



Office of the City Auditor Review of GASB 45 Actuarial Valuation

Report Date: August 14, 2012



Office of the City Auditor

"Promoting Accountability and Integrity in City Operations"

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Date: August 14, 2012
To: James K. Spore, City Manager
Subject: Review of GASB 45 Actuarial Valuation

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 July 2, 2012.

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.

We would like to commend Milliman Inc. 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
Cindy Curtis, 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 Milliman Inc. (Milliman) by the Consolidated Benefits Office (CBO) for use in performing the GASB 45 June 30, 2012 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 June 30, 2012 valuation by Milliman. Our fieldwork concluded on July 2, 2012.



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.
- Obtained and reviewed the City/Schools Postretirement Benefit Valuation drafts and final report for the fiscal year ending June 30, 2012, dated August, 2012.
- 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 AAL for the City/Schools' for June 30, 2012.
- 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 audit.



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, had 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.

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 approximately the \$30,000 actuarial fee in the *off* year the valuation is not performed. Nonetheless, a funding contribution was still made in the *off* year of 2011 in an amount equal to the prior year 2010 contribution.

Mercer Health & Benefits, LLC (Mercer) performed the GASB 45 valuation for 2008 through 2010 but no longer performs GASB 45 valuation services. The City and the Virginia Beach City Public Schools contracted with Milliman Inc. to perform the June 30, 2012 valuation.

Milliman Inc. performed the 2012 valuation utilizing the same valuation method as Mercer used 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 as well 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.

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.



Summary of GASB 45 Review Findings

Audit Finding Summary	Effect on Annual Required Contribution ² (ARC)
Removal of LOD Benefits and Spouses Only Receiving Dental	- 178,000.00
Use of Actual Non-Claim costs as Opposed to 10% Add on	-1,001,863.00
Decrease in ARC	1,179,863.00

Results

1. 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, 2012 after making the following corrections:

The data originally utilized in the valuation included 72 public safety personnel currently receiving Line of Duty (LOD) benefits. LOD benefits involve payments to public service personnel that are either killed or disabled in the line of duty. These payments involve a lump sum payment upon death and continued health insurance for the member and his family upon death or disablement. The state used to fund the LOD benefit until 2011, when the funding was passed on to the localities. The state, however, through the VRS, set up a trust funding option to charge the localities and then reimburse the cost of the actual benefits paid out. The VRS trust has its own OPEB program and charges each participating locality their portion of the associated ARC. As these LOD benefits are not retiree health care and the funding of such benefits is from a different source, the LOD benefits should not be included in the City's GASB 45 calculation for retiree health care. The LOD benefits originally included in the data were therefore removed.

There were also some spouses included in the original data which were receiving dental care only, not health care. Dental care is not included in retiree health care and as such these spouses were removed from the valuation. These two corrections in the data had a net effect of reducing our ARC by \$178,000.

2. We determined that the AAL and Normal Cost calculations presented in Milliman's valuation dated August 2012 are reasonable. The resulting ARC and incremental cash amounts needed to fully fund the ARC is reasonably stated in the final valuation after making the following correction:

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.



Milliman's original draft utilized assumptions and cost trends to estimate the amount of expected retiree health claims paid through the *calendar* year of 2012 instead of the *fiscal* year ending June 30, 2012 – the date of the valuation. Correcting the estimated 2012 retiree benefits paid to reflect the fiscal year end date of June 30, 2012 reduced the estimated benefits paid by \$816,600, but leaves the overall ARC unchanged. The ARC consists of the cash payment of current year benefits and the cash payment to the OPEB trust.

3. Actuarial assumptions utilized in the final valuation are reasonable and agree to supporting documentation/sources after making the following correction:

In developing their medical cost assumption for the valuation, Milliman, like most actuaries, uses a blended rate from various age groups to reflect the fact that medical costs generally increase with age. The rate reflects claims costs and other costs of the plan as well, principally the third party administrative (TPA) fees we pay Optima for administering the plan and stop loss premiums. In developing the medical cost rate used in the valuation, Milliman was initially unable to obtain the *actual* non-claim costs associated with the plan to incorporate in their rate because the information was thought to be proprietary and restricted by contract. In fact, our contract with Optima does contain a proprietary information clause, Section 4.8, but does allow disclosure of the information of the material with the “*express written consent of Sentara*”. We contacted Consolidated Benefits Office and the City Attorney's Office and had Optima Health Inc. prepare a release statement for use of the information to prepare the GASB 45 valuation. Prior to the release of the actual information, Milliman, had used a random add-on amount of 10% (much higher than the actual costs) to the average monthly claims to reflect those non-claim expenses. Once the *actual* expense items were released for use by Milliman as opposed to the 10% add on, the cost of the ARC was reduced by approximately \$1,001,863.

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.

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



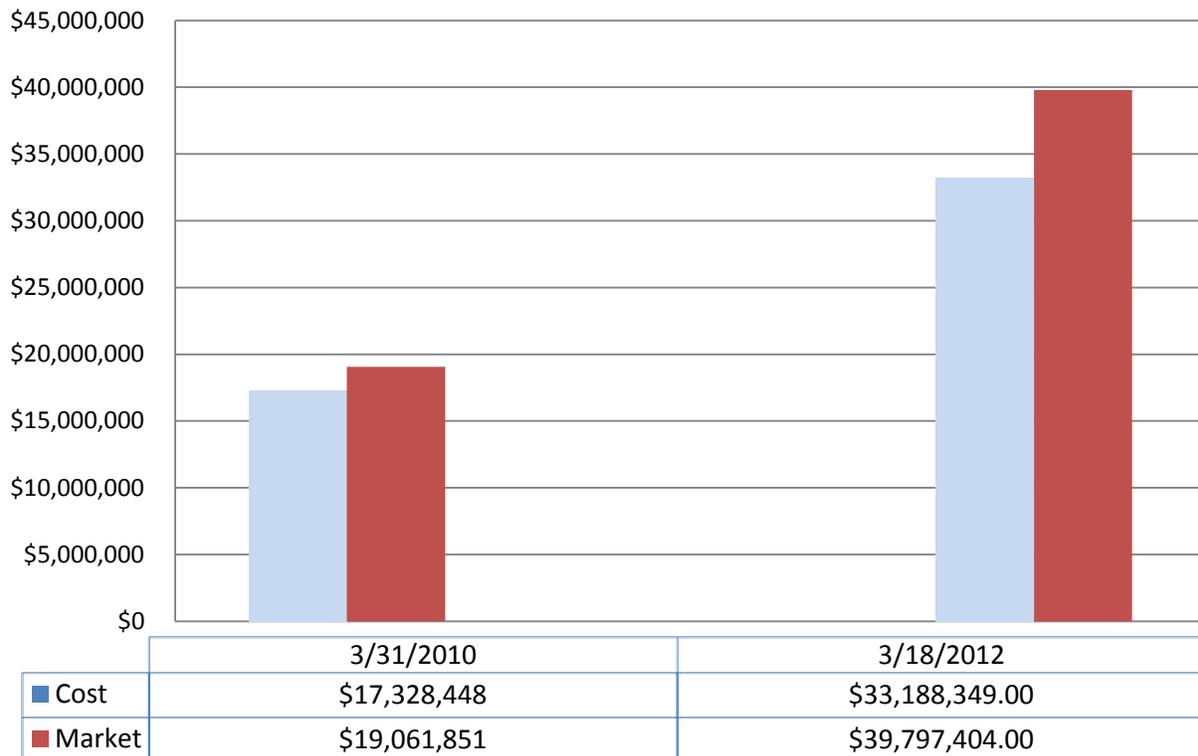
Virginia Pooled OPEB Trust Fund Investment Return

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 audit:

Summary	3/31/10- 3/31/2012		OPEB Trust Activity
	Cost	Market	
3/31/2010 Balance	\$17,328,448.25	\$19,061,850.93	Agrees with prior wps & 3/31/10 Statement
Contributions	\$15,920,008.00	\$15,920,008.00	2010 and 2011 contributions
Earnings	\$9,247.46	\$4,824,899.18	Market earnings are unrealized gains
Fees	-\$69,354.23	-\$69,354.23	Fees
3/31/2012 Balance	\$33,188,349.48	\$39,737,403.88	Agrees with 3/31/12 Trust Statement

The most recent statement balance (June 30, 2012) of the trust is \$42,762,565.35 which includes the 2012 contribution in the amount of \$3,996,000.00.

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





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 August 2012.

Acknowledgements

We would like to thank Milliman, 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

	Mercer Calculation 4/19/2010	Milliman Calculation 8/2012	Explanation
Actuarial Accrued Liability (AAL)	\$ 154,060,789.00	\$ 170,625,800.00	The actuarial value of OPEB benefits already earned by past service
Less: Actuarial Value of Assets (AVA)	\$ (18,207,186.00)	\$ (38,288,300.00)	Value of City/School contributions and earnings held in trust
Unfunded Actuarial Accrued Liability (UAAL)	\$ 135,853,603.00	\$ 132,337,500.00	Unfunded portion of the liability
Amortized Over 30 Years	\$ 10,700,365.00	\$ 10,423,400.00	Amortized portion of the liability
Normal Cost	\$ 5,780,510.00	\$ 5,429,000.00	Cost for OPEB being earned by employees for current year
Interest to End of Year	\$ 1,236,065.00	\$ 583,700.00	Interest
Annual Required Contribution (ARC)	\$ 17,716,940.00	\$ 16,436,100.00	Required Amount Needed current year to fund the liability
Less PAYGO- Expected Current Year Retiree Cost	\$ (9,765,591.00)	\$ (12,440,100.00)	Estimated retiree claims and costs paid for 2012
Cash Needed to Fully Fund ARC	\$ 7,951,349.00	\$ 3,996,000.00	Cash contribution needed to fully fund the ARC

Source: Actuarial Valuations prepared by Mercer and Milliman