Tennessee Comptroller of the Treasury

Financial and Compliance Audit Report

State of Tennessee Postemployment Benefits Trust

For the Year Ended June 30, 2019

Justin P. Wilson
Comptroller of the Treasury

Division of State Audit

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Tennessee Comptroller of the Treasury

Justin P. Wilson
Comptroller

Jason E. Mumpower
Deputy Comptroller

July 16, 2020

The Honorable Bill Lee, Governor
Members of the General Assembly
Members of the Board of Trustees of the
Postemployment Benefits Trust

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State of Tennessee Postemployment Benefits Trust for the year ended June 30, 2019. 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
Division of State Audit

20/004

Audit Report

State of Tennessee Postemployment Benefits Trust

For the Year Ended June 30, 2019

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Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Findings

The audit report contains no findings.

Tennessee Comptroller of the Treasury

Justin P. Wilson
Comptroller

Jason E. Mumpower
Deputy Comptroller

Independent Auditor's Report

The Honorable Bill Lee, Governor
Members of the General Assembly
Members of the Board of Trustees of the
Postemployment Benefits Trust

Report on the Financial Statements

We have audited the accompanying financial statements of the State of Tennessee Postemployment Benefits Trust, a fiduciary fund of the State of Tennessee, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the trust's 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 audit. 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. 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 policies used

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and the 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the State of Tennessee Postemployment Benefits Trust as of June 30, 2019, and the changes in fiduciary net position thereof for the year 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 State of Tennessee Postemployment Benefits Trust, a fiduciary fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2019, and the changes in financial position and cash flows thereof 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 Matter – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 6; the schedule of changes in the plan's net OPEB liability and related ratios on page 14; the schedule of contributions and notes to the schedule of contributions on page 15; and the schedule of investment returns on page 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 14, 2020, on our consideration of the trust's 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 trust's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA, Director
Division of State Audit
July 14, 2020

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our management discussion and analysis (MD&A) of the State of Tennessee Postemployment Benefits Trust's (OPEB Trust) financial performance provides an overview of the OPEB Trust financial activities for the year ended June 30, 2019. Please read it as a narrative introduction to the financial statements that follow. MD&A includes a description of the basic financial statements for the plan, condensed financial information along with analyses of balances and financial position, and significant issues affecting financial position.

BACKGROUND

Governmental Accounting Standards Board (GASB) Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* prescribes uniform financial reporting standards for other postemployment benefits (OPEB) plans of all state and local governments. OPEB refers to postemployment benefits other than pension benefits and includes postemployment healthcare benefits which are covered under the state's OPEB plan.

During fiscal year 2019, the state established the irrevocable OPEB Trust in accordance with Tennessee Code Annotated (TCA) 8-27-802. The trust was established for the sole purpose of providing for the advance funding of OPEB benefits accrued by employees of the state or authorized employees of local education agencies, as determined by the trustees of the OPEB Trust. Currently, the OPEB Trust is limited to the accrued OPEB benefits for eligible pre-65 retired employees of the state and certain component unit employers participating in the Employee Group OPEB Plan (EGOP). It is intended that the OPEB Trust shall constitute a qualified trust according to the standards set forth in GASB Statement No. 74. The OPEB Trust is a fiduciary blended component unit of the state.

The general assembly has adopted a plan requiring participating employers to advance fund OPEB costs according to an actuarially determined contribution rate (ADC) that is obtained on an annual basis. Starting in fiscal year 2017, the general assembly has appropriated the full annual ADC for the plan.

FINANCIAL HIGHLIGHTS

The information below represents the activity of the OPEB Trust during the initial year of operation. Due to this, comparative information is not yet available.

The net position of the OPEB Trust at June 30, 2019, was $213.7 million. The net position is restricted and may only be used to meet the state's ongoing obligations to eligible pre-65 retired employees of the primary government and certain component unit employers.

When the OPEB Trust was established, the participating employers made significant initial deposits of $301.5 million from appropriations made by the general assembly in fiscal years 2017, 2018 and 2019. The amounts appropriated in prior years were reported as reserves in the general fund until the OPEB Trust was established.

Net investment income for fiscal year 2019 totaled $5.2 million. Investments for the initial year were primarily in short-term instruments.

Total benefits paid for fiscal year 2019 were $93 million. This amount includes administrative expenses of $4.1 million.

OVERVIEW OF THIS ANNUAL REPORT

This annual report consists of four parts: management's discussion and analysis (this section), the OPEB Trust financial statements, the related notes to the financial statements, and required supplementary information. The financial statements consist of a statement of fiduciary net position and a statement of changes in fiduciary net position. The financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB Statement No. 74.

The financial statements are prepared using the economic resources measurement focus and full accrual basis of accounting. With this measurement focus, all assets and liabilities associated with the operation of this fiduciary component unit are included on the statement of fiduciary net position. The statement of changes in fiduciary net position recognizes contributions from employers when they are due and benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Fiduciary funds are used to report resources held for the benefit of parties outside the government. The assets of the OPEB Trust cannot be used to finance state operations. Instead, the trustees of the OPEB Trust are responsible for using the assets for the intended purposes.

FINANCIAL ANALYSIS

The following is an analysis of the statement of changes in fiduciary net position of the OPEB Trust for the fiscal year ended June 30, 2019.

State of Tennessee Postemployment Benefits Trust
Changes in Fiduciary Net Position
For the Fiscal Year Ended June 30
(Expressed in Thousands)

	2019
ADDITIONS	
Employer contributions	$ 301,486
Investment income	5,167
Total additions	306,653
DEDUCTIONS	
Benefit payments	88,858
Administrative expenses	4,093
Total deductions	92,951
Change in net position	213,702
Net position, July 1	-
Net position, June 30	$ 213,702

* The EGOP trust was established in January 2019. Comparative amounts will be presented once available.

Additions - Additions to the OPEB Trust consist of employer contributions and earnings from investments of plan assets. Retiree contributions to the trust are not considered additions. Instead, they are treated as liabilities when received and reductions of liabilities when spent. The State Treasurer is responsible for the investment of plan assets.

Deductions - Deductions from the OPEB Trust consists of the employer portions of benefits paid for retiree healthcare claims and amounts paid for administrative expenses. The claims payments made from retiree contributions are not considered benefit payments. Administrative expenses are made up of internal and external charges incurred in the payment of retiree claims.

For the fiscal year ended June 30, 2019, the OPEB Trust reported total assets of $219.5 million and total liabilities of $5.8 million.

FACTS, DECISIONS, OR CONDITIONS WITH EXPECTED FUTURE IMPACT

The State of Tennessee’s fiscal year 2019-2020 budget included a $153.4 million dollar appropriation for the purpose of funding current and future OPEB obligations of the EGOP. This represents the full ADC of $145.4 million calculated for this period as well as additional funding of $8 million.

Beginning in fiscal year 2020, the OPEB Trust will employ an investment strategy designed to meet the long-term expected rate of return.

On December 20, 2019, a federal spending package was signed into law that eliminated three tax provisions that will have an impact on the liability for the EGOP. The excise tax on high-cost plans, health insurer fee and the medical device tax were all repealed. The impact of these changes will vary and will not be fully understood until the actuarial valuation as of June 30, 2019 is completed.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the OPEB Trust's finances for all those with an interest in the plan's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to the Department of Finance and Administration, Division of Accounts, 312 Rosa L. Parks Avenue, Suite 2100, Nashville, TN 37243.

State of Tennessee Postemployment Benefits Trust
Statement of Fiduciary Net Position
June 30, 2019
(Expressed in Thousands)

ASSETS		
Cash and cash equivalents	$	30,273
Receivables:		
Rebates and recoveries		1,526
Interest and dividends		189
Investments, at fair value:		
Mutual funds		187,488
Total assets		219,476
LIABILITIES		
Accounts payable and accruals		5,774
Total liabilities		5,774
NET POSITION		
Restricted for		
Other postemployment benefits		213,702
Total net position	$	213,702

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

State of Tennessee Postemployment Benefits Trust
Statement of Changes in Fiduciary Net Position
For the Fiscal Year Ended June 30, 2019
(Expressed in Thousands)

ADDITIONS		
Contributions:		
Employer contributions	$	301,486
Total contributions		301,486
Investment income:		
Net increase/(decrease) in fair value of investments		1,126
Interest and dividends		4,041
Total investment income		5,167
Net investment income		5,167
Total additions		306,653
DEDUCTIONS		
Benefit payments		88,858
Administrative expenses		4,093
Total deductions		92,951
Net increase in fiduciary net position		213,702
Net position, July 1		-
Net position, June 30	$	213,702

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

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1

Summary of Significant Accounting Policies

A. Financial Reporting Entity

The State of Tennessee Postemployment Benefits Trust (OPEB Trust) was established for the purpose of pre-funding OPEB accrued by employees of the state and certain component units that participate in the closed Employee Group OPEB Plan (EGOP). The EGOP is a single-employer defined benefits other postemployment benefit plan that provides for the postemployment healthcare costs of eligible employees of the state, the University of Tennessee, the State University and Community College System, the Tennessee Housing Development Authority and the Tennessee Student Assistance Corporation. The irrevocable OPEB Trust was created during fiscal year 2019 in accordance with Tennessee Code Annotated (TCA) Title 8, Chapter 27, Sections 801-806.

In accordance with TCA 8-27-802, the OPEB Trust may invest in any security or investment in which the Tennessee Consolidated Retirement System (TCRS) is permitted to invest. TCA 8-27-803 states all assets of the OPEB Trust shall be preserved, invested and expended solely for the purpose of making payments for postemployment benefits of eligible plan members and for the costs of administering the trust. Although assets of the OPEB Trust may be commingled for investment purposes with other funds held by the State Treasurer, the balance of the OPEB Trust will be accounted for separately and will only be used in accordance with the trust documents.

The OPEB Trust is a blended fiduciary component unit of the State of Tennessee. Because of the state's fiduciary responsibility, the OPEB Trust has been included as an other employee benefit trust fund in the *Tennessee Comprehensive Annual Financial Report* (CAFR).

B. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual method, additions are recorded when earned and deductions are recorded at the time the liability is incurred regardless of the timing of the related cash flows.

Employer contributions are recognized in the period of time for which they are due, in accordance with legal provisions. Benefits represent the portion of EGOP claims expenses that are funded by employer contributions and are recognized when due and payable in accordance with the terms of each plan. EGOP member contributions are recognized as a liability when received and as a reduction of liabilities when paid out. Member contributions are considered to be the first funds spent on eligible claims.

C. Cash and Cash Equivalents

Cash and cash equivalents includes cash and short-term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received that cannot be immediately invested in securities, or that is needed for operations, is invested in either the State Pooled Investment Fund (SPIF) sponsored by the State of Tennessee and administered by the State Treasurer or a short-term, open-end mutual fund under the contractual arrangement for master custody services and has been invested in State Street Government Money Market Fund. The SPIF investments are valued at amortized cost. Investments not in SPIF are stated at fair value.

D. Methods Used to Value Investments

Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price. Investment income consists of 1) realized and unrealized appreciation (depreciation) in the fair value of investments, and 2) interest and dividend income. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on a trade-date basis.

The fair value of assets held at June 30, 2019 represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Assets held are categorized for fair value measurement within the fair value hierarchy established by Generally Accepted Accounting Principles (GAAP). The hierarchy is based on the valuation inputs used to measure the fair value of the asset and give the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

- Level 1 Unadjusted quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date.

- Level 2 Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; assets or liabilities that have a bid-ask spread price in an inactive dealer market, brokered market and principal-to-principal market; and Level 1 assets or liabilities that are adjusted.

- Level 3 Valuations derived from valuation techniques in which significant inputs are unobservable.

Where inputs used in the measurement of fair value fall into different levels of the hierarchy, fair value of the instrument in its entirety is categorized based on the lowest level input that is significant to the valuation. This assessment requires professional judgement and as such management developed a fair value committee that worked in conjunction with our custodian and investment professionals to make these valuations. All assets held were valued individually and aggregated into classes so to be represented in the table below.

Short-term securities generally include investments in money market-type securities reported at cost plus accrued interest.

Equity and equity derivative securities classified in Level 1 are valued using last reported sales prices quoted in active markets that can be accessed at the measurement date.

Investments Measured at Fair Value
For Fiscal Year Ended June 30, 2019
Expressed in Thousands

Investments at Fair Value Level	**GAAP Hierarchy Level 1**
Exchange Traded Equity Funds	$187,488
TOTAL INVESTMENTS AT FAIR VALUE	187,488
Cash and Cash Equivalents	30,273
Investment Income Receivable	189
Other Receivable	1,526
TOTAL ASSETS	$219,476

NOTE 2

Deposits and Investments

In accordance with State statute, the Board of Trustees shall cause the amount on deposit in the OPEB Trust to be invested in any instrument or investment vehicle that the board deems reasonable and appropriate to achieve the objectives of the trust. The statutes also require the board establish an investment policy for the trust fund. The board has authorized assets of the trust fund to be invested in instruments, obligations, securities or other properties that constitute a legal investment for assets of the Tennessee Consolidated Retirement System (TCRS). State statute authorizes the TCRS to invest in bonds, debentures, preferred stock and common stock, real estate and in other good and solvent securities subject to the approval of the Board of Trustees. In addition, the assets of the OPEB Trust may be pooled for investment purposes with the assets of the TCRS or any other assets under the custody of the State Treasurer. The authority for investing the assets of the OPEB Trust is vested in its Board of Trustees and the responsibility for implementing the investment policy established by the Board is delegated to the State Treasurer.

The OPEB Trust does not maintain its own bank accounts but utilizes the SPIF for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in U.S. Direct Obligations, U.S. Agency Securities, U.S. Instrumentality Securities, repurchase or reverse repurchase agreements, collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances and securities lending agreements. Investments in derivative type securities and investments of high risk are prohibited. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented in the State Pooled Investment Fund Report. The SPIF annual report can be found at:
https://treasury.tn.gov/Investments/Investment-Management/Investments-at-a-Glance

Custodial credit risk
Custodial Credit Risk for deposits is the risk that in the event of a bank failure, the OPEB Trust deposits may not be returned to OPEB Trust. The OPEB Trust does not have an explicit policy with regards to custodial credit risk for deposits. As of June 30, 2019, the OPEB Trust had uninsured and uncollateralized cash deposits of $30,029 held by our master custodian, State Street Bank, in State Street's name. These deposits were used for investments pending settlement.

NOTE 3
OPEB Plan

Plan description
Employees of the state and of certain discretely presented component units, who were hired prior to July 1, 2015 and choose coverage, are provided with pre-65 retiree health insurance benefits through the closed Employee Group OPEB Plan (EGOP) administered by the State of Tennessee through cooperation of the appointed Trustees, the Department of Finance and Administration, and the State Treasurer. This plan is considered to be a single-employer defined benefit plan that is used to provide postemployment benefits other than pensions. This plan is closed to the employees of all participating employers that were hired on or after July 1, 2015. The component units participating in the plan are the Tennessee Student Assistance Corporation, the Tennessee Housing Development Agency, the University of Tennessee and the 46 institutions that make up the State University and Community College System. The OPEB Trust was established in January of 2019 and currently serves the purpose of pre-funding the accrued OPEB liabilities of the EGOP.

Management of the EGOP is vested in the insurance committee established in TCA 8-27-201. The trustees of the OPEB Trust were established in TCA 8-27-801 to be the four trustees designated in TCA 8-27-205(f). These designated individuals include the Commissioner of Finance and Administration, the Chair of the Finance, Ways and Means Committee of the Senate, the Chair of the Finance, Ways and Means Committee of the House of Representatives and the chair of the consolidated retirement board. The trustees are responsible for the establishment of any trust for the purpose of pre-funding OPEB as well as for the adoption of an investment policy authorizing how assets in the OPEB Trust may be invested. The investment of OPEB Trust assets is administered by the State Treasurer.

Plan membership
At June 30, 2018 the EGOP membership consisted of the following:

Inactive employees currently receiving benefit payments	7,844
Inactive employees entitled to but not yet receiving benefit payments	120
Active employees eligible for benefit payments	48,362
	56,326

Benefits provided
The EGOP is offered to provide health insurance coverage to eligible retired and disabled participants and is the only postemployment benefit provided to eligible pre-65 participants. Benefits are established and amended by the insurance committee. All retirees and disabled employees of the primary government and certain component units, who are eligible and choose coverage, and who have not yet reached the age of 65 are enrolled in this plan. All members have the option of choosing between the premier preferred provider organization (PPO) plan, standard PPO plan or the wellness healthsavings consumer-driven health plan (CDHP) for healthcare benefits. Retired plan members receive the same plan benefits as active employees, at a blended premium rate that considers the cost of active and retired employees. This creates an implicit subsidy for the retirees. The retirees' cost is then directly subsidized, by the employers, 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.

Contributions
Annually, the insurance committee establishes the required contributions to the plan by member employees through the premiums established that are calculated to approximate claims cost for the year. Pre-age 65 retired members of the EGOP pay a premium based on a blended rate that considers the cost of active and retired employees as well as their individual years of service. These payments are made to the OPEB Trust. Employers currently contribute to the OPEB Trust based on an actuarially determined contribution (ADC) rate calculated in a manner to meet the funding goals of the state. During the fiscal year ended June 30, 2019, plan employers contributed $301.5 million to the OPEB Trust. Retiree premium payments to the OPEB Trust during the reporting period were $22.4 million. The state general assembly has the authority to change the contribution requirements of the employers participating in the EGOP.

Investments
TCA 8-27-802 establishes the responsibility of the trustees to adopt written investment policies authorizing how assets in the OPEB Trust may be invested and reinvested by the State Treasurer. The treasurer may invest trust assets in any security or investment in which the Tennessee Consolidated Retirement System (TCRS) is permitted to invest, provided that investments by the OPEB Trust shall be governed by the investment policies and guidelines adopted by the trustees. Any changes to the investment policy will be the responsibility of the established trustees. The OPEB Trust investment policy target asset allocation and allocation range for each major asset class is summarized in the following table:

Asset Class	Allocation Range Minimum	Maximum	Target Allocation
Equities	25%	80%	53%
Fixed income and short-term securities	20%	50%	25%
Real estate	0%	20%	10%
Private equity and strategic lending	0%	20%	7%
Cash and cash equivalents	0%	25%	5%
			100%

The best-estimates of geometric real rates of return for each major asset class included in the target asset allocation as of June 30, 2019 are summarized in the following table:

Asset Class	Long-term Expected Real Rate of Return
U.S. equity	5.69%
Private equity and strategic lending	5.79%
U.S. fixed income	2.01%
Real estate	4.32%
Short-term securities	0.00%

Rate of return

For the year ended June 30, 2019, the annual money-weighted rate of return on investments was 6 percent. The money-weighted rate of return expresses investment performance, net of OPEB plan investment expense, adjusted for the changing amounts actually invested.

Net OPEB liability

The components of the net OPEB liability for the EGOP at June 30, 2019, were as follows (expressed in thousands):

Total OPEB liability	$ 1,209,386
Plan fiduciary net position	(213,702)
Net OPEB liability	$ 995,684
Plan fiduciary net position as a percentage of the total OPEB liability	17.67%

Actuarial assumptions

The total OPEB liability was determined by an actuarial valuation with a valuation date of June 30, 2018, using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified. Standard actuarial techniques were used to roll that liability to the end of the reporting period:

Inflation	2.25 percent
Investment rate of return	6 percent
Healthcare cost trend rate	6.75% for 2019, decreasing annually to an ultimate rate of 3.91% for 2050 and later years.
Retirees' share of benefit-related costs	Members are required to make monthly contributions in order to maintain their coverage. For the purpose of this valuation a weighted average has been used with weights derived from the current distribution of members among plans offered.

Unless noted otherwise, the actuarial demographic assumptions used in the June 30, 2018, valuations were the same as those employed in the July 1, 2017 Pension Actuarial Valuation of the Tennessee Consolidated Retirement System (TCRS). These assumptions were developed by TCRS based on the results of an actuarial experience study for the period July 1, 2012 - June 30, 2016. The demographic assumptions were adjusted to more closely reflect actual and expected future experience. Mortality tables are used to measure the probabilities of participants dying before and after retirement. The mortality rates employed in this valuation are taken from the RP-2014 Healthy Participant Mortality Table for pre-retirement mortality and the RP-2014 Mortality Table for Annuitants for non-disabled post-retirement mortality, with mortality improvement projected to all future years using Scale MP-2016. Post-retirement tables are Blue Collar and adjusted with a 2% load for males and a -3% load for females. Mortality rates for impaired lives are the same as those used by TCRS and are taken from a gender distinct table published in the IRS Ruling 96-7 for disabled lives with a 10% load.

The long-term expected rate of return of 6 percent on OPEB Trust investments was established by consultation with the plan actuaries and TCRS investment staff.

Discount rate

The discount rate used to measure the total OPEB liability was 6%. This represents an increase of 2.38% over the 3.62% used in the June 30, 2018 valuation for employer reporting for fiscal year ended June 30, 2019. The projection of cash flows used to determine the single discount rate assumed that employer contributions will be made at rates equal to the ADC rates pursuant to an actuarial valuation in accordance with the state's funding goals. Inactive plan members are assumed to contribute their share of the premium rate for the coverage option in which they are enrolled. Based on those assumptions, the OPEB Trust fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on OPEB Trust investments was applied to all periods of projected benefit payments to determine the total OPEB liability. The change in discount rate used is due to the transition of the EGOP from a pay-as-you-go arrangement to a prefunding arrangement through a qualified trust. The measurement period for employer reporting is the fiscal year prior to the current reporting period.

Sensitivity of net OPEB liability to changes in the discount rate

The following presents the net OPEB liability of the OPEB Trust, as well as what the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current discount rate.

	1% Decrease (5%)	Discount Rate (6%)	1% Increase (7%)
Net OPEB Liability	$ 1,075,791	$ 995,684	$ 921,138

Sensitivity of net OPEB liability to changes in the healthcare cost trend rate

The following presents the net OPEB liability of the OPEB Trust, as well as what the net OPEB liability would be if it were calculated using a healthcare cost trend rate that is 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rate.

	1% Decrease (5.75% decreasing to 2.91%)	Healthcare Cost Trend Rates (6.75% decreasing to 3.91%)	1% Increase (7.75% decreasing to 4.91%)
Net OPEB Liability	$ 879,885	$ 995,684	$ 1,129,707

Required Supplementary Information
A. Schedule of Changes in the Plan Net OPEB Liability and Related Ratios

State of Tennessee
Postemployment Benefits Trust
Schedule of Changes in the EGOP's Net OPEB Liability and Related Ratios
(expressed in thousands)

	2019
Total OPEB liability	
Service cost	$65,979
Interest	50,851
Changes in benefit terms	-
Differences between actual and expected experience	-
Changes of assumptions	(199,731)
Benefit payments, including refunds of employee contributions	(92,951)
Net change in total pension liability	($175,852)
Total OPEB liability-beginning	1,385,238
Total OPEB liability-ending (a)	$1,209,386
Plan fiduciary net position	
Contributions-employer	$301,486
Net investment income	5,167
Benefit payments, including refunds of employee contributions	(92,951)
Administrative expense	-
Net change in plan fiduciary net position	213,702
Plan fiduciary net position-beginning	-
Plan fiduciary net position-ending (b)	$213,702
Net OPEB liability-ending (a)-(b)	$995,684
Plan fiduciary net position as a percentage of total OPEB liability	17.67%

This schedule is intended to display ten years of information. Additional years will be displayed as they become available.

The amount noted for change in assumptions is primarily due to the change in discount rate used to roll the total liability forward from the June 30, 2018 actuarial date to the current fiscal year end.

Required Supplementary Information
B. Schedule of Contributions

Schedule of Employer Contributions to the State of Tennessee Postemployment Benefits Trust (expressed in thousands)

	2019
Actuarially determined contribution	$135,810
Contributions in relation to the actuarially determined contribution	301,486
Contribution deficiency (excess)	($165,676)

This schedule is intended to display ten years of information. Additional years will be displayed as they become available.

Notes to Schedule of Contributions

Valuation Date: Actuarially determined contribution rates are calculated based on valuations as of June 30 two years prior to the fiscal year, in which the ADC is calculated.

Methods and Assumptions Used to Determine Contribution Rates:

Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed (not to exceed 20 years)
Remaining amortization period	20 years
Asset valuation	Market value
Inflation	2.25 percent
Salary increases	Graded salary ranges from 3.44 to 8.72 percent based on age, including inflation.
Investment rate of return	6 percent
Retirement age	Pattern of retirement determined by experience study
Mortality	Mortality tables used in the July 1, 2017 actuarial valuation of the Tennessee Consolidated Retirement System. They are taken from the RP-2014 Healthy Participant Mortality Tables with adjustments and are generally projected using Society of Actuaries scale MP-2016.

Required Supplementary Information
C. Schedule of Investment Returns

Schedule of Investment Returns State of Tennessee Postemployment Benefits Trust	
	2019
Annual money-weighted rate of return, net of investment expense	6%
This schedule is intended to display ten years of information. Additional years will be displayed as they become available.	

Justin P. Wilson
Comptroller

Jason E. Mumpower
Deputy Comptroller

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 Lee, Governor
Members of the General Assembly
Members of the Board of Trustees of the
Postemployment Benefits Trust

We have audited the financial statements of the State of Tennessee Postemployment Benefits Trust, a fiduciary fund of the State of Tennessee, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the trust's basic financial statements, and have issued our report thereon dated July 14, 2020. 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 trust's 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 trust's internal control. Accordingly, we do not express an opinion on the effectiveness of the trust'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, 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.

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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 trust's 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
Division of State Audit
July 14, 2020