



Office of the City Auditor

Agreed-Upon Procedures applied to GASB 45 Actuarial Valuation

Report Date: April 18, 2014



Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

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Office of the City Auditor
Transmittal Letter



Date: April 18, 2014
To: James K. Spore, City Manager
Subject: Agreed Upon Procedures applied to GASB 45 Actuarial Valuation

We have performed the procedures requested by City Council in the resolution titled *"A Resolution Regarding the City's 2014 Employee and Retiree Health Care Insurance Plans"* dated June 11, 2013. 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 April 14, 2014.

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 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
City Auditor

c: City Council Members
Audit Committee Members
Cindy Curtis, Deputy City Manager
Benefit Executive Committee Members



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Purpose

To perform agreed-upon procedures related to the actuarial valuation of the City/Schools' Governmental Accounting Standards Board Statement 45 (GASB 45) liability and the underlying assumptions.

Scope and Objectives

The objectives of our review were:

1. To 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 GASB 45 June 30, 2014 valuation.
2. To determine whether the Actuarial Accrued Liability (AAL) and normal cost calculations performed by Milliman were reasonable.
3. To determine whether actuarial assumptions utilized by Milliman in their valuation are reasonable and agree to supporting documentation.
4. To 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.

Our review was limited to the January 1, 2014 valuation by Milliman. Our fieldwork concluded on April 14, 2014.



Methodology

To accomplish our objectives, we performed the following procedures:

- Obtained 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.
- Consulted with representatives of Milliman to gain an understanding of their GASB 45 valuation methods, processes and assumptions.
- Performed appropriate tests of completeness, reliability and reasonableness of employee/retiree census data.
- Reviewed the drafts and final report of the City/Schools' Actuarial Valuation of Other Post Employment Benefits (OPEB) as of January 1, 2014.
- Reviewed supporting documentation for overall actuarial assumptions.
- Obtained a list of individual Actuarial Accrued Liability (AAL) calculations and Normal Cost calculations for current enrollees.
- Recalculated the total AAL for the City/Schools' for January 1, 2014.
- Verified the present value factor used in the amortization of the City/Schools' liability.
- Compiled and summarized the activity in the Virginia Pooled OPEB Trust Fund since the last valuation.



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, and appropriate management within the City and Virginia Beach City Public Schools. This report is also available to the public.



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 health care. 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 and 2013.

Milliman performed the 2014 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 and prior funding and investment results.

Please see **Appendix I** for a summary of the 2014 valuation results. **Appendix II** provides Milliman's projections for 2015 based on 2014 health plan information.

¹ Employees of the City of Virginia Beach and/or the Virginia Beach City Public Schools 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.



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.

The results of our assessment are as follows:

- We identified 71 full-time City employees that were not included in the original Census data. Please see table below.

| NOT INCLUDED IN CENSUS DATA | # OF EMP | HEALTHCARE ENROLLMENT | | | |
|--------------------------------|-----------|-----------------------|-----------|-----------|-----------|
| | | HDHP | POS | NONE | TOTAL |
| NEW HIRE | 52 | 3 | 35 | 14 | 52 |
| ACTIVE, NOT ON CENSUS | 1 | | 1 | | 1 |
| CHANGE IN WORK HOURS, PT TO FT | 7 | | 5 | 2 | 7 |
| REEMPLOYMENT | 5 | 1 | 3 | 1 | 5 |
| REINSTATEMENT | 6 | | 3 | 3 | 6 |
| TOTALS | 71 | 4 | 47 | 20 | 71 |

- Approximately 72% (51) of these employees are enrolled in one of the City's healthcare plans.
- There were 12 employees included in the census data where the Medical Option field was blank, but payroll records show withholdings for healthcare.
- There were seven employees reported in the census as having healthcare where there are no payroll withholdings.
- There are three employees where census data shows them enrolled in the HDHP plan. Payroll withholding is for the POS plan.

The net impact to premium totals for these employees was approximately \$15,000 per pay period, or \$360,000 per year.

During our review of the Schools' census data, we identified 9,016 of the 10,144 records were missing data in the VRS field.

All exceptions were corrected by Milliman.



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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, 2014 after making the above-mentioned corrections.

2. Through analysis and comparison of individual amounts, we determined that the AAL and Normal Cost calculations presented in Milliman's valuation dated April 2014 are reasonable. The resulting ARC² and incremental cash amounts needed to fully fund the ARC is reasonably stated in the final report.
3. Actuarial assumptions utilized in the final valuation are reasonable and agree to supporting documentation/sources after making the following correction:

For the GASB 45 valuation, Milliman uses the VRS pension actuarial assumptions for nearly all of its *demographic* assumptions of plan members such as retirement rates, withdrawal rates, disability rates, mortality rates etc. In the initial 2014 draft, the VRS demographic assumptions that were applied to *all* participants of the *joint* City /Schools valuation were the demographic assumptions from the VRS valuation that were applicable *solely to the City members* as adopted by the VRS Board of Trustees in the experience study for the four year period ending June 30, 2012. The VRS had performed a separate experience study specific to City employees, and one specific to the School participant population. As would be expected, the City and School populations are in fact demographically different (and Schools has nearly twice as many active members). The VRS experience studies and resulting assumptions reflect those demographic differences. We pointed this out to Milliman and they agreed with us and changed the valuation to incorporate the separate VRS assumptions specific to City and Schools participant populations.

4. We recomputed the smoothing 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.

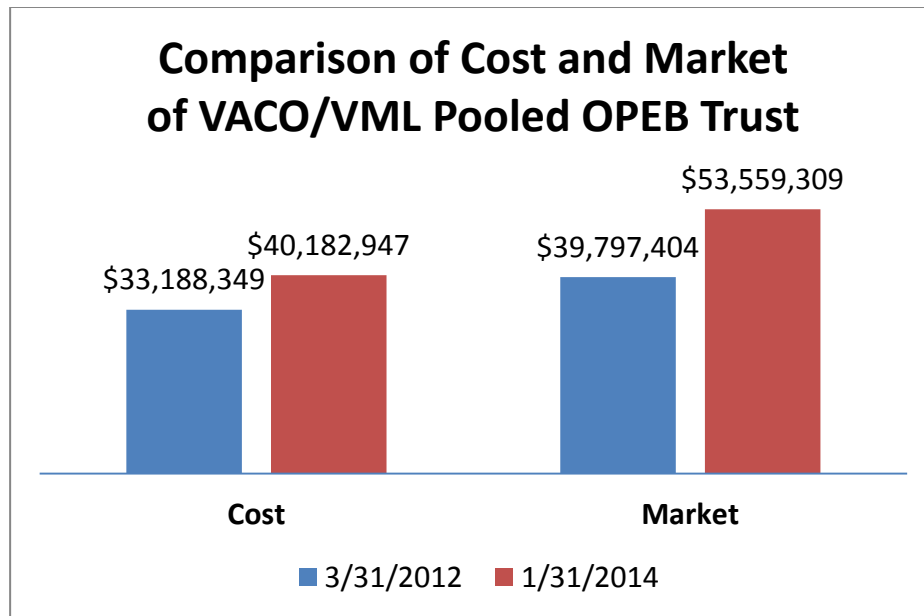
² The ARC is the total outlay of cash for retiree healthcare for any one year. The ARC consists of actual claims paid and the required amount paid to the OPEB trust to be invested to fund future retiree claims.



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 last valuation in 2012.

| Summary of OPEB Trust Activity March 31, 2012 through January 31, 2014 | | |
|---|------------------------|------------------------|
| | 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 | \$40,182,947.49 | \$53,559,308.90 |





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 April 2014.

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.



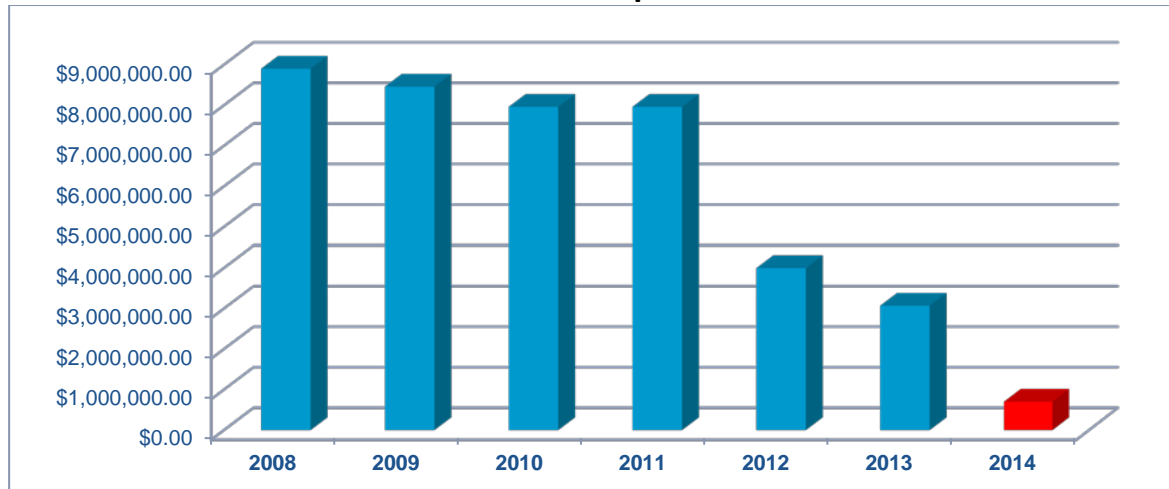
APPENDIX I

Incremental Amount to Fund Annual Required Contribution

| | Milliman Calculation August 2012 | Milliman Calculation April 2014 | Explanation |
|--|--|---------------------------------------|---|
| Actuarial Accrued Liability (AAL) | \$ 170,625,800 | \$ 149,533,600 | The actuarial value of OPEB benefits already earned by past service |
| Less: Actuarial Value of Assets (AVA) | \$ (38,288,300) | \$ (52,527,900) | Value of City/School contributions and earnings held in trust |
| Unfunded Actuarial Accrued Liability (UAAL) | \$ 132,337,500 | \$ 97,005,700 | Unfunded portion of the liability |
| Amortized over 30 Years | \$ 10,423,400 | \$ 7,640,500 | Amortized portion of the liability |
| Normal Cost | \$ 5,429,000 | \$ 4,707,600 | Cost for OPEB being earned by employees for current year |
| Interest to End of Year | \$ 583,700 | \$ 454,700 | Interest |
| Annual Required Contribution (ARC) | \$ 16,436,100 | \$ 12,802,800 | Required Amount Needed current year to fund the liability |
| Less PAYGO- Expected Current Year Retiree Cost | \$ (12,440,100) | \$ (12,099,900) | Estimated retiree claims and costs paid for 2014 |
| Cash Needed to Fully Fund ARC | \$ 3,996,000 | \$ 702,900 | Cash ³ contribution needed to fully fund the ARC |

Source: Actuarial Valuations prepared by Milliman

Incremental Amount to Fund Annual Required Contribution Historical Trend



³ The cash needed to fully fund the ARC is the net of \$1,043,800 due from the City and a \$340,900 credit for Schools.



APPENDIX II

Estimated Incremental Amount to Fund 2015 Annual Required Contribution

| Milliman's 2015 Projection | |
|------------------------------------|----------------|
| ARC | \$13,091,400 |
| Benefits | (\$13,088,700) |
| Amount Needed to Fully Fund | \$2,700 |

Source: Actuarial Valuation prepared by Milliman dated April 2014

NOTE: This 2015 projection, included in Milliman's 2014 valuation report, was performed utilizing the 2014 plan information as that was the most current plan information available. Thus, actual 2015 amounts may vary based on plan changes.