFAX-generated errors and warnings.
- All samples had adequate documentation to explain variances between employer contributions and PENFAX-anticipated contributions.

3.13 *Benefits* – The Public Service Superannuation Plan Regulations calculate retirement benefits as two percent of an individual's years of service multiplied by the individual's five years of highest salary. An individual who partakes in the Plan cannot collect pension benefits before age 50 if employment started prior to April 6, 2010, or age 55 if employment began on or after April 6, 2010. In some cases, an employee may obtain the required years of service before reaching the specified age; in those instances, the employee would not qualify for an unreduced pension.

3.14 *Benefits testing* – We selected a sample of 60 benefit recipients from August, 2012. Our testing objective was two-fold:

- to determine whether benefit payments were accurate based on information in the PENFAX system; and
- to determine whether information in PENFAX was accurate based on the retiree's salary and service history, and any other relevant factors used to determine the amount paid.

3.15 We extracted information from PENFAX on the salary and service history for each of our sample items and determined what the pension should be based on the Public Service Superannuation Plan Regulations. We also applied the appropriate indexing factor. Each amount was then compared to what was paid in August 2012. We concluded that all payments were accurate.

3.16 We then attempted to verify the accuracy of the information in PENFAX for our sample items.

- Thirty-six items were from government departments and we could not verify benefit payments for any sample items.
- Twelve items were from Capital Health and we were able to verify benefit payments for one individual.
- One item was from Nova Scotia Business Inc. and 2 items were from the Nova Scotia Liquor Corporation. We were able to verify these three sample items from retirees' paper files at either organization.

3.17 The remaining nine of 60 sample items related to retirees from entities outside the consolidated group. We anticipated there would be difficulties in verifying information for these individuals (for example, in one instance, the entity no longer exists) and we considered selecting an additional nine sample items from the consolidated entity. However, because we had already encountered significant difficulties in attempting to verify information in retiree files tested, as noted above, we concluded it was inefficient to select an additional nine items as we had already concluded we could not achieve our audit objective.

3.18 In total, we were able to verify benefit payments for four of 51 sample items, or eight percent, because information was unavailable or incomplete. It is not possible to conclude on our audit objective. Lack of information to verify the accuracy of benefit payments results in a scope limitation in our audit.

3.19 *Testing at government departments* – We were unable to verify benefit payments for any of the sample items related to government departments. Of the 36 sample items, employee files could be located for only 19 retirees. None of these paper files contained sufficient information to verify that the salary details in PENFAX used to calculate pension benefit payments were complete and accurate.

3.20 We requested paper files from the Public Service Commission for each of our sample items. According to the government's employee personnel record policy, there should be a paper file for all retired employees with information on such matters as performance appraisals, disciplinary measures and long-term disability benefits. These files are to be stored for 60 years. As noted, only 19 files could be located.

3.21 The paper file should also include hard copy of employee pay records created prior to April 1990. Four of the individuals in our sample began working with the Province and retired before this date. In each instance, there should have been a paper file containing pay information for the entire length of employment with the Province. Paper files could not be located for any of these individuals.

3.22 Twenty-eight individuals began work prior to April 1990 but retired subsequent to this date. Each of these individuals should have had a paper file with the required master record information, but the Commission was only able to locate 18 of these files. However, because the policy allows pay records subsequent to April 1990 to be captured in the Province's human resources IT system once an individual has retired from, or is no longer employed with, the Province, there was no support in these files for pay subsequent to April 1990. We could not verify that the information in PENFAX represented the individuals' highest salaries for benefit calculation purposes.

3.23 Four of the 36 individuals started work with the Province subsequent to April 1990. Although these individuals pay records should be captured in the Province's human resources or general ledger system, each individual should also have had a stored paper file containing master record information. Only one file could be located. Since all pay information is only stored electronically subsequent to retirement or employment, there was no support in the file for the information in PENFAX.

3.24 The lack of historical salary information is a serious deficiency. Information should be available for retirees to verify that their benefits are accurate. In addition to the lack of files for 17 of our 36 sample items (47%), the Public Service Commission's policy allows for electronic records only for pay information subsequent to April 1990. However there is no requirement to indicate in the master record whether the pay information in government's human resources system has been verified. Pay information has not been scanned and maintained meaning there is nothing to support that the pay information on which pension benefits are calculated is accurate.

3.25 *Capital Health testing* – The inability to verify benefit payments at Capital Health is equally concerning. We were only able to verify one sample item from our testing. Capital Health's current retention policy has been in place since 2007 and specifies what is to be maintained in a retired employee's file. Management told us that there was no official Capital Health document retention policy prior to 2007.

3.26 Four of the 12 sample items at Capital Health related to individuals who retired prior to 1989, before the creation of Capital Health. We were informed that the personnel files of the legacy hospitals had been destroyed. Four of the retirees we selected for sample testing retired between 1989 and 2007. Four paper files were located, although none contained sufficient information to enable us to determine that the benefit payments were accurate.

3.27 Paper files were available for the remaining four individuals in our sample. However, only one file, or 8% of our sample, contained sufficient information to allow us to determine that benefit payments were accurate.

3.28 *Records management* – We did not conduct an audit of records management or retention policies. However, staff in the Province's Corporate Information

Management Program Office gave us an overview of these policies. Records management and retention policies are either administrative policies that apply to all departments (referred to as STAR), or records management and retention policies which apply to each department based on its business needs (STOR policies).

3.29 While individuals work for the Province of Nova Scotia, employee personnel records fall under the STAR policy. While an individual works for the Province, pay information is maintained in hard copy in the respective department. However, once an individual is no longer employed, their file is sent to the Public Service Commission and separated to be filed under the Public Service Commission's STOR policy. Certain information from the employee master record must be maintained in hard copy, but pay-related information is destroyed and subsequently only available in summary form in the Province's electronic pay records. Therefore, adequate support is not retained for pay information to facilitate verification once an individual retires. The current policy provides that pay information forming part of the employee master record (a sub-record of the employee personnel record) is to be stored electronically in the Province's general ledger and human resources system once the individual retires or no longer works for the Province.

3.30 This STOR policy needs to be reviewed to ensure it meets the future needs of retirees. There are only two ways to allow retirees to verify benefit calculations – either maintain a paper record, or scan paper records and keep electronic copies which would then allow hard copies to be destroyed.

3.31 The Province's STOR policy should be revised so that pay information can be verified by employees once they have retired. Pay records should be maintained to ensure verifiable information is stored to recalculate pensions paid.

Recommendation 3.1
The Public Service Commission, working with the Province's Corporate Records Management Group, should define how pay information is maintained in employee personnel records once they retire or no longer work for the Province to ensure there is appropriate support to recalculate pension benefit payments in the future. This revised STOR policy should be communicated to, and implemented by, all departments.

Public Service Commission Response:
The Department agrees with the recommendation. The Public Service Commission will review its current practices and work with the Department of Finance's Payroll Client Relations group, to clarify the roles and responsibilities regarding the maintenance of pay information in employee personnel records and amend its STOR policy appropriately.

3.32 When an individual retires, the separated employee master record discussed above along with a summary form listing what had been in the main personnel record, is to be kept for 60 years. It is evident that the existing policy is not being followed. Paper files could only be located for 53% (19 of 36) of our sample items. Controls need to be established within the Public Service Commission to strengthen implementation of this policy.

3.33 Once an individual starts receiving a pension, the last department with the employee master record is required to send it to the Commission. The Commission could determine that it has received the retiree files by working with the Nova Scotia Pension Services Corporation to obtain a list of new retirees. This could be compared to files received from departments to ensure information is complete. Once the files have been received, the Commission must ensure they are sent intact to storage. A control should be established to ensure there is a complete list of records sent for storage.

Recommendation 3.2
The Public Service Commission should establish controls to determine it has received all retiree files from departments, and that they have been correctly labelled and sent to storage as required.

Public Service Commission Response:
The Department agrees that existing controls are not sufficient. The Public Service Commission will take steps to review and improve current controls regarding the transfer of all retiree personnel files from HRU's to the PSC central registry, their content, labelling and storage in accordance with the department's STOR.

3.34 Further, we have concerns about the length of time employee records are to be held by the Commission. While pensions are being paid, either to members, spouses or dependents, the benefit paid should be verifiable. The Public Service Commission has determined its retention policy for employee master files is 60 years. The criterion should not be a number of years but rather whether the pension is still being paid. We believe a process could be established with the Pension Services Corporation to notify the Commission when a pension is no longer paid.

Recommendation 3.3
The Public Service Commission should revise its file retention policy for retiree files to ensure files are maintained until pensions are no longer paid.

Public Service Commission Response:
The Department neither agrees nor disagrees with this recommendation. The Public Service Commission will work with the Pension Services Corporation to determine the efficacy of changing its current practice regarding the retention of Employee Master Records in light of this recommendation.

3.35 We have similar concerns with respect to the records management policy related to personnel records at Capital Health. The human resources and benefits divisions receive employment information and supporting documentation, and file these in employment records as employment events occur. These files are maintained in accordance with the Employment Information on Record Policy.

3.36 We reviewed the policy and concluded that, if followed, there should be sufficient information in retiree files to confirm their benefit payments at a later date. However, we were only able to verify one of four benefit payments during our testing for retirees whose files were maintained under this policy.

Recommendation 3.4
Capital Health should review and improve controls to ensure information to be included in employee records is received and maintained.

Capital Health Response:
Capital Health agrees with this recommendation and will review its current processes for obtaining information on employment events and filing these in employee records.

3.37 Appendix A of the policy specifies information to include in employee records. The policy notes that information is to be maintained in paper and electronic format. We discussed with management that the policy should be clarified to indicate that information that originates in paper format should be maintained in hard copy until pensions are no longer being paid. Capital Health management agreed with this clarification.

3.38 Further, the current policy provides that sensitive information related to employee medical leave be maintained in central human resources records storage at Capital Health. Management agreed that it would be efficient to cross-reference this information to the applicable employee record. This would facilitate verification of such leave at a later date.

3.39 The current retention schedule at Capital Health is 35 years. Thirty-five years may not be adequate for an individual who leaves the employ of Capital Health. For example, an individual who worked with Capital Health from age 25 to 35 will likely still be collecting benefits at age 70, but no record of employment will be kept past this age. This limits the timeframe a pensioner can verify their benefits.

Recommendation 3.5
Capital Health should revise its file retention policy for retiree files to ensure files are maintained until pensions are no longer paid.

Capital Health Response:
Capital Health agrees with this recommendation and intends to implement it. Capital Health will amend its policy to identify those employees terminating due to retirement and will maintain their files until such time that their pension is no longer in payment. On a go-forward basis, these files will be held offsite and will be divided into retirements, deaths and terminations until such time as these files can be scanned and maintained electronically and no longer in paper versions.

3.40 *Current contributors* – We selected 60 current contributors from the Province's payroll module for November 17, 2012. We compared information in PENFAX to each employee's master file maintained by their employer. We verified the employee's date of birth, employment start date, full-time or part-time status, and other relevant information to supporting records. We did not find any errors in our sample.

3.41 *Pension statement testing* – The Corporation provides Plan members with an annual statement which includes information such as employment start date and years of service. For the 60 current contributors we tested, we compared the information contained in the annual pension statement to information held in PENFAX and in employer files. No discrepancies were noted.

3.42 In addition, we recalculated the years of service to date, the earliest reduced pension retirement date, and earliest unreduced pension retirement date to ensure that information regarding when an employee could retire with reduced and full pension was accurate.

- In 58 of 60 samples, we were able to accurately recalculate the years of service to date, the earliest reduced pension retirement date, and the earliest unreduced pension retirement date
- Two of the 60 employees in our sample started work with the Province after January 1, 2011 and accordingly, had not received an annual statement at the time we completed our work.

Changes to the Public Service Superannuation Plan

Conclusions and summary of observations

Recent changes made to the Public Service Superannuation Plan were as a result of due process. A working group was established which provided input to the former Minster of Finance, as sole trustee of the Plan, on changes in governance and funding strategies. As a result of changes to the Plan, and limits in the Auditor General Act, this Office is no longer able to conduct independent audits of such matters as governance and investment performance of the Plan. We have recommended that the new Board of Trustees undertake nonfinancial statement audits for the Plan. Auditors should be engaged and results reported directly to the Board or its Audit and Actuarial Committee.

3.43 *Introduction* – Prior to April 1, 2013, the Minister of Finance was the sole trustee of the Plan. On April 1, 2013 the Minister of Finance transferred responsibility for the Plan to the Public Service Superannuation Plan Trustee Inc., moving the Plan from sole trusteeship to joint trusteeship. Joint trusteeship was established by an appointed board consisting of equal employee and employer members. In addition to this change in governance, the Province removed its guarantee of the Plan.

3.44 The board has the power to designate an administrator which runs the day-to-day operations of the Plan. The designated administer is the Nova Scotia Pension Services Corporation, formerly the Nova Scotia Pension Agency.

3.45 In Chapter 2 of our February 2013 Report of the Auditor General, we provided detailed observations on enacted and proposed changes to the Public Service Superannuation Plan, including the following.

- The removal of the Province's guarantee significantly shifts the risks of the Plan from the Province to the members of the Plan and this should have been adequately communicated.
- The accounting implications of the changes in the Plan structure should have been discussed with the Department of Finance's Government Accounting Division.
- It is inaccurate to describe the removal of indexing of Plan benefits as other than a reduction in benefits.
- We are concerned that the revised governance structure (as of April 1, 2013) includes only one retired member on the new board of trustees.

3.46 We recommended that the Minister of Finance directly communicate all significant proposed changes to the Plan to its members. In its response, the Department of Finance told us that it disagreed with our recommendation. Department management noted that they believed such changes had been sufficiently communicated.

3.47 *Working group* – A working group was established in the summer and fall of 2010 to provide input to the Minister of Finance, as sole trustee of the Plan, on changes to be made. The group consisted of nine members including:

- a representative from each of the Nova Scotia Government and General Employees Union, the Canadian Union of Public Employees, and the Nova Scotia Government Retired Employees Association;
- government representatives, including an individual who represented the interests of nonunionized provincial employees;
- senior management of the Nova Scotia Pension Services Corporation; and

- a consultant hired by government, through a competitive process, to provide input on governance practices in Canadian public sector pension plans.

3.48 Stakeholders were asked to put forward their representatives for the group. The Public Service Commission was not considered a stakeholder despite the potential impact of Plan changes on recruitment and retention in the civil service. We were informed various aspects of the working group deliberations were discussed with senior staff at the Commission, but there is no documentation to support this.

3.49 There were no terms of reference for the working group. However, meeting minutes indicate members were told that the Minister of Finance wanted the group to provide input to changes to the Plan, but that all decisions would be made by the Minister as sole trustee.

3.50 There were communications with the Minister regarding the group's progress, some of which was documented in memos. Meetings were held periodically between the Minister, the consultant and senior management of the Corporation. The results of these minutes were communicated to the working group and documented in the meeting minutes.

3.51 Corporation senior management indicated that the working group provided recommendations to the Minister of Finance on two significant changes to the Public Service Superannuation Plan – governance structure and a revised funding formula.

3.52 *Governance structure* – Working group meeting minutes indicate there was considerable discussion regarding the structure of the new board of trustees. The prospect of joint trusteeship had been established by 2010 Plan amendments but the specific composition of the board had not been determined.

3.53 The consultant provided information to the group on the governance structure in 14 Canadian public sector pension plans. The group discussed various governance models, including whether there should be representation from retired members and whether the board should include someone to represent the interests of nonunionized employees who represent about 20% of the current civil service.

3.54 The consultant reported back to the group that, after discussions with the Minister, the government, as employer, must be allocated 50% of the trustee seats, and that nonunionized employees must have one seat (to be allocated from the employees' representation).

3.55 Ultimately, a newly created body known as the Public Service Superannuation Plan Trustee Inc. assumed responsibility for the Plan when they were appointed as the trustee to replace the Minister of Finance as sole trustee on April 1, 2013.

3.56 The Trustee's board is composed of directors representing employers, employees, and retirees.

- Three directors as designated by the Nova Scotia Government and General Employees Union
- One director as designated by the Canadian Union of Public Employees Local 1867
- One director representing non-unionized employees
- One director representing retirees
- Six directors as designated by the government

3.57 An independent chair has been appointed by the board of directors. An appeals committee chair has been appointed and additional committee members will be appointed each time an appeal is to be considered.

3.58 *Funding formula* – Minutes from the working group meetings reflect discussions held with the Minister, including the following comments about the nature and extent of the funding formula which now forms part of the Plan.

- The Minister wanted the funding formula to be established in legislation to the extent possible. This would take much of the decision-making out of the hands of the Board of Trustees.
- Changes to the Plan are meant to establish its long-term sustainability.
- The future liability to the Province is to be minimized.

3.59 The consultant provided the funding targets and related action plans that are now included in the Public Sector Superannuation Plan Act. There is still room for decision-making by the Board of Trustees with respect to the range of possible contribution rate and benefit changes. To the extent guidelines can be developed to assist in future changes, such as a range of contribution increases given a particular funding level, these should be established by the new Board.

3.60 *Process for Plan changes* – Changes made to the Public Service Superannuation Plan were the result of an established process which met its objective.

3.61 *Future audit of the Plan* – Section 50(2) of the Public Service Superannuation Act states:

> *"Where a replacement Trustee is appointed ... and, notwithstanding the Auditor General Act or any other enactment, the Trustee shall annually appoint an auditor who shall audit the accounts and investments of the Superannuation Fund..."*

3.62 The Auditor General Act specifically excludes trust funds which are subject to joint trusteeship. Therefore, as of April 1, 2013, this Office can no longer audit any aspect of the Public Service Superannuation Plan.

3.63 The annual financial statement audit will provide assurance on the fair presentation of the assets and liabilities of the Fund. However, the new Board of Trustees should develop processes to provide for future audits of operations, including investment performance, and governance. This would assist the Board in fulfilling its responsibilities by identifying processes that require improvement. These audits would also provide further assurance to Plan members that their investments are well-managed and that their future benefits are secured.

3.64 There are many ways in which the Board could obtain additional audit services. The Plan's financial statement auditors could be asked to expand their annual audit processes to include compliance testing. Other private sector auditors could be engaged to perform these audits. Alternatively, the Board may wish to establish an internal audit function to provide such assurances. Auditors should be engaged through the Board's Audit and Actuarial Committee and audit results should be reported directly to this Committee or the Board. This helps to ensure audit processes remain independent of management, and also facilitates the Committee's oversight of timely implementation of audit recommendations by management.

Recommendation 3.6
The Public Service Superannuation Plan Trustee Inc. should develop a process to undertake nonfinancial statement audits for the Plan. Auditors should be engaged and results reported directly to the Board or its Audit and Actuarial Committee.

Public Service Superannuation Plan Trustee Inc. Response:
The Public Service Superannuation Plan Trustee Inc. accepts Recommendation 3.6 and has received a commitment from the Nova Scotia Pension Services Corporation to have a Controls Audit performed on the Corporation's operations by an external party. Implementation shall be completed by March 31, 2016.

However, The Compliance Officer, as detailed in the Compliance Monitoring Manual, is responsible for the internal audit of operations as well as the audit of the internal policies and procedures. In addition, on April 1, 2013, an Audit, Actuarial & Risk Committee derived from members of the new PSSPTI board was implemented. The Compliance Officer has a direct reporting line to the Audit, Actuarial & Risk Committee. On a minimum basis, the Compliance Officer meets with the Committee quarterly.

Investment Performance

Conclusions and summary of observations

The Nova Scotia Pension Services Corporation needs to prepare an operational risk assessment for the Public Service Superannuation Plan. The Corporation should use the assessment results to ensure its policies and procedures provide controls to mitigate identified risks. The investment philosophy and risks are detailed in the Plan's Statement of Investment Policies and Goals but the Board of Trustees considers the Statement to be confidential. We have recommended that this information be made available to Plan members. We have further recommended that the timing of a periodic review of the Plan's asset mix, included in this Statement, be established by the new Board. We tested the Corporation's processes for monitoring investment performance and concluded these were adequate. We found the Corporation has adequate processes to hire investment managers and assess their performance on a regular basis.

3.65 *Risk assessment* – The most significant risk of any defined benefit pension plan is whether there are sufficient resources to meet the obligations of the plan. This risk is mitigated through adequate contributions, and investment strategies that serve to optimize risk and return over the life of the plan.

3.66 Investments that yield high returns may carry an unacceptably high risk. The Plan's Statement of Investment Policies and Goals documents its investment risk tolerances. This Statement contains information on the parameters used to manage the Fund and provides guidance to the Corporation, and to external parties who may provide services to the Fund. The Statement includes the approved asset mix, as well as an acceptable variance from those ratios. It also identifies key risks to the Plan such as market risk, interest rate risk, and credit risk. The Statement notes that these risks are mitigated through investment policies, including the asset mix, and operational policies and procedures, including internal controls.

3.67 The Corporation has a Risk and Compliance Manual. It includes a schedule of identified controls which are to be tested for compliance with Corporation policies and procedures. Corporation management noted that the Manual was the result of a risk assessment process; however, there is no documented risk assessment.

3.68 A risk assessment is a process to evaluate possible risks that could impact on achieving an organization's goals and objectives. These risks could be external to the entity and beyond its control, such as economic downturns. Risks could also be internal risks such as having an inadequate succession plan if key personnel leave the organization. In order to manage risks, they must be identified and evaluated.

3.69 There should be a documented risk assessment to support the operations of the Pension Services Corporation in administering the Public Service Superannuation Plan. In addition, the newly-established Board may have different views of risk than the Minister did as sole trustee. We provided the Corporation with our finding on this matter and they informed us that they intend to enhance the compliance program by performing a risk assessment by June 30, 2014. The risk assessment should be the source of information for the compliance manual, not a byproduct of it. Management told us that they plan to revise the compliance program after the risk assessment has been completed.

Recommendation 3.7
The Nova Scotia Pension Services Corporation should conduct a risk assessment and map the results to existing policies and procedures. Any gaps should be addressed with new or revised policies and procedures. The Risk and Compliance Manual and its related monitoring program should be updated.

Nova Scotia Pension Services Corporation Response:
Nova Scotia Pension Services Corporation accepts Recommendation 3.7 and intends to complete a risk assessment and subsequently update the current Risk and Compliance Manual. Completion date shall be June 30, 2014.

The current Risk and Compliance Manual documents the risks and the procedures in place to mitigate them. The limits and tolerances for risks are identified in internal policies and procedures. The Compliance Program is designed to ensure that these policies and procedures are being followed. The Compliance Program is re-evaluated on an on-going basis. In addition, a strategic risk assessment of Nova Scotia Pension Services Corporation's enterprise risks is carried out no less than quarterly by the Enterprise Risk Committee. The Committee takes a risk based approach to mitigating the strategic and operational risks faced by the corporation.

3.70 *Asset mix* – The Plan consists of investments in fixed income and real estate, infrastructure, equities, commodities and hedge funds. The asset mix was approved by the then Minister of Finance in October 2010 as part of the approval of a revised Statement of Investment Policies and Goals.

3.71 The approved mix resulted from an independent asset allocation study prepared by a consultant engaged by the Corporation in fall 2010. The consultant's recommended mix was confirmed through the Corporation's internal analysis as well as a second consultant.

3.72 The historical asset mix was a more traditional combination of fixed income and equity holdings. This changed in 2007 with the introduction of a new inflation-linked asset class (an example of which is real estate). That change was intended to help improve the match between the Plan's liabilities and assets.

3.73 More recently, further changes to the asset mix were considered necessary to address two factors: market declines in 2008-09; and Plan changes in 2010. A memo from senior staff of the Pension Services Corporation to the Minister dated October 20, 2010 which recommends the revised asset mix notes *"The objective*

...is to establish a new asset mix that will reduce the Fund's exposure to equities and thereby reduce the expected volatility of investment performance without diminishing expected returns."

3.74 Our audit objective was to assess whether the revised mix was the result of a reasonable process. We did not assess the appropriateness of the approved asset mix. Senior management at the Corporation noted that the move to the new asset mix will take place over time; this is anticipated to take a few years.

3.75 The Corporation has an internal Asset Allocation Committee that meets biweekly and whose purpose is to review the current asset mix and consider whether action is needed to bring the assets more in line with the approved mix. The Committee may choose to leave the mix and allow the assets to balance over time, or the Committee may recommend that action be taken to rebalance the mix. However, the terms of reference do not include a timeframe for review of the approved asset mix. Periodic review would help ensure that the approved mix continues to enable the Plan to meet its objectives.

Recommendation 3.8
The Public Service Superannuation Plan Trustee Inc. should establish timeframes for the review and update of the Plan's asset mix to ensure it continues to meet Plan objectives.

Public Service Superannuation Plan Trustee Inc. Response:
The Public Service Superannuation Plan Trustee Inc. agrees with and has already implemented Recommendation 3.8. The Statement of Investment Policies and Goals, approved by the Trustee April 1, 2013 stipulates the periods of time for strategic reviews of the Fund's policy asset mix.

3.76 *Reporting investment performance* – The Corporation prepares a quarterly investment report for Plan members and provides this information through its website. An annual report is also prepared which includes the Plan's audited financial statements. Although our audit objectives did not consider the quality of information provided to members and other users, we identified a reporting issue during our work which we consider necessary to report.

3.77 Each of the quarterly and annual reports includes information on investment performance. Summary comments on market performance and issues are noted in the quarterly report. Detailed and comparative information on investment performance is included in the annual report, as well as details of the Plan's funded status and membership.

3.78 The revised asset mix was included in the Plan's annual report for the years ended March 31, 2011 and March 31, 2012. However, the asset mix reported in the March 31, 2013 annual report is the actual mix as of that date (and as reported in the audited financial statements). There is no information on the approved asset mix, and therefore members and users were unable to compare actual results to the approved asset mix.

3.79 Further, neither the annual report nor the Corporation's website includes the Statement of Investment Policies and Goals. We reviewed the document as part of our audit and noted that it is marked as confidential. The Plan's March 31, 2013 annual report notes:

> *"The [Statement of Investment Policies and Goals] sets out the parameters within which the investments may be made. These parameters include permissible investments and the policy asset mix of the four main asset classes ... The Investment Beliefs ... state the general principles upon which the investments are made."*

3.80 Two significant public sector pension plans – the Ontario Teachers' Pension Plan and the Canada Pension Plan – disclose their targeted asset mix on their websites. Since the Statement provides valuable information on the Plan's risk management practices and on the Corporation which administers the Plan, the Statement should be provided to members. It serves as both a governance and accountability document.

Recommendation 3.9
The Public Service Superannuation Plan Trustee Inc. should make its Statement of Investment Policies and Goals, including the approved asset mix and permissible investments, available to current and retired members of the Public Service Superannuation Plan.

Public Service Superannuation Plan Trustee Inc. Response:
The Public Service Superannuation Plan Trustee Inc. agrees with and intends to implement Recommendation 3.9 by making available the Statement of Investment Policies and Goals on the Plan's website. Implementation shall be completed by March 31, 2014.

However, the approved targeted asset mix was published in the 2011 and 2012 annual reports of the Public Service Superannuation Plan.

3.81 *Monitoring investment performance* – The Nova Scotia Pension Services Corporation has contracts with numerous external investment managers who are responsible for investing, or providing advice on investments, in a particular asset class. Each contract usually specifies the type of asset for which the manager is responsible (for example, Canadian equity or fixed income) and a benchmark against which the manager's performance will be measured (for example, the TSX). We discuss investment manager contracts in greater detail later in this chapter.

3.82 The Corporation has monthly and quarterly procedures to monitor investment performance and report results. Each of these procedures is included in the Investment Policies Manual. There are timeframes in which procedures are to be completed, and a review and approval process for monthly and quarterly reporting. The procedures also specify acceptable deviations when differences occur during certain reconciliation processes.

3.83 We tested compliance with monthly and quarterly procedures for monitoring investment performance for June and September 2012 and found procedures were followed. We identified areas for improvement such as the need to update procedures to reflect that tolerable deviation thresholds vary by asset class as opposed to one overall threshold, and that the procedures in the manual should be accessible to staff in read-only format. Management has indicated improvements will be made by June 30, 2014, and has assigned responsibility for the tasks.

3.84 *Investment manager selection* – The Corporation has an investment manager search and selection procedure in its Investment Procedures Manual. This provides guidance in selecting an investment manager including developing a list of candidates; preparing a request for proposals; and generating a short list of managers. These managers are then subject to further due diligence.

3.85 This due diligence includes collecting background information on the investment manager including its compliance processes, code of conduct, operational information such as risk management and insurance details. Corporation senior management conduct conference calls and onsite visits which they told us provide a better sense of the manager's strategy and fit with the Corporation.

3.86 We reviewed the documentation supporting the hiring process for one investment manager and noted that the information required by the procedures had been collected through conference calls and onsite visits.

3.87 Contracts with investment managers follow a standard format. Terms may be modified as negotiations with the managers proceed. The template covers such basics as reporting requirements, duty of care, termination, and privacy and confidentiality. Contracts also include the mandate of the investment manager and the benchmark against which the manager's performance will be measured. Previously, contracts were signed by the Minister of Finance as sole trustee of the Plan.

3.88 The Corporation's manual requires that agreements be reviewed annually but this has not been done. When a new agreement is signed with terms that differ from the template, existing contracts may be reviewed to assess whether changes are required. Management has indicated they will revise the procedure to reflect the current practice.

3.89 *Investment manager monitoring* – The Corporation has developed portfolio compliance and monitoring procedures for investment managers, including the commodities' advisor; hedge funds; and real assets.

3.90 Procedures differ for each type of investment. Investment managers who are responsible for managing more traditional investments such as equities and fixed income instruments are subject to monthly, quarterly, annual and biennial procedures. For example, quarterly procedures include receipt of manager's quarterly performance report, and quarterly compliance attestation. If there are concerns that a manager is not meeting performance targets, that manager may be placed on a watch list. There are different procedures for hedge funds; several procedures focus on the monitoring performed by the Corporation's Hedge Fund Committee which meets monthly. Regular conference calls are held with the hedge fund advisor and an annual call or site visit is also held with individual hedge fund managers.

3.91 We concluded that the Corporation has adequate processes to monitor investment managers' and advisor's performance. We tested the monitoring program for each asset class by selecting one or more investment managers or advisors within each class and comparing procedures performed to required procedures. We noted that there was no documentation to support that monthly and quarterly conference calls were held with the hedge fund advisor or the commodities investment managers. However, staff indicated the customized performance reports provided by these investment managers or advisors address several of the required topics (review of individual hedge fund managers; and firm updates, changes in assets, changes in key personnel, etc, for commodity investment managers). We agree additional documentation is not required in these instances.