Office of the City Auditor

Agreed-Upon Procedures applied to 2020 Actuarial Valuation of Other Postemployment Benefits (OPEB)

Report Date: August 12, 2020

Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

www.vbgov.com/cityauditor

Lyndon Remias, CPA, CIA	City Auditor
Gretchen Hudome, CIA, CRMA	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

Date: August 12, 2020

To: Patrick A. Duhaney, City Manager

Subject: Agreed-Upon Procedures applied to 2020 Actuarial Valuation of Other Postemployment Benefits (OPEB)

We have performed certain agreed-upon procedures related to the City/Schools 2020 Actuarial Valuation of Other Postemployment Benefits (OPEB). 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 2020 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 July 28, 2020.

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
City Auditor

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

Background

In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement 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.

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.

In 2015, the GASB released new accounting standards for public postemployment benefit plans other than pension plans (OPEB). 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).* GASB Statements 74 and 75 substantially revised the accounting requirements previously mandated under GASB Statements 43 and 45. For example, GASB Statements 74 and 75:

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

---

[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 combined cumulative service with the City and/or Schools receive an employer contribution toward the cost of the health plan. Retirees with less than 25 years of service do not receive the subsidy.

City employees hired before July 1, 2014 who retire under the VRS guidelines with five (5) or more years of cumulative service with a work-related disability may elect retiree coverage and are eligible for the employer contribution.

City of Virginia Beach and/or Virginia Beach City Public Schools hired on or after July 1, 2014 do 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.

[2] See Note 14, Other Postemployment Benefits, City of Virginia Beach Comprehensive Annual Financial Report (CAFR).

The newer 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 continue to use the PUC method for funding.

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.

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. The City implemented GASB 75 for the fiscal year ended June 30, 2018. GASB 75 requires a liability for OPEB obligations, known as the Net OPEB Liability, to be recognized on the balance sheet. In addition, GASB 75 separates the funding aspect of OPEB from the financial reporting required by GASB 74 and 75.

With the transition and implementation of GASB 74 and 75, the City and Schools have opted to continue to fully fund the Actuarially Determined Employer Contribution (ADEC).

This valuation report is for the *funding* of the OPEB trust for fiscal years ended June 30, 2020 and 2021. A separate report, using the same January 1, 2020 member information and assumptions reviewed herein, is issued for the financial reporting information required for the June 30, 2020 City's Comprehensive Annual Financial Report (CAFR).

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

The City/Schools combined January 1, 2020 actuarial liability[3] is $149.7 million.

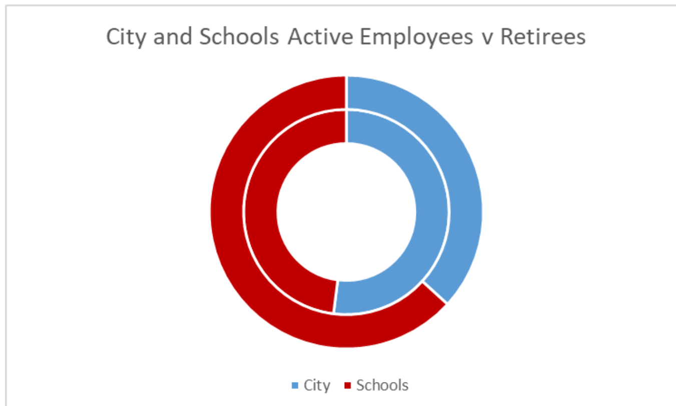
Please see **Appendix I** for 2020 Valuation Highlights and Changes and Milliman's projection for FY21.

[3] The actuarial liability represents the present value of OPEB attributable to the service performed up to the valuation date.

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, 2020 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. As of January 1, 2020 there were 16,311 active City and Schools employees and 1,398 retirees receiving OPEB benefits. Active employees are represented in the outer ring of the chart above. Retiree participants are represented in the inner ring.

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, 2020.

2. *Through review, computation and analysis determine the reasonableness of the Actuarial Liability and Normal 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 Liability and Normal Cost calculations presented in Milliman's valuation issued on June 30, 2020 are reasonable.

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[4] calculation made by Milliman to state the Actuarial Value of Assets (value of our contributions) and verified balances to the City/Schools Virginia Pooled OPEB Trust account, when appropriate, without exception. Milliman calculates the actuarially determined employer contribution (ADEC) for fiscal year ending June 30, 2020 as the normal cost plus a 26-year amortization of the plan's unfunded actuarial liability as of January 1, 2020. The ADEC is reasonably stated in the final report.

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

   The following schedule summarizes the activity in the City/Schools Virginia Pooled OPEB Trust since the date of the last actuarial valuation on January 1, 2018.

Summary of Combined Virginia Pooled Trust Activity for City and Schools

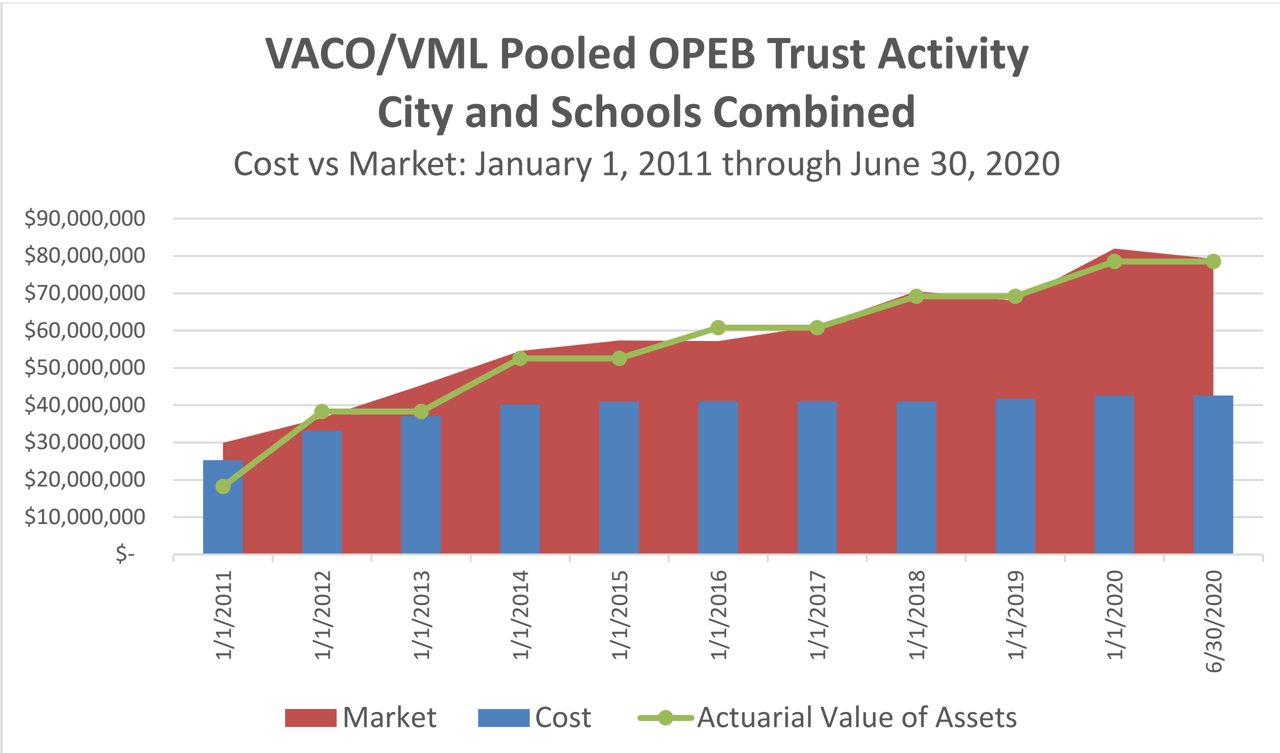
January 1, 2018 through June 30, 2020

	Cost	Market
Balance at January 1, 2018	$41,013,657.91	$70,584,557.86
Contributions	$1,695,800.00	$1,695,800.00
Earnings	$70,341.09	$7,083,125.88
Fees	($159,989.85)	($159,989.85)
Balance at June 30, 2020	$42,619,809.15	$79,203,493.89

The actuarial value of assets as of January 1, 2020 was $78,505,300. This amount is used for purposes of the valuation.

The chart on the next page shows a comparison of cost to market as well as the change in the actuarial value of assets over a ten year period.

[4] 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.



Acknowledgements

We would like to thank Milliman, Inc., 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.

APPENDIX I

2020 Valuation Highlights and Changes

Comparison of City and Schools Combined 2018 and 2020 Actuarial Valuations

	Milliman Valuation				
		January 2018		January 2020	Explanation
Actuarial Liability	$	168,611,200	$	149,705,800	The actuarial value of OPEB benefits already earned by past service using the PUC Method.
Less: Actuarial Value of Assets (AVA)	$	69,182,300	$	78,505,300	Value of City/School contributions and earnings held in trust. See NOTE 1 below.
Unfunded Actuarial Liability (UAL)	$	99,428,900	$	71,200,500	Unfunded portion of the liability.
Amortization of UAL	$	7,656,200	$	5,394,800	Amortized portion of the liability. See NOTE 2 below.
Normal Cost	$	5,554,700	$	4,562,700	Annual ongoing cost of benefits accruing to active participants.
Interest to June 30	$	454,500	$	318,500	Interest
Actuarially Determined Employer Contribution (ADEC)	$	13,665,400	$	10,276,000	Required amount needed current year to fund the liability.
Less: Expected Net Benefit Payments	$	14,066,300	$	12,959,100	Estimated retiree claims and costs paid for current year.
Incremental Amount to Fully Fund ADEC	**$**	(400,900)	**$**	(2,683,100)	Combined City /School overfunded amounts.

SOURCE: 2018 and 2020 Actuarial Valuations prepared by Milliman, Inc.

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: For purposes of determining the level of OPEB trust funding, the unfunded actuarial liability is amortized over a closed period (26 years as of January 1, 2020) as a level dollar amount.

NOTE 3: The actuarially determined employer contribution (ADEC) is equal to the normal cost plus the amortization of the unfunded actuarial liability plus interest.

Milliman's 2020 Valuation Report included the following FY21 funding projection:

Projected Incremental Amount to Fund FY21 ADEC	
FY21 Actuarially Determined Employer Contribution (ADEC)	$10,493,400
Less: FY21 Expected Net Benefit Payments	($13,430,300)
Amount Needed to Fully Fund FY21 ADEC	($2,936,900)

SOURCE: January 1, 2020 Actuarial Valuation prepared by Milliman, Inc.

The FY21 projection was performed utilizing the 2020 plan information as that was the most current plan information available. Thus, actual FY21 amounts may vary based on plan changes.

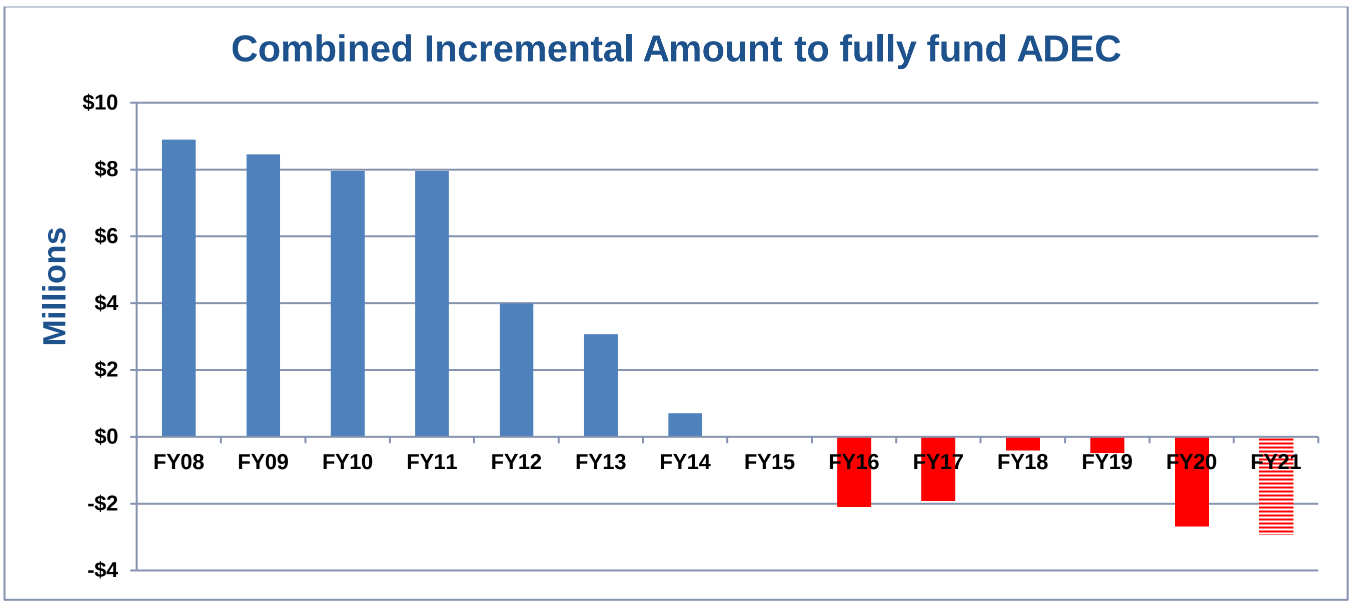
Changes impacting January 1, 2020 Actuarial Liability

The following assumption changes are reflected in the City's and Schools' January 1, 2020 OPEB valuation:

- The interest rate assumption was decreased from 7.0% in 2018 to 6.5% in 2020.
- The age-related claims cost assumptions were changed. The January 1, 2020 age-related claims cost assumptions for retiree and spouses reflect *actual* retiree and dependent claims experience.
- The healthcare trend assumption was changed. The healthcare trend rates are consistent with information from the Getzen Trend Model, Milliman's Health Cost Guidelines™, and actuarial judgment.
- The Schools' spousal election assumption was decreased from 20% to 15%, based on retiree election experience indicated by the Schools' January 1, 2020 retiree census data.

Historical Funding Perspective

The following chart provides a historical perspective of the City and Schools combined OPEB funding requirements from inception through Milliman's FY21 projection.



SOURCE: Actuarial valuations, 2008 through 2020.