

SHELBY COUNTY OPEB TRUST

ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2019



SHELBY COUNTY OPEB TRUST
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INDEPENDENT AUDITORS' REPORT

To the Chairman and Members
Shelby County Board of Commissioners and
the Mayor of Shelby County, Tennessee
Memphis, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the Shelby County OPEB Trust as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Shelby County OPEB 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 opinions 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 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 opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Shelby County OPEB Trust, as of June 30, 2019, and the changes in financial position and cash flows 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 Shelby County OPEB Trust and do not purport to, and do not, present fairly the financial position of Shelby County, Tennessee as of June 30, 2019, the changes in its financial position, or, where applicable, its cash flows for the year 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 Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and the schedules of changes in the net OPEB liability and related ratios, employer contributions, and annual money-weighted rate of return be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board, who 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 December 23, 2019, on our consideration of the Shelby County OPEB Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 *Government Auditing Standards* in considering the Shelby County OPEB Trust's internal control over financial reporting and compliance.

Watkins Mikunall, PLLC *Banks, Jolley, White & Co.*

Memphis, Tennessee
December 23, 2019

SHELBY COUNTY OPEB TRUST

Management's Discussion and Analysis
June 30, 2019

Management's Discussion and Analysis

The management of the Shelby County OPEB Trust (Trust) presents this narrative overview and analysis of the financial activities of the Trust for the fiscal year ended June 30, 2019. This information should be considered in conjunction with the information in the financial statements, the Notes to Financial Statements (Notes) and the Required Supplementary Information (RSI), which follow this section.

Accounting principles generally accepted in the United States of America for governmental entities are established by the Governmental Accounting Standards Board (GASB). This report uses the standards established by GASB's Statement No. 74 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. Effective with the June 30, 2017 report, Statement No. 74 superseded Statement No. 43 of the same title. Statement No. 74 did not change the reporting in the two primary financial statements, but it added requirements for additional and multi-year disclosures in the Notes and RSI. Readers are encouraged to review the Notes and RSI to better understand the financial and operational results of the Trust. This report also uses other authoritative literature known collectively within the accounting profession as "generally accepted accounting principles."

The Shelby County OPEB Trust

The Trust was established as of July 1, 2007 to receive contributions from plan participants and Shelby County Government for certain benefits provided to Shelby County Government employees after active employment ends (postemployment) and former employees receiving long-term disability benefits. Two types of benefits are provided by this Trust: health care coverage and life insurance. The Trust is managed by a five-member committee of Trustees, consisting of two designated members of the Shelby County Board of Commissioners and three designated administrators of Shelby County Government.

Financial statements of the Trust show the amounts received (additions) from the County as employer of the plan participants, amounts received from the participants and the amounts expended (deductions) for benefits and administrative expenses. The Trust itself has no obligation to provide funding for the benefits nor does it independently have the capacity to raise funds. Responsibility for determining the benefits and their funding rests with Shelby County Government.

Financial Highlights

The following financial highlights occurred during this fiscal year:

- Net position (fund balance) of the Trust increased by \$13,500,217 during FY 2019 to a total of \$273,471,591, an increase of 5.2% compared to the previous year's increase of 12.0%.
- The Trust had additions during the year of \$27.1 million and deductions for benefits and administrative expenses of \$13.6 million.
- Considering the reinvestment of interest, dividends, realized capital gains and the net change in the fair value of investments during the year, investments increased \$11.8 million, net of an increase in the cash balance. Total investments at year end were \$255.6 million.
- The latest actuarial valuation for the Trust showed that the "funded ratio" (the percent of actuarial accrued liability covered by net assets) increased from 96.7% to 107.4% as of June 30, 2019.

More details on these highlights and other information are in the remainder of this discussion and analysis.

Overview of the Financial Report

The Trust is classified as a “fiduciary fund” since the assets are held for the exclusive benefit of retired County employees. Financial reports are prepared using the economic resources measurement focus and the accrual basis of accounting. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date. The basic statements included in the financial report are described below.

Statement of Fiduciary Net Position. This statement presents information on the assets, liabilities and net position of the Trust at a point in time (the end of the fiscal year). Over time the changes in net position may serve as a useful indicator of the status of funding other postemployment benefits based on current benefits provided or planned for retired employees. Net position is classified as “net position restricted for postemployment benefits other than pensions.”

Statement of Changes in Fiduciary Net Position. This statement presents information on the additions and deductions to the Trust during the year being reported. Additions include employer contributions to the Trust, employee contributions, net investment income and any other additions that are available to support benefits and expenses. Deductions include the cost of benefits provided during the year and administrative expenses associated with the benefits and Trust administration.

Notes to Financial Statements (Notes). The Notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The recently issued GASB Statement No. 74, as previously mentioned, has required more information in the Notes. These Notes provide meaningful information for those reviewing the Trust financial statements. Readers desiring a better understanding of the Trust are encouraged to review the Notes.

Required Supplementary Information (RSI). The recently issued GASB Statement No. 74 has also required more information in the RSI. This section contains several schedules that provides useful information, some with data for multiple years. The new information can help determine the funding status of the Trust compared to previous years.

Financial Analysis and Discussion

Statement of Fiduciary Net Position.

Following is a summary of the Statement of Fiduciary Net Position as of June 30, 2018 and June 30, 2019:

	<u>June 30, 2018</u>	<u>June 30, 2019</u>	Increase <u>(Decrease)</u>
Investments	\$ 243,816,265	\$255,621,823	\$11,805,558
Cash and other assets	<u>17,063,250</u>	<u>18,906,993</u>	<u>1,843,743</u>
Total assets	260,879,515	274,528,816	13,649,301
Total liabilities	<u>908,141</u>	<u>1,057,225</u>	<u>149,084</u>
Net position restricted for postemployment benefits other than pensions	<u>\$259,971,374</u>	<u>\$273,471,591</u>	<u>\$13,500,217</u>

Assets of \$255,621,823 were invested at year end in various investments. Assets include cash and cash equivalents of \$18,870,793. Small amounts of accounts receivable and accrued revenue totaling \$36,200 existed at year end.

Liabilities at year end were \$1,057,225 and consist primarily of benefit claims and insurance premiums due to third-party administrators or insurance companies for benefits payable as of the reporting date. These liability balances vary from year to year primarily from an increase in claims payable of \$221,455. Plan liabilities do *not* include actuarial accrued liabilities for future benefits that are not due and payable at the reporting date.

Net position restricted for postemployment benefits other than pensions is the net difference between assets and liabilities and is the amount of the assets available to pay future benefits and administrative expenses. Based on current year amounts, the net position of \$273.5 million would cover the actual benefits and expenses payable for approximately eighteen years.

Statement of Changes in Fiduciary Net Position.

Following is a summary of the Statement of Changes in Fiduciary Net Position for fiscal years 2018 and 2019:

	FY 2018	FY 2019	Increase (Decrease)
Employer contributions	\$14,255,535	\$9,824,460	\$(4,431,075)
Employee/participant contributions	4,508,490	4,561,359	52,869
Other revenue	2,541,562	15,705	(2,525,857)
Net investment income (loss)	<u>20,554,526</u>	<u>12,677,098</u>	<u>(7,877,428)</u>
Total additions	<u>41,860,113</u>	<u>27,078,622</u>	<u>(14,781,491)</u>
Benefit expenses	13,388,064	12,948,338	(439,726)
Administrative expenses	<u>621,531</u>	<u>630,067</u>	<u>8,536</u>
Total expenses	<u>14,009,595</u>	<u>13,578,405</u>	<u>(431,190)</u>
Net increase in fiduciary net position	<u>\$27,850,518</u>	<u>\$13,500,217</u>	<u>\$(14,350,301)</u>

Employer contributions decreased by \$4.4 million, a 31.1% decrease. These contributions were from the fringe benefit charge based on salaries of active employees. The employer contribution rate was set at 5.61% of salary. Participants contributed \$4.6 million as their share of health and life premiums, an increase of 1.2% or \$53,000. The retirees' share of the cost increased for FY 2019. Net investment income was \$12.7 million, which was 38.3% lower than the \$20.6 million of income in FY 2018.

Deductions included \$13.0 million for benefit expenses, a 3.3% decrease. These expenses vary from year to year primarily as the result of large-dollar claims. Deductions also included \$630,068 for administrative costs of third-party administrators and certain other administrative expenses.

A significant factor for consideration and perhaps the major issue from GASB 74 (unchanged from GASB 43 and 45) is the employer's annual contribution to the Trust compared to the "actuarially determined contribution" (ADC). The ADC has two components. One component is the estimated amount of benefits and administrative expenses accrued each year based on employee services that year. The second component is the amortization of the "actuarially determined liability" (Net OPEB Liability) for OPEB benefits earned in previous years. The Net OPEB Liability is allocated to the ADC over a thirty-year period (beginning in FY 2008), as actuarially adjusted for assumptions about increases in the health care rate, the earnings rate on investments, the average age at which employees will retire, mortality rates, etc. The County's current year ADC was \$5.9 million; employer contributions in FY 2019 were \$9.8 million, 65.2% more than the calculated ADC. Since the ADC calculation for a fiscal year is not completed until several months into the year to which it relates, it is not practical to budget the exact ADC amount into the budget for a fiscal year. The County's goal and intent is to fully fund the ADC each year at the actuarially calculated percent of payroll for the last actuarial valuation available at the time the budget is prepared for an upcoming year, which resulted in funding at 3.73% of covered payroll during FY 2019.

Requests for Information

This financial report is designed to provide an overview of the Shelby County OPEB Trust. Questions concerning any of the information provided or requests for additional information should be addressed to Administrator of Finance, Shelby County Government 160 North Main Street, Suite 800, Memphis, Tennessee 38103.

SHELBY COUNTY OPEB TRUST
Statement of Fiduciary Net Position
June 30, 2019

Assets

Cash and cash equivalents		\$ 18,870,793
Investments		
Domestic Equity	112,604,200	
International equity	36,739,672	
Fixed income	40,830,493	
Global low-volatility equity	16,993,155	
Private real assets	5,488,969	
Alternative investments	23,580,781	
Master limited partnerships	<u>19,384,553</u>	
Total Investments		255,621,823
Accrued revenue		<u>36,200</u>
Total assets		<u>274,528,816</u>

Liabilities

Accounts payable and accrued liabilities		4,472
Benefits payable		70,608
Claims payable		<u>982,145</u>
Total liabilities		<u>1,057,225</u>

Net position restricted for postemployment benefits other than pensions		<u><u>\$ 273,471,591</u></u>
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SHELBY COUNTY OPEB TRUST
Statement of Changes in Fiduciary Net Position
For the Year Ended June 30, 2019

Additions

Contributions	
Employer	\$ 9,824,460
Plan members	4,561,359
Miscellaneous revenue	15,705
Total contributions	<u>14,401,524</u>
Investment income (expense)	
Interest income	772,496
Dividend income	4,814,031
Net realized gains & losses	4,642,558
Net change in fair value of investments	2,824,346
Total investment income	<u>13,053,431</u>
Less investment management expenses	<u>(376,333)</u>
Net investment income	<u>12,677,098</u>
Total additions	<u>27,078,622</u>

Deductions

Benefits	12,948,338
Administrative expense	630,067
Total deductions	<u>13,578,405</u>

Net increase **13,500,217**

**Net position restricted for postemployment
benefits other than pensions**

Beginning of year	<u>259,971,374</u>
End of year	<u><u>\$ 273,471,591</u></u>

SHELBY COUNTY OPEB TRUST

Notes to the Financial Statements
for the Year Ended June 30, 2019

Note 1 – Summary of significant accounting policies

Reporting entity

The Shelby County OPEB Trust (Trust) is a single-employer, defined benefits plan that covers retired and disabled employees of Shelby County Government. The Trust was established as of July 1, 2007. The Trust is included in the annual financial report of Shelby County Government as a fiduciary fund. The Trust provides postemployment benefits other than retirement benefits. Benefits provided are health insurance (including prescription drug coverage) and life insurance.

Basis of accounting

The Trust's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

Governmental accounting standards

The financial statements of the Trust have been prepared in accordance with *generally accepted accounting principles* (GAAP) followed in the United States of America. In the U.S., the Governmental Accounting Standards Board (GASB) is the established and recognized standard-setting body for governmental accounting and financial reporting. GASB Statement No. 74 was implemented beginning with the June 30, 2018 fiscal year; this Statement did not change the two primary financial statements but made significant changes to the Notes to Financial Statements and the Required Supplementary Information.

Deposits and investments

Cash and cash equivalents include cash on hand, demand deposits, savings accounts and short-term investments with maturities of three months or less at the time of purchase. The Trust uses the amortized cost basis as the value for all investments that mature within a year or less at the date of purchase.

Investments are reported at fair value. Investments in equity securities, corporate bonds and issues of U.S. Government and government-backed obligations are valued at the last reported sales price of the fiscal year end. International securities reflect current exchange rates in effect at fiscal year end. Investments in private investment companies consisting of interests in limited partnerships, hedge funds and private real estate limited liability companies are valued at estimated fair value as provided by the investment manager of the investee company. Interest income is recorded on the accrual basis, and dividends are recorded on the ex-dividend date. All distributions from mutual funds are classified as dividends, whether generated within the fund from interest, dividends or capital gains/losses. Purchases and sales of securities are recorded on a trade-date basis.

Receivables and payables

Plan member contributions are recognized in the period the contributions are due. Employer contributions are recognized when due, as the employer has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the terms of the plan; liabilities for health claims are recognized in the period when the related services are provided. Plan liabilities do not include actuarial accrued liabilities for benefits that are not due and payable at the reporting date.

Net position

The net position of the Trust is reported as "Net position restricted for postemployment benefits other than pensions."

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and net position. Estimates also affect the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period.

Note 2 – Plan description

The Plan is named the “Shelby County OPEB Trust” and is a single-employer, defined benefit OPEB plan for Shelby County Government.

Governance and management of the Trust

The Trust was established by a Trust Agreement effective July 1, 2007. The Agreement established a “Trustee Committee” comprised of five designated officials of Shelby County Government:

- Chairman of the Board of County Commissioners or another Commissioner designated by the Chairman
- Chairman of the Budget Committee of the Board of County Commissioners
- Director of the Division of Administration & Finance
- Administrator of the Department of Finance
- Investment Manager of the Shelby County Retirement System

Routine investment activities are handled by the Investment Manager of the County Retirement System. Significant investment transactions, policies, policy changes and other significant matters are approved by the full Trustee Committee. The Trust’s Investment Policy Statement includes policies on asset allocation, with target percentages for asset classes and minimum and maximum percentages for each category.

The health insurance and life insurance benefits are arranged by or coordinated through the Benefits Section of the Shelby County Human Resources Department and the Shelby County Retirement System staff. The sharing of the costs between the Trust and retirees is based on the similar sharing of costs by active employees.

Benefit eligibility provisions and rates are established or amended by the Shelby County Board of Commissioners as part of the approval of the County’s annual budget, including Trust contribution rates. The Trust has no financial obligations beyond the funds made available through Shelby County Government. Trust financial records are maintained by the County’s Finance Department. The Trust’s Annual Financial Report is prepared by the County’s Finance Department with significant assistance from the Investment Manager.

A member must be currently receiving a retirement benefit from the Shelby County Retirement System to be eligible for OPEB benefits, except for recipients of long-term disability benefits.

Other postemployment benefits provided by the Trust

The Trust provides two kinds of postemployment benefits: health insurance and life insurance. Health insurance is available for an individual or a family; life insurance is available only for the retired employee. Retirees under the age of 65 participate in the same health insurance program as active employees, which is self-insured by Shelby County Government. Retirees continuously employed from before April 1, 1986 until retirement and never covered by Medicare also participate in the self-insured plan. The self-insured health plan includes prescription drug coverage. Retirees age 65 and older and Medicare-eligible, as well as retirees hired prior to April 1, 1986 that are not eligible for Medicare Part A but are eligible for Part B, must use Medicare as their primary health insurance. These retirees are provided a Medicare Part D prescription drug plan through a Medicare Advantage plan. Life insurance is provided to retirees only (not to spouses or dependents) and is provided through a traditional term life insurance policy. Employees who entered deferred status on July 1, 2007 or later are never eligible for health or life insurance. The amount of life insurance, when provided, is equal to the last annual salary before retirement or termination. Employees hired July 1, 2007 or later are provided retiree health insurance only at age 65 or older and are provided no life insurance in retirement.

Plan membership

The Trust had the following membership as of June 30, 2019, the date of the latest actuarial valuation:

Inactive employees and beneficiaries	
currently receiving benefits	3,121
Inactive members entitled to but not receiving benefits	---
Active participants	5,053
Total	<u>8,174</u>

Plan members receiving health insurance under the County's self-insured plan pay a monthly premium based on benefits experience of the retiree group. Members under age 65 pay a monthly premium from \$151 to \$636 for single coverage and from \$321 to \$1,271 for family coverage. Member premiums for those 65 and older and eligible for Medicare or Medicare Part B are based on the Medicare Advantage insurance plan. Members with less than 7.5 years of service are eligible for coverage only at age 65 and pay 100% of the premium. For all other ages, the member premium represents from 30% (20+ years of service) to 50% (7.5 through 19 years of service) of the total premium cost per member. Premiums for single coverage range from \$36 to \$655 per month and from \$72 to \$1,310 for family coverage. For members hired prior to April 1, 1986 and not eligible for Medicare Part A, coverage is provided through the Medicare Advantage plan at a higher monthly premium for single and family members. Members contributed \$4,561,359 during the year for both health and life insurance. In FY 2019, the total contributions from retirees was 31.7% of total contributions with the other 68.3% provided by the County contribution to the Trust.

Plan members receiving life insurance under the Trust contribute an amount that is 30% of the composite (average) premium for both active and retired employees; an age-adjusted premium would be more than nine times higher. The Trust pays an age-adjusted premium for the retiree life insurance.

Shelby County Government provides an employer contribution to the Trust. The County contributes the actuarially determined contribution (ADC), or more, as a percent of payroll of active employees based on the latest available actuarial valuation at the time the budget is approved for a fiscal year. The FY 2019 contribution was 3.73% of covered payroll.

The cost of third-party administrators, actuarial reports, audits and similar costs incurred exclusively for the Trust are paid from resources of the Trust. Routine daily administrative costs of administering the benefit plans, accounting services and similar costs are absorbed by Shelby County Government.

The Trust has no legally required reserves.

Note 3 – Net OPEB liability and related information.

OPEB Trust liability as of June 30, 2019

Total liability of the OPEB Trust	\$254,539,310
OPEB Trust's fiduciary net position	<u>273,471,591</u>
Net OPEB Trust liability	<u>(\$ 18,932,283)</u>
OPEB Trust fiduciary net position as a percent of the total OPEB liability	107.44%

The net OPEB liability is being amortized by regular annual contributions at a level dollar amount over a 30-year period, with 18 years remaining, with the intent that the amortization period will decrease by one each subsequent year.

The OPEB Trust total liability, as shown above, was provided by the latest actuarial valuation as of June 30, 2019.

Significant assumptions and other inputs used to measure the total OPEB liability and the discount rate

- a. No significant changes in the current pattern of practice for benefits provided or contributions to the Trust are anticipated.
- b. Shelby County Government will continue to fund the actuarially calculated annual required contribution or ADC. Since the County's budget must be prepared and adopted before the actuarial calculations for a fiscal year can be performed, the actual funding rate is always two years delayed.
- c. The ADC includes funding for the current year expenditures plus amounts to increase the Trust's net position each year with the expectation that the Trust will be fully funded within the initial 30 years of its existence (with 18 years remaining).
- d. Discount rate: 5.25% per annum, net of investment expenses, compounded annually. This discount rate has been applied since the creation of the Trust. This rate was set as a conservative projection based on years of results for the Shelby County Retirement plan, and, intentionally, it has been unchanged. No changes to the discount rate are anticipated. The discount rate assumes that future cash flows will cover future benefit costs and provide funding so that the Trust will be fully funded by the end of the initial 30-year funding period.

- e. Actuarial method: Entry-age normal actuarial method.
- f. Asset valuation method: market value of assets. No significant change in the asset allocation of the Trust's investments is anticipated.
- g. Healthcare cost trend rates: (1) For retirees not covered by Medicare costs, rate increases are projected to decrease to 7.00% in FY 2019 and decrease annually to 4.75% by FY 2028. (2) For retirees covered by Medicare, their supplemental plans are projected to decrease to 5.25% in FY 2019 and decrease annually to 4.75% by FY 2022. (3) Employees hired before April 1, 1986 were not covered by Medicare; employees hired or re-hired on or after April 1, 1986 were required to be covered by Medicare. Over an extended time period, Trust medical costs should decrease as more retirees' Medicare plans cover more of the cost.
- h. With regard to the healthcare cost trend rate the net Trust liability (NOL) (in thousands) would increase / (decrease):
 - (1) A 1% increase in the trend rate would increase the NOL to \$1,679.
 - (2) A 1% decrease in the trend rate would decrease the NOL to (\$35,945).
- i. With regard to the discount rate used, the net OPEB Trust liability (in thousands) would increase/(decrease):
 - (1) A 1% increase in the discount rate would decrease the NOL to (\$46,915).
 - (2) A 1% decrease in the discount rate would increase the NOL to 14,934.
- j. Trust share of total cost of benefits provided: no change in the percent provided
- k. Salary increase, including wage inflation 2.75% to 5.25% range.
- l. Deaths after retirement: the actuarial study uses the RP-2014 Mortality Table with Blue Collar Adjustment and projected to 2020 with projection scale MP-2017, set forward two years for males and set forward three years for females. For those with disability retirement, the expected future deaths based on the table are 7-11% less than the actual number that occurred during the study period for service retirements and beneficiaries.
- m. Long-term investment rate of return, net of investment expense, including inflation: 5.25%

Note 4 – Funded status and funding progress

Actuarial valuations are prepared as of each fiscal year end. The funded status of the Trust is shown in the Required Supplementary Information. Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The ADC is an amount actuarially determined in accordance with the parameters of GASB Statement No. 74. The ADC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Note 5 – Deposits and investments

Cash and cash equivalent

Deposits at June 30, 2019, at fair value, consist of \$8,192,862 in demand deposits and \$10,677,931 of 91-day Treasury Bills.

Investments

All investments of \$255,621,823 are in various domestic and international mutual funds or limited partnerships, even though some may invest in foreign securities. On the statement of fiduciary net position, investments are presented by asset class to provide a more meaningful representation of the underlying investments.

The Trust is authorized to invest in the following, with policies on asset allocations shown when they exist:

- Bonds, notes or treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies.
- Certificates of deposit and other evidences of deposit at Tennessee or federally-chartered financial institutions. The institutions must be federally insured.
- Obligations of the United States or its agencies under a repurchase agreement.
- Prime commercial paper which is rated at least A2 and issued by a corporation having no record of default of obligations during ten (10) years preceding the investment.
- Prime banker's acceptances, which are eligible for purchase by the Federal Reserve System.
- Corporate bonds rated B3 or better by Moody's or B- or better by Standard and Poor's.
- Common or preferred shares of stock in any entity listed on the New York Stock Exchange, American Stock Exchange or NASDAQ Stock Exchange or in American Depositary Receipts (ADRs). The total market value of ADRs and common or preferred shares of stock, calculated on a monthly basis, shall not exceed 70% of the total market value of the Trust.
- Covered call and put options on individual stocks or indexes, with the prior approval of the Trustees.
- Financial futures contracts on a limited basis for bona fide hedging purposes only with prior approval of the Trustees.
- Real estate, including interests in real estate investment trusts, provided that the total real estate investments of the Trust shall not exceed five percent (5%) of the total value of the Trust.
- International equities, provided that the total international investments, excluding ADRs, shall not exceed thirty percent (30%) of the total value of the Trust.
- Co-mingled funds, including registered mutual funds and interests in collective trusts.
- Other investments, as approved individually by the Trustees, including securities offered through private placement memoranda.

Investment policies may be revised by the OPEB Trustee Committee. There have been no changes to the investment policy since the creation of the Trust.

Following are the individual investments as of June 30, 2019 for which each investment is equal to 5% or more of the Trust's net position:

Amount	% of Net Position	Investment
\$ 13,709,696	5.01%	Vanguard Developed Markets Index
14,344,535	5.25%	Credit Suisse Floating Rate High Income
16,993,155	6.21%	Acadian All-Country Managed Volatility Equity
18,793,849	6.87%	Lazard Emerging Markets Total Return Debt
19,518,889	7.14%	DFA U.S. Small Cap
23,580,781	8.62%	Ironwood Partners - International Ltd.
27,412,591	10.02%	Carillon Eagle Mid Cap Growth
52,731,293	19.28%	Vanguard Institutional Index (S&P 500)

Money-weighted rate of return

The annual money-weighted rate of return on the Trust investments in FY 2019 was 4.93%, net of the Trust's investment expenses. The average rate of return for the last ten years is 8.36%. These rates of return express investment performance, net of Trust investment expenses, adjusted for the changing amounts actually invested.

Investment Risks

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment or deposit. Duration (period of time to maturity or redemption) is the primary measure of the sensitivity of investments to this risk; the longer the duration the greater its sensitivity to changes in interest rates. The Trust limits its exposure to interest rate risk by investing in mutual funds that diversify their investments by security type and institution.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Trust controls risk by investing in mutual funds that diversify their credit risk by investing in a combination of bonds.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the future fair market value of the investment. To manage this risk, no investment manager or mutual fund should have exposure to any one currency exceeding the following:

<u>Currency</u>	<u>Maximum Exposure</u>
Euro	70%
Japanese Yen	50%
British Sterling	40%
Other (excluding U.S. dollar)	25%

Custodial credit risk for deposits and investments is the risk that in the event of a financial institution's failure, the Trust would be unable to recover from the financial institution the trust's deposits, investments or collateralized securities. Deposits and investments are exposed to custodial credit risk if they are not insured, unregistered or not in the name of the Trust, or not collateralized. The Trust's cash deposits may be covered by federal depository insurance ("FDIC") or by collateral held in a multiple financial institution collateral pool administered by the State. The FDIC insures the first \$250,000 of the Trust interest bearing deposits at each financial institution. Deposit balances over \$250,000 are insured by the collateral pool for those participating financial institutions. At June 30, 2019 and 2018, deposits of \$18,620,793 and \$16,777,998 were uncollateralized, respectively.

Note 6 – Fair Value Measurement

Generally accepted accounting principles establish a framework for measuring fair value, which provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3).

The three levels of the fair value hierarchy are described below:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; and
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used during the current fiscal year.

For the Trust, level 1 securities are valued using prices quoted in active markets for those securities. Level 2 securities are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Level 3 securities are valued using unobservable inputs (i.e. extrapolated data, proprietary models, indicative quotes, and estimated net asset value) as provided by the investment manager of the investee company.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Trust believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the Trust's assets at fair value as of June 30, 2019.

	Assets at Fair Value as of June 30, 2019			
	Level 1	Level 2	Level 3	Total
Equities				
Communication services	\$ 1,145,417	\$ -	\$ -	\$ 1,145,417
Consumer discretionary	1,052,568	-	-	1,052,568
Consumer staples	1,366,475	-	-	1,366,475
Energy	906,041	-	-	906,041
Financials	2,255,719	-	-	2,255,719
Health Care	1,423,791	-	-	1,423,791
Industrial	2,628,558	-	-	2,628,558
Information technology	968,401	-	-	968,401
Materials	1,099,270	-	-	1,099,270
Real estate	399,152	-	-	399,152
Utilities	408,990	-	-	408,990
Miscellaneous	-	66,440,989	86,241,656	152,682,645
Total equities	13,654,382	66,440,989	86,241,656	166,337,027
Fixed Income				
Corporate bond	-	8,302,315	14,344,534	22,646,849
Government bond	-	-	11,260,321	11,260,321
Funds - other fixed income	-	-	6,923,323	6,923,323
Total investment funds	-	8,302,315	32,528,178	40,830,493
Alternative investments	-	-	23,580,781	23,580,781
Real estate	-	-	5,488,969	5,488,969
Master limited partnerships	19,384,553	-	-	19,384,553
Total investments measured at fair value	\$ 33,038,935	\$ 74,743,304	\$ 147,839,584	\$ 255,621,823

Note 7 – Additional Information about Investments

The actuarial demographic assumptions used in the June 30, 2019 valuation were based on the results of an actuarial experience study for the period July 1, 2012 through June 30, 2017. The actuarial economic assumptions used in the June 30, 2019 valuation were based on the results of an Economic Experience Investigation as of June 30, 2015 with the assumed investment Rate of return reduced to 5.25% by the Retirement board of Trustees on September 13, 2016. This information is regarding the actuarial assumptions and other inputs used to measure the Total OPEB Liability.

The actuarial assumptions (e.g., initial per capita costs, health care cost trends, rate of plan participation, rates of plan election, etc.) used in the June 30, 2019 valuation were based on a review of recent plan experience concurrently with such valuation.

Several factors should be considered in evaluating the long-term rate of return assumption, including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) are developed by the investment consultant for each major asset class. These ranges should be combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation. The capital market assumptions developed by the investment consultant may cover a shorter investment horizon and may not be useful in setting the long-term rate of return for funding OPEB plans, which are likely to cover a longer timeframe. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

The target asset allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table

Asset Class	Target Asset Allocation	Expected Return	Expected Standard Deviation
Domestic Equity	14.1%	6.25%	17.00%
International Equity	10.4%	6.45%	18.70%
Low Volatility Equity	8.2%	6.45%	13.40%
Private Equity	6.6%	8.70%	27.50%
Core Fixed Income	6.7%	3.25%	5.00%
High Yield	1.0%	5.00%	10.00%
EMD Hard Currency	6.4%	5.50%	10.00%
Global Fixed Income	5.1%	2.35%	3.90%
Credit Opportunities	6.4%	6.20%	13.40%
Absolute Return	16.0%	5.85%	6.50%
Private Real Estate	1.0%	5.55%	14.00%
Private Real Asset	8.0%	6.80%	15.00%
MLPs	10.0%	9.00%	17.00%
Cash	0.0%	1.55%	1.25%

In preparing the actuarial report as of June 30, 2019 the actuary noted the following:

In accepting the long-term expected return for the Plan, the actuary performed a high-level review of the information provided by the Plan. The actuary's review indicates the long-term expected rate of return assumption of 5.25% is reasonable.

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of the investment. The Trust's exposure to foreign currency risk in U.S. Dollars as of June 30, 2019, is as follows:

<u>Currency</u>	<u>Equities</u>	<u>Other Fixed Income</u>	<u>Global low-volatility Equity</u>	<u>Total</u>
Australian dollar	\$ 166,705			\$ 166,705
Brazilian real	-			-
British sterling pound	2,730,890			2,730,890
Canadian dollar	753,619			753,619
Colombian peso	-			-
Danish krone	260,237			260,237
Euro	4,079,382			4,079,382
Indonesian rupiah	-			-
Japanese yen	1,828,232			1,828,232
Malaysian ringgit	-			-
Mexican peso	-			-
New Israeli shekel	166,100			166,100
Norwegian krone	327,537			327,537
Polish zloty	-			-
Singapore dollar	368,227			368,227
South Africa rand	-			-
Swedish krona	613,580			613,580
Swiss franc	665,950			665,950
Total securities subject to foreign currency risk	11,960,459	-		11,960,459
International portfolio in U.S. dollars	24,779,213	5,139,467	16,993,155	46,911,835
Total international securities	\$ 36,739,672	\$ 5,139,467	\$ 16,993,155	\$ 58,872,294

SHELBY COUNTY OPEB TRUST
Required Supplementary Information
for the Year Ended June 30, 2019

**SCHEDULE OF CHANGES IN THE
NET OPEB LIABILITY AND RELATED RATIOS**
Last 6 Fiscal Years

	2019	2018	2017	2016	2015	2014
Total OPEB liability						
Service cost	\$4,571,000	\$4,887,000	\$5,409,000			
Interest on liability	13,777,000	14,285,000	15,541,000			
Difference between expected & actual and experience	(2,655,000)	7,364,000	(10,467,000)			
Benefit payments	(12,948,000)	(13,388,000)	(14,865,000)			
Changes in assumptions and other inputs	(17,014,000)	(23,135,644)	(20,277,857)			
					Detailed data not available for 2013-2016	
					Comparative data for earlier years not available	
Net change in total OPEB Liability	(14,269,000)	(9,987,644)	(24,659,857)	3,758,713	(12,994,435)	(77,089,666)
Total OPEB liability:						
Beginning	<u>268,805,304</u>	<u>278,792,948</u>	<u>303,452,805</u>	<u>299,694,092</u>	<u>312,688,527</u>	<u>389,778,193</u>
Ending (a)	<u>254,539,310</u>	<u>268,805,304</u>	<u>278,792,948</u>	<u>303,452,805</u>	<u>299,694,092</u>	<u>312,688,527</u>
Plan fiduciary net position:						
Contributions-employer	9,824,460	14,370,801	15,873,291	21,265,925	31,445,399	36,731,249
Contributions-retirees	4,561,359	4,393,224	6,310,326	5,029,246	4,984,144	5,248,569
Net investment income	12,677,098	20,554,527	26,639,833	(7,926,742)	1,377,274	21,219,220
Miscellaneous revenue	15,705	2,541,562	22,231	57,808	-	59,500
Benefit payments	(12,948,338)	(13,388,064)	(14,865,282)	(16,948,963)	(17,094,301)	(18,630,198)
Administrative expense	(630,067)	(621,531)	(536,864)	(657,080)	(450,148)	(484,663)
Net change in plan fiduciary net position	13,500,217	27,850,519	33,443,535	820,194	20,262,368	44,140,677
Plan fiduciary net position:						
Beginning	<u>259,971,374</u>	<u>232,120,856</u>	<u>198,677,321</u>	<u>197,857,127</u>	<u>177,594,759</u>	<u>133,454,082</u>
Ending (b)	<u>273,471,591</u>	<u>259,971,375</u>	<u>232,120,856</u>	<u>198,677,321</u>	<u>197,857,127</u>	<u>177,594,759</u>
Net OPEB liability – ending (a)-(b)	(18,932,283)	8,833,929	46,672,092	104,775,484	101,836,965	135,093,768
Plan fiduciary net position as a % of total OPEB liability	107.44%	96.71%	83.26%	65.47%	66.02%	56.80%
Covered payroll	263,235,112	264,317,000	255,925,000	254,988,000	253,536,000	239,752,000
County's net OPEB liability as a % of covered payroll	-7.19%	3.34%	18.24%	41.09%	40.17%	56.35%

Notes to this schedule:

1. Actuarial data was available for all data only for FY 2017 through FY 2019 as shown above.
2. Actuarial data was available for FY 2016 only for the Total OPEB ending liability, Plan fiduciary net position, Net OPEB liability, Net position as a % of total OPEB liability, Covered payroll and net OPEB as a % of covered payroll.
3. No actuarial data was available for FY 2015, FY 2014 and FY 2013. The above data was provided from prior years' financial report to provide more comparative data when such data was available.
4. There have been no changes to the benefit terms during the life of the Trust.
5. Changes were made in FY 2019 to the assumed initial per capita health care costs, rates of health care inflation used to project the per capita costs, and health care plan election rates based on recent experience and current expectations.

SHELBY COUNTY OPEB TRUST
Required Supplementary Information
for the Year Ended June 30, 2019

SCHEDULE OF SHELBY COUNTY CONTRIBUTIONS
Last 6 Fiscal Years

	2019	2018	2017	2016	2015	2014
Actuarially determined Contribution	5948000	9,129,451	13,717,466	12,984,462	15,810,652	29,261,919
Contributions in relation to the Actuarially determined contribution	9824000	14,370,801	15,873,291	21,265,925	31,445,399	36,731,249
Contribution deficiency (excess)	(3,876,000)	(5,241,350)	(2,155,825)	(8,281,463)	(15,634,747)	(7,469,330)
Covered payroll	263235000	264,317,000	255,925,000	254,988,000	253,536,000	239,752,000
Contributions as a % of covered payroll	3.73%	5.44%	6.20%	8.34%	12.40%	15.32%

Only six years of information is available from the actuarial valuations. Prior years are unavailable.

**SCHEDULE OF ANNUAL MONEY-WEIGHTED RATE OF RETURN
ON OPEB TRUST INVESTMENTS**
Last 10 Fiscal Years (in %)

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Annual money rate of return, net of investment expenses	4.93%	8.99%	13.42%	-4.11%	0.89%	15.44%	12.35%	-2.43%	23.68%	13.67%

Notes to Required Supplementary Information

The Actuarially Determined Contribution rates, as a percentage of payroll, used to determine the Actuarially Determined Contribution amounts in the Schedule of Shelby County Contributions are calculated as of the prior Valuation Date. The following actuarial methods and assumptions (from the June 30, 2018 actuarial valuation) were used to determine contribution rates reported in that schedule for the year ending June 30, 2019.

Actuarial Valuation, Method and Assumptions

Valuation date	June 30, 2019
Actuarial cost method	Entry Age normal
Amortization method	Level Dollar Closed
Remaining amortization period	18 years
Asset valuation method	Market value of assets
Actuarial assumptions:	
Investment Rate of Return*	5.25%
Projected salary increases*	2.75% - 5.25%
*Includes inflation at	3.00%

	Pre Medicare	Medicare
Healthcare cost trend rate	7.00	5.25
Ultimate trend rate	4.75	4.75
Year of Ultimate trend rate	2028	2022

Note 1: The Trust was established as of July 1, 2007.

Note 2: Actuarial valuations are performed as of the close of a fiscal year to determine the employer's ADC for the following fiscal year. Since budgets and appropriations by the County's legislative body must be completed before the beginning of each fiscal year, the County's annual OPEB contribution is budgeted at the ADC as a percent of payroll from the latest actuarial valuation available at the time the budget is prepared. From fiscal year 2012 to date, the County has contributed at least 100% of the ADC being used for the year; continuing this funding level is the most significant factor affecting the trends shown above.

**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**

To the Chairman and Members
Shelby County Board of Commissioners and
the Mayor of Shelby County, Tennessee
Memphis, Tennessee

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Shelby County OPEB Trust, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the Shelby County OPEB Trust's basic financial statements, and have issued our report thereon dated December 23, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Shelby County OPEB 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Shelby County OPEB Trust's internal control. Accordingly, we do not express an opinion on the effectiveness of the Shelby County OPEB 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.

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 Shelby County OPEB Trust's financial statements are free from material misstatement, we performed tests of its 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 *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.

Watkins Mikusall, PLLC Banks, Jolley, White & Co.

Memphis, Tennessee
December 23, 2019