

**Report 19-21
September 2019**

State Retiree Health Insurance Reporting for the State of Wisconsin

June 30, 2018

STATE OF WISCONSIN



Legislative Audit Bureau ■

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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

September 27, 2019

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 and for the year ended June 30, 2018. These schedules, and our unmodified opinions on them, may be found on DOA's website. These schedules will be used by DOA and other employers that are part of the State's financial reporting entity but that prepare separately issued financial statements.

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.

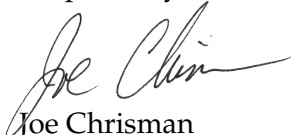
DOA will report a total OPEB liability of \$539.7 million as of June 30, 2018, for the State Retiree Health Insurance program. This liability will be reported in the State's financial statements, which will be included in the State's Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2019. This is a decrease of \$179.6 million from the \$719.3 million liability as of June 30, 2017, which was reported in the CAFR for the year ended June 30, 2018. The decrease in the total OPEB liability is attributed primarily to a change in the participation rate assumption.

The participation rate assumption measures how many retirees are expected to continue health insurance coverage after retirement and when retirees may discontinue coverage. Because of its effect on the total OPEB liability, we recommended in our prior audit (report 18-14) that DOA 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. This study was performed and the actuary developed an assumption that included three participation rates that were used in the calculation of the total OPEB liability for June 30, 2018. Because changes in participation may occur in future periods, we recommend DOA work with the actuary for the State Retiree Health Insurance program to establish a timeline for conducting periodic experience studies to ensure the participation rate assumption used in the calculation of the total OPEB liability continues to be supported by actual experience.

We also found that the actuary initially used incorrect participant data when determining the participation rate assumption, and we report a significant deficiency in internal control, which is described in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 11.

We appreciate the courtesy and cooperation extended to us by DOA and ETF 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 accounting 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, the Department of Employee Trust Funds (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), which is the entity responsible for preparing the financial statements of the State of Wisconsin on the basis of generally accepted accounting principles (GAAP), is responsible for ensuring that the employer reporting requirements of the 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.

Assumptions Used to Calculate the Total OPEB Liability

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

Three important assumptions used in the calculation of the total OPEB liability include the participation rate, discount rate, and health care cost trend rates. In determining the total OPEB liability for the program, the actuary for the State Retiree Health Insurance program used these, and other assumptions, to perform an actuarial valuation as of January 1, 2017. This valuation was adjusted for changes such as interest earned, contributions paid, and benefits paid through June 30, 2018. Based on this valuation and the adjustments, the total OPEB liability for the program was \$539.7 million as of June 30, 2018, a decrease of \$179.6 million from the \$719.3 million OPEB liability calculated 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.

Participation Rate

The participation rate assumption measures how many retirees are expected to continue health insurance coverage after retirement as well as when retirees may discontinue coverage. 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. The participation rate also can 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 Credits program, which is a separate program funded by state contributions and administered by ETF.

For the fiscal year ended June 30, 2017, the actuarial valuation used historical data and assumed a participation rate of 85.0 percent. Because of its effect on the total OPEB liability, we recommended in our prior audit (report 18-14) that DOA 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 85.0 percent assumption. In determining the total OPEB liability for the year ended June 30, 2018, DOA worked with the actuary to have an experience study completed using data provided by ETF that resulted in the determination of three participation rates that were used in the calculation of the liability.

DOA should work with the actuary for the State Retiree Health Insurance program to ensure periodic experience studies are performed to support the participation rate assumption.

The actuaries reported that the change in the participation rate assumption was a primary reason for the decrease in the total OPEB liability from June 30, 2017, to June 30, 2018. Because the participation rate assumption has a significant effect on the calculation of the total OPEB liability and changes to program participation may occur in future periods, DOA should continue to work with the actuary for the State Retiree Health Insurance program to establish a timeline for periodically performing future studies to ensure that the participation rate assumption continues to be supported by actual experience.

Recommendation

We recommend the Department of Administration work with the actuary for the State Retiree Health Insurance program to establish a timeline for periodically performing future studies to ensure the participation rate assumption used in the calculation of the total OPEB liability continues to be supported by actual experience.

We also found that the actuary used incorrect participant data when determining the participation rate assumption, and we reported a significant deficiency in internal control, which is described in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters, which begins on page 11.

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 the State Retiree Health Insurance program. 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 3.87 percent as of June 30, 2018, 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 \$503.6 million (at 4.87 percent), and a one percentage point decrease in the discount rate increases the liability to \$578.0 million (at 2.87 percent).

Health Care Cost Trend Rates

The health care cost trend 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.

These trend rates can have a significant effect on the total OPEB liability. A one percentage point increase in each health care cost trend rate increases the total OPEB liability to \$614.1 million, and a one percentage point decrease in each health care cost trend rate decreases the total OPEB liability to \$477.1 million.

Employer Reporting

As of June 30, 2018, the total OPEB liability was \$539.7 million for the State Retiree Health Insurance program.

The total OPEB liability of \$539.7 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, 2019. In addition, some state agencies, such as the University of Wisconsin (UW) System, and various authorities, including the UW 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, 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*, begins on page 11.

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Auditor's Report



Report 19-21

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

Mr. Joel Brennan, 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, 2018, and the related notes. We have also audited the totals for the columns titled Ending Total OPEB Liability, Total Deferred Outflow of Resources, Total Deferred Inflow 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, 2018, and the related notes. We have issued our report on these schedules thereon dated September 24, 2019. 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. We did identify a deficiency in internal control that we consider to be a significant deficiency. As described in the accompanying Finding and Response Schedule, this deficiency is related to the data used in the participation rate assumption for the State Retiree Health Insurance program.

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*.

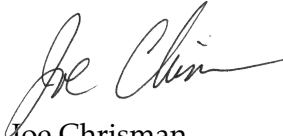
Response to Finding

DOA's written response to the finding identified in our audit is described in the accompanying Finding and Response Schedule. DOA's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

September 24, 2019

FINDING AND RESPONSE SCHEDULE

Participation Rate Assumption—State Retiree Health Insurance Program

Criteria:

The State Retiree Health Insurance program provides postemployment health insurance coverage to all eligible retired employees of the State of Wisconsin. An other postemployment benefit (OPEB) liability is created because the State provides the option to continue participation in the State's Group Health Insurance program to retirees who are not yet eligible for Medicare benefits but who pay the premium rate set for active employees. The total OPEB liability is the sum of amounts needed to pay for the OPEB earned by each participant as of the date of the actuarial valuation. The calculation of the total OPEB liability is complex and includes projecting future benefits and considering assumptions about program participation, demographics, turnover, mortality, disability, retirement, and health care trends.

DOA, as the entity responsible for preparing the GAAP-based financial statements of the State of Wisconsin, is responsible for calculating the total OPEB liability, taking steps to ensure the assumptions and information used in the calculations are accurate, and ensuring that the employer-reporting requirements are being met. DOA worked with the actuarial firm for the health insurance program to measure the State's obligation to provide OPEB under the State Retiree Health Insurance program.

Condition:

We found that the participation rate assumption, which measures how many retirees are expected to continue health insurance coverage after retirement and when retirees may discontinue coverage, was determined using incorrect participant data. We identified participants included in one of the participant counts that were age 65 and over. Because the total OPEB liability is calculated for participants that are not yet age 65 (pre-Medicare eligible), these participants should not have been included. As a result, the participation rates were initially incorrect and subsequently revised as follows:

Rate	Description	As Initially Determined	As Revised
Commencement Rate	Percentage of active employees who retire prior to age 65 (pre-Medicare eligible) and elect retiree medical coverage immediately upon retirement with immediate eligibility for coverage.	80.0 percent in year one and 4.0 percent for five subsequent years	80.0 percent in year one and 2.5 percent for eight subsequent years
Annual Deferred Participant Commencement Rate	Percentage of former active employees who currently have elected to defer benefits and commence receiving retiree medical benefits prior to age 65.	20.0 percent per year for five subsequent years	12.5 percent per year for eight subsequent years
Lapse Rate	Percentage of retired participants who terminate coverage prior to age 65.	10.0 percent per year	10.0 percent per year

Context:

The participation rate assumption is one of the critical assumptions used in the calculation of the total OPEB liability. The actuarial valuation completed for June 30, 2017, used historical data and assumed a participation rate of 85.0 percent for employees that retire prior to age 65 and elect retiree medical coverage immediately upon retirement. Because of its effect on the total OPEB liability, we recommended in our prior audit (report 18-14) that DOA 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 85.0 percent assumption used. DOA worked with the actuary to have this experience study completed using data provided by the Department of Employee Trust Funds (ETF) for the valuation completed for June 30, 2018.

In completing its analysis, the actuary requested summarized participant counts from ETF, including the number of participants that participated in the health insurance program prior to retirement and continued coverage after retirement. These participant counts were used by the actuary in determining the participation rate assumption. As part of our audit, we requested the detailed participant data used to support the participant counts provided and assessed the appropriateness of the participants included in the data.

Effect:

The change in the participation rate assumption:

- decreased the total OPEB liability by \$45,053,060, or 8.0 percent, from \$584,756,522 to \$539,703,462;
- decreased total employer OPEB expense by \$4,505,306, or 8.0 percent, from \$56,947,962 to \$52,442,656; and
- increased total deferred inflows arising from assumption changes by \$40,547,754, or 16.0 percent, from \$251,165,898 to \$291,713,652.

Cause:

DOA relied on the actuary to request the appropriate data from ETF, and DOA did not have procedures in place to ensure the accuracy of the data.

 Recommendation

We recommend the Department of Administration implement review procedures to ensure data provided to the actuary and used to calculate the total OPEB liability for the State Retiree Health Insurance program is complete and accurate.

Agency Response: DOA agrees with the recommendation and will develop review procedures and share them with ETF and the actuary.

Response ■



STATE OF WISCONSIN
DEPARTMENT OF ADMINISTRATION

Tony Evers, Governor
Joel Brennan, Secretary

September 24, 2019

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 2019 audit report for the Schedule of Employer Allocations of the State Retiree Health Insurance program. The Department of Administration understands their responsibility for calculating the total OPEB liability which includes ensuring the assumptions and information used in the calculations are accurate. DOA agrees with your recommendation to implement review procedures to ensure the accuracy of the data being provided to the actuary.

DOA also agrees with the recommendation to establish a timeline for periodically performing future studies to ensure the participation rate assumption used in the calculation of the total OPEB liability continues to be supported by actual experience.

Sincerely,

A handwritten signature in blue ink that reads "Joel Brennan". The signature is written in a cursive style with a long horizontal line extending to the right.

Joel Brennan, Secretary
Department of Administration