



Office of the City Auditor Review of GASB 45 Actuarial Valuation

Report Date: April 23, 2010



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 23, 2010

To: James K. Spore, City Manager

Subject: Review of GASB 45 Actuarial Valuation Report

I am pleased to present the report of our review of the GASB 45 Actuarial Valuation. The results of this review will be provided to City Council through the City's Audit Committee.

We have performed the procedures requested by City Council in the resolution titled "*A Resolution Authorizing Changes to the Health Care Coverage Available to Active and Retired Employees*" dated June 24, 2008. 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 Office of the City Auditor reports to City Council through the City's Audit Committee and is organizationally independent of all other City Departments. The procedures we agreed to perform and the associated results are enclosed. Findings considered to be of insignificant risk have been discussed with management. We completed the agreed-upon procedures on April 21, 2010.

This report is intended solely for the information and use of the Audit Committee, City Council, 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.



Office of the City Auditor
Transmittal Letter

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We would like to commend Mercer Health & Benefits, LLC for the courtesy and cooperation extended to us during the review. 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
Susan D. Walston, Deputy City Manager
Benefit Executive Committee Members



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Purpose

To determine if the valuation of the City/Schools' Governmental Accounting Standards Board Statement 45 (GASB 45) liability and the underlying assumptions are reasonable.

Scope and Objectives

The objectives of our review were:

1. To determine the completeness, reliability and reasonableness of employee/retiree census data provided to Mercer Health & Benefits, LLC (Mercer) by the Consolidated Benefits Office (CBO) for use in performing the GASB 45 June 30, 2010 valuation.
2. To determine whether the Actuarial Accrued Liability (AAL) and normal cost calculations performed by Mercer were reasonable.
3. To determine whether actuarial assumptions utilized by Mercer 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 June 30, 2010 valuation by Mercer dated April 16, 2010. Our fieldwork concluded on April 21, 2010.



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.
- Met with representatives of Mercer to gain an understanding of their GASB 45 valuation methods, processes and assumptions.
- Obtained and reviewed the City/Schools Postretirement Benefit Valuation Report for the fiscal year ending June 30, 2010, dated April 16, 2010.
- Performed appropriate tests of completeness, reliability and reasonableness of employee/retiree census data.
- 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 Actuarial Accrued Liability for the City and Schools' for June 30, 2010.
- Traced a judgmental sample of individuals, step-by-step through the actuarial valuation model, including a review of the actuarial assumptions, census data, and health plan data involved for each selected individual.
- Verified the present value factor used in the amortization of the City/Schools' liability.

Standards

Our audit was conducted in accordance with generally accepted government auditing standards. The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all City Departments. This report will be 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 will also be made 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 establishes 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, has been accounting for postretirement medical benefits¹ on a pay-as-you-go basis. The standard now 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.

The City/Schools Consolidated Benefits Office has engaged Mercer Health & Benefits, LLC to perform the June 30, 2010 GASB 45 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.

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 of \$5,400 toward the cost of the health plan. Retirees with less than 25 years of service do not receive the subsidy.



Results

1. Based on our tests of completeness, reliability and reasonableness, we found the employee/retiree census data provided to Mercer by the Consolidated Benefits Office to be materially accurate for relying on members enrolled in the health plan as of January 1, 2010.
2. We determined that the Actuarial Accrued Liability (AAL) and normal cost calculations presented in Mercer's valuation dated April 16, 2010 are reasonable, except as noted below. The resulting ARC and incremental cash amounts needed to fully fund the ARC is reasonably stated as well.

During our review of the individual valuation data supporting the April 16, 2010 valuation amount, we identified an issue related to the identification of Double Employee subscribers resulting from the reversal of subscriber and spouse designations (i.e., the subscriber was identified as the spouse and the spouse as the subscriber). The effect of this finding was a reduction to the Actuarial Accrued Liability (AAL) of \$582,657 and an increase in the Normal Cost of \$28,118. Mercer made the necessary changes and the revised amounts are presented in the Postretirement Benefit Valuation Report dated April 19, 2010.

3. Actuarial assumptions utilized in the valuation are reasonable and agree to supporting documentation.
4. We recomputed the smoothing calculation made by Mercer 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.
5. We traced selected individuals step- by- step through the actuarial model ultimately verifying that their individual AAL and Normal Cost were included in the spreadsheet amounts of all enrollee's AAL and Normal Cost included in the valuation without exception.

Please see Appendix I for a summary of the valuation results.



Status of Prior Findings

Percentage of Retiree Spouses Electing Coverage

In our prior year review of the GASB 45 Actuarial Valuation dated April 2, 2009 we noted the following:

“Mercer utilizes a general assumption concerning the expected percentage of retiree spouses that will elect health care coverage. The spousal participation percentage used in the actuarial valuation is 48%. The actual retiree spousal participation percentage for the City and Schools as of December 2008 was 24.7%. The percentage was significantly lower in the previous three years as well.”

As a result of our prior year finding, Mercer reduced the spousal participation assumption rate from 48% to 32% for the current valuation. The dollar impact of this change is as follows:

FYE 6/30/10	Valuation Assuming a 48% Spousal Participation	Valuation Assuming a 32% Spousal Participation	Amount of Reduction	%
ARC	\$ 18,600,000	\$ 17,700,000	\$ 900,000	5%
Less: PAYGO	\$ 9,800,000	\$ 9,800,000	\$ 0-	0%
Amount to Fully Fund	\$ 8,800,000	\$ 7,900,000	\$ 900,000	10%

Thus, based on changing the retiree spousal participation rate from 48% to 32%, the Annual Required Contribution (ARC) for the current year was reduced by \$900K (5%) and the amount to fully fund the ARC was reduced by \$900K (10%).



Virginia Pooled OPEB Trust Fund Investment Return

On June 25, 2008, the City made an initial contribution to the Virginia Pooled OPEB Trust Fund in the amount of \$8,900,000. On June 23, 2009, a second contribution was made in the amount of \$8,458,751 to fully fund the ARC. It should be noted that the unrealized loss of \$2.2 million reported in last year’s review has been fully recovered and the market value² of the trust’s assets as of March 31, 2010 was \$19,061,851.

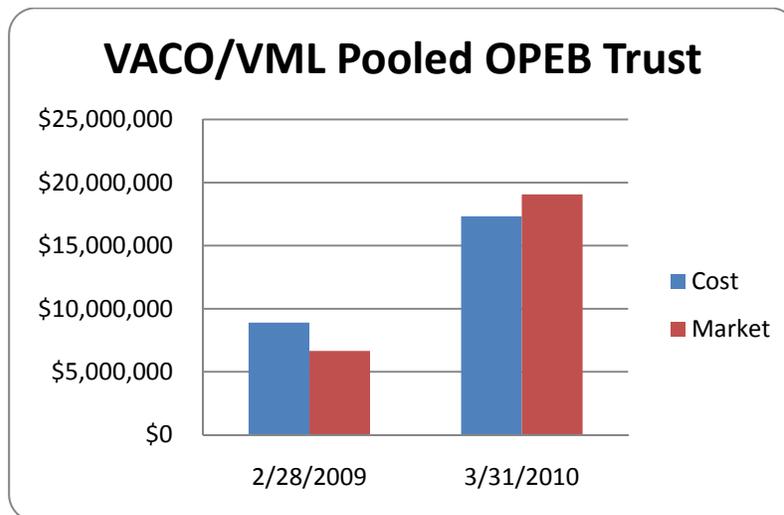


Table 1. Comparison of VACO/VML OPEB Trust

Date	Cost	Market	Variance	Return
2/28/2009	\$ 8,894,449	\$ 6,648,986	(\$2,245,463)	-25.2%
3/31/2010	\$17,328,448	\$19,061,851	\$1,733,403	10%

Recommendation

As with the spousal assumption, we recommend the City/Schools Benefits Executive Committee continue to work with the actuary to monitor and evaluate the City’s actual data against the general and/or VRS actuarial assumptions. If warranted, the actuarial assumptions utilized in future valuations should be adjusted accordingly.

² For valuation purposes, Mercer uses a five-year smoothing period in accordance with IRS Revenue Procedure 2000-40, Paragraph 3.11, whereby gains and losses are “smoothed” so as not to recognize short-term spikes or aberrations. The asset value used for purposes of the GASB 45 valuation is \$18,207,186.



Management's Response

The City/Schools Benefits Executive Committee concurs with the findings and recommendation of the Office of the City Auditor. The BEC agrees to continue to monitor City/Schools actual experience data and evaluate its use against general and/or VRS actuarial assumptions for future Postretirement Benefit Valuation Reports on the City/Schools liability for retiree health care under GASB 45.

Conclusion

Based upon the results of our review, we believe the valuation of the City/Schools' GASB 45 liability and the underlying assumptions are reasonable as presented in the revised version of the valuation dated April 19, 2010.

Acknowledgements

We would like to thank Mercer, the Consolidated Benefits Office and City staff for their responsiveness to our requests during the review 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 Fiscal Year Ending June 30, 2010

	Original Calculation 4/16/2010	City Auditor's Findings	Revised Calculation 4/19/2010
Actuarial Accrued Liability (AAL)	\$ 154,643,446	\$ (582,657) ⁽¹⁾	\$ 154,060,789
Less: Actuarial Value of Assets (AVA)	(18,207,186)		(18,207,186)
Unfunded Actuarial Accrued Liability (UAAL)	\$ 136,436,260		\$ 135,853,603
Amortized Over 30 Years	\$ 10,746,257		\$ 10,700,365
Normal Cost	5,752,392	\$ 28,118 ⁽¹⁾	5,780,510
Interest to End of Year	1,237,398		1,236,065
Annual Required Contribution (ARC)	\$ 17,736,047		\$ 17,716,940
Less: PAYGO- Expected 2010 Retiree Cost	(9,776,043)		(9,765,591)
Amount Needed to Fully Fund ARC	\$ 7,960,004		\$ 7,951,349

(1) During our review of the individual valuation data supporting the April 16, 2010 valuation amount, we identified an issue related to the identification of Double Employee subscribers, the effect of this finding was a reduction to the Actuarial Accrued Liability (AAL) of \$582,657 and an increase in the Normal Cost of \$28,118. Mercer made the necessary changes and the revised amounts are presented in the Postretirement Benefit Valuation Report dated April 19, 2010.