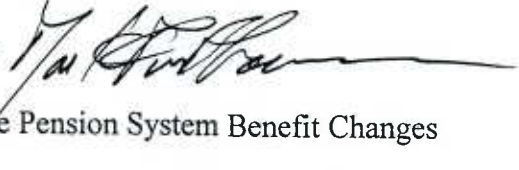




Inter-Departmental Communication

DATE: November 30, 1998

TO: Judy Swope, Chair, and Members of the Finance and Administration Committee

FROM: Mark Funkhouser, City Auditor 

SUBJECT: Review of Information on Police Pension System Benefit Changes

On Monday, November 23, 1998, you requested that the City Auditor's Office review and comment on the information provided by the attorney for the Police Retirement Board concerning proposed changes in retirement system benefits.

CONCLUSIONS

The information provided on the costs of the proposed benefit changes is inadequate to allow the Finance and Administration Committee to properly evaluate the impact of the changes on city funding and the actuarial soundness of the system's funding. The board attorney's assurances that these changes have no impact on city contributions is based on contribution rates already acknowledged to exceed actuarial requirements. Handouts showing the actuarial costs of the proposed changes provide only percentages, but dollar amounts would be more useful for considering the impact.

Our estimates place the additional cost of the proposed changes at more than \$300,000 annually, which virtually eliminates the excess of city contributions over actuarial requirements and reduces the likelihood that the city will be able to reduce future contributions. In fact, any future reductions in employee contributions or investment returns could force the city to increase its annual contributions in order to fulfill its fiduciary responsibilities.

WORK PERFORMED

In response to your request, we reviewed the information provided by the attorney for the Police Retirement Board, our special report, *Police Retirement Funds*, the Police Retirement Board's 1998 annual report, and the Police Retirement System's *Report on the Actuarial Valuation for the Plan Year Ending April 30, 1998*. We do not make or imply any judgement on the propriety of the proposed changes to the police retirement systems. Instead, using the information provided, we have calculated the dollar amount of the proposed changes and its impact on the excess between current city contributions and required contribution amounts.

ANALYSIS

Dollar Costs Should Be Provided

The attorney for the Police Retirement Board provided two letters to the Finance and Administration Chair, dated October 29th, and November 11th, summarizing the legislative changes and the resulting text changes to the state statutes. During the November 23rd committee meeting, the retirement board attorney and the board chairman distributed a handout summarizing the impact of these changes on the actuarial calculation of benefit costs. However, the information provided was in the form of percentages of covered payroll, based on assets as of August 31, 1998. Providing the information in this form obscures the actual dollar impact of the proposed changes, making it difficult for the committee to be aware of the fiscal impact of the changes under consideration. Reporting the impact in dollars would have provided the committee with a clearer sense of what these changes would actually cost.

Furthermore, the October 29th letter states that there are no costs to the proposed changes, implying that the changes in benefits are not subject to the Hancock Amendment. Based on information provided by the Law Department during preparation of our special report, it is still our conclusion that the Hancock Amendment controls the level of benefits required of the city. The determination of what new benefits are appropriate may, in the final analysis, be the state's responsibility, although the city may choose to provide additional funding to provide the benefits, or choose to challenge the new benefits. We believe it is important to recognize that the Hancock Amendment applies to these decisions. Being provided information in a straightforward dollar-impact form for any new benefit or any benefit change would allow the City Council to concentrate on the policy issues involved.

To fully understand the fiscal impact of the proposed changes, the committee needs information on the actual dollar cost and the actual dollar and percentage changes in excess city contributions over actuarial requirements. All of this information is necessary for the committee to adequately consider the proposed changes.

The estimated costs are significant. To estimate the dollar impact of the proposed changes on the Police Retirement System, we used the total covered payroll as of April 30, 1997 reported in the Police Retirement System's *Report on the Actuarial Valuation for the Plan Year Ending April 30, 1998*. We updated this amount to estimate covered payroll as of August 31, 1998, by using the 4.5 percent annual growth rate assumed in the retirement system report. The calculations were as follows:

Total covered payroll as of April 30, 1997	\$48,173,740
Estimated increase in covered payroll to April 30, 1998 (4.5%)	2,167,818
Estimated increase in covered payroll to August 31, 1998 ¹	<u>755,123</u>
Estimated covered payroll as of August 31, 1998	\$51,096,681

Using our estimate for covered payroll, we then converted the percentages of covered payroll reported by the board attorney into actual dollar amounts. The calculated figures are as follows:

Cost Description	Reported Percentage	Estimated Dollar Amount
Existing Benefits	29.19%	\$14,915,121
Increasing Survivors Benefit to 80%	0.51%	\$260,593
Increase in Minimum Pension	0.10%	\$51,097

We estimate that the proposed benefit changes would increase annual retirement system costs by approximately \$312,000.

The Information Provided by the Board Attorney Is Inadequate

According to the October 29, 1998 letter from the Police Retirement Board attorney to the Finance and Administration Committee chair, the first set of proposed legislative changes are the same ones proposed but eventually vetoed by the governor during the 1998 legislative session. The letter further states that no increase in city contributions will be required. However, the fiscal note attached to the 1998 legislation indicates that the unfunded accrued liabilities of the retirement system would increase by \$4.5 million, a fact that was not included in the information recently provided to the committee. The statement that no increase in city contributions is required is misleading because city contribution rates are already known to exceed actuarial requirements. The November 11, 1998 letter from the Retirement Board attorney proposed an additional benefit change concerning the standards for disability payments. While noting that there would be a slight cost effect to this change, a cost figure was not provided, citing a lack of historical data to develop an estimate.

We estimate that the increase in survivor benefits and minimum pensions *will* increase actuarial requirements by approximately \$300,000 annually, thus closing the gap between what is needed to keep the system actuarially sound and what the city is paying.

¹ Annual increase of 4.5 percent for 4 of 12 months is assumed to be 1.5 percent.

Excess city contributions will be virtually eliminated. As indicated in our August 1998 report, *Police Retirement Systems*, the city contribution rate of 20.6 percent has been in effect since May 1, 1991. The rate was established by the City Council with the January 16, 1987 passing of Resolution 60466. At that time, the rate was well in excess of the amount required to keep the Police retirement system actuarially sound, but the excess amount has been steadily eroded over the years by increases in benefit costs.

Exhibit 1 compares city contributions at the agreed upon rate to those actuarially required to maintain the retirement system for fiscal years 1992 through 1999, assuming the proposed benefit changes are approved. The comparison shows that actuarial requirements have steadily grown closer to the 20.6 percent contribution level the city agreed to in 1991.

Exhibit 1. Schedule of City Contributions, 1992 through 1999.

Fiscal Year	Actual City Contributions	Actuarial Requirements	Excess of Contributions over Requirements	Percent of Requirements Contributed
1992	\$8,713,583	\$6,108,839	\$2,604,744	143%
1993	8,953,982	7,709,970	1,244,012	116%
1994	9,196,647	7,602,692	1,593,955	121%
1995	9,293,708	8,346,925	946,783	111%
1996	9,478,903	8,587,324	891,579	110%
1997	9,721,985	8,716,539	1,005,446	112%
1998	9,923,790	9,355,956	567,834	106%
1999 (est.) ²	10,525,916	10,347,078	178,838	102%

Sources: City Auditor's Office, *Police Retirement Systems*, (August 1998); Police Retirement System, *Report on the Actuarial Valuation for the Plan Year Ending April 30, 1998* (November 1997); and City Auditor's Office calculations.

For fiscal year 1992, city contributions were 143 percent of what was required to maintain the actuarial soundness of the Police retirement system. By April 30, 1997, city contributions equaled only 112 percent of required amounts. Based on the recent information provided by the Retirement Board attorney, we estimate that contributions will only provide 105 percent of requirements for fiscal year 1999, *without the proposed changes*. If the proposed benefit changes are enacted, contributions will only equal 102 percent, virtually eliminating the excess.

Although current contribution amounts would continue to cover requirements, the opportunity to reduce city contributions in the future would be slight indeed. In fact, any decrease in future employee contributions or investment returns could result in future increases in

² Estimates for fiscal year 1999 based on provided cost data and assumes approval of proposed benefit changes.

city contributions, since the city has fiduciary responsibility for assuring benefit costs are funded. Thus the benefit increases could represent additional costs to the city in the future.

If you have any questions or need additional information, please let me know.

MF:glw

cc: Mayor Emanuel Cleaver II
Members of the City Council
Robert Collins, City Manager