Office of the City Auditor

Agreed-Upon Procedures applied to the 2018 Actuarial Valuation of Other Post Employment Benefits (OPEB)

Report Date: July 3, 2018

Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

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Date: July 3, 2018

To: David L. Hansen, City Manager

Subject: Agreed-Upon Procedures applied to 2018 Actuarial Valuation of Other Post Employment Benefits (OPEB)

We have performed the procedures requested by City Council in the resolution titled *"A Resolution Regarding the City's 2018 Employee and Retiree Health Care Insurance Plans"* dated May 9, 2017. 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 2018 OPEB funding 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 21, 2018.

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

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

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

Background

Governmental Accounting Standards Board

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 benefits[1] on a pay-as-you-go basis. GASB 45 required accrual-based accounting with regards to recognizing the liability related to retiree healthcare. To ensure the continued availability of necessary funds, the City and the Virginia Beach City Public Schools fully funded the Annual Required Contribution (ARC) while GASB 45 was in effect through 2017.

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

The GASB released new accounting standards for public postemployment benefit plans other than pension plans (OPEB) in 2015. These standards, GASB Statements 74 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB)* and 75 *Accounting and Financial Reporting **by Employers** for Postemployment Benefits Other Than Pensions (OPEB)* have substantially revised the accounting requirements previously mandated under GASB Statements 43 and 45. With the transition and implementation of GASB 74 and 75, the City and Schools will continue with the decision to fully fund the Actuarially Determined Employer Contribution (ADEC -- new terminology) in 2018.

In a broad sense, the change in standards for OPEB from 43/45 to 74/75 does three main things:

1. Changes how the long-term obligation and the annual cost of OPEB are measured;
2. Requires the recognition of the net OPEB liability on the face of the financial statements; and,
3. Requires more extensive note disclosure and related schedules in the financial statements.

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[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.

GASB 74 applies to financial reporting ***for public OPEB plans*** and is required to be implemented for plan fiscal years beginning after June 15, 2016. The City implemented GASB 74 for the fiscal year ended June 30, 2017[2].

GASB 75 governs the specifics of accounting for public OPEB plan obligations and is required to be implemented for employer fiscal years beginning after June 15, 2017 (i.e., FY 18). GASB 75 requires a liability for OPEB obligations, known as the Net OPEB Liability to be recognized on the balance sheet as was required for our pension liability under GASB 68, *Accounting and Financial Reporting for Pensions*.

In addition, GASB 75 separates the funding aspect of OPEB from the financial reporting required by GASB 74 and 75. *This* valuation report is for the *funding* of the OPEB trust for fiscal years ended June 30, 2018 and 2019. A separate report, using the same January 1, 2018 valuation member information and assumptions reviewed here, will be issued later for the financial reporting information required to be reported in the June 30, 2018 CAFR.

The new standards require the use of the Entry Age Normal (EAN) cost method rather than the Projected Unit Credit (PUC) method used in past valuations for reporting purposes. The PUC method can still be used for funding purposes. The City/Schools have opted to do so. The interest rate used in the 2018 valuation is 7.0%; reduced from the 7.5% utilized in prior valuations. Other internal changes to increase accuracy, such as the use of actual claims history as opposed to budgeted premiums and the use of available teacher specific assumptions, all pushed the liability higher. The positive performance of our OPEB trust assets, the termination of retiree health care for employees starting after July 1, 2014, and other structural changes to our plans have helped reduce the liability. Most of the same assumption sources (i.e., Virginia Retirement System) used in prior valuations are still utilized in this valuation.

Please see **Appendix I** for a summary of the 2018 valuation results. **Appendix II** provides Milliman's projections for 2019. Milliman's 2019 projection is based on 2018 health plan information.

[2] See Note 14, Other Postemployment Benefits, City of Virginia Beach Comprehensive Annual Report (CAFR) for the year ended June 30, 2017 (Pages 101 – 107).

Financial Summary of OPEB (Retiree Health Care) – 2008 to Present

- Until 2009, City and Schools retiree health care claims were paid just as active employees' claims were – pay-as-you-go – with no provision or reporting requirements for future claims.
- In 2008, the General Accounting Standards Board passed GASB 43/45 requiring disclosure of the amounts of our future OPEB promises to retirees; and, if not fully funded, any shortage to the Annual Required Contribution (ARC) must be recognized as a liability.
- In 2009, the City and Schools joined the Virginia Pooled OPEB Trust (OPEB Trust) to manage its OPEB contributions and house the resulting investments. The Trust's Board of Trustees has fiduciary responsibility for the investment of monies and administration of the Trust pursuant to the Trust Agreement. City Council appointed the City's Deferred Compensation Board Trust as the OPEB's Local Finance Board to serve as trustee of the City and School Board with respect to the OPEB Trust.
- The City and Schools opted to contribute the full Annual Required Contribution (ARC) amount each year; and, thus did not have to accrue a liability on the face of the financial statements under GASB 45.
- From 2008 through 2015, the City and Schools contributed approximately $41 million to the OPEB Trust for future retiree health care claims. The value of the trust assets as of April 30, 2018 is approximately $71 million.
- Due to the City and School's decision to end the subsidy for retiree healthcare for employees beginning work after July 1, 2014, our increasing trust assets, and structural changes to retiree contributions, neither the City nor the Schools were required to make a contribution in 2016 or 2017 to fully fund the liability.
- In 2017, GASB 75 replaced GASB 45. As a result, we must now record the entire Net OPEB Liability on our balance sheet for the year ended June 30, 2018.
- GASB 75 separates the funding from the accounting requirements of GASB 74/75. The City and Schools chose to continue funding by the Projected Unit Cost (PUC) method and thus two valuation reports will be issued every two years; one to determine the trust funding requirements and one for the accounting requirements for GASB 74/75.
- As the OPEB Trust investments are irrevocable; and, can only be used to pay out OPEB benefits, at some appropriate future time, those funds will be spent to pay actual retiree health claims.

Agreed-Upon Procedures and Findings

The procedures performed and associated findings are as follows:

1. *Through testing, review and analysis determine the completeness, reliability and reasonableness of employee/retiree census data provided to Milliman by the City/Schools Consolidated Benefits Office (CBO) for use in performing the January 1, 2018 OPEB Trust funding valuation.*

   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 prior to providing the census data to the actuaries for their valuation.

   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 care plan as of January 1, 2018.

2. *Through review, computation and analysis determine the reasonableness of the Total OPEB Liability and Service Cost calculations performed by Milliman and agree them with the totals of their detail of individual member calculations.*

   Through analysis and comparison of individual amounts, we determined that the Total Actuarial Accrued Liability and Service Cost calculations presented in Milliman's valuation issued June 29, 2018 are reasonable. The resulting Actuarially Determined Employer Contribution (ADEC) is reasonably stated in the final report.

3. *Trace the actuarial assumptions utilized by Milliman in their valuation to supporting documentation.*

   Actuarial assumptions utilized in the final valuation are reasonable and agree to supporting documentation/sources.

4. *Through review and analysis, determine that the Actuarial Value of Assets and Actuarially Determined Employer Contribution are reasonable and properly supported.*

   We recomputed the smoothing[3] calculation made by Milliman to state the Actuarial Value of Assets (value of our contributions) and verified balances to the OPEB Trust account when appropriate without exception.

5. *Compile and summarize the activity in the OPEB Trust since the last valuation.*

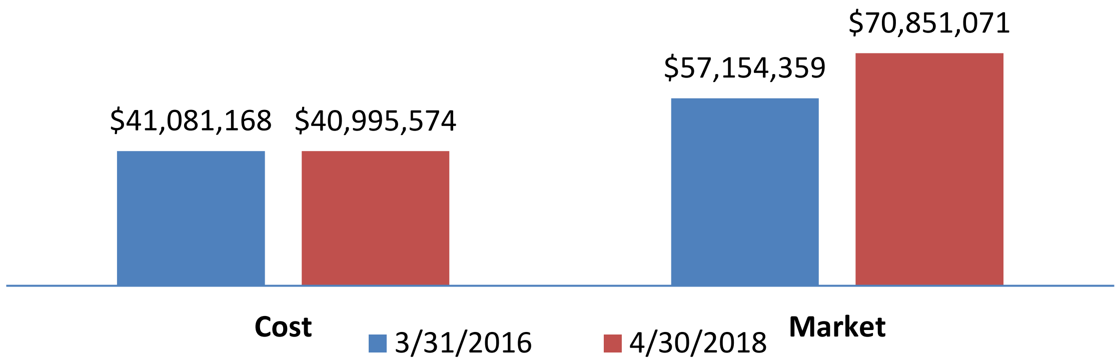
   The City and Schools GASB 75 contributions are invested with the OPEB Trust since making its initial annual contribution in June of 2008. The following schedule summarizes the activity in the trust since January 31, 2014.

Summary of OPEB Trust Activity January 31, 2014 through April 30, 2018		
	Cost	**Market**
Balance, January 31, 2014	**$40,182,947.49**	**$53,559,308.90**
Contributions	$705,600.00	$705,600.00
Earnings	$307,658.69	$3,004,788.04
Fees	-$115,958.69	-$115,338.37
Balance, March 31, 2016	**$41,081,167.81**	**$57,154,358.57**
Contributions	$0.00	$0.00
Earnings	$49,067.44	$13,831,373.65
Fees	-$134,661.59	-$134,661.59
Balance, April 30, 2018	**$40,995,573.66**	**$70,851,070.63**

The actuarial value of assets as of January 1, 2018 was $69,182,300. This amount is used for purposes of the valuation.

[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.

Comparison of Cost to Market of City/Schools Contributions to the Virginia Pooled OPEB Trust



Acknowledgements

We would like to thank Milliman, the City/Schools Consolidated Benefits Office, and City and Schools 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 Actuarially Determined Employer Contribution

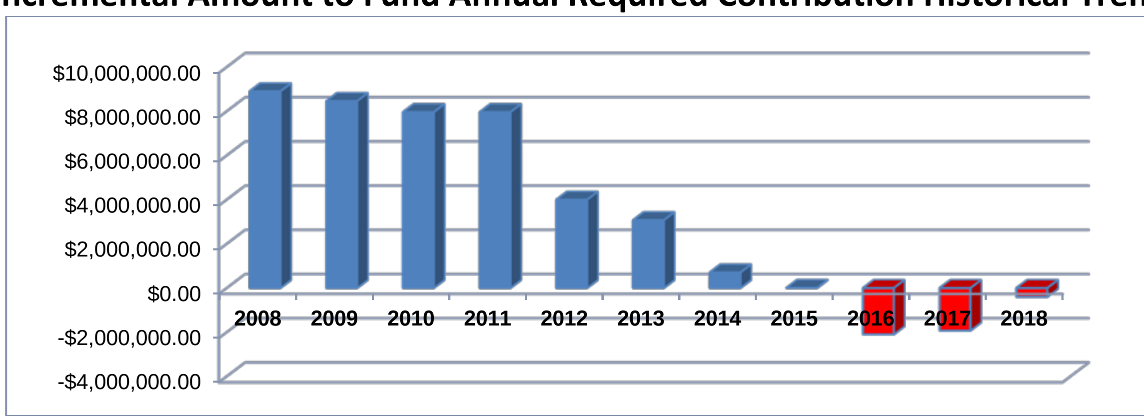
Milliman Valuation					
		January 2016 GASB 45		January 2018 OPEB Funding	Explanation
Actuarial Accrued Liability (AAL)- PUC method chosen	$	128,445,000	$	168,611,200	The actuarial value of OPEB benefits already earned by past service.
Less: Actuarial Value of Assets (AVA)	$	(60,768,300)	$	(69,182,300)	Value of City/School contributions and earnings held in trust. See NOTE 1 below.
Unfunded Actuarial Accrued Liability	$	67,676,700	$	99,428,900	Unfunded portion of the liability.
Amortized over 28 Years @ 7%	$	5,330,500	$	7,656,200	Amortized portion of the liability.
Normal Cost	$	3,976,000	$	5,554,700	Cost for OPEB being earned by employees for current year.
Interest to End of Year	$	342,700	$	454,500	Interest
Actuarially Determined Employer Contribution (ADEC)	$	9,649,200	$	13,665,400	Required Amount Needed current year to fund the liability.
Less PAYGO- Expected Current Year Retiree Costs	$	(11,746,200)	$	(14,066,300)	Estimated retiree claims and costs paid for current year.
Cash Needed to Fully Fund ADEC	**$**	**(2,097,000)**	**$**	**(400,900)**	Combined City /School overfunded amount – See Note 2 below.

SOURCE: 2016 and 2018 actuarial valuations prepared by Milliman.

NOTE 1: 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.

NOTE 2: The $400,900 combined overfunding is combination of the City overfunded amount of $(1,091,200) and the Schools amount due of $690,300.

Incremental Amount to Fund Annual Required Contribution Historical Trend



APPENDIX II

Estimated Incremental Amount to Fund 2019 Actuarially Determined Employer Contribution

Milliman's 2019 Projection	
ADEC	$14,061,800
Expected Benefits	($14,545,400)
Overfunded – see below	($483,600)

SOURCE: Actuarial Valuation prepared by Milliman dated June 29, 2018.

NOTE: *The 2019 projection, included in Milliman's 2018 valuation report, was performed utilizing the 2018 plan information as that was the most current plan information available. Thus, actual 2019 amounts may vary based on plan changes. The $483,600 overfunded total consists of an overfunded City amount of ($1,489,100) and an amount due from the Schools of $1,005,500.*