

**Report 18-14
October 2018**

State Retiree Health Insurance Reporting for the State of Wisconsin

June 30, 2017

STATE OF WISCONSIN



Legislative Audit Bureau ■

**State Retiree Health Insurance
Reporting for the State of
Wisconsin
June 30, 2017**

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OPINIONS PUBLISHED SEPARATELY

The schedules and our opinions on them are available on the Department of Administration's website.



STATE OF WISCONSIN | Legislative Audit Bureau

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Joe Chrisman
State Auditor

October 5, 2018

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

Dear Senator Cowles and Representative Kerkman:

As requested by the Department of Administration (DOA), we have completed an audit of the Schedule of Employer Allocations of the State Retiree Health Insurance program, the Schedule of OPEB Amounts by Participating Employer of the State Retiree Health Insurance program, and the related notes to these schedules as of June 30, 2017. These schedules, and our unmodified opinions on them, may be found on DOA's website.

The State Retiree Health Insurance program, which is one of the other postemployment benefit (OPEB) plans offered by the State of Wisconsin to eligible retirees, is administered by the Department of Employee Trust Funds (ETF). 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.

Under the State Retiree Health Insurance program, the State offers retirees who are not yet eligible for Medicare the option to participate in the State's Group Health Insurance program. Although the State does not directly pay any portion of the premium for retirees who choose to participate in the program, the State does pay higher premiums for its active employees than it otherwise would if retirees were excluded. Therefore, the State implicitly subsidizes the premiums paid by participating retirees by offering these individuals access to health insurance coverage at a lower rate than they might otherwise pay based upon their age. This, in turn, creates an OPEB liability the State must recognize for purposes of financial reporting.

In 2015, the Governmental Accounting Standards Board (GASB) issued two new OPEB standards, which changed the accounting and financial reporting requirements for OPEB plans and for employer reporting in financial statements prepared in accordance with generally accepted accounting principles (GAAP). These standards, which are now in effect, are discussed in report 18-10.

DOA will report a total OPEB liability of \$719.3 million for the State Retiree Health Insurance program, as well as other collective amounts, in the State's financial statements, which will be included in the State's Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2018. In addition, the schedules will be used by employers that are part of the State's financial reporting entity but that prepare separately issued financial statements.

The total OPEB liability for the State Retiree Health Insurance program is calculated based on an assumed participation rate, which is the estimated percentage of eligible retired state employees who will elect coverage under the program. We recommend DOA work with the actuary for the State Retiree Health Insurance program to more thoroughly evaluate the current participation rate and potential future changes in the rate when calculating the total OPEB liability for June 30, 2018, which will be used for financial reporting for the year ended June 30, 2019.

The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required by *Government Auditing Standards*, is on page 11. We did not identify any control or compliance concerns that were required to be reported under these standards.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Joe Chrisman". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Joe Chrisman
State Auditor

JC/CS/ss

State Retiree Health Insurance Program ■

Under s. 40.51, Wis. Stats., the State Retiree Health Insurance program provides postemployment health insurance coverage to all eligible retired employees of the State of Wisconsin. Through the program, the State offers certain retirees who are not yet eligible for Medicare benefits the option to continue participating in the State's Group Health Insurance program and to pay for coverage at the premium rate set for active state employees. Although the State does not directly pay any portion of the premium for retirees who choose to participate in the program, the State does pay higher premiums for its active employees than it otherwise would if retirees were excluded. Therefore, the State implicitly subsidizes the premiums paid by participating retirees by offering these individuals access to health insurance coverage at a lower rate than they might otherwise pay based upon their age. This subsidy, in turn, creates an other postemployment benefit (OPEB) liability, which the State must recognize and report under Governmental Accounting Standards Board (GASB) standards.

Calculating the Total OPEB Liability

The State Retiree Health Insurance program is considered a non-trusted OPEB plan.

Under GASB standards, the State Retiree Health Insurance program is considered a non-trusted OPEB plan because the program does not accumulate assets dedicated to providing benefits to plan members. With the oversight of the Group Insurance Board, ETF has administrative responsibilities for the program, including collecting premiums and paying the providers. However, because it is a non-trusted OPEB plan, ETF is not responsible for calculating the total OPEB liability. Instead, the Department of Administration (DOA),

as the entity responsible for preparing the generally accepted accounting principles (GAAP)-based financial statements of the State of Wisconsin, is responsible for ensuring that the employer reporting requirements of the new standards are being met, including the calculation of 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 State has 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 active and retired participants 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 currently needed 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.

Premiums are established and collected based on the current needs of the program, and assets are not accumulated to pay future benefits.

To determine the total OPEB liability for the program, the actuary for the State Retiree Health Insurance program performed an actuarial valuation as of January 1, 2017, and adjusted for changes such as interest earned, contributions paid, and benefits paid through June 30, 2017. Based on this valuation and the adjustments, the total OPEB liability for the program was \$719.3 million as of June 30, 2017. Because the program is funded on a “pay-as-you-go” basis, premiums are established and collected based on the current needs of the program, and assets are not accumulated to pay future benefits.

Discount Rate

The discount rate is the interest rate used to calculate the present value of projected benefit payments and is used to calculate the total OPEB liability. For a non-trusted OPEB plan, the GASB standards require the discount rate to be the 20-year, tax exempt general obligation municipal bond index rate (with an average rating of AA/Aa), which was 3.58 percent as of June 30, 2017, using the Bond Buyer 20-year general obligation municipal bond index.

A change in 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 can have a significant effect on the amount of the total OPEB liability. A one percentage point increase in the discount rate for the program reduces the total OPEB liability to \$671.6 million (at 4.58 percent), and a one percentage point decrease in the discount rate increases the liability to \$769.3 million (at 2.58 percent).

Health Care Cost Trend Rates

A key assumption in the calculation of the total OPEB liability for health-related programs is the health care cost trend rates. These rates measure the rate of change in per capita health costs over time and are calculated for significant portions of costs, such as medical, prescription drug, and dental. For the State Retiree Health Insurance program, the actuary develops the assumption using its internal guidelines, including various data sources and actual claims experience.

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

Because these trend assumptions can have a significant effect on the total OPEB liability, the GASB standards require that information be disclosed related to changes in these assumptions. A one percentage point increase in each health care cost trend rate increases the total OPEB liability to \$818.1 million, and a one percentage point decrease in each health care cost trend rate decreases the total OPEB liability to \$636.3 million.

Participation Rate

Another key assumption related to the calculation of the total OPEB liability is the assumed participation rate. The participation rate for the State Retiree Health Insurance program is the estimated percentage of eligible retired state employees who will elect coverage under the program. Several factors can affect the participation rate, including the cost of insurance on the open market, age at retirement, and eligibility for subsidized health care on public health care exchanges. Participation rates also will be affected by the option for retired state employees to use accumulated sick leave balances to pay health insurance premiums under the State's Accumulated Sick Leave Conversion Credit program, which is a separate program funded by state contributions and administered by ETF.

Previous actuarial valuations of the OPEB liability performed by the State for the State Retiree Health Insurance program have assumed a participation rate of 95.0 percent. However, using actual historical data related to participation that showed that participation rates were below 85.0 percent, DOA and the actuary for the State Retiree Health Insurance program determined that 85.0 percent was a more

appropriate participation rate assumption for the actuarial valuation completed as of January 1, 2017. This decrease in the participation rate assumption resulted in a \$65.4 million decrease in the total OPEB liability as of June 30, 2017.

To better evaluate the participation rate, a careful and thorough analysis should be performed.

Although an 85.0 percent participation rate does not appear unreasonable given the historical data, consideration of future trends that could impact future participation is required under actuarial standards of practice. To better evaluate the current participation rate, and any future changes in the rate, DOA and the actuary for the State Retiree Health Insurance program should complete a careful and thorough analysis of the participation rate through an experience study, which analyzes an assumption by considering different factors. For example, the experience study could consider the cost of coverage for early retirees participating in the plan and the cost of available coverage in the public health care exchanges. An experience study would be valuable given the significant effect of the participation rate assumption on the total OPEB liability.

Recommendation

We recommend the Department of Administration work with the actuary for the State Retiree Health Insurance program to conduct an experience study in order to more thoroughly evaluate and support the participation rate assumption used for the calculation of the total OPEB liability as of June 30, 2018, which will be used for financial reporting for the year ended June 30, 2019.

Calculating Other Collective Amounts

In addition to calculating the total OPEB liability, the new standards require the calculation of OPEB expense, as well as amounts that are considered deferred for the plan. OPEB expense is the net increase or decrease in the total OPEB liability, with certain adjustments, and is reported in the period during which the employee earned the OPEB. For the year ended June 30, 2017, OPEB expense for the State Retiree Health Insurance program was \$85.4 million.

Employer Reporting

As of June 30, 2017, the total OPEB liability was \$719.3 million for the State Retiree Health Insurance program.

The total OPEB liability of \$719.3 million for the State Retiree Health Insurance program, as well as other collective amounts presented on the employer schedules, will be presented in the State's financial statements in the State of Wisconsin's Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2018. In addition, some state agencies, such as the University of Wisconsin

System, and various authorities, including the University of Wisconsin Hospitals and Clinics Authority, that are reported in the State's CAFR, also separately issue GAAP-based financial statements. To assist each of these agencies and authorities in determining their proportionate share of the total OPEB liability, as well as other collective amounts including OPEB expense, DOA prepared employer schedules that include these amounts. We audited and provided unmodified opinions on these schedules, which are published on DOA's website. In addition, the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required by *Government Auditing Standards*, is on page 11.

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Auditor's Report ■



Report 18-14

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

Ms. Ellen Nowak, Secretary
Department of Administration

We have audited the Schedule of Employer Allocations of the State Retiree Health Insurance program as of and for the year ended June 30, 2017, and the related notes. We have also audited the totals for the columns titled Beginning Total OPEB Liability, Ending Total OPEB Liability, Total Deferred Outflows of Resources, Total Deferred Inflows of Resources, and Total Employer OPEB Expense included in the Schedule of OPEB Amounts by Participating Employer of the State Retiree Health Insurance program as of and for the year ended June 30, 2017, and the related notes. We have issued our report on these schedules thereon dated October 2, 2018. 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.

Internal Control over Financial Reporting

Management of the Department of Administration (DOA) is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit of the State Retiree Health Insurance program schedules, we considered DOA's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the schedules, but not for the purpose of expressing an opinion on the effectiveness of DOA's internal control. Accordingly, we do not express an opinion on the effectiveness of DOA'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 the schedules 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 the State Retiree Health Insurance program schedules 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 schedule 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 DOA'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 DOA's internal control or on compliance. Accordingly, this report is not suitable for any other purpose.

LEGISLATIVE AUDIT BUREAU


Joe Chrisman
State Auditor

October 2, 2018

Response ■



STATE OF WISCONSIN
DEPARTMENT OF ADMINISTRATION

Scott Walker, Governor
Ellen Nowak, Secretary

October 2, 2018

Mr. Joe Chrisman, State Auditor
Legislative Audit Bureau
22 East Mifflin Street, Suite 500
Madison, Wisconsin 53703

Dear Mr. Chrisman,

Thank you for the opportunity to respond to the 2018 audit report for the Schedule of Employer Allocations of the State Retiree Health Insurance program. We agree with the recommendation to work with our actuary to conduct an experience study to more thoroughly evaluate and support the participation rate.

The underlying calculations made for this schedule required the implementation of two new standards issued by the Governmental Accounting Standards Board. This required additional planning and coordination by both DOA and the Legislative Audit Bureau. We appreciate LAB's efforts, and the timeliness of this audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "Ellen Nowak". The signature is fluid and cursive, written over a white background.

Ellen Nowak, Secretary
Department of Administration