



Office of Missouri State Auditor
Nicole Galloway, CPA

FOLLOW-UP REPORT ON AUDIT FINDINGS

**City of Bridgeton Employees Retirement Plan
Funding and Governance**

Report No. 2017-145
November 2017

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City of Bridgeton Employees Retirement Plan Funding and Governance Follow-Up Report on Audit Findings

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NICOLE GALLOWAY, CPA Missouri State Auditor

Members of the City Council
Bridgeton, Missouri

We have conducted follow-up work on audit report findings contained in Report No. 2016-107, *City of Bridgeton Employees Retirement Plan Funding and Governance* (rated as Poor), issued in October 2016, pursuant to the Auditor's Follow-Up Team to Effect Recommendations (AFTER) program. The objectives of the AFTER program are to:

1. Identify audit report findings that require immediate management attention and any other findings for which follow up is considered necessary at this time, and inform the City Council about the follow-up review on those findings.
2. Identify and provide status information for each recommendation reviewed. The status of each recommendation reviewed will be one of the following:
 - Implemented: Auditee fully implemented the recommendation, either as described in the report or in a manner that resolved the underlying issue.
 - In Progress: Auditee has specific plans to begin, or has begun, to implement and intends to fully implement the recommendation.
 - Partially Implemented: Auditee implemented the recommendation in part, but is not making efforts to fully implement it.
 - Not Implemented: Auditee has not implemented the recommendation and has no specific plans to implement the recommendation.

As part of the AFTER work conducted, we reviewed documentation provided by city officials and held discussions with officials to verify the status of implementation for the recommendations. Documentation provided by the city included financial reports and budgets, actuarial reports, and other pertinent documents. This report is a summary of the results of this follow-up work, which was substantially completed during October 2017.

A handwritten signature in black ink that reads "Nicole R. Galloway".

Nicole R. Galloway, CPA
State Auditor

City of Bridgeton Employees Retirement Plan Funding and Governance

Follow-Up Report on Audit Findings

Status of Findings

1. Financial Condition The City of Bridgeton Employees Retirement Plan's (plan) financial condition was poor primarily because the city had not met contribution requirements since plan year 2008 and investment returns had 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. The plan's funded ratio had declined from 80 percent in plan year 2006 to 67 percent in plan year 2015, and the unfunded actuarial accrued liability (UAAL) was nearly \$14 million as of plan year 2015.

1.1 Funding Actuarially determined annual contributions (ADC) had not been received from the city since 2008, and the city had not developed a funding policy. In addition, the city's actions in 2013 and 2015 to address the plan's poor financial condition were made without timely analysis of the impact and sufficiency of the changes.

Recommendation The City Council, as the plan's trustee, 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.

Status **Partially Implemented**
Because the city contributed only 69 percent of the ADC amount in 2016, and smoothed investment returns were less than assumed returns, the plan's UAAL grew to over \$14.6 million and the funded ratio declined to 66 percent as of plan year 2016.

In 2017, the city increased its budget for plan contributions by \$325,000, to \$1,525,000, or 91 percent of the \$1,680,000 ADC amount determined by the actuary. As of October 2017, the city had made three quarterly contribution payments with the final payment due in December 2017. City officials indicated they plan to fully fund the ADC amount in the 2018 budget and all subsequent years; however, a formal funding policy has not been adopted. As noted in sections 1.2 and 3.1, the city obtained projection analyses from its actuary when changes to the pension plan were considered during 2017.

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

Recommendation The City Council, as the plan's trustee, 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.



City of Bridgeton Employees Retirement Plan Funding and Governance
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Status of Findings

Status

Not Implemented

The City Council has not obtained an experience study or similar procedures to evaluate the sufficiency of the plan's assumed investment rate of return, and has no plans to obtain such a study. In April 2017, the city's actuary prepared a projection analysis that evaluated the impact of 1) lowering the assumed rate of return and salary scale, 2) increasing contributions by \$200,000 each year for 5 years, or 3) changing the amortization period, on future funded ratios and ADC amounts. However, this analysis did not evaluate the reasonableness of the plan's assumed rate of return of 7.50 percent based on relevant factors, such as historical investment performance and asset allocation. City officials indicated the plan's investment advisor and members of the city's recently-created Pension Commission believe this rate of return is achievable; however, a formal analysis has not been performed. As indicated in the audit report, the plan's investment returns over the previous 30, 20, and 10-year time periods ended December 31, 2015, have been significantly less than the plan's assumed 7.50 percent rate of return. For plan year 2016, the plan's market rate of return was 7.60 percent; however, the 3-year smoothed rate of return was 3.50 percent.

The City Council has not developed a formal investment policy. Based on our review of Pension Commission meeting minutes, during August 2017, Commission members and city officials agreed to start developing a formal investment policy. City officials indicated the initial discussions regarding a policy will occur during the November 2017 meeting.

2. Plan Governance

The plan was not governed by an independent board. Because the plan was governed by the City Council, the governance structure did not allow for a variety of interest groups to be represented. This governance structure provided for an inherent conflict of interest because the City Council was 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.

The City Council, as plan trustee, did not sufficiently monitor and oversee the plan. The city delegated oversight of the plan to the Finance Commission, but the Finance Commission did not hold meetings during 2012, 2013, or 2014. In addition, the city had not established a plan board member education program and City Council members had not received training concerning their fiduciary responsibilities and duties, as required by state law.

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.



City of Bridgeton Employees Retirement Plan Funding and Governance
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Status

Partially Implemented

The City Council still serves as the plan's trustee and has not delegated fiduciary responsibilities to an independent pension board.

In December 2016, the City Council approved Ordinance 16-47 to establish a Pension Commission to serve in an advisory capacity to the City Council. The Commission is required to meet at least once a year for the purpose of monitoring the plan's financial condition and making recommendations to the City Council, as necessary. The authorizing ordinance requires the Commission to be composed of five members, including one current city employee, one retiree, and three citizens. However, the Pension Commission serves in an advisory capacity only; and therefore an inherent conflict of interest still exists because the plan is governed by the City Council.

City Council members are now obtaining training as required. City officials provided training certificates showing all eight City Council members attended required annual pension training during 2016. Officials indicated the next annual pension training for City Council members is scheduled for November 2017.

3. Actuarial Valuations

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

3.1 Amortization Method

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

Recommendation

The City Council, as the plan's trustee, work with the actuary to evaluate implementing a closed amortization period recommended by best practices.

Status

Implemented

In May 2017, the plan's actuary performed a projection analysis to determine the impact of using a 30-year closed amortization period on future funded ratios and ADC amounts. City officials indicated they plan to implement the 30-year closed amortization period for plan year 2018.

3.2 Actuarial Audit

The city had 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.

Recommendation

The City Council, as the plan's trustee, consider periodically obtaining actuarial audits or alternative reviews.



City of Bridgeton Employees Retirement Plan Funding and Governance
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Not Implemented

The City Council has not obtained an actuarial audit. City officials indicated they considered obtaining an actuarial audit, but decided they did not want to incur this expense at this time. However, discussions on this matter were not documented in the meeting minutes or other records. They indicated they would consider obtaining an independent actuarial audit or alternative review in the future.

4. Communication to Key Stakeholders

City officials did not prepare or distribute reports of financial information, including information showing the impact of insufficient contributions on the plan's financial condition, to key stakeholders such as employees, retirees, and citizens. In addition, city officials primarily used a less relevant "funded percentage" statistic, rather than the plan's funded ratio, to communicate the plan's financial condition. The funded percentage statistic was unrealistic because it used current wages only and did not consider future wage increases for current employees. In addition, the use of this statistic could be misleading and provide a false sense of security to stakeholders.

Recommendation

The City Council, as the plan's trustee, prepare and distribute reports summarizing plan financial information, including the impact of insufficient contributions on the plan's 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 the plan's financial condition.

Status

Partially Implemented

City officials indicated various efforts were made to communicate the pension plan's financial condition to key stakeholders. Such efforts included an October 2016 letter from the Mayor to retirees, meetings with current employees, and a statement from the Mayor published in the city's November/December 2016 newsletter to residents. We reviewed the Mayor's letter and newsletter statements and noted the statements contained only limited plan financial information, such as plan assets and increased contribution amounts. The Mayor's letter to retirees correctly cited the plan's funded ratio of 67 percent, but the newsletter to citizens stated the plan "will be over 70 percent funded" after increased contributions in 2016 and 2017. City officials indicated this statement was based on an estimate, rather than a formal projection analysis.