AUDIT REPORT

Retiree Health Funds

For the Year Ended
June 30, 2014

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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January 15, 2015

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable Larry B. Martin, Chairman
State Insurance Committee
Local Education Insurance Committee
Local Government Insurance Committee

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Retiree Health Funds for the year ended June 30, 2014. You will note from the independent auditor's report that an unmodified 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,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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Audit Report
Retiree Health Funds
For the Year Ended June 30, 2014

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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, 2014

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.

STATE OF TENNESSEE
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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable Larry B. Martin, Chairman
State Insurance Committee
Local Education Insurance Committee
Local Government Insurance Committee

Report on the Financial Statements

We have audited the accompanying financial statements of the Retiree Health Funds, agency funds of the State of Tennessee, as of and for the years ended June 30, 2014, and June 30, 2013, and the related notes to the financial statements, which collectively comprise the funds' basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit 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 Insurance Committee, the Local Education Insurance Committee, and the Local Government 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.

Opinion

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, 2014, and June 30, 2013, and the changes in fiduciary assets and liabilities thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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, 2014, and June 30, 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the funds' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts 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 *Government Auditing Standards* in considering the funds' internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

RETIREE HEALTH FUNDS
Statements of Fiduciary Assets and Liabilities
June 30, 2014, and June 30, 2013

(Expressed in Thousands)

	June 30, 2014	June 30, 2013
Assets		
Current assets:		
Cash (Note 2)	$28,753	$20,787
Accounts receivable	1,442	2,082
Total assets	30,195	22,869
Liabilities		
Current liabilities:		
Accounts payable and accruals	17,791	16,684
Amount held in custody for others	12,404	6,185
Total liabilities	$30,195	$22,869

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, 2014

(Expressed in Thousands)

	Balance July 1, 2013	Additions	Deductions	Balance June 30, 2014
Assets				
Cash (Note 2)	$20,787	$238,183	$230,217	$28,753
Accounts receivable	2,082	11,097	11,737	1,442
Total assets	22,869	249,280	241,954	30,195
Liabilities				
Accounts payable and accruals	16,684	26,265	25,158	17,791
Amount held in custody for others	6,185	239,414	233,195	12,404
Total liabilities	$22,869	$265,679	$258,353	$30,195

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, 2013

(Expressed in Thousands)

	Balance July 1, 2012	Additions	Deductions	Balance June 30, 2013
Assets				
Cash (Note 2)	$17,796	$225,947	$222,956	$20,787
Accounts receivable	2,258	11,433	11,609	2,082
Total assets	20,054	237,380	234,565	22,869
Liabilities				
Accounts payable and accruals	18,027	23,363	24,706	16,684
Amount held in custody for others	2,027	229,170	225,012	6,185
Total liabilities	$20,054	$252,533	$249,718	$22,869

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

RETIREE HEALTH FUNDS
Notes to the Financial Statements
June 30, 2014, and June 30, 2013

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The following agency funds comprise the Retiree Health Funds:

- State Employee Group Insurance,
- Teacher Group Insurance,
- Local Government Group Insurance, and
- 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.* That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

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.

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 $28,752,703 and $20,787,056 in the State Treasurer's pooled investment fund at June 30, 2014, and June 30, 2013, respectively. 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 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 risk 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.

State Employee Group Insurance Plan

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 64 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, 2014, there were 6,849 retirees and disabled participants enrolled in one of two options: the standard preferred provider organization (PPO) plan or the partnership PPO plan. The state insurance committee establishes premiums annually.

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.

Contributions and reserves - An insurance committee created in accordance with Section 8-27-201, *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%; 20 but less than 30 years, 70%; and less than 20 years, 60%. This plan is funded on a pay-as-you-go basis.

Teacher Group Insurance Plan

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 129 local education agencies and one education cooperative 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, 2014, there were 5,174 retirees and disability participants enrolled in one of three options: the partnership preferred provider organization (PPO) plan, the standard (PPO) plan, or the PPO limited plan. The insurance committee establishes premiums annually.

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.

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.

Local Government Group Insurance Plan

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 56 counties, 148 municipalities, and 140 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, 2014, there were 115 retirees and disability participants enrolled in one of three options: the partnership preferred provider organization (PPO) plan, the

standard (PPO) plan, or the PPO limited plan. The insurance committee establishes premiums annually.

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.

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 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.

Medicare Supplement Insurance Plan

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. 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, 2014, there were 28,261 retirees enrolled. The state insurance committee establishes premiums annually.

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.

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.

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Independent Auditor's 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*

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable Larry B. Martin, Chairman
State Insurance Committee
Local Education Insurance Committee
Local Government Insurance Committee

We have audited the financial statements of the Retiree Health Funds as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the funds' basic financial statements, and have issued our report thereon dated December 19, 2014. 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* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Retiree Health Funds' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the funds' internal control. Accordingly, we do not express an opinion on the effectiveness of the funds' 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, 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 entity's financial statements will not be prevented, or 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 Retiree Health Funds' financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014