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April 7, 2020

Mr. Richard Bendall
Chief, Internal Audit
Los Angeles County Employees Retirement Association
300 North Lake Avenue, Suite 820
Pasadena, CA 91101

Subject: Review of GASB 68 Report for June 30, 2020 Reporting Date

Dear Mr. Bendall:

Under our contract with the Los Angeles County Employees Retirement Association (LACERA), Cavanaugh Macdonald Consulting, LLC provides various actuarial auditing services, as requested by LACERA. One of the specific items included in the contract for the current fiscal year is an audit of the report prepared under Governmental Accounting Standards Board Statement Number 68 (GASB 68) for LACERA's Financial Statement Disclosure Reporting. This report is prepared annually by LACERA's retained actuary, Milliman, Inc. Audits have generally been performed every two years with the last audit performed on the June 30, 2018 GASB 68 report.

Cavanaugh Macdonald was asked to provide an audit of the GASB 68 disclosure report for the June 30, 2020 reporting date, which is based on a June 30, 2019 measurement date and a June 30, 2018 actuarial valuation date. The objective of the audit is to review the work of the retained actuary, Milliman, Inc., and provide an opinion as to whether the results presented in the report are actuarially sound, reasonable, and consistent with industry standards and the requirements of GASB 68. Because the information included in the GASB 68 report relies heavily on the information presented in the GASB 67 report, our review and analysis extended to the reasonableness of the information in GASB 67 report, prepared as of the measurement date of June 30, 2019. However, a review of the underlying actuarial valuation used to produce the liability results for the GASB 67 report (the June 30, 2018 actuarial valuation) was not part of the scope of this project and, thus, we relied upon its accuracy as part of our review of the GASB 67 and 68 reports.

3802 Raynor Pkwy, Suite 202, Bellevue, NE 68123
Phone (402) 905-4461 • Fax (402) 905-4464
www.CavMacConsulting.com
Offices in Kennesaw, GA • Bellevue, NE

Review Methodology

In order to complete our audit, the following information was provided by LACERA:

(1) Milliman's GASB 68 report for the reporting date of June 30, 2020, dated March 20, 2020.

(2) Milliman's GASB 67 report for the measurement date of June 30, 2019, dated September 16, 2019.

(3) Milliman's Actuarial Valuation report, as of June 30, 2018, dated November 29, 2018.

Our review process included the following:

- Review of the Total Pension Liability (TPL) as of June 30, 2019 for reasonableness;
- Independent review of the roll forward of the TPL, including the methodology used;
- Review of the Projection of Fiduciary Net Position used in the depletion date analysis;
- Review of the methodology and assumptions used in the determination of the discount rate;
- Review of the methodology and calculation of the proportionate share of Net Pension Liability (NPL);
- Review of the sensitivity analysis in the GASB 68 report;
- Review of the calculation of pension expense, deferred inflows/outflows and the determination of each participating employer's proportionate share; and
- Review of the GASB 68 report for reasonableness and completeness, along with compliance with actuarial standards and Cavanaugh Macdonald's understanding of GASB Standards 67 and 68.

In conducting our review, our focus was to determine whether the results presented in the GASB 67 and 68 reports, prepared by Milliman, are reasonable and sound based on the underlying actuarial valuation and the asset and financial information provided by LACERA. Generally, we have attempted to replicate calculations, wherever possible, and to determine the reasonableness of calculated values where we do not have sufficient information to replicate the values. We have especially focused on those areas where our background and expertise as actuaries is relevant to confirming the accuracy of the results.

Current Audit Findings

Our key findings and observations are summarized below. We do not believe it is useful to note stylistic differences so our comments are limited to issues we believe are most important and more critical to LACERA.

Review of Prior Audit Findings

There were no recommendations or major findings in the prior audit report that needed to be addressed. However, we note that Milliman included an exhibit to demonstrate the fiduciary net position is projected to cover all future benefit payments for current members in the current GASB 68 report (page 6). During our last review of the June 30, 2018 GASB 68 report, we had discussions with Milliman about periodically performing the full projection to ensure the results are as expected instead of consistently relying on the alternate approach. After discussions with LACERA, the decision was made to include the full projection of Fiduciary Net Position every year in the GASB 68 report. This fully addresses the recommendation of the prior audit and provides comprehensive support for using the investment return assumption as the discount rate.

Current Findings and Observations

Many of the calculations in Milliman's GASB 68 report are based on results from their GASB 67 report and funding valuation report. While a complete review of these reports was outside the scope of our assignment, we did sufficiently review them to ascertain that the liability results leading to the Total Pension Liability in the GASB 68 report were reasonable. During our review two years ago, we reviewed Milliman's experience study that was the basis for the underlying assumptions used in the GASB calculations and did not have any significant concerns. Note that we had not replicated the results of that experience study so our review was somewhat limited. Although there is a more recent experience study (presented to the Board in January 2020), the GASB 68 results being audited are based on the set of assumptions developed in the prior experience study. A full replication of the June 30, 2018 actuarial valuation, the valuation used as the basis for the Total Pension Liability, was not performed by Cavanaugh Macdonald Consulting, but we did prepare a replication of the liabilities in the June 30, 2019 actuarial valuation. As a result, we were able to use the replication of the 2019 valuation as a proxy to conclude that the Total Pension Liability as of June 30, 2019 is reasonable based upon our expectations and professional judgment.

We reviewed and replicated, where possible, the significant calculations presented in the GASB 68 report. We note that many of the numerical exhibits were also presented in the GASB 67 report and are simply repeated in the GASB 68 report. Our specific findings are discussed below:

<u>Total Pension Liability (TPL) and Net Pension Liability (NPL)</u>

The discount rate of 7.38% used in the GASB reports is different from the 7.25% long-term investment return assumption used in the funding valuation. This is due to the fact the discount rate under GASB 68 is required to be gross of administrative expenses, but LACERA uses an investment return assumption for funding that is net of administrative expenses. In the experience study performed in 2016, Milliman estimated the impact on the expected return of paying administrative expenses out of investment income to be 0.13%. Therefore, the use of a discount rate of 7.38% for GASB calculations is consistent with the investment return assumption of 7.25%, net of administrative expenses, developed in that experience study.

When reviewing the projection of the TPL from June 30, 2018 to June 30, 2019, we were able to verify that the calculations were properly performed, using standard actuarial techniques. In addition, we reviewed the TPL at June 30, 2018 for reasonableness given the differences between the actuarial accrued liability in the June 30, 2018 funding valuation and the TPL (calculated using a 7.38% discount rate and reflecting different treatment of the liabilities for the STAR COLA).

Discount Rate/Depletion Date Projection

The June 30, 2020 GASB 68 report includes an exhibit to document Milliman's projection of the fiduciary net position in future years to demonstrate that the fiduciary net position will be sufficient to cover the estimated benefit payments for current members. We reviewed those projections and verified that they are reasonable and consistent with the operation of the plan and with general actuarial principles. We believe that such a demonstration supports their assertion that the projected fiduciary net position will be sufficient to pay all projected benefit payments in future years for the current members, thereby justifying the use of the long-term assumed rate of return on investments as a discount rate.

Sensitivity Analysis

While we did not replicate the June 30, 2018 actuarial valuation and, therefore, the TPL used in the roll forward of the June 30, 2019 TPL, we were able to use our replication of the June 30, 2019 actuarial valuation results to verify the reasonableness of the June 30, 2019 TPL. In addition, we were able to run the sensitivity analysis, using a discount rate +1.00% and -1.00% from the 7.38% discount rate, using our replicated valuation in order to calculate the percentage change in the actuarial accrued liability. Using the calculated percentage changes in liabilities, we were able to verify the reasonableness of the TPL calculated by Milliman at a discount rate of 6.38% and 8.38%. Therefore, the results of the sensitivity analysis results are acceptable and reasonable.

Pension Expense and Deferred Inflows/Outflows

We verified the calculation of pension expense and deferred inflows and outflows, based on the TPL, Plan Fiduciary Net Position and service cost shown in Milliman's report. We concur with the calculation of the collective pension expense.

Proportionate Share Allocations

Because LACERA is a cost-sharing multiple employer plan, as defined by GASB, there are multiple participating employers and the reports include several exhibits presenting the allocation of the key results by employer. We examined the methodology used to perform this allocation and verified the calculation of each employer's proportionate share. The employer proportion is determined and rounded to seven decimal places, which is consistent with the prior year's report, and reasonable in our professional opinion.

We also reviewed the calculation of each employer's proportionate share of deferred outflows and inflows, as well as the pension expense. We found that all of the work was performed in a manner consistent with our understanding of GASB 68. We note that because most results are rounded, sufficient detail was not available to exactly match all of the detailed allocations, but matched within a reasonable level and, therefore, have no concerns with Milliman's approach.

Reconciliation of Net Pension Liability

We verified the reconciliation of the prior and current year NPL, by employer, as shown on page 21 of Milliman's report. We agree with the results for each employer and in total.

Conclusion

In general, we believe that the Milliman report presents a fair and accurate assessment of the information needed from the actuary for the use and presentation of results under GASB 68. We found no issues with the presentation of the key GASB results and the related commentary in Milliman's reports. Ultimately, GASB 68 is an accounting standard, and we therefore yield to any alternative opinion that LACERA, its auditors, and the auditors serving other interested parties may have.

In preparing this report, we relied without audit on information (some oral and some in writing) supplied by LACERA's staff. This information includes, but is not limited to, statutory provisions, financial information, and previously issued reports. We have not performed a complete audit on the results, but have reviewed the results to confirm that they are reasonable based upon the information provided.

On the basis of the foregoing, we hereby certify that, to the best of our knowledge and belief, this report is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Actuarial Standards of Practice promulgated by the Actuarial Standards Board and the applicable Guides to Professional Conduct, amplifying Opinions, and supporting Recommendations of the American Academy of Actuaries.

We would like to acknowledge the help in the preparation of the data for this review given by LACERA staff and the Milliman consultants.

I, Patrice A. Beckham, FSA, am a member of the American Academy of Actuaries and a Fellow of the Society of Actuaries, and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

I, Brent A. Banister, FSA, am a member of the American Academy of Actuaries and a Fellow of the Society of Actuaries, and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Sincerely,

Patrice Beckham

Patrice A Beckham, FSA, FCA, EA, MAAA
Principal and Consulting Actuary

Brent A. Banister

Brent A. Banister, PhD, FSA, EA, FCA, MAAA
Chief Actuary