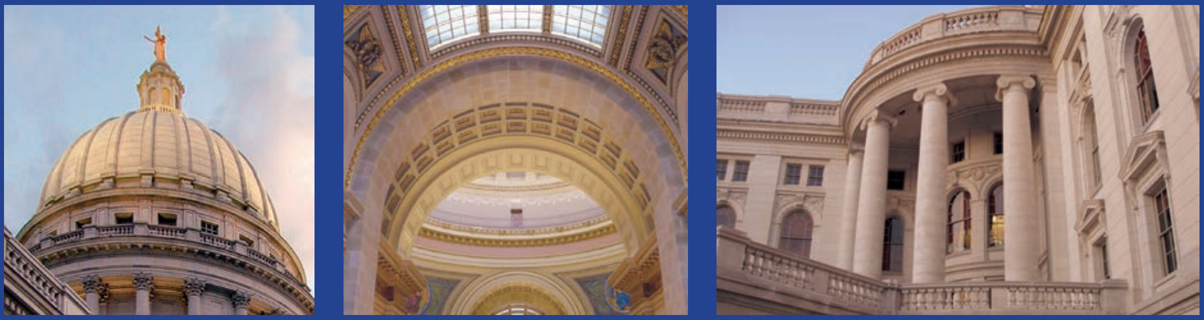
Report 20-24
December 2020

Supplemental Health Insurance Conversion Credit Program

Calendar Year 2019

State of Wisconsin



Legislative Audit Bureau

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OPINION PUBLISHED SEPARATELY

The financial statements and our opinion on them are included in the Department of Employee Trust Funds' *State of Wisconsin Supplemental Health Insurance Conversion Credit Financial Report.*

STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman
State Auditor

December 4, 2020

Senator Robert Cowles and
Representative Samantha Kerkman, Co-chairpersons
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles and Representative Kerkman:

The Department of Employee Trust Funds (ETF) is responsible for administering the Supplemental Health Insurance Conversion Credit (SHICC) program. As required by s. 13.94 (1) (dd), Wis. Stats., we have completed an audit of ETF's financial statements for this program and the related notes, as of and for the year ended December 31, 2019. ETF's *State of Wisconsin Supplemental Health Insurance Conversion Credit Financial Report*, which can be found on its website, includes these statements and our unmodified opinion on them.

In July 2020, ETF separated the financial reporting for the two sick leave programs: the basic Accumulated Sick Leave Conversion Credit program (basic ASLCC) and the SHICC program. These programs convert unused sick leave balances earned by participating employees during employment, and additional amounts under certain circumstances, for use in paying postemployment premiums for state group health insurance coverage. Financial statements for the basic ASLCC program, as of and for the year ended December 31, 2019, will be included in ETF's Comprehensive Annual Financial Report, which will be issued by ETF at a later date.

As of December 31, 2019, the SHICC program fiduciary net position, which represents resources available to pay benefits, was $1.1 billion. The SHICC program is considered an other postemployment benefits (OPEB) plan because it provides benefits to employees after they have left employment. As of December 31, 2019, ETF calculated a net OPEB asset of $151.8 million for the SHICC program. Under accounting standards, each employer participating in an OPEB plan is required to report its proportionate share of the net OPEB asset on its financial statements if prepared on the basis of generally accepted accounting principles. To assist with this reporting, ETF prepared employer schedules. We audited and provided unmodified opinions on the schedules for the SHICC program in report 20-25.

We appreciate the courtesy and cooperation extended to us by ETF staff during the audit. A response from the Secretary of ETF follows our report.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/SH/ss

Introduction ▪

The State of Wisconsin, including UW System, and certain state authorities such as the UW Hospital and Clinics Authority, participate in the sick leave programs.

The Department of Employee Trust Funds (ETF) administers employee benefit programs for participating employees, including two sick leave programs: the basic Accumulated Sick Leave Conversion Credit (basic ASLCC) program and the Supplemental Health Insurance Conversion Credit (SHICC) program. The State of Wisconsin, including the University of Wisconsin (UW) System, and certain state authorities such as the UW Hospital and Clinics Authority, participate in the sick leave programs. As of December 31, 2019, approximately 73,300 current employees of these participating employers may be eligible in future years for benefits under these programs.

Under s. 40.03, Wis. Stats., the 13-member ETF Board is responsible for the overall direction and oversight of ETF, including oversight of the sick leave programs. In administering the sick leave programs, ETF is responsible for maintaining balances for eligible participants, collecting required contributions from participating employers, and paying health insurance providers for participants receiving benefits. ETF also uses an actuary to perform actuarial calculations to project future benefit payments and recommend changes to contribution rates that employers pay to fund program benefits.

The sick leave programs provide payment of postemployment premiums for state group health insurance coverage.

The sick leave programs are administered under the provisions of s. 40.05 (4) (b), 40.05 (4) (bc), 40.95, and 230.12 (9), Wis. Stats. When employees terminate state service, the basic ASLCC program allows eligible employees to convert earned but unused sick leave balances, for use in paying postemployment premiums for state group health insurance coverage. Established in 1995, the SHICC program provides certain eligible employees additional sick leave hours at the time of termination that increases the balance available to pay for health insurance premiums.

As of December 31, 2019, 17,593 participants were using basic ASLCC or SHICC balances to pay health insurance premiums.

As of December 31, 2019, 17,593 participants, with a combined basic ASLCC and SHICC balance of $1.5 billion, were using their balances for the payment of postemployment premiums for state group health insurance. An additional 11,617 participants had balances, totaling over $500.0 million, which were not being used or were being held for future use.

The sick leave programs are funded through annual participating employer contributions and investment earnings. Employer contribution rates are paid as a percentage of payroll determined by the consulting actuary and approved by the ETF Board. For calendar year 2019, the total contribution rate for most participating employers was 1.1 percent, for which 0.8 percent was allocated to fund basic ASLCC program benefits and 0.3 percent for SHICC program benefits. Contribution rates have remained fairly consistent over time.

Accumulated assets for the sick leave programs are invested in the Core Fund.

The accumulated assets held by the sick leave programs are invested by the State of Wisconsin Investment Board in the Core Retirement Investment Trust Fund (Core Fund). The Core Fund is a fully diversified fund, or balanced fund, which provides less volatile investment returns and is invested for the long term. Report 20-23 provides more information about the investment performance and financial condition of the Core Fund as of December 31, 2019. For financial reporting, ETF allocates investment income or loss to each program that participates in the Core Fund, including the sick leave programs, based upon the average annual investment balance of each program.

Program Benefits

To receive basic ASLCC program benefits, employees of participating employers must generally be enrolled in the State's group health insurance program at the time of termination from a participating employer and meet one of several requirements including, but not limited to:

- eligibility for retirement benefits under the Wisconsin Retirement System (WRS) and either receiving an immediate retirement annuity or a lump-sum benefit; or

- eligibility for WRS disability benefit, long-term disability insurance benefit, or a protective occupation duty disability benefit; or

- 20 years of service with a WRS participating employer, regardless of whether they are currently eligible for an immediate WRS retirement benefit.

Eligible participants may defer the use of program benefits. For example, those with 20 years of service that are not eligible for an immediate WRS retirement benefit may defer the use of program benefits. Upon the death of an employee of a participating employer or the death of a program participant, surviving spouses and dependents may also be eligible for the program or elect to defer the use of the program benefits.

Basic ASLCC balances are determined by an employee's accumulated sick leave balance and their highest rate of pay.

Upon determination of eligibility, a participant's basic ASLCC balance will be calculated using the highest rate of pay multiplied by the accumulated, unused sick leave balance at termination. For example, an eligible employee with a participating employer who had an accumulated sick leave balance of 800 hours and a highest rate of pay of $28 per hour would have a $22,400 basic ASLCC balance.

Employees with a minimum of 15 years of service with a participating employer are also eligible for SHICC program benefits, which provide additional sick leave hours based on years of service.

Employees with a minimum of 15 years of service with a participating employer, who are eligible for the basic ASLCC program, are also eligible to receive additional benefits under the SHICC program. Most employees will receive an additional 52 hours of sick leave for each year of service up to 24 years and an additional 104 hours for each year of service beyond 24 years, generally not to exceed the accumulated unused sick leave balance that the employee had at termination. Because eligibility for the SHICC program is dependent upon also being eligible for the basic ASLCC program, all employees with a SHICC balance will also have a basic ASLCC balance. When an eligible participant meets the requirements of the SHICC program, two separate calculations are performed to determine the balance that will be available for payment of health insurance premiums. Under the SHICC program, the same employee noted above with 15 years of service and 800 sick leave hours at termination would receive 780 hours of additional sick leave or a SHICC balance of $21,840.

As health insurance premiums for the participant or beneficiary come due, the participant's balance is used to pay premium amounts due for state group health insurance coverage. A participant's basic ASLCC balance must be exhausted before any SHICC balance is used. Premiums are paid solely by the retired participant as employers do not contribute to the monthly health insurance premium payments. Therefore, when balances are exhausted, participants must either pay the premiums from other sources or are no longer covered under the State's group health insurance program. Participant balances do not accrue interest and cannot be paid out to participants in cash or for any other purpose.

Financial Condition

In July 2020, ETF determined that it would separate the financial reporting for the basic ASLCC program and SHICC program.

ETF implemented GASB Statement Number 84, *Financial Activities*, and as a result reassessed the financial reporting for the SHICC program. In July 2020, ETF determined that it would separately report the financial information for the basic ASLCC program and for the SHICC program. Because basic ASLCC program benefits are based on sick leave earned during an employee's years of service and are available to the employee during their employment, ETF determined that the activity for this program should be presented as a compensated absence. However, because the SHICC program provides additional benefits that are provided only upon termination and are based on meeting certain requirements at termination, ETF determined that this program should be presented as an other postemployment benefits (OPEB) plan. This report includes the results of our audit of the SHICC program financial statements as of and for the year ended December 31, 2019. Financial statements for the basic ASLCC program, as of and for the year ended December 31, 2019, will be included in ETF's Comprehensive Annual Financial Report (CAFR).

As of December 31, 2019, the fiduciary net position of the SHICC program was $1.1 billion.

The Net Position Restricted for OPEB (fiduciary net position) of the SHICC program represents the value of the plan's assets that are available to meet benefit obligations as they become due. As of December 31, 2019, the SHICC program had a fiduciary net position of $1.1 billion.

Contributions from employers totaled $14.4 million and investment earnings were $180.3 million during 2019. Payments to state group health insurance providers for SHICC program participants totaled $53.0 million during 2019.

Audit Results

As required by statutes, we have completed an audit of the financial statements and related notes of the SHICC program as of and for the year ended December 31, 2019. The financial statements were prepared by ETF using generally accepted accounting principles prescribed by the Governmental Accounting Standards Board. To complete our audit of the financial statements, we reviewed ETF's internal controls over financial reporting, tested financial transactions, and reviewed the financial statements, notes, and required supplementary information that were prepared by ETF management.

We provided an unmodified opinion on the financial statements and related notes of the SHICC program as of and for the year ended December 31, 2019.

In addition to providing an unmodified opinion on the financial statements and related notes of the SHICC program as of and for the year ended December 31, 2019, we have issued our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required by *Government Auditing Standards* and begins on page 15. We did not identify any control or compliance concerns that are required to be reported under these standards.

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Other Postemployment Benefits (OPEB) ■

OPEB refers to the benefits, other than pensions, that a state or local government employee may receive after they have left employment, generally upon retirement. An OPEB plan can include medical, prescription drug, dental, vision, and other health-related benefits, whether provided separately or through a pension plan, as well as death benefits, life insurance, and long-term care coverage, when provided separately from a pension plan.

The SHICC program is considered an OPEB plan.

OPEB accounting standards establish financial reporting requirements for measuring the OPEB liability for OPEB plans, as well as requirements for both the notes and required supplementary information to the OPEB plan financial statements, and the financial statements based on generally accepted accounting standards (GAAP) for the employers that participate in OPEB plans. As noted, ETF determined that the SHICC program should be considered an OPEB plan, which resulted in the calculation of a new OPEB liability under accounting standards.

Calculating the Total OPEB Liability

The total OPEB liability is the sum of amounts needed to pay for the OPEB benefits earned by each participant as of the date of the actuarial valuation. A liability exists because the employers participating in the OPEB plan have committed to providing the benefit at some point in the future. The calculation of the total OPEB liability is complex and includes various actuarial assumptions and calculations, such as:

- a projection of future benefit payments for current plan members and their beneficiaries based upon the current terms of the plan;

- a discount of those payments to their present value, which is the amount of funds needed currently to provide the projected payments in the future; and

- an allocation of the present value of benefit payments over past, present, and future periods of employee service.

As of December 31, 2019, the total SHICC program OPEB liability was $932.6 million.

ETF's actuaries performed an actuarial valuation as of December 31, 2019, to determine the total OPEB liability for the SHICC program as of December 31, 2019. Based on this valuation, the total OPEB liability for the SHICC program was $932.6 million as of December 31, 2019, compared to $949.8 million as of December 31, 2018.

The discount rate can have a significant effect on the amount of the total OPEB liability.

The discount rate is a critical factor in calculating the total OPEB liability, and it can have a significant effect on the amount of the total OPEB liability. The discount rate, or interest rate, used to calculate the present value of projected benefit payments is specifically defined under the accounting standards. Because the assets accumulated for the SHICC program are projected to be sufficient to make all projected future benefit payments of current active and retired eligible employees, ETF used the long-term expected rate-of-return assumption for the SHICC program, which is 7.0 percent, as the discount rate for the program. Increasing or decreasing the discount rate can have a significant effect on the total OPEB liability. For instance, a one percentage point decrease in the discount rate (6.0 percent) would increase the total OPEB liability to $1.0 billion and a one percentage point increase in the discount rate (8.0 percent) would decrease the total OPEB liability to $853.2 million.

Changes in the health care cost trend rates can have a significant effect on the amount of the total OPEB liability.

The health care cost trend rates are also significant in the calculation of the total OPEB liability. These rates measure the rate of change in per capita health care costs over time. These trend rates, which were assumed to be 3.2 percent, can have a significant effect on the amount of the total OPEB liability. A one percentage point increase in the health care cost trend rate (4.2 percent) increases the total OPEB liability to $993.1 million, and a one percentage point decrease in the health care cost trend rate (2.2 percent) decreases the total OPEB liability to $868.9 million.

Calculating the Net OPEB Liability or Asset

To determine the net OPEB liability or asset, the accounting standards require the total OPEB liability be subtracted from the OPEB plan's fiduciary net position. When the total OPEB liability is greater than the fiduciary net position, the OPEB plan will disclose a net OPEB liability in its notes. When the fiduciary net position is greater than the total OPEB liability, the OPEB plan will disclose a net OPEB asset in its notes.

As of December 31, 2019, ETF reported a net OPEB asset of $151.8 million for the SHICC program.

As of December 31, 2019, the SHICC program reported a net OPEB asset. As shown in Table 1, the SHICC program had a fiduciary net position of $1.1 billion and a total OPEB liability of $932.6 million, which resulted in a net OPEB asset of $151.8 million as of December 31, 2019.

Table 1

Net OPEB (Liability) Asset for the SHICC Program
As of December 31, 2019
(in millions)

	Amount
Fiduciary Net Position	$1,084.4
Total OPEB Liability	(932.6)
Net OPEB (Liability) Asset	**$ 151.8**

Employer Reporting

Each employer participating in the SHICC program is obligated to make contributions to ensure benefit payments are adequately funded.

For the SHICC program, contributions from employers are combined, and the benefits are paid out of the resulting common pool of assets. Each participating employer has made a commitment to provide additional sick leave hours that can convert to a balance to pay health insurance premiums and is obligated to make contributions to ensure that benefit payments are adequately funded. Therefore, because the employer has responsibility for the resulting OPEB obligations, each employer will be required to report its share of the net OPEB asset on its GAAP-based financial statements.

Each participating employer must report its share of the net OPEB asset in its GAAP-based financial statements.

To assist the State of Wisconsin and those agencies and authorities that are part of the State's financial reporting entity but that prepare separately issued financial statements, ETF has prepared a Schedule of Employer Allocations and a Schedule of Collective OPEB Amounts as of and for the year ended December 31, 2019. We audited these schedules and provided unmodified opinions on them in report 20-25. The net OPEB asset of $151.8 million for the SHICC program will be included in the State's GAAP-based financial statements, which will be published in the State of Wisconsin's CAFR for the year ended June 30, 2020.

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Auditor's Report ■

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Joe Chrisman
State Auditor

Report 20-24

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters

Senator Robert Cowles and
Representative Samantha Kerkman, Co-Chairpersons
Joint Legislative Audit Committee

Members of the Employee Trust Funds Board and
Mr. Robert J. Conlin, Secretary
Department of Employee Trust Funds

We have audited the financial statements and related notes for the Supplemental Health Insurance Conversion Credit program administered by the State of Wisconsin Department of Employee Trust Funds (ETF) as of and for the year ended December 31, 2019. We have issued our report thereon dated December 3, 2020. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, which is issued by the Comptroller General of the United States. The financial statements and related auditor's report have been included in ETF's *State of Wisconsin Supplemental Health Insurance Conversion Credit Financial Report.*

Internal Control over Financial Reporting

Management of ETF is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the financial statements, we considered ETF's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ETF's internal control. Accordingly, we do not express an opinion on the effectiveness of ETF's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent misstatements, or to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of ETF's financial statements will not be prevented, or that a material misstatement will not be detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ETF's financial statements are free from material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Purpose of This Report

This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be used when considering ETF's internal control and compliance. The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of ETF's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU

Joe Chrisman
State Auditor

December 3, 2020

Response ■

STATE OF WISCONSIN
Department of Employee Trust Funds
Robert J. Conlin
SECRETARY

Wisconsin Department
of Employee Trust Funds
PO Box 7931
Madison WI 53707-7931
1-877-533-5020 (toll free)
Fax 608-267-4549
etf.wi.gov

December 3, 2020

JOE CHRISMAN, STATE AUDITOR
LEGISLATIVE AUDIT BUREAU
22 E MIFFLIN ST SUITE 500
MADISON WI 53703

Dear Mr. Chrisman,

Thank you for the opportunity to review and comment on the audit of the Supplemental Health Insurance Conversion Credit (SHICC) program as of and for the year ended December 31, 2019. We are pleased the audit results found no instances of noncompliance or other matters that are required to be reported under the Government Auditing Standards. The SHICC program is in a strong financial position. Following the financial reporting methodology prescribed by the Governmental Accounting Standards Board (GASB), the programs funding ratio is 116% as of December 31, 2019.

As noted in the report, we determined the SHICC program meets the definition of an Other Postemployment Benefit (OPEB) and should be reported as an OPEB plan. This conclusion required many months of significant research and discussions with various parties, including the Legislative Audit Bureau staff, to develop and to work through the related changes required to ensure compliance with accounting standards. We appreciate the Legislative Audit Bureau staff collaboration and professionalism over those many months in working through the changes and in auditing a separate financial report for this program to meet the financial reporting needs of participating employers.

Sincerely,

Robert J. Conlin
Secretary