Office of Missouri State Auditor

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City of Bridgeton Employees Retirement Plan Funding and Governance

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Missouri State Auditor

CITIZENS SUMMARY

Findings in the audit of the City of Bridgeton Employees Retirement Plan

Background and Summary

The City of Bridgeton Employees Retirement Plan, a defined benefit retirement plan, was established by the City of Bridgeton, Missouri in 1971. The city's Code of Ordinances designate the City Council as the plan's trustee, and the city's Finance Commission assists with oversight of the plan. The plan guarantees monthly payments to eligible members, beginning upon retirement, based on a fixed percentage of members' average annual earnings multiplied by years of credited service. The plan is non-contributory and is funded by annual contributions from the city and plan investment earnings. The plan was closed to new employees hired on or after January 1, 2012.

As of plan year 2015, actuarial studies indicated the plan was only 67 percent funded and had unfunded liabilities of nearly $14 million. Similar to many retirement plans nationwide, the plan's financial condition was significantly impacted by the 2007 to 2009 recession. We identified various internal factors that also negatively impacted the plan's financial condition. Inadequate plan governance and oversight allowed for decisions that were unfavorable to the plan, including insufficient contributions and investment return assumptions higher than actual returns.

Financial Condition

The plan's financial condition is poor primarily because the city has not met annual contribution requirements and investment returns have been historically less than assumed returns. Annual contributions received from the city during the 7-year period from 2009 to 2015, averaged only 60 percent of actuarially determined contribution (ADC) amounts, an average contribution shortfall of $628,000 per year. The failure to provide ADC amounts for a number of years has a compounding effect on the plan's poor financial condition and increases the risk the plan may not be able to pay all future benefit payments owed to members. The city also has not developed formal funding or investment policies. In addition, the city's recent actions to address the plan's poor financial condition were made without timely analysis of the impact and sufficiency of the changes.

Plan Governance

Because the plan is governed by the City Council, the governance structure does not allow representation of varied and balanced interests and provides for an inherent conflict of interest. The City Council, as plan trustee, does not sufficiently monitor and oversee the plan. In addition, the Finance Commission is responsible for oversight of the plan, but did not hold meetings during 2012, 2013, or 2014. The city has not established a plan board member education program and City Council members have not received training concerning their fiduciary responsibilities and duties, as required by state law.

Actuarial Valuations

The city's continued use of a 30-year open amortization method for calculating the annual ADC provides for inequities because costs of current covered employees are shifted to future generations. The city has never obtained an independent actuarial audit or alternative review to ensure the reliability of amounts reported in plan actuarial reports and the reasonableness of the actuarial methods and assumptions used by the plan actuary.

Communication to Key Stakeholders	City officials have not prepared or distributed reports of financial information, including information showing the impact of insufficient contributions on plan financial condition, to key stakeholders such as employees, retirees, and citizens. City officials primarily used a less relevant and misleading funding statistic, rather than the plan's funded ratio, to communicate the plan's financial condition. For example, city officials cited an 83 percent "funded percentage" in 2014 and 2015, when the plan funded ratio was only 64 percent.

In the areas audited, the overall performance of this entity was **Poor**.*

*****The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

Excellent: The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.

Good: The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.

Fair: The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.

Poor: The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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Missouri State Auditor

Members of the City Council
Bridgeton, Missouri

Due to concerns regarding plan financial condition, we have audited the City of Bridgeton Employees Retirement Plan's funding and governance as authorized under Chapter 29, RSMo. The objectives of our audit were to:

1. Analyze key data indicating the plan's financial condition.

2. Evaluate the impact of key factors influencing the plan's financial condition.

3. Evaluate the internal controls, management practices, and decisions impacting the plan's financial condition.

4. Evaluate compliance with certain legal provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

For the areas audited, we identified (1) data indicating a poor overall financial condition, (2) various key factors contributing to the plan's financial condition, (3) the need to improve plan oversight and management practices, and (4) noncompliance with legal provisions.

As of plan year 2015, actuarial studies indicated the plan was 67 percent funded and had unfunded liabilities of nearly $14 million. Similar to many retirement plans nationwide, the plan's financial condition was significantly impacted by the 2007 to 2009 recession. We identified various internal factors that also negatively impacted the plan's financial condition. Inadequate plan governance and oversight allowed for decisions that were unfavorable to the plan, including insufficient contributions and investment return assumptions higher than actual returns. Also, the city has not followed best practices related to management of retirement plans, complied with training requirements in state law, or adequately communicated with key stakeholders regarding the plan's financial condition.

The accompanying Management Advisory Report presents our findings arising from our audit of the Bridgeton Employees Retirement Plan's funding and governance.

Nicole R. Galloway, CPA
State Auditor

The following auditors participated in the preparation of this report:

Deputy State Auditor:	Keriann Wright, MBA, CPA
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Background

The City of Bridgeton Employees Retirement Plan (plan), a defined benefit (DB) retirement plan, was established by the City of Bridgeton, Missouri in 1971. The plan was created by local ordinance and is codified by Chapter 140 of the city's Code of Ordinances.

The city's Code of Ordinances designate the City Council as the plan's trustee unless the City Council designates an individual or committee of individuals as fiduciaries. No such alternate designation has been made. As the plan's trustee, the City Council has the power and duty to take all actions and make all decisions necessary to carry out the plan, except that selection of administrative and professional service providers is subject to approval of the mayor.

The city's Finance Commission assists with oversight of the plan. The Finance Commission consists of five city residents, appointed by the mayor and approved by the City Council. One councilmember serves as an ex-officio member of the commission. General responsibilities of the commission include monitoring the plan's investment performance and financial condition based on the annual actuarial valuation. The city's Code of Ordinances grant the commission no legal authority to make decisions on behalf of the plan, therefore the commission functions solely in an advisory capacity.

Key city personnel involved in plan matters include the city administrator and city finance officer. The city administrator is appointed by the mayor and acts as chief finance officer, assists the mayor with preparation and administration of the annual city budget, and assists with plan administration. The finance officer reports to the city administrator. Both employees provide plan information and documentation to the Finance Commission and participate in commission meetings.

The plan guarantees monthly payments to eligible members, beginning upon retirement, based on a fixed percentage of members' average annual earnings multiplied by years of credited service. The plan is non-contributory, meaning members are not required to make contributions to the plan. The plan is funded by annual contributions from the city and plan investment earnings. The City Council made 2 significant changes to plan benefits in the last 15 years. The benefit multiplier was increased from 1.75 to 2.0 percent in 2001 and the plan was closed to new employees in 2013. For new employees not eligible for the plan, the city matches employees' contributions to the city's defined contribution plan up to a selected percentage (5 percent for 2015) of each employee's annual salary.

The plan is part of the city's financial reporting entity and is included in the city's audited Comprehensive Annual Financial Report (CAFR).[1] The city contracts with an actuary to perform annual actuarial valuations for the plan. Actuarial valuations determine plan liabilities, assets, and contributions. An annual actuarial valuation is used to calculate the contributions needed to fully fund the plan. Starting in 2014, the plan receives an additional actuarial valuation report that is used to present the plan's financial information in accordance with newly implemented governmental accounting standards.

In September 2014, the State Auditor's Office issued Report No. 2014-092, *Survey of Public Employee Retirement Systems in Missouri*. Our survey report analyzed financial data of all 89 public employee DB retirement plans in Missouri as of plan years 2011 and 2012. During this survey, we identified the Bridgeton Employees Retirement Plan as one of several plans having indicators of a poor financial condition. Our survey reported the plan's funded ratio had declined from 100 percent in plan year 2002 to 61 percent in plan year 2011, and the city's actual annual contributions to the plan as a percentage of actuarially determined contributions had declined from 92 percent in plan year 2006 to 57 percent in plan year 2012. In March 2016, we obtained and analyzed Missouri public employee retirement plan data from a database maintained by the Joint Committee on Public Employee Retirement (JCPER), noting continued concerns regarding the plan's financial condition.

The JCPER prepares an annual "watch list" of retirement plans whose market value of assets is less than 70 percent of the plans' actuarially accrued liabilities. The Bridgeton Employees Retirement Plan has been listed on the watch list since 2009.

Defined Benefit Plans

DB plans typically promise retirement benefits to eligible members in the form of monthly payments. The monthly payments begin upon members' retirement and continue throughout their remaining lives, normally with some options for survivor benefits. The authorizing government and/or the sponsoring government and the plan's governing board design various aspects of the DB plan's benefit structure and policies. The governing board manages the plan's assets/investments and retirement benefit payments. Because benefit payments are guaranteed, the sponsoring government is responsible for funding these payments and assumes nearly all of the financial risk associated with operating the plan.

[1] Recent CAFR reports are available through the city's website at http://www.bridgetonmo.com/departments/administration/finance

Retirement benefits are funded by plan assets accumulated from contributions by sponsoring governments, employees, or other sources; and investment earnings. These assets are held in trust for future benefit payments to retirees. To be considered fully funded, current plan assets should equal the estimated current (present) value of future benefit payments (accrued liabilities) earned by employees as of the actuarial valuation date.

Contributions necessary to fund retirement benefits of DB plans are often determined using an actuarial funding approach. With this approach, an actuarial analysis estimates and compares the present value of future benefit payments (actuarially accrued liabilities, or AAL) to plan assets. The actuary calculates the actuarially determined contributions (ADC) necessary to meet plan funding goals. The ADC includes an amount for normal costs and an amortization payment for the unfunded actuarially accrued liability (UAAL). The ADC must be paid to achieve funding goals.

Scope and Methodology

To analyze and evaluate the plan's financial condition, and due to the long-term nature of retirement plan funding, we reviewed plan data that was readily available for the 10 years ended December 31, 2015. We obtained and analyzed key plan data indicating the plan's financial condition. Plan data was primarily obtained from the city's annual financial statements and the plan's annual actuarial reports. We also compared plan data to aggregate data of all Missouri DB plans obtained from the JCPER. This aggregate data was compiled by the JCPER in a database from information submitted by the DB plans. The most recent data in the JCPER database was as of plan year 2014.

Our methodology included conducting interviews with current and former city officials regarding various management practices and actions related to plan financial condition and reporting, and the plan's contracted actuary. We obtained an understanding of the funding and governance approaches and applicable controls that are significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violation of contract or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions. Records reviewed included the city's audited financial statements, actuarial reports, contracts with vendors, and meeting minutes of the City Council and the Finance Commission.

Our evaluation considered best practices related to management of public employee DB retirement plans, as identified in our survey report. The best practice sources include various guides and advisories issued by the Government Finance Officers Association (GFOA) and recommendations issued by the Pension Funding Task Force in its report, *PENSION FUNDING: A Guide for Elected Officials*. The Pension Funding Task Force was established by several national organizations representing local and state governments and its publication is intended to offer guidance on funding standards and practices.

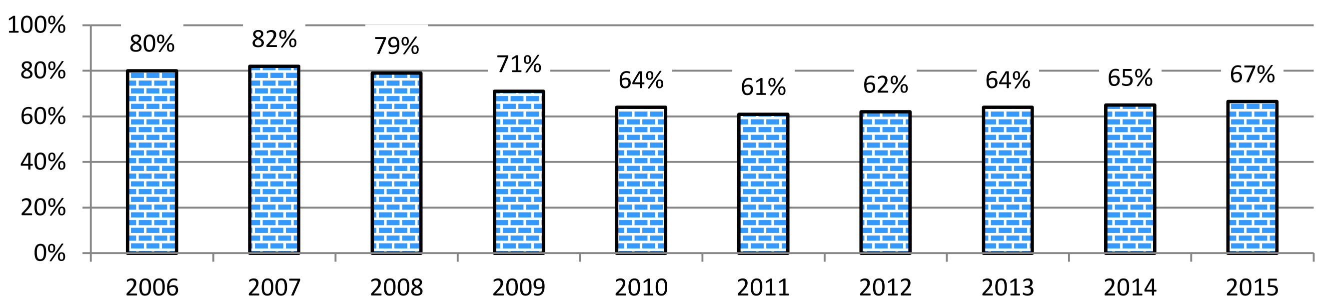
Since 1997, the city annually engaged RubinBrown, LLP, Certified Public Accountants (CPAs), to audit the city's financial statements, including the Pension Trust Fund. The audit of the city's year ended December 31, 2015 financial statements had not been completed at the time of our audit. Therefore, we reviewed the audit report and substantiating workpapers of the CPA firm for the year ended December 31, 2014, to minimize duplication of effort and obtain an understanding of the nature, timing, and extent of audit procedures relating to the audited financial statement amounts and disclosures pertaining to the Pension Trust Fund.

Plan Financial Condition

The plan's financial condition is poor. As of plan year 2015, the plan was 67 percent funded and had unfunded liabilities (UAAL) of nearly $14 million.

Funded Ratio

The plan's funded ratio, one of the most often cited indicators of financial condition, has declined from 80 percent in plan year 2006 to 67 percent in plan year 2015. The following chart shows the plan's funded ratios at year-end over the last 10 years.

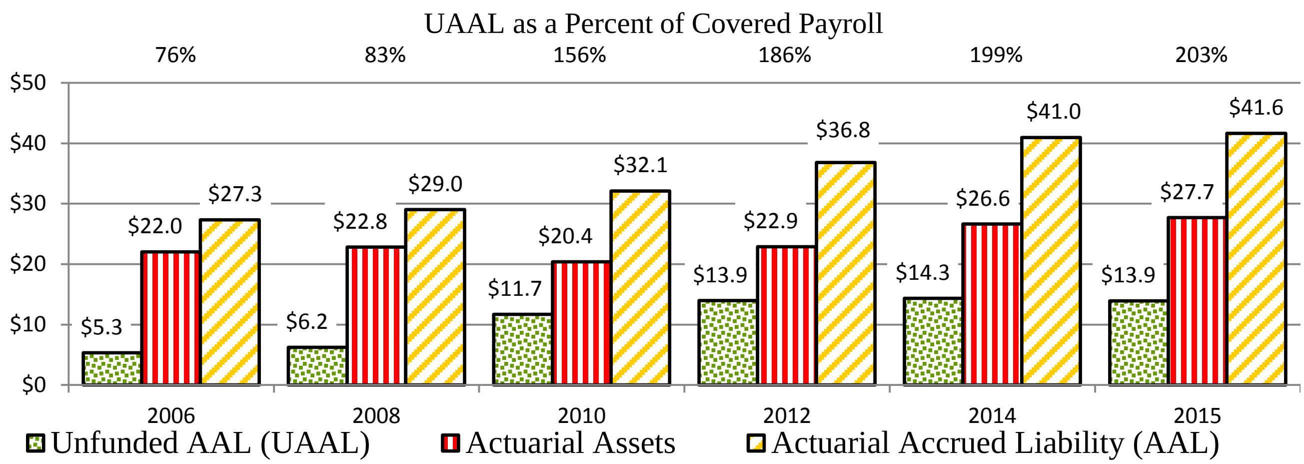


While slight improvements to the plan's funded ratio have occurred in recent years due to higher than average investment returns in plan years 2012 and 2013, the plan's funded ratio indicates the plan has been significantly underfunded for several years. The funded ratio is determined by dividing the actuarial value of assets by actuarially accrued liabilities (AAL) and represents the percentage of the present value of future benefit payments (accrued liabilities) earned that are covered by plan assets as of the valuation date. When a plan has not accumulated enough assets to cover expected benefit payments in future years based on service to date, the plan has UAAL. A plan is considered fully funded if the plan's assets meet or exceed the plan's liabilities.

For comparison, the aggregate funded ratio for all Missouri public employee DB retirement plans for plan year 2014 was 80 percent according to plan data in the JCPER's database. While there are widely varying viewpoints regarding what minimum funded ratio percentage indicates a plan is adequately funded, it is common for a public employee DB retirement plan with a funded ratio of less than 80 percent to be considered insufficiently funded. A DB plan's goal should be to achieve at least 100 percent funding so plan assets are sufficient to cover all future benefit payments.

Unfunded Liabilities

The following chart shows the plan's AAL and UAAL at year-end over the last 10 years. The chart shows trends of a widening gap between actuarial assets and AAL, and an increasing UAAL. The chart also shows the growing UAAL as a percentage of annual covered payroll. This percentage increased from 76 percent in plan year 2006 to 203 percent in plan year 2015. Unless the UAAL significantly declines, the percentage will continue to increase because covered payroll is expected to decrease due to the plan closing to new employees.



Note: Amounts are presented in millions of dollars

The Governmental Accounting Standards Board (GASB) standards for accounting and reporting requirements for DB Plans were amended in 2012 and implemented by plans and sponsoring governments in 2014 and 2015. The new accounting standards significantly changed the pension data available in plan and sponsoring government financial statements. The plan's total pension liability (TPL) and fiduciary net position (FNP), calculated using newly required asset and liability measurements, showed a TPL of $45.6 million for plan year 2014 and $48.2 million for plan year 2015. The plan's FNP was $26.3 million for plan year 2014 and $24.9 million for plan year 2015. The plan's resulting FNP/TPL was only 58 percent for plan year 2014 and 52 percent for plan year 2015.

1. Financial Condition

The City of Bridgeton Employees Retirement Plan's financial condition is poor primarily because the city has not met contribution requirements since plan year 2008 and investment returns have been historically less than assumed returns. The lack of adequate board governance, policies, and oversight, as noted at MAR finding number 2, allowed for decisions that worsened the plan's financial condition.

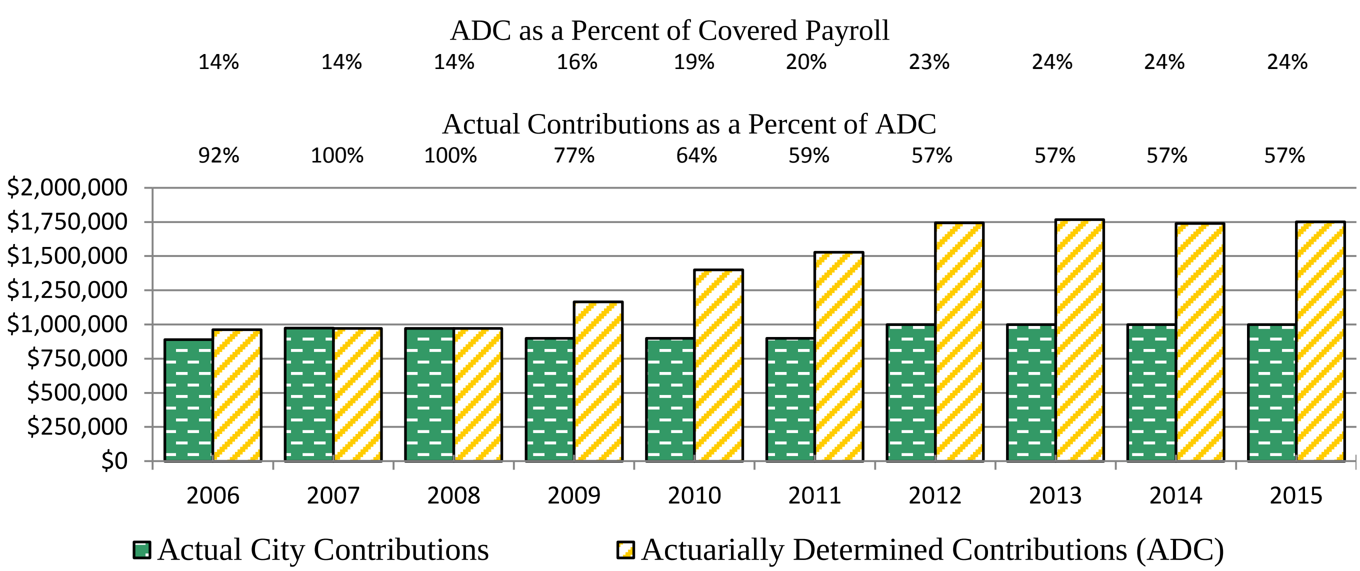
1.1 Funding

Actuarially determined annual contributions have not been received from the city since 2008, and the city has not developed a funding policy. In addition, the city's recent actions to address the plan's poor financial condition were made without timely analysis of the impact and sufficiency of the changes.

Contributions

The city's decisions to contribute significantly less than ADC amounts has been a primary factor in the plan's poor financial condition.

Actual contributions as a percentage of ADC, or percentage of ADC paid, indicates the extent the city is making the contribution payments as determined by the actuary. This factor measures the city's commitment to achieving the plan's overall funding goals. The ADC is determined based on various actuarial assumptions and practices. The following chart shows the ADC amounts and amounts actually contributed by the city over the last 10 years.



Despite annual actuarial reports indicating the plan is in poor financial condition, the city contributed significantly less than ADC amounts in each of the last 7 years (2009 through 2015). The ADC significantly increased over the last 7 years; however, the city's contributions remained at levels contributed prior to 2009. Actual contributions as a percentage of ADC averaged only 60 percent during the 7-year period, and the contribution shortfall averaged $628,000 per year during the period. For 2016, the city budgeted contributions to the plan totaling $1.2 million, or 71 percent of the approximately $1.7 million ADC amount. While the city generally makes contributions to the plan based on budgeted amounts, the budgeted amounts recommended by the mayor and approved by the City Council did not increase to cover increasing ADC amounts. The city's continued underfunding of pension obligations was cited by Moody's Investor Services as a factor in its November 2015 downgrading of the city's issuer rating.

Our review of City Council and Finance Commission meeting minutes and budget messages during the last 10 years noted no documented discussions concerning the City Council's decision to budget and pay less than the ADC amounts. City officials stated city resources were insufficient to provide the needed funding to the plan, and decreases to city programs, staffing, services, and employee benefits would have been necessary to fully contribute ADC amounts. City officials indicated the city has experienced revenue shortfalls during this period due to a number of reasons including (1) the recent economic recession, (2) a decline in population due to the airport expansion, (3) costs associated with natural disasters, and (4) increasing employee health insurance premiums. The city's audited financial statements show the city's general fund expenditures exceeded revenues during the last 10 years, and the general fund unreserved balance decreased from $3.8 million at January 1, 2006, to $1.1 million at December 31, 2015.

The failure to provide ADC amounts for a number of years has a compounding effect on the plan's poor financial condition and increases the risk the plan may not be able to pay all future benefit payments owed to members. The GFOA[2] recommends "under no circumstance should state and local government plan sponsors engage in pension contribution holidays or make insufficient contributions. When employers skip an actuarially determined contribution or make smaller payment, they defer that cost to the future and jeopardize the long-term funding of the plan. When governing bodies arbitrarily reduce contributions to a plan, the resulting systemic underfunding ensures future financial shortfalls and places the burden for that shortfall on future taxpayers. These types of funding decisions compound future funding problems and are, in many instances, a leading cause of funding shortfalls."

[2] "Responsible Management and Design Practices for Defined Benefit Pension Plans," Government Finance Officers Association, October 2010, <http://www.gfoa.org/responsible-management-and-design-practices-defined-benefit-pension-plans>, accessed on June 7, 2016, p. 1.

Funding policy

The city has not developed a formal funding policy. As a result, there are no policies or guidelines for city officials to utilize when making decisions impacting the plan's financial condition.

The city's ordinance regarding plan contributions does not require making actuarially determined contributions. Section 140.380 of the city's Code of Ordinances states "the City intends to contribute, but does not guarantee to do so, funds hereunder in amounts actually necessary for the funding of the plan."

A plan's funding policy plays an integral role in the plan's financial condition. The GFOA[3] recommends "every state and local government that offers defined benefit pensions formally adopt a funding policy that provides reasonable assurance that the costs of those benefits will be funded in an equitable and sustainable manner." In addition, the Pension Funding Task Force[4] states that a clear pension funding policy is important because it "lays out a plan to fund pensions; provides guidance in making annual budget decisions; demonstrates prudent financial management practices; reassures bond rating agencies; and shows employees and the public how pensions will be funded." The Task Force recommends the policy address the core elements of pension funding (actuarial cost method, asset smoothing method, and amortization policy) consistent with the general objectives of basing funding on actuarially determined contributions, building funding discipline, maintaining intergenerational equity, making employer costs a consistent percentage of payroll, and requiring clear reporting.

Recent actions

The city did not obtain written projection analyses to determine the sufficiency of recent changes to plan provisions and contribution amounts. The city took actions in 2013 and 2015 to try to improve the plan's financial condition. While these decisions show the city acknowledged and tried to address the plan's deteriorating financial condition, the actions were made without determining the impact of the changes and the extent the changes will improve the plan's financial condition.

- In January 2013, the City Council voted to close the plan to new employees hired or rehired on or after January 1, 2012. This decision was made in response to a concern raised by the actuary in February 2012 that plan funding was nearing the criteria of contribution

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[3] "Funding Defined Benefit Pension," Government Finance Officers Association, June 2012, < http://www.gfoa.org/funding-defined-benefit-pensions>, accessed on June 7, 2016, p. 1.

[4] "PENSION FUNDING: A Guide for Elected Officials," 2013, <http://www.nasact.org/files/News_and_Publications/White_Papers_Reports/2013_03_25_Pension_Funding_Guide.pdf>, accessed on June 7, 2016, p. 4.

deficiency under state law. Section 105.683, RSMo, states if a plan's funded ratio is below 60 percent and has been descending for 5 consecutive years, and the sponsoring government has not paid 100 percent of the ADC for 5 years, the sponsoring government can be considered delinquent in making contribution payments. The law provides certain plans in this situation can intercept state payments due to the sponsoring government in the amount of 25 percent of the contribution deficiency.

- In early 2015 city officials decided to begin making incremental annual increases in contributions and seek voter approval for a general hotel/motel tax increase to help fund the increases. In April 2015, voters approved the tax increase, which city officials project will increase the city's general revenues by $900,000 per year. City officials decided to increase annual contribution amounts by $200,000 each year until the full ADC amount is reached, and to make the full ADC each year thereafter. Accordingly, the city budgeted $1.2 million for contributions for 2016, an increase from $1.0 million paid in each of the previous 4 years.

In the cover letter to the 2016 funding actuarial valuation report, the actuary warned "to date, the plan asset values have been relatively stable year over year, but the magnitude of the benefit payments is considerably greater than the contributions being made, and you can anticipate that the asset values will begin to decline." In the 2016 actuarial valuation prepared under newly implemented accounting standards for financial statement purposes, even with the city's planned contribution increases and eventual full contributions, and current actuarial assumptions, the actuary was required to use a blended assumed investment rate of return (discount rate) of 6.15 percent because the plan's FNP will not be sufficient to make all projected future benefit payments of current plan members.

Analyzing the impact of changes to plan benefits and contributions would assist City Council members in determining whether proposed changes are adequate to provide anticipated outcomes, and whether additional changes are necessary.

Conclusions

To attain good plan financial condition, it is imperative the City Council reinstate contributions to the plan of at least ADC amounts. The City Council should work with the plan's actuary to develop a funding plan that will increase plan assets to a level sufficient to pay all projected benefit payments. In developing such a plan, the City Council should first evaluate and revise as necessary, various actuarial assumptions and methods as recommended in this report. The City Council should develop a formal funding policy to guide funding decisions and communicate its funding intentions to plan members and the public. Also, the city should obtain an actuarial analysis that evaluates the projected impact of recent decisions on the plan's financial condition.

1.2 Investments

Actual investment returns have historically been less than assumed returns, and the city has not established an investment policy or analyzed the sufficiency of plan investment return assumptions.

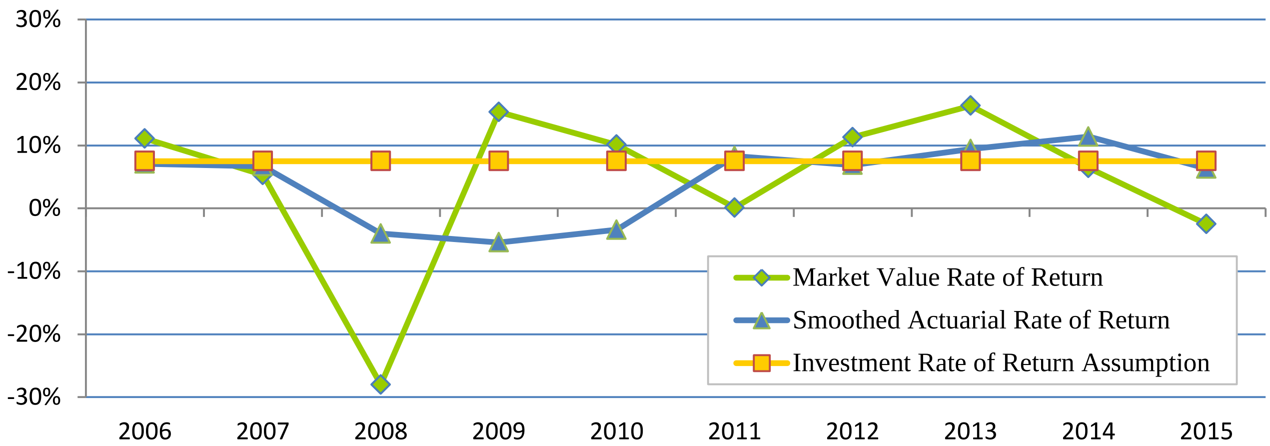
The plan's investments are managed by a contracted investment firm. The city changed plan investment firms in April 2015, and had contracted with the previous investment firm for 29 years.

Assumed rate of return

The plan's actual rate of return has historically been lower than the assumed investment rate of return, and a formal analysis has not been performed to determine the reasonableness of the assumed investment rate of return.

The assumed investment rate of return is the long-term rate of return expected on plan assets, and is often cited as the actuarial economic assumption having the most impact on plan financial condition. Changes to the assumed rate of return can significantly influence the determination of the ADC amounts and funded ratio. When setting the assumed rate of return, a plan should consider current and past economic conditions, long-term economic outlook predictions, expected inflation, past investment performance, investment policies, and asset allocation. The same or similar rate is typically assumed each year due to the long-term nature of the rate. The assumed rate of return is typically used as the discount rate when calculating the present value of plan liabilities through a method called discounting.

A comparison of the plan's market value, smoothed, and assumed investment rates of return over the last 10 years is shown in the following chart. For determining actuarial asset valuations, the plan's actuary smooths the market value gains and losses over a 3-year time period. As shown in the chart, the plan's assumed rate of return was 7.50 percent, while the market and smoothed rates of return were significantly less than 7.50 percent in several years during the 10-year period.



The plan's long-term time-weighted smoothed investment returns[5] have been significantly less than the plan's current assumed rate of return of 7.50 percent. The chart below shows the plan's time-weighted smoothed returns over the previous 30, 20, and 10-year time periods ended December 31, 2015. These calculations are based on smoothed annual investment returns reported in the plan's 2016 funding actuarial report.

Time Period	Time-Weighted Return
30 years	6.42%
20 years	5.14%
10 years	4.16%

City officials indicated the plan's assumed rate is comparable to other public employee DB retirement plans but a formal analysis to determine the reasonableness of the rate has not been performed. Our survey report showed the average assumed investment return for Missouri's 89 public employee DB plans was 7.17 percent as of plan year 2012. Recent information from the JCPER's database indicates this amount decreased to 7.07 percent as of plan year 2014. This average had declined from 7.58 percent in plan year 2003, a likely indicator plans were anticipating slower economic growth in future years. While the plan's assumed rate of return is in line with that of other plans statewide, there is significant debate among pension and public finance professionals regarding whether these rates are too high. This debate is discussed in the Risk-Free Discount Rate Debate section of the survey report.

[5] The plan changed asset valuations methods from a market value method to a 3-year smoothed method beginning with the January 1, 1996 valuation.

Retirement plans should achieve at least the assumed investment rate of return over the long term to properly fund benefit payments. If the rate is not reevaluated regularly, plans cannot ensure the reasonableness of the rate and the resulting ADC and funded ratio. If rate is not set realistically, over time the funded ratio and contributions could become inconsistent with plan liabilities. A rate set too high could jeopardize the financial condition of the plan. The GFOA[6] states "Unrealistically high investment return assumptions are likely to result in a chronically declining funded ratio and higher contributions in the future. Caution should be exercised to ensure the investment return assumption reflects the reasonably expected returns of the plan's asset allocation over a reasonable period of time."

The GFOA[7] recommends retirement plans periodically engage an actuary to perform additional services to assist management in determining the reasonableness of actuarial assumptions. Such services include an experience study, performed no less frequently than every 5 years, that determines whether actuarial assumptions are in line with a plan's demographic and economic experience. Experience studies can include a review of a plan's assumed rate of return and would assist plan management in determining if changes to the rate or the plan's investment strategy are necessary. Given the significant role of a plan's assumed rate of return, the City Council should consider obtaining an experience study or performing similar procedures.

Investment policy

The city has not developed a formal investment policy outlining the key aspects of the plan investment program, such as investment strategies and goals and monitoring of investment performance.

City officials indicated the current asset allocation (60 percent equities and 40 percent fixed income) was developed through discussions of the Finance Commission and former investment firm personnel, but the allocation and other investment strategies and goals have not been formalized in an investment policy. Additionally, the City Council does not directly monitor plan investment performance or approve investment decisions. The current investment firm requested the city develop a formal investment policy in August 2015; however, city officials had not developed a policy as of May 2016.

[6] "Responsible Management and Design Practices for Defined Benefit Pension Plans," Government Finance Officers Association, October 2010, <http://www.gfoa.org/responsible-management-and-design-practices-defined-benefit-pension-plans>, accessed on June 7, 2016, p. 2.
[7] "Enhancing Reliability of Actuarial Valuations for Pension Plans," Government Finance Officers Association, September 2014, <http://www.gfoa.org/enhancing-reliability-actuarial-valuations-pension-plans>, accessed on June 7, 2016, p. 1.

A sufficiently designed investment policy is essential due to the significance of investment income to plan assets. The GFOA[8] recommends "state and local entities establish a formal investment policy that is approved by the governing board or trustee(s) of the pension plan." The GFOA recommends such a policy should address a variety of issues such as asset allocation, investment guidelines, roles and responsibilities of key decision makers, investment goals, and procedures for reporting and monitoring investment performance. The absence of a formal investment policy prevents the governing board from clearly communicating the investment goals, priorities, and responsibilities to plan officials and personnel, the contracted investment manager, and other interested parties. Also, when there is no policy and the assumed rate of return is too high, there is increased risk of poor investment decisions in an attempt to meet rate of return assumptions.

Recommendations

The City Council, as the plan's trustee:

1.1 Consult with the plan's actuary to develop a plan to increase plan assets to a level sufficient to pay all projected benefit payments and ensure annual contribution amounts are no less than the actuarially determined amounts. The City Council should develop a formal funding policy and obtain projection analyses when making changes impacting the plan's financial condition.

1.2 Obtain an experience study or similar procedures to evaluate the sufficiency of the plan's assumed investment rate of return and make changes to the rate and/or investment strategy if necessary. In addition, the City Council should develop a formal investment policy.

Auditee's Response

1.1 The city has regularly consulted with the plan actuary over the past 30 years evaluating asset values, returns, and contributions. The city contributions from 1987-2008 mirrored or exceeded the ADC. After the recession of 2008 the ADC spiked to levels unseen before. The city continued to make significant contributions of $1,000,000 per year for several years during a rough period of revenue declines. A consequence of making the full ADC of $1,700,000 during those years would have resulted in staff layoffs and program and service cuts to the residents. The city was optimistic that the economy would rebound and budgeted to keep up the desired levels of service. The city has always made the budgeted City Council approved contributions. Yet the 30 percent asset loss in 2008 was very difficult to catch up in a short period of time. The city

[8] "Pension Investment Policies," Government Finance Officers Association, February 2003, <http://www.gfoa.org/pension-investment-policies>, accessed on June 7, 2016, p. 1.

developed a plan in 2015 to increase contributions incrementally from $1,000,000 to $1,600,000 over three years to reach the full ADC and implemented a soft freeze for new hires. Voters approved a hotel tax increase, which helped to fund a portion of the increased contributions. Subsequently the funded ratio has increased in each of the last four years and contributions as a percent of the ADC increased to 69 percent in 2016 and will increase to approximately 83 percent in 2017. Therefore, the recent city actions did impact the plan favorably and valuations continue to trend upward. In the future, if further plan changes are considered, the city will obtain a formal projection analysis as recommended.

1.2 The plan's assumed actuarial rate of return is discussed regularly with the actuary as part of the annual review process. The rate of return of 7.5 percent is comparable to that of many other public plans and the actuary and commission has felt it to be reasonable. The Missouri Joint Committee on Public Employee Retirement in their 2015 Annual Report cited the Missouri State Employees Retirement Plan having an 8 percent rate assumption. Over the past ten years, the market value rate of return of the plan has achieved or exceeded the rate assumption seven times. The 30 percent investment loss in 2008 also affected subsequent years due to the three year smoothed valuations. In the future the city will consider such a procedure as well as developing formal investment and funding policies. The Finance Commission did formally approve the asset allocation guidelines at the quarterly meeting on August 11, 2016. Investments are monitored monthly by staff and reviewed quarterly with presentations by the asset managers to the Commission. The "Prudent Person Rule" is strictly adhered to. The plan returns for the six months ending June 30, 2016 is at 7.15 percent.

Auditor's Comments

1.1 While city officials have established a plan to increase contribution amounts incrementally each year beginning in 2016, this plan will not provide for full ADC payments for at least 3 more years. In addition, this plan assumes the ADC will remain the same each year, which is not guaranteed. Under the current plan, any increases in ADC will further delay full funding of the ADC. The continued failure to provide ADC amounts compounds the plan's funding problems and shifts the costs to future taxpayers.

1.2 Because the plan's actual rate of return has historically been lower than the assumed investment rate of return, a review of the assumed rate of return is necessary. This review should be based on actual plan experience, rather than a comparison to other retirement plans. As noted in our survey report, many Missouri public employee defined benefit retirement plans have reduced their assumed investment rates of return in recent years because they anticipate economic growth will be slower in future years. It is unrealistic to compare the plan's assumed rate of return to that of the Missouri State Employees' Retirement System (MOSERS) as MOSERS' assets are more than 300 times those of the Bridgeton Employees Retirement Plan. In June 2016, the MOSERS Board of Trustees voted to reduce its assumed rate of return from 8 percent to 7.65 percent, effective July 1, 2017.

2. Plan Governance

The plan's governance structure does not allow representation of varied and balanced interests. The City Council, which serves as the plan's trustee, does not provide adequate oversight and monitoring of the plan and City Council members have not received pension training as required.

Section 140.220 of the city's Code of Ordinances provides that the City Council manage and control the plan. While the Code of Ordinances allows the City Council to designate an individual or committee of individuals to serve as the plan's trustee, no such designation has been made. The city has delegated oversight of the plan to the Finance Commission, but only in an advisory capacity.

Governing Board

The plan is not governed by a board, independent from the city, and consisting of members representing varied and balanced interests.

Because the plan is governed by the City Council, the governance structure does not allow for a variety of interest groups to be represented. This governance structure provides for an inherent conflict of interest because the City Council is responsible for budgeting and planning decisions regarding both the city and the plan. The exclusion of viewpoints from all key stakeholders in plan decisions may have contributed to the plan's poor financial condition. During the 10 years ended December 31, 2015, City Council and Finance Commission membership did not include current employees or retirees.

The GFOA[9] states "board governance is a crucial component of a properly managed DB plan. It is the manner and process by which Trustees exercise authority and control over all plan activities. DB plan sponsors should pay particular attention to the composition of the Board of Trustees and make efforts to ensure that varied interests are represented and balanced among those of employers, employees, retirees, taxpayers and unions, if

[9] "Design Elements of Defined Benefit Retirement Plans," Government Finance Officers Association, February 2008, <http://www.gfoa.org/design-elements-defined-benefit-retirement-plans>, accessed on June 7, 2016, p. 3.

applicable." Providing for varied and balanced representation of a plan's governing board help ensure decisions are unbiased and the interests of all parties are considered.

Oversight

The City Council, as the plan's trustee, does not sufficiently monitor and oversee the plan.

The City Council does not always review and approve documents relating to the plan's financial condition such as actuarial reports and investment performance reports, and does not approve some key decisions impacting the plan's financial condition, including decisions to maintain or change actuarial assumptions and investment practices. City officials indicated copies of Finance Commission meeting minutes and actuarial reports are distributed to councilmembers when the Finance Commission meets; however, the Finance Commission did not meet for a 3-year period.

Our review of City Council meeting minutes from 2006 through 2015 noted the plan was rarely discussed during semi-monthly City Council meetings. Meeting minutes during 2014 and 2015, only included two discussions regarding the plan. Both occurred in October 2014 after the plan was mentioned in our survey report.

In addition, the Finance Commission did not hold meetings during 2012, 2013, or 2014. City officials indicated the Finance Commission was often not able to establish a quorum until the appointment of new commission members in 2015. Our review of meeting minutes from Finance Commission meetings during the period 2006 through 2011 and 2015 noted the Finance Commission reviewed plan actuarial reports and investment performance reports, but the minutes included no documented discussions regarding the plan's poor financial condition. In the absence of the Finance Commission, these reports were reviewed by the city administrator and the finance officer.

As the plan's trustee and fiduciary, the City Council is expected to administer the plan in a prudent manner. The GFOA[10] indicates the general standard for this "duty of prudence" is that "a trustee should act in a way that a reasonable or prudent person acts in a similar situation or in the conduct of his or her own affairs." Without reviewing and approving documents and decisions relating to the plan's financial condition, the City Council is unable to fulfill its fiduciary responsibilities.

[10] "Governance of Public Employee Postretirement Benefits Systems," Government Finance Officers Association, March 2010, <http://www.gfoa.org/governance-public-employee-postretirement-benefits-systems>, accessed on June 21, 2016, p 1.

Training

The city has not established a plan board member education program and City Council members, who serve as the plan's trustee, have not received training concerning their fiduciary responsibilities and duties, as required by state law. The Finance Officer and the former City Administrator received pension training in 2015 but the City Council members have not received training.

Effective January 2008, Section 105.666.1, RSMo, requires pension boards to establish a board member education program. The statute requires new board members to complete an orientation training program within 90 days of becoming new board members and all other board members to attend 6 hours of continuing education programs each year. Without adequate training, City Council members may lack adequate knowledge regarding the key aspects of public employee DB retirement plans and their role as plan fiduciaries. This could prevent the City Council from making decisions that ensure the plan is responsibly managed and financially solvent to satisfy all pension obligations.

Recommendation

The City Council, as the plan's trustee, maintain effective oversight of the plan by delegating fiduciary responsibilities to a pension board that consists of a varied and balanced representation of key stakeholders. Additionally, the City Council should develop and implement a training program for pension board members as required by state law.

Auditee's Response

The City Council and Mayor have delegated oversight responsibilities to an advisory board, the Finance Commission. The selection of members involves the balancing of representation of stakeholders (employers, taxpayers, unions, etc.). There is a residency requirement which limits the availability of retirees while the meetings are attended by staff and open to the public. The City Council is elected by the voters, thus there is little control over the composition of the Council. A councilmember is appointed as an ex-officio member of the Commission where actuarial reports are distributed and reviewed. The financial condition of the plan is discussed at the meetings, which were regularly held from 1988-2012. Member vacancies during 2012-2014 resulted in missed meetings. The Commission has met regularly since 2015. All plan amendments, key decisions, and annual contributions are approved by City Council.

The Missouri legislature passed HB 1882 in 2014, requiring 6 hours of continuing education annually for pension board members. Bridgeton's City Administrator and Finance Officer did complete this training in 2015. The training seminars have had limited offerings in various cities, requiring time commitments and enrollment fees. These offerings have and will be made available to councilmembers as recommended and they will be encouraged to attend to fulfill this requirement.

3. Actuarial Valuations

The method used to amortize the UAAL when calculating the annual ADC amounts is contrary to recommended best practices and the city has not obtained an actuarial audit.

The city has engaged the same actuary to prepare annual actuarial valuations for 10 years. The annual actuarial valuations are reviewed by the Finance Commission, city administrator, and finance officer, and report the plan's liabilities, assets, contributions, and other key information that indicate plan financial condition.

3.1 Amortization Method

The city's continued use of a 30-year open amortization method for calculating the annual ADC provides for inequities because costs of current covered employees are shifted to future generations.

Amortization methods are used to determine the contributions needed to fund the UAAL. Retirement plans typically spread the contribution payments across several years, called the amortization period. An open amortization period allocates UAAL over an identified number of years on a rolling year basis. A closed amortization period sets a future date the UAAL will become fully funded and reduces the amortization period by 1 year each year after the closed period policy is adopted. The city utilizes a 30-year open amortization period, which spreads the UAAL over the next 30 years. In theory, this method could eventually approach full funding of the liability; however, it will require significantly longer than the 30 years to arrive at a nearly fully funded position because there is no definite date in the future to achieve the goal.

Since the plan was closed to new employees beginning in January 2012, the use of a 30-year open amortization period will spread a portion of the UAAL into periods after the covered employees are no longer employed. The plan's actuary warned of this concern in the cover letter to the 2016 funding actuarial valuation report. City officials indicated they have always used this amortization method and have not analyzed the potential results of using other methods.

The GFOA[11] recommends "the ADC should be calculated in a manner that fully funds the long-term costs of promised benefits, while balancing the goals of 1) keeping contributions relatively stable and 2) equitably allocating the costs over the employees' period of active service." The Pension Funding Task Force states the principle of intergenerational equity in relation to pension funding ensures "the cost of employee benefits is paid

[11] "Funding Defined Benefit Pensions," Government Finance Officers Association, June 2012, <http://www.gfoa.org/funding-defined-benefit-pensions>, accessed on June 7, 2016, p. 1.

by the generation of taxpayers who receives services."[12] In addition, the GFOA[13] recommends amortization of the UAAL should use closed periods and should "never exceed 25 years, but ideally fall in the 15-20 year range." Implementation of amortization period best practices is only effective when full ADC payments are made.

3.2 Actuarial Audit

The city has never obtained an independent actuarial audit or alternative review to ensure the reliability of amounts reported in plan actuarial reports and the reasonableness of the actuarial methods and assumptions used by the plan actuary. City officials indicated they are satisfied by the services provided by their current actuary and obtaining an actuarial audit would result in additional costs to the plan.

The GFOA[14] indicates "a comprehensive audit of the plan's actuarial valuations performed by an independent actuary at least once every five to eight years can be used to evaluate the appropriateness of the actuarial methods, assumptions, and their application." Without periodically obtaining an actuarial audit or similar procedures, the city has less assurance regarding the reliability of the plan actuarial reports.

Recommendations

The City Council, as the plan's trustee:

3.1 Work with the actuary to evaluate implementing a closed amortization period recommended by best practices.

3.2 Consider periodically obtaining actuarial audits or alternative reviews.

Auditee's Response

3.1 The city will work with the actuary to evaluate implementing a closed amortization period as recommended.

3.2 The city will consider periodically obtaining actuarial audits or alternative reviews as recommended. The city did engage the actuary to perform a retirement incentive study in 2016 to continue to seek ways to improve the plan condition. Subsequently, 7 of the 106 active members have retired to date in 2016.

[12] "PENSION FUNDING: A Guide for Elected Officials," 2013, <http://www.nasact.org/files/News_and_Publications/White_Papers_Reports/2013_03_25_Pension_Funding_Guide.pdf>, accessed on June 7, 2016, p. 6.
[13] "Core Elements of a Funding Policy," Government Finance Officers Association, March 2013, <http://www.gfoa.org/core-elements-funding-policy> , accessed on June 7, 2016, pp. 1-2.
[14] "The Role of the Actuarial Valuation Report in Plan Funding," Government Finance Officers Association, February 2013, <http://www.gfoa.org/role-actuarial-valuation-report-plan-funding>, accessed on June 7, 2016, p. 3.

4. Communication to Key Stakeholders

The city has not adequately communicated plan financial information to key stakeholders. City officials have not distributed reports to stakeholders and used a less relevant funding statistic rather than the plan's funded ratio in communications regarding the plan's financial condition.

Reports to stakeholders

City officials have not prepared or distributed reports of financial information, including information showing the impact of insufficient contributions on plan financial condition, to key stakeholders such as employees, retirees, and citizens. While the city's annual financial statements contain plan financial information and are made available on the city's website, plan financial information is not provided directly to key stakeholders.

Misleading use of funding statistics

Our review of documentation of discussions of the plan's financial condition in City Council and Finance Commission meeting minutes as well as documentation submitted to the JCPER in response to the plan's inclusion on the annual watch list, noted city officials primarily used a less relevant funding statistic, rather than the plan's funded ratio, to communicate the plan's financial condition.

During an October 2014 City Council meeting, city officials discussed a newspaper article regarding our survey report. The meeting minutes indicate the article "created some unnecessary concerns" and "was based on old and incorrect information and the financial plan is solid." The minutes also state the plan is now at 83 percent funding and growing, and will be self-sufficient eventually. However, the plan funded ratio at that time was only 64 percent. The 83 percent was similarly cited in the August 2015 Finance Commission meeting minutes that quoted the City Administrator as saying "we are in very good standing with this pension fund." Furthermore, the city referenced the 83 percent in its "watch list" response to the JCPER.

The 83 percent figure was the "funded percentage," separately calculated by the actuary and included in the 2014 funding actuarial report based on projected liability calculations using current wages and did not take into account future wage increases. The funded percentage is not the funded ratio calculated assuming wage increases and commonly used to monitor the financial condition of public employee DB plans. The use of the funded percentage statistic has never been required by governmental accounting standards and is not monitored by the JCPER. This statistic is unrealistic because future wage increases for current employees are likely. Furthermore, the use of this statistic can be misleading and provide a false sense of security to stakeholders. City officials indicated they understood the difference between the calculated funded percentage and the actuarially determined funded ratio, but were unable to explain why the higher, less relevant statistic was cited in meeting minutes and reported to the JCPER rather than the plan's funded ratio.

Conclusion

The GFOA[15] recommends the plan's financial information included in the city's annual financial report be summarized and distributed to all plan participants. The GFOA best practice guide further recommends when contributions are below the actuarially determined rates, "the board of trustees should prepare a report that analyzes what effect the underfunding has on the system and distribute the report to all stakeholders." Without receiving adequate and accurate summarized financial information, key stakeholders may not be fully aware of the plan's financial condition and the fiscal impact of the city's contributions of less than actuarially determined amounts.

Recommendation

The City Council, as the plan's trustee, prepare and distribute reports summarizing plan financial information, including the impact of insufficient contributions on plan financial condition, to key stakeholders. In addition, the City Council should cite the plan's funded ratio, rather than the funded percentage statistic, in communications regarding plan financial condition.

Auditee's Response

The city has made available the plan information in the Comprehensive Annual Financial Report, posted on the city's website. Actuarial and budget documents are also made available and employees do receive annual benefit information. The city has made strides in correcting a downturn in funding and has seen the funded ratio increase in each of the last four years. The city will seek to develop a meaningful report to summarize the plan to stakeholders. The long-term nature of a pension plan allows for gradual improvement over time. This trend upward is what the plan is currently experiencing.

The funded percentage is a statistic used in the actuarial report and does not take into account future wage increases. Wage increases have been negligible due to low inflation and the plan being frozen to new hires in 2012. The funded ratio will be cited in the future, rather than the funded percentage as recommended.

Again, the recession of 2008 and the loss of population and revenue from the airport expansion had a major negative impact on the plan. The city is committed to reach full funding levels and believes that trend is moving in the right direction.

[15] "Sustainable Funding Practices of Defined Benefit Pension Plans," Government Finance Officers Association, October 2009, <http://www.gfoa.org/sustainable-funding-practices-defined-benefit-pension-plans>, accessed on June 7, 2016, p. 2.

City of Bridgeton Employees Retirement Plan
Funding and Governance
Organization and Statistical Information

The City of Bridgeton Employees Retirement Plan (plan) was established by the City of Bridgeton, Missouri in 1971. The plan was created by local ordinance and is codified by Chapter 140 of the city's Code of Ordinances.

The plan is a single-employer, defined benefit retirement plan for employees of the City of Bridgeton hired before January 1, 2012. The plan provides retirement and death benefits to its members and survivors. Members are not required to make contributions to the plan.

Members are vested in the plan after 5 years of service. Any member who has attained the age of 60 and who has 5 or more years of creditable service may retire with full benefits. The retirement benefit is calculated at 2 percent of average annual earnings multiplied by the number of years of credited service. Average annual earnings are based on the highest consecutive 5 years of the member's last 10 years of service. A member may elect to retire at age 50 (age 45 for police employees) with reduced benefits if the member has 5 or more years of creditable service.

As of December 31, 2015, there were 106 active members, 120 retired members and beneficiaries, and 27 terminated-vested members. The plan was frozen to new employees as of January 1, 2012.

City Council and Key Plan Personnel

The plan is under the control and management of the City Council. Two City Council members are elected from each of the city's four wards and serve 2-year terms. The members of the City Council as of December 31, 2015, were:

Ferd Fetsch, Council President and Ward 3 Councilmember
Bob Saettele, Ward 1 Councilmember
Scott Zimmer, Ward 1 Councilmember
Linda Eaker, Ward 2 Councilmember
Jerry Grimmer, Ward 2 Councilmember
Randy Hein, Ward 3 Councilmember
Barbara Abram, Ward 4 Councilmember
Joni Norris, Ward 4 Councilmember

Terry Briggs was elected Mayor in April 2015, and serves a 4-year term. He replaced Conrad Bowers who served 28 years as Mayor. The city administrator and city finance officer oversee plan matters. Kevin Bookout has served as City Administrator since November 2015. He replaced Police Chief Donald Hood who served as City Administrator from September 2012 to November 2015. Dennis Rainey has served as Finance Officer since November 1988.

Plan Consultants

The City contracts with Aetna, Inc., for pension administration services; US Bancorp, for investment management services; Buck Consultants, for actuarial services; and RubinBrown, LLP, for auditing services.

Additional information regarding the plan's provisions and benefits, investments, financial activities, consultants, and actuarial valuations can be obtained by contacting the city directly at (314) 739-7500.