

AUDIT REPORT

Retiree Health Funds

**For the Year Ended
June 30, 2011**



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

**Department of Audit
Division of State Audit**



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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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July 10, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable Mark Emkes, Chairman
State Insurance Committee
Local Education Insurance Committee
Local Government Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Retiree Health Funds for the year ended June 30, 2011. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/tlk
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State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Retiree Health Funds
For the Year Ended June 30, 2011

AUDIT OBJECTIVES

The objectives of the audit were to consider the funds' internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

**Audit Report
Retiree Health Funds
For the Year Ended June 30, 2011**

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Retiree Health Funds For the Year Ended June 30, 2011

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Retiree Health Funds. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller of the treasury.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The State Insurance Committee was created by an act of the General Assembly, codified as Title 8, Chapter 27, Section 101, *Tennessee Code Annotated*. In addition to the committee’s responsibilities related to current state employees, the committee’s purpose is also to provide insurance benefits and services to qualified retired state employees, higher education employees, teachers, and certain local government retirees.

Prior to July 1, 2006, the state had a Medicare Supplement Insurance Fund, an enterprise fund, which accounted for the post-age-65 Medicare supplement health insurance of participating retired state employees, and both active and retired employees were commingled in each of the three healthcare plans administered by the state, which were accounted for in three separate funds. However, during the fiscal year ended June 30, 2007, the state implemented Governmental Accounting Standards Board Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. As a result, the state was required to remove retired employees from the state employee group insurance plan (fund), the teacher group insurance plan (fund), and the local government group insurance plan (fund) and reclassify them into agency funds; the former enterprise fund, Medicare Supplement Insurance Fund, had to be reclassified as an agency fund. These four funds comprise the Retiree Health Funds, which account for and report assets and liabilities related to both the pre-age-65 and post-age-65 health insurance of qualified retired state employees, including higher education employees, retired teachers in political subdivisions, and certain retired employees of local governments and quasi-governmental organizations.

ORGANIZATION

The State Insurance Committee, in cooperation with the Local Education and Local Government Insurance Committees, oversees the administration of the Retiree Health Funds. The State Insurance Committee is composed of the Commissioner of Finance and Administration, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Commerce and Insurance, the Commissioner of the Department of Human Resources, a representative of the Tennessee State Employees Association, two elected representatives of the state employees, and an elected representative of higher education.

The Department of Finance and Administration's Division of Benefits Administration and the Department of the Treasury's Tennessee Consolidated Retirement System (TCRS) coordinate in the administration of the Retiree Health Funds. TCRS is responsible for the day-to-day operations including customer service to retirees, enrollment, and collection of premiums through TCRS. Benefits Administration is responsible for the processing of all payments, refunds, and cash receipts of the Retiree Health Funds.

Benefits Administration has contracted with POMCO Group for the administrative services, coordination with Medicare intermediaries, and payment of claims for the funds.

An organization chart of the funds' administration is on the following page.

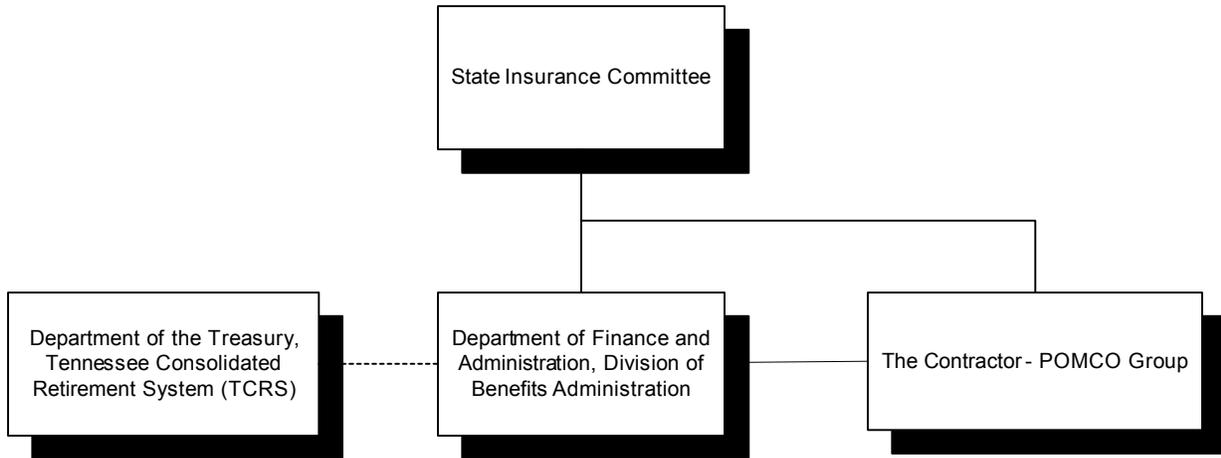
AUDIT SCOPE

The audit was limited to the period July 1, 2010, through June 30, 2011, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 2011, and for comparative purposes, the year ended June 30, 2010. The Retiree Health Funds form integral parts of state government and as such have been included as agency funds in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered fund codes 51000, 52000, 53000, and 59000 of Edison (business unit 31786).

Retiree Health Funds Administration

Organization Chart



OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the funds' internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the

effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Retiree Health Funds' financial statements for the year ended June 30, 2011, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Retiree Health Funds' financial statements.



STATE OF TENNESSEE
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**Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

June 1, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and
The Honorable Mark Emkes, Chairman
State Insurance Committee
Local Education Insurance Committee
Local Government Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have audited the financial statements of the Retiree Health Funds, as of and for the year ended June 30, 2011, and have issued our report thereon dated June 1, 2012. 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 generally accepted government auditing standards.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Retiree Health Funds' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the funds' internal control over financial reporting.

Accordingly, we do not express an opinion on the effectiveness of the funds' internal control over financial reporting.

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, or 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 financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Retiree Health Funds' financial statements are free of material misstatement, we performed tests of the funds' compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 generally accepted government auditing standards.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the State Insurance Committee, the Local Education Insurance Committee, the Local Government Insurance Committee, the audit committee, and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,



Arthur A. Hayes, Jr., CPA
Director

AAH/tlk



STATE OF TENNESSEE
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DEPARTMENT OF AUDIT
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Independent Auditor's Report

June 1, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and
The Honorable Mark Emkes, Chairman
State Insurance Committee
Local Education Insurance Committee
Local Government Insurance Committee
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have audited the accompanying statements of fiduciary assets and liabilities of the Retiree Health Funds, agency funds of the State of Tennessee, as of June 30, 2011, and June 30, 2010, and the related statements of changes in fiduciary assets and liabilities. These financial statements are the responsibility of the funds' management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the State

June 1, 2012
Page Two

Insurance Committee. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Retiree Health Funds.

As discussed in Note 1, the financial statements present only the Retiree Health Funds, agency funds, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2011, and June 30, 2010, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary assets and liabilities of the Retiree Health Funds of the State of Tennessee, as of June 30, 2011, and June 30, 2010, and the changes in its fiduciary assets and liabilities for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with generally accepted government auditing standards, we have also issued our report dated June 1, 2012, on our consideration of the funds' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with generally accepted government auditing standards and should be considered in assessing the results of our audit.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." The signature is written in a cursive style with a large initial "A" and "H".

Arthur A. Hayes, Jr., CPA
Director

AAH/tlk

Retiree Health Funds
Statement of Fiduciary Assets and Liabilities
June 30, 2011, and June 30, 2010

(Expressed in Thousands)

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Assets:		
Current assets:		
Cash (Note 2)	\$ 17,264	\$ 21,074
Accounts receivable	<u>1,461</u>	<u>1,188</u>
Total assets	<u>\$ 18,725</u>	<u>\$ 22,262</u>
Liabilities:		
Current liabilities:		
Accounts payable and accruals	\$ 17,664	\$ 15,434
Amount held in custody for others	<u>1,061</u>	<u>6,828</u>
Total liabilities	<u>\$ 18,725</u>	<u>\$ 22,262</u>

The notes to the financial statements are an integral part of this statement.

Retiree Health Funds
Statement of Changes in Fiduciary Assets and Liabilities
For the Year Ended June 30, 2011

(Expressed in Thousands)

	<u>Balance</u> <u>July 1, 2010</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2011</u>
Assets:				
Cash (Note 2)	\$ 21,074	\$ 248,268	\$ 252,078	\$ 17,264
Accounts receivable	<u>1,188</u>	<u>8,811</u>	<u>8,538</u>	<u>1,461</u>
Total assets	<u>\$ 22,262</u>	<u>\$ 257,079</u>	<u>\$ 260,616</u>	<u>\$ 18,725</u>
Liabilities:				
Accounts payable and accruals	\$ 15,434	\$ 27,237	\$ 25,007	\$ 17,664
Amount held in custody for others	<u>6,828</u>	<u>249,479</u>	<u>255,246</u>	<u>1,061</u>
Total liabilities	<u>\$ 22,262</u>	<u>\$ 276,716</u>	<u>\$ 280,253</u>	<u>\$ 18,725</u>

The notes to the financial statements are an integral part of this statement.

Retiree Health Funds
Statement of Changes in Fiduciary Assets and Liabilities
For the Year Ended June 30, 2010

(Expressed in Thousands)

	<u>Balance</u>		<u>Deductions</u>	<u>Balance</u>
	<u>July 1, 2009</u>	<u>Additions</u>	<u>Deductions</u>	<u>June 30, 2010</u>
Assets:				
Cash (Note 2)	\$ 21,486	\$ 224,255	\$ 224,667	\$ 21,074
Accounts receivable	<u>1,446</u>	<u>7,494</u>	<u>7,752</u>	<u>1,188</u>
 Total assets	 <u>\$ 22,932</u>	 <u>\$ 231,749</u>	 <u>\$ 232,419</u>	 <u>\$ 22,262</u>
 Liabilities:				
Accounts payable and accruals	\$ 17,607	\$ 29,364	\$ 31,537	\$ 15,434
Amount held in custody for others	<u>5,325</u>	<u>7,206</u>	<u>5,703</u>	<u>6,828</u>
 Total liabilities	 <u>\$ 22,932</u>	 <u>\$ 36,570</u>	 <u>\$ 37,240</u>	 <u>\$ 22,262</u>

The notes to the financial statements are an integral part of this statement.

Retiree Health Funds
Notes to the Financial Statements
June 30, 2011, and June 30, 2010

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The following agency funds comprise the Retiree Health Funds:

- State Employee Group Insurance
- Teacher Group Insurance
- Local Government Group Insurance
- Medicare Supplement Insurance

The Retiree Health Funds are used to account for premiums and claims paid on behalf of qualified retired state employees, higher education employees, teachers, and certain local government retirees. The funds have been included as agency funds in the *Tennessee Comprehensive Annual Financial Report*. This report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Retiree Health Funds follow all applicable GASB pronouncements.

C. Measurement Focus and Basis of Accounting

The Retiree Health Funds are custodial in nature and do not measure results of operations or have a measurement focus. The funds are accounted for on the accrual basis of accounting.

D. Cash

Cash is defined as cash on hand and demand deposits, such as the pooled investment fund.

NOTE 2. DEPOSITS

The Retiree Health Funds had \$17,263,952 in the State Treasurer's pooled investment fund at June 30, 2011, and \$21,074,065 at June 30, 2010. The pooled investment fund, administered by the State Treasurer, is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current

Retiree Health Funds
Notes to the Financial Statements (Cont.)
June 30, 2011, and June 30, 2010

resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, bonds, notes, and bills of the United States Treasury or other obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements for obligations of the United States or its agencies, and in securities lending agreements whereby securities may be loaned for a fee. The pooled investment fund's required risks disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov or by calling (615) 741-2956.

NOTE 3. OTHER POSTEMPLOYMENT BENEFITS

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The following retiree health plans, administered by the state, are reported in the Retiree Health Funds and are financially independent. Each participating employer is required by GASB Statement 45, *Accounting and Financial Reporting by Employer for Postemployment Benefits Other Than Pensions*, to disclose additional information with regard to funding policy, the employer's annual OPEB cost and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

A. State Employee Group Insurance Plan

1. Plan description - State and higher education retired employees participate in the State Employee Group Insurance Plan. For accounting and financial reporting purposes, the balances and transactions for these retirees have been removed from the State Employee Group Insurance Plan internal service fund and reported in an agency fund. The State Employee Group Insurance Plan is a cost-sharing, multiple-employer defined benefit health insurance plan that is considered to be an agent, multiple-employer plan for accounting purposes. Approximately 91 employers contribute to the plan.

All retired employees and disability participants of the primary government and component units, who are eligible and choose coverage, are included in this plan. Retirees and disability participants prior to the age of 65 participate in this plan. At June 30, 2011, there were 8,145 retirees and disabled participants enrolled in one of two options: standard preferred provider organization plan (PPO), or the partnership preferred

Retiree Health Funds
Notes to the Financial Statements (Cont.)
June 30, 2011, and June 30, 2010

provider organization plan (PPO). The state insurance committee establishes premiums annually.

2. Summary of significant accounting policies - Premiums are recognized when due and benefits are recognized when incurred using the accrual basis of accounting. Premium refunds reduce premium revenue, and claim recoveries reduce claims expense.
3. Contributions and reserves - An insurance committee created in accordance with Section 8-27-101, *Tennessee Code Annotated*, establishes the contributions to the plan by member employers and employees. Both active and pre-age-65 retired members of the Employee Group Insurance Plan pay the same premium rate. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to plan participants. Retiree premiums are based on years of service; therefore, retirees with 30 years of service are subsidized 80 percent; 20 but less than 30 years, 70 percent; and less than 20 years, 60 percent. This plan is funded on a pay-as-you-go basis.

B. Teacher Group Insurance Plan

1. Plan description - Retired teachers participate in the Teacher Group Insurance Plan. For accounting and financial reporting purposes, the balances and transactions for these retirees have been removed from the Teacher Group Insurance Plan enterprise fund and reported in an agency fund. The Teacher Group Insurance Plan is a cost-sharing, multiple-employer defined benefit health insurance plan that is considered to be an agent, multiple-employer plan for accounting purposes. Approximately 123 local education agencies and two education cooperatives participate in the plan.

All retired teachers and disability participants of the local education agencies, who are eligible and choose coverage, are included in this plan. Retirees and disability participants prior to the age of 65 participate in this plan. At June 30, 2011, there were 5,950 retirees and disability participants enrolled in one of two options: standard preferred provider organization plan (PPO), or the partnership preferred provider organization plan (PPO). The insurance committee establishes premiums annually.

2. Summary of significant accounting policies - Premiums are recognized when due and benefits are recognized when incurred using the accrual basis of accounting. Premium refunds reduce premium revenue, and claims recoveries reduce claims expense.

Retiree Health Funds
Notes to the Financial Statements (Cont.)
June 30, 2011, and June 30, 2010

3. Contributions and reserves - An insurance committee created in accordance with Section 8-27-302, *Tennessee Code Annotated*, establishes the contributions to the plan by member employers and employees. Both active and pre-age-65 retired members of the Teacher Group Insurance Plan pay the same premium rate. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to plan participants. Not all employers contribute to retirees' healthcare premiums. Those employers who do contribute to the retirees' premiums primarily do so based on years of service. This plan is funded on a pay-as-you-go basis.

C. Local Government Group Insurance Plan

1. Plan description - Local government retired employees participate in the Local Government Group Insurance Plan. For accounting and financial reporting purposes, the balances and transactions for these retirees have been removed from the Local Government Group Insurance Plan enterprise fund and reported in an agency fund. The Local Government Group Insurance Plan is a cost-sharing, multiple-employer defined benefit health insurance plan that is considered to be an agent, multiple-employer plan for accounting purposes. Approximately 55 counties, 168 municipalities, and 153 quasi-governmental organizations participate in the plan.

All retired employees and disability participants of the local governments, who are eligible and choose coverage, are included in this plan. Retirees and disability participants prior to the age of 65 participate in this plan. At June 30, 2011, there were 185 retirees and disability participants enrolled in one of two options: standard preferred provider organization plan (PPO), or the partnership preferred provider organization plan (PPO). The insurance committee establishes premiums annually.

2. Summary of significant accounting policies - Premiums are recognized when due and benefits are recognized when incurred using the accrual basis of accounting. Premium refunds reduce premium revenues, and claims recoveries reduce claims expense.
3. Contributions and reserves - An insurance committee created in accordance with Section 8-27-207, *Tennessee Code Annotated*, establishes the contributions to the plan by member employers and employees. Both

Retiree Health Funds
Notes to the Financial Statements (Cont.)
June 30, 2011, and June 30, 2010

active and pre-age-65 retired members of the Local Government Group Insurance Plan pay the same premium rate. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to plan participants. Not all employers contribute to retirees' healthcare premiums. Those employers who do contribute to the retirees' premiums primarily do so based on years of service. This plan is funded on a pay-as-you-go basis.

D. Medicare Supplement Insurance Plan

1. Plan description - Post-65 retired employees of the state, higher education, local education agencies, and certain local governments may participate in the Medicare Supplement Insurance Plan. This plan is reported in an agency fund. Prior to July 1, 2006, this plan was reported as an enterprise fund. The Medicare Supplement Plan is a cost-sharing, multiple-employer defined benefit health insurance plan that is considered to be an agent, multiple-employer plan for accounting purposes. Employers who participate in the State Employee Group Insurance Plan, Teacher Group Insurance Plan, and Local Government Group Insurance Plan may participate in this plan. All retired employees who are Medicare eligible by virtue of age and receive a retirement benefit from the Tennessee Consolidated Retirement System, and choose coverage, are included in this plan. At June 30, 2011, there were 24,006 members enrolled. The state insurance committee establishes premiums annually.
2. Summary of significant accounting policies - Premiums are recognized when due and benefits are recognized when incurred using the accrual basis of accounting. Premium refunds reduce premium revenue, and claims recoveries reduce claims expense.
3. Contributions and reserves - In accordance with Section 8-27-701, *Tennessee Code Annotated*, the state insurance committee establishes the contributions to the plan by member employers and employees. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to plan participants. Not all employers contribute to retirees' healthcare premiums. Employers contribute a fixed amount to retirees' premiums based on years of service; therefore, retirees with 30 years of service receive \$50 per month; 20 but less than 30 years, \$37.50; and 15 but less than 20 years, \$25. This plan is funded on a pay-as-you-go basis.