



Office of the City Auditor

Agreed-Upon Procedures applied to 2016 GASB 45 Actuarial Valuation

Report Date: August 12, 2016



Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

www.vbgov.com/cityauditor

Lyndon Remias, CPA, CIA, CRMA, CGAP

Chris Ford , CPA

Gretchen Hudome, CIA, CRMA

City Auditor

Deputy City Auditor

Deputy City Auditor

Office of the City Auditor
2401 Courthouse Drive, Room 344
Virginia Beach, VA 23456

Telephone: 757.385.5870

Fax: 757.385.5875

Fraud, Waste, and Abuse Hotline 757.468.3330



Office of the City Auditor
Transmittal Letter

Date: August 12, 2016

To: David L. Hanson, City Manager

Subject: Agreed-Upon Procedures applied to 2016 GASB 45 Actuarial Valuation



We have performed the procedures requested by City Council in the resolution titled “*A Resolution Regarding the City’s 2016 Employee and Retiree Health Care Insurance Plan*” dated June 11, 2015. This agreed-upon procedures engagement was conducted in accordance with Government Auditing Standards. Government Auditing Standards incorporate financial and attestation standards established by the American Institute of Certified Public Accountants. These standards also provide guidance for performing and reporting the results of agreed-upon procedures. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described herein either for the purpose for which this report has been requested or for any other purpose.

We were not requested to perform, and did not perform an audit of the valuation, the objective of which would have been the expression of an opinion on the actuarial accuracy of the GASB 45 valuation. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that would have been reported to you. We completed the agreed-upon procedures on June 10, 2016.

This report is intended solely for the information and use of the City Council, Audit Committee, City Manager, and appropriate management including the City/Schools Benefits Executive Committee and the Consolidated Benefits Office. It is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

We would like to commend Milliman, Inc. for the courtesy and cooperation extended to us during the valuation.

If you have any questions about this report or any audit-related issue, I can be reached at 385-5872 or via email at lremias@vbgov.com.

Respectfully submitted,

Lyndon S. Remias, CPA, CIA, CRMA, CGAP
City Auditor

c: City Council Members
Audit Committee Members
Kenneth Chandler, Deputy City Manager
Benefit Executive Committee Members



Transmittal Letter	i
Background	1
Agreed-Upon Procedures	3
Standards	4
Results	5
Conclusion and Acknowledgements	8
Appendix I: Incremental Amount to Fund Annual Required Contribution.....	9
Appendix II: Estimated Incremental Amount to Fund 2017 Annual Required Contribution	10



Background



In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45: *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which established new accounting standards for other postemployment benefits (OPEB). The primary type of OPEB covered by the statement is postretirement health benefits. The City of Virginia Beach, like most governmental employers, had been accounting for postretirement medical benefits¹ on a pay-as-you-go basis. The standard requires accrual-based accounting with regards to recognizing the liability related to retiree healthcare. The City and the Virginia Beach City Public Schools have decided to fully fund the annual required contribution to ensure the continued availability of necessary funds.

Originally, the GASB 45 valuation was performed annually as required by a June 24, 2008 City Council resolution. After the June 30, 2010 valuation, City Council decided to allow the valuation to be performed every two years as permitted by the GASB. This decision saves the City/Schools approximately \$30,000 in actuarial fees in the *off* year the valuation is not performed. Nonetheless, funding contributions were made in the *off* years of 2011, 2013 and 2015.

Milliman, Inc. (Milliman) performed the 2016 valuation using the same valuation method as in prior valuations – the projected unit credit (PUC) actuarial cost method. In addition, most of the same assumption sources used in prior valuations were employed, giving us a measure of consistency in the valuation.

The major components of the valuation are the City's health plan, employee/retiree census data, actuarial assumptions/methodology, retiree plan costs, prior funding and investment results.

In 2017, GASB 45 will be replaced by GASB 75, *Accounting and Financial Reporting for Postemployment Benefits other than Pensions*, which will set new reporting requirements for governmental employer OPEB plans. Much like GASB 68, *Accounting and Financial Reporting for Pensions*, did for pension accounting, GASB 75 will require the recognition of the net OPEB liability

¹ City of Virginia Beach and/or Virginia Beach City Public Schools Employees hired before July 1, 2014 who retire under VRS guidelines with at least five (5) years of service may opt to continue on the City's health plan until they reach 65 years of age. Retirees with 25 or more years of service receive an employer contribution toward the cost of the health plan. Retirees with less than 25 years of service do not receive the subsidy.

Employees hired on or after July 1, 2014 will not receive an employer contribution to retiree health insurance. Per State law (Virginia Code 15.2-1517), such employees with fifteen years of continuous service with the City or Schools may elect to continue on a City/Schools health insurance plan upon retirement, but the retiree would be responsible for the full premium cost of the selected plan.



Office of the City Auditor

Agreed-Upon Procedures applied to 2016 GASB 45 Actuarial Valuation

in their statement of net position (balance sheet). In addition, the new standards will require the use of the entry age normal cost method rather than the projected unit credit method currently in use by many jurisdictions, including the Virginia Beach City and Schools. The change in cost method may result in significant one-time changes in the size of the plan's liability.

Please see **Appendix I** for a summary of the 2016 valuation results. **Appendix II** provides Milliman's projections for 2017 based on 2016 health plan information.



Agreed-Upon Procedures

1. Through testing, review and analysis determine the completeness, reliability and reasonableness of employee/retiree census data provided to Milliman by the Consolidated Benefits Office (CBO) for use in performing the January 1, 2016 GASB 45 valuation.
2. Through review, computation and analysis determine whether the Actuarial Accrued Liability (AAL) and normal cost calculations performed by Milliman are reasonable and agree with their detail of individual member calculations.
3. Trace the actuarial assumptions utilized by Milliman in their valuation to supporting documentation.
4. Through review and analysis, determine whether the Actuarial Value of Assets (AVA), the Annual Required Contribution (ARC), and the Cash Flow Increase (incremental amount needed to fully fund the City/Schools' ARC) are reasonable and properly supported.

Some of the related methodology utilized to accomplish the above procedures was as follows:

- Obtain a basic understanding of GASB 45 through researching *GASB Statement 45: Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* and other pertinent professional literature related to postretirement benefits.
- Contact representatives of Milliman to gain an understanding of their GASB 45 valuation methods, processes and assumptions.
- Obtain and review the actuary's report entitled *Virginia Beach City and Virginia Beach Schools Actuarial Valuation of Other Post Employment Benefits (OPEB) as of January 1, 2016*.
- Compile and summarize the activity in the Virginia Pooled OPEB Trust fund since the last valuation.
- Present findings and recommendations to representatives of Milliman and the City Council related to our review.



Standards

This agreed-upon procedures engagement was conducted in accordance with Government Auditing Standards which incorporate financial and attestation standards established by the American Institute of Certified Public Accountants. These standards also provide guidance for performing and reporting the results of agreed-upon procedures.

The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all City Departments. This report is distributed to the City's Audit Committee, City Council, City Manager, City/Schools Benefits Executive Committee and appropriate management within the City and Virginia Beach City Public Schools. This report is also available to the public.



Results

1. We tested the City/Schools' census data provided to Milliman for reliability, completeness and validity. Data is considered reliable when (1) complete and (2) accurate. Reliability does not mean that the data is error-free but that the assessment has determined that the potential risks and errors are not significant enough to cause a reasonable person to doubt a finding, conclusion or recommendation. We performed extensive tests on the City data, but only basic tests of completeness and validity on the Schools side, as we do not have access to documentation supporting the Schools' data.

All exceptions identified were corrected by the City/Schools Consolidated Benefits Office.

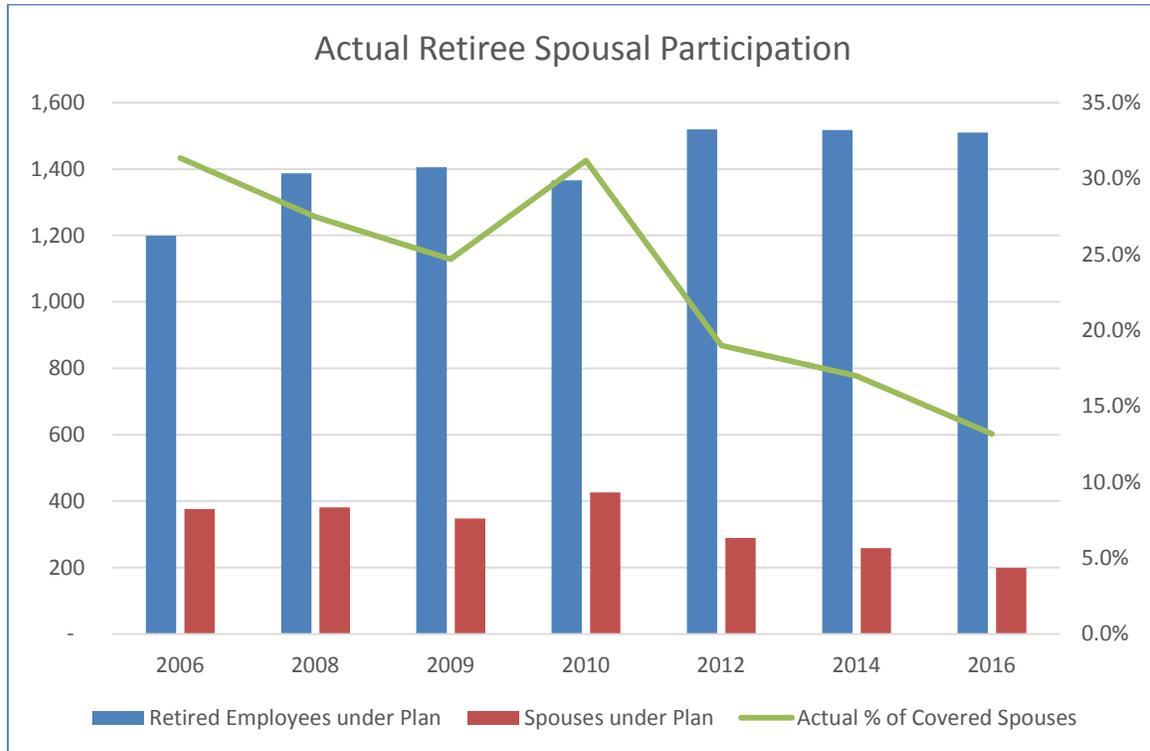
Based on our tests of completeness, reliability and reasonableness, we found the employee/retiree census data provided to Milliman by the Consolidated Benefits Office to be materially accurate for relying on members enrolled in the health plan as of January 1, 2016.

2. Through analysis and comparison of individual amounts, we determined that the AAL and Normal Cost calculations presented in Milliman's valuation dated June 2016 are reasonable. The resulting ARC² is reasonably stated in the final report. No additional cash contribution is required by the City or Schools to fully fund the ARC.
3. Actuarial assumptions utilized in the final valuation are reasonable and agree to supporting documentation/sources after making the following adjustment:
 - One of the demographic assumptions used in calculating the City/Schools' liability is that 40% of married retirees electing health coverage would cover a spouse. The City/Schools' actual rate of retiree spousal participation has historically been much lower. Please see Exhibit 1 on Page 6.

² The ARC is the total outlay of cash for retiree healthcare for any one year. The ARC consists of actual claims paid and the required amount paid to the OPEB trust to be invested to fund future retiree claims.



Exhibit 1



- Actual employee spousal coverage shows a similar trend (12.7% of current enrollees). The spousal participation assumption was lowered from 60% to 40% in 2010 based on a previous finding.
- Additionally, effective January 1, 2015, the City/Schools implemented a change to spouse health plan eligibility whereby spouses with access to their own employer group health coverage that meets the Affordability and Minimum Essential Services requirements of the Affordable Care Act are no longer permitted to participate in the City/Schools health plans.

We shared these findings with Milliman and they agreed to lower the spousal participation assumption to 20% for the final 2016 valuation resulting in a reduction to the Actuarial Accrued Liability (AAL) of just over \$3 million.



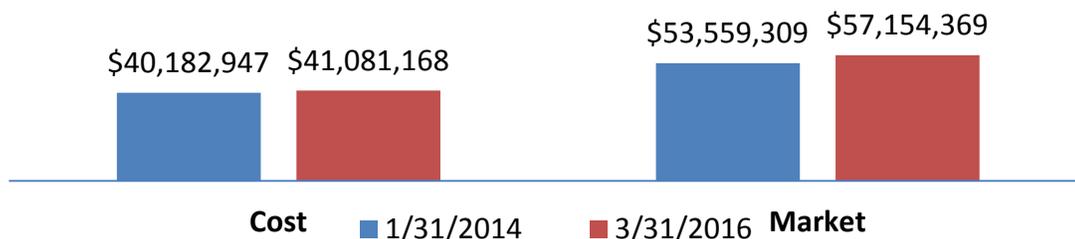
- We recomputed the smoothing³ calculation made by Milliman to state the Actuarial Value of Assets (value of our contributions) and verified balances to the City's VACO/VML Pooled OPEB account when appropriate without exception. No additional cash contributions were required to fully fund the ARC.

Virginia Pooled OPEB Trust Fund Investment Return

The City and Schools GASB 45 contributions are invested with the VACO/VML Pooled OPEB Trust since making its initial annual contribution in June of 2008. The following schedule summarizes the activity in the trust since the 2012 valuation.

Summary of OPEB Trust Activity March 31, 2012 through March 31, 2016		
	Cost	Market
Balance, March 31, 2012	\$33,188,349.48	\$39,737,403.88
Contributions	\$7,065,200.00	\$7,065,200.00
Earnings	\$18,461.69	\$6,845,768.70
Fees	-\$87,063.68	-\$87,063.68
Balance, January 31, 2014 (last valuation)	\$40,182,947.49	\$53,559,308.90
Contributions	705,600.00	705,600.00
Earnings	307,658.69	3,004,788.04
Fees	-115,338.37	-115,338.37
Balance, March 31, 2016	\$41,081,167.81	\$57,154,358.57

Comparison of Cost and Market
of VACO/VML Pooled OPEB Trust



³ Smoothing is a term used by accountants and actuaries to describe the legal process of dealing with changes in the value of a certain balance sheet entry or asset over a long period of time. By taking an average of all the different values, smoothing can deliver a constant figure for the shorter time periods that accountants and actuaries might need to consider.



Conclusion

Based upon the results of our procedures, we believe the valuation of the City/Schools' GASB 45 liability and the underlying assumptions are reasonable as presented in the final valuation dated June 2016.

Acknowledgements

We would like to thank Milliman, the Consolidated Benefits Office and City staff for their responsiveness to our requests during the performance of our procedures and their receptiveness to questions and comments. We thank all involved in the process for their help and offer our assistance should future concerns regarding this or other audit issues arise.



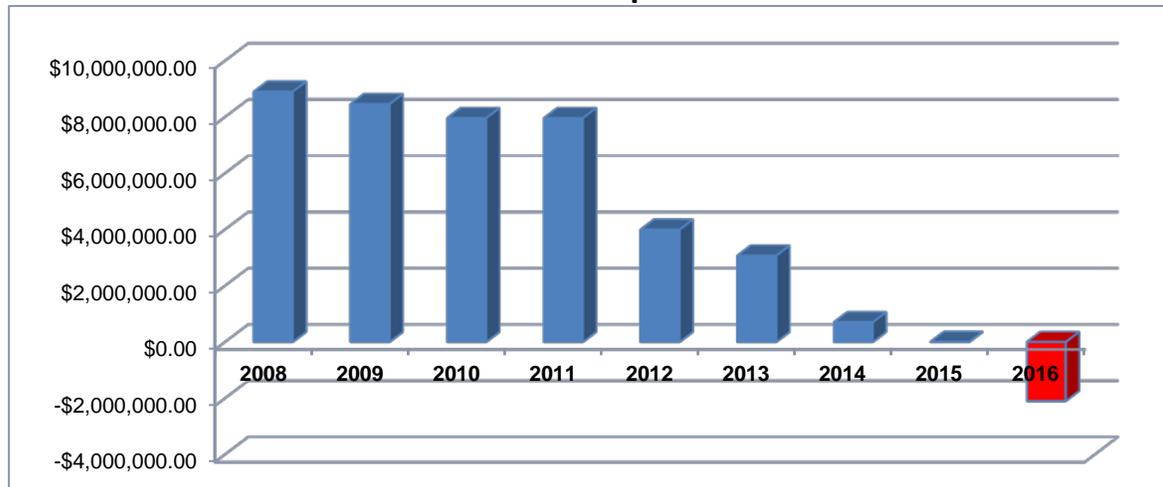
APPENDIX I

Incremental Amount to Fund Annual Required Contribution

		Milliman Valuation April 2014	Milliman Valuation January 2016	Explanation
Actuarial Accrued Liability (AAL)	\$	149,533,600	\$ 128,445,000	The actuarial value of OPEB benefits already earned by past service
Less: Actuarial Value of Assets (AVA)	\$	(52,527,900)	\$ (60,768,300)	Value of City/School contributions and earnings held in trust
Unfunded Actuarial Accrued Liability (UAAL)	\$	97,005,700	\$ 67,676,700	Unfunded portion of the liability
Amortized over 30 Years	\$	7,640,500	\$ 5,330,500	Amortized portion of the liability
Normal Cost	\$	4,707,600	\$ 3,976,000	Cost for OPEB being earned by employees for current year
Interest to End of Year	\$	454,700	\$ 342,700	Interest
Annual Required Contribution (ARC)	\$	12,802,800	\$ 9,649,200	Required Amount Needed current year to fund the liability
Less PAYGO- Expected Current Year Retiree Cost	\$	(12,099,900)	\$ (11,746,200)	Estimated retiree claims and costs paid for current year
Cash Needed to Fully Fund ARC	\$	702,900	\$ (2,097,000)	Cash ⁴ contribution needed to fully fund the ARC

Source: Actuarial Valuations prepared by Milliman

Incremental Amount to Fund Annual Required Contribution Historical Trend



⁴ In 2016, the ARC was overfunded by the estimated amount of the current year payment of claims and benefits of retirees.



APPENDIX II

Estimated Incremental Amount to Fund 2017 Annual Required Contribution

Milliman's 2017 Projection	
ARC	\$9,786,900
Expected Benefits	(\$11,712,700)
Amount Exceeding Fully Funded	\$1,925,800

Source: Actuarial Valuation prepared by Milliman dated June 2016.

NOTE: This 2017 projection, included in Milliman's 2016 valuation report, was performed utilizing the 2016 plan information as that was the most current plan information available. Thus, actual 2017 amounts may vary based on plan changes.