STATE OF WISCONSIN

Legislative Audit Bureau

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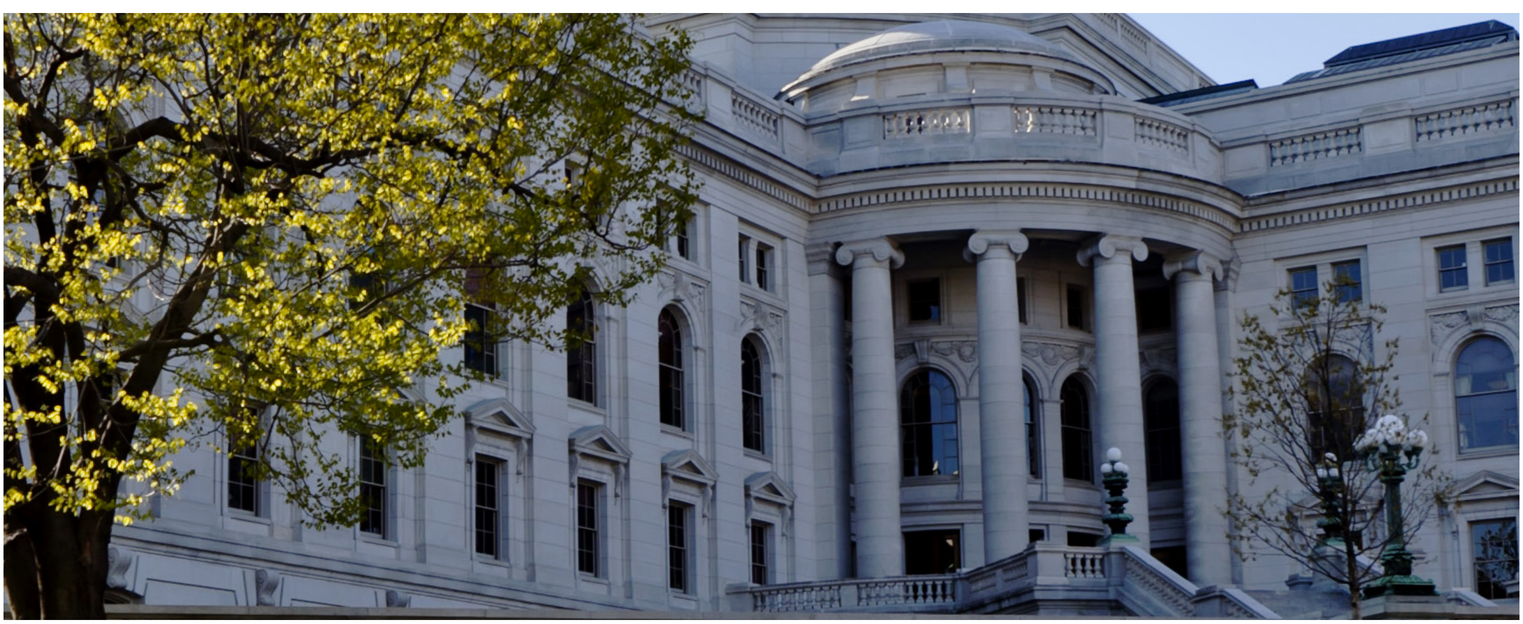
Report 22-18
September 2022

Supplemental Health Insurance Conversion Credit Program

Calendar Year 2021



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Opinions 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

Joe Chrisman
State Auditor

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September 28, 2022

Senator Robert Cowles, Co-chairperson
Joint Legislative Audit Committee
State Capitol
Madison, Wisconsin 53702

Dear Senator Cowles:

As required by s. 13.94 (1) (dd), Wis. Stats., and as requested by the Department of Employee Trust Funds (ETF), we have completed an audit of ETF's financial statements, and the related notes, for the Supplemental Health Insurance Conversion Credit (SHICC) program as of and for the year ended December 31, 2021. 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. ETF chose to separately issue the SHICC program financial statements and plans to issue its *2021 Annual Comprehensive Financial Report* (ACFR), which will also include the SHICC program financial statements, at a later date.

ETF administers two sick leave programs: the basic Accumulated Sick Leave Conversion Credit program (basic ALSCC) 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, 2021, will be included in ETF's 2021 ACFR.

The SHICC fiduciary net position, which represents resources available to pay benefits, increased from $1.2 billion as of December 31, 2020, to $1.4 billion as of December 31, 2021, or by 13.5 percent. This increase is primarily attributable to higher returns on investments.

The SHICC program is considered an other postemployment benefit (OPEB) plan. 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. As of December 31, 2021, ETF calculated a net OPEB asset of $329.0 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 22-19. The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which is required by *Government Auditing Standards*, begins on page 13.

We appreciate the courtesy and cooperation extended to us by ETF staff during the audit.

Respectfully submitted,

Joe Chrisman
State Auditor

JC/ES/ag

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, 2021, approximately 72,700 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 ss. 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.

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 2021, 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 was allocated to fund 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 22-12 provides more information about the investment performance and financial condition of the Core Fund as of December 31, 2021. 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;

- 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

ETF separately reports 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 presents the activity for this program 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 presents this program 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, 2021. Financial statements for the basic ASLCC program, as of and for the year ended December 31, 2021, will be included in ETF's *2021 Annual Comprehensive Financial Report* (ACFR), which will be issued by ETF at a later date.

As of December 31, 2021, the fiduciary net position of the SHICC program was $1.4 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, 2021, the SHICC program had a fiduciary net position of $1.4 billion, which was a 13.5 percent increase from the prior year. This increase is attributable to higher returns on investments during 2021.

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, 2021. The financial statements were prepared by ETF using generally accepted accounting principles prescribed by the Governmental Accounting Standards Board (GASB). 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.

For 2021 reporting, ETF chose to separately issue the financial statements of the SHICC program and plans to issue its 2021 ACFR, which will also include the financial statements of the SHICC program, at a later date.

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, 2021.

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, 2021, 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 13.

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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, the SHICC program is an OPEB plan.

Calculating the Total OPEB Liability

As of December 31, 2021, the SHICC program total OPEB liability was $1.0 billion.

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. ETF’s actuary performed an actuarial valuation as of December 31, 2021, to determine the total OPEB liability for the SHICC program as of December 31, 2021. Based on these valuations, the total OPEB liability for the SHICC program was $1.0 billion as of December 31, 2021, compared to $924.0 million as of December 31, 2020.

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. 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 SHICC long-term expected rate-of-return assumption, which is 6.8 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 (5.8 percent) would increase the total OPEB liability to $1.2 billion and a one percentage point increase in the discount rate (7.8 percent) would decrease the total OPEB liability to $947.6 million.

The health care cost trend rate, which measures the rate of change in per capita health costs over time, is also significant in the calculation of the total OPEB liability. A one percentage point increase in the health care cost trend rate increases the total OPEB liability to $1.1 billion, and a one percentage point decrease in the health care cost trend rate decreases the total OPEB liability to $974.4 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, 2021, the net OPEB asset was $329.0 million for the SHICC program.

As of December 31, 2021, the SHICC program reported a net OPEB asset. A net OPEB asset indicates that, at that point in time, the assets of the program exceed the projected liability for benefit payments. The SHICC program had a fiduciary net position of $1.4 billion and a total OPEB liability of $1.0 billion, which resulted in a net OPEB asset of $329.0 million. As shown in Table 1, this represents an increase from the net OPEB asset reported as of December 31, 2020.

Table 1

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

	2020	2021
Fiduciary Net Position	$1,208.8	$1,371.7
Total OPEB Liability	(924.0)	(1,042.7)
Net OPEB Asset (Liability)	**$ 284.8**	**$ 329.0**

Employer Reporting

Employers have made a commitment to provide postemployment benefits to employees and have an obligation to make contributions to fund these benefits.

For the SHICC program, contributions from employers are combined and the benefits are paid out of the 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 into the future to ensure that sufficient resources are available to make the benefit payments. Therefore, because each 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.

Employers participating in the SHICC program include state agencies, such as UW System, and the various authorities that participate in the program, such as the UW Hospitals and Clinics Authority. 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 prepared a Schedule of Employer Allocations and a Schedule of Collective OPEB Amounts as of and for the year ended December 31, 2021, for the SHICC program. We audited these schedules and provided unmodified opinions on them in report 22-19. The net OPEB asset 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 ACFR for the year ended June 30, 2022.

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Auditor’s Report

Report 22-18

STATE OF WISCONSIN
Legislative Audit Bureau

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

Senator Robert Cowles, Co-chairperson
Joint Legislative Audit Committee

Members of the Employee Trust Funds Board and
Mr. A. John Voelker, Secretary
Department of Employee Trust Funds

We have audited the financial statements and the related notes of the Supplemental Health Insurance Conversion Credit program of the State of Wisconsin, administered by the Department of Employer Trust Funds (ETF), as of and for the years ended December 31, 2021, and have issued our report thereon dated September 26, 2022. 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 opinion 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 as a basis for designing 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 financial statements of the Supplemental Health Insurance Conversion Credit program 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 financial statements. 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

Legislative Audit Bureau

September 26, 2022