

**Howard County Police and Fire  
Employees' Retirement Plan**

**Financial Statements  
(With Supplementary Information)  
and Independent Auditor's Report**

**June 30, 2014 and 2013**

# Howard County Police and Fire Employees' Retirement Plan

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## Independent Auditor's Report

To the Retirement Plan Committee  
Howard County Police and Fire Employees' Retirement Plan

Report on the Financial Statements

We have audited the accompanying financial statements of the Howard County Police and Fire Employees' Retirement Plan, which comprise the statements of fiduciary net position as of June 30, 2014 and 2013, and the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 Plan'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 Plan'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 opinion.

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Howard County Police and Fire Employees' Retirement Plan as of June 30, 2014 and 2013, and the changes in its fiduciary net position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### *Emphasis of Matter*

As discussed in note 2 to the financial statements, the Plan adopted GASB Statement No. 67, "Financial Reporting for Pension Plans." as of the fiscal year ended June 30, 2014. The related financial reporting requirements have been applied to the accompanying financial statements.

### Required Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary schedules as of June 30, 2014, listed in the foregoing index, together referred to as "required supplementary information," are presented for the purpose of additional analysis and are not a required part of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

A handwritten signature in cursive script that reads "Cohn Reznick LLP".

Baltimore, Maryland  
November 20, 2014

## Howard County Police and Fire Employees' Retirement Plan

### Statements of Fiduciary Net Position June 30, 2014 and 2013

	2014	2013
<u>Assets</u>		
Receivables		
Employer contributions	\$ 900,923	\$ 768,125
Employee contributions	275,033	240,583
Interest and dividends	583,973	583,685
Due from sale of investments	5,340	998,925
Other	3,287	8,965
Total receivables	1,768,556	2,600,283
Investments, at fair value		
Equities	218,444,063	173,700,405
Alternative investments	50,375,775	37,789,474
Money market funds	7,714,607	4,539,235
Fixed income	116,303,162	109,179,748
Real estate funds	16,696,616	17,464,744
Total investments	409,534,223	342,673,606
Prepaid insurance	409	20,409
Total assets	411,303,188	345,294,298
<u>Liabilities</u>		
Investments purchased	701,370	853,423
Accounts payable	331,202	301,312
Total liabilities	1,032,572	1,154,735
Net position held in trust for pension benefits	\$ 410,270,616	\$ 344,139,563

See Notes to Financial Statements.

**Howard County Police and Fire Employees' Retirement Plan**

**Statements of Changes in Fiduciary Net Position  
Years Ended June 30, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
Additions		
Contributions		
Employer	\$ 20,822,339	\$ 19,307,076
Employee	<u>6,525,501</u>	<u>6,202,389</u>
Total contributions	<u>27,347,840</u>	<u>25,509,465</u>
Investment income		
Net appreciation in fair value of investments	46,022,344	26,646,221
Interest	2,580,183	2,313,389
Dividends	7,422,106	5,963,000
Other, net	<u>23,887</u>	<u>56,381</u>
Total investment income	56,048,520	34,978,991
Less investment expense	<u>1,315,242</u>	<u>1,152,773</u>
Net investment income	<u>54,733,278</u>	<u>33,826,218</u>
Total additions	<u>82,081,118</u>	<u>59,335,683</u>
Deductions		
Benefit payments		
Annuities	15,083,565	13,761,384
Refunds of contributions	<u>595,950</u>	<u>127,779</u>
Total benefits	15,679,515	13,889,163
Administration expenses	<u>270,550</u>	<u>237,013</u>
Total deductions	<u>15,950,065</u>	<u>14,126,176</u>
Net change	66,131,053	45,209,507
Net position held in trust for pension benefits		
Beginning of year	<u>344,139,563</u>	<u>298,930,056</u>
End of year	<u>\$ 410,270,616</u>	<u>\$ 344,139,563</u>

See Notes to Financial Statements.

# Howard County Police and Fire Employees' Retirement Plan

## Notes to Financial Statements June 30, 2014 and 2013

### Note 1 - Plan description

#### Plan administration

The Howard County Police and Fire Employees' Retirement Plan (the "Plan") is a single-employer defined benefit public employee retirement system established and administered by Howard County (the "County"), Maryland, to provide defined pension benefits for career firefighters and sworn police officers. The Plan is considered part of the County's financial reporting entity and is included in the County's financial statements as a pension trust fund. The accompanying financial statements present only the operations of the Plan and are not intended to present the financial position and results of operations of the County.

#### Plan membership

At July 1, 2013 and 2012, the Plan's membership consisted of the following:

	<u>2013</u>	<u>2012</u>
Active	849	828
Retired and beneficiaries	274	263
Disabled	24	22
Terminated vested	24	21
	<u>1,171</u>	<u>1,134</u>

The Plan was established, is operated, and may be amended under the provisions of Sections 1.400 and 1.401A to 1.478A of the Howard County Code. All of the County's full-time career firefighters and sworn police officers are eligible to participate in the Plan. The Retirement Plan Committee established by Howard County Code Section 1.455 has full power and authority to administer and operate the Plan in accordance with its terms and in particular the authority contained in subsection 1.454(a). The Pension Oversight Commission established by Howard County Section 1.482 provides ongoing assessment and evaluation of the Plan's operations.

#### Benefits provided

All of the County's full-time career police and fire officers hired on or after July 1, 1990 must enroll in the Police and Fire Plan. The Plan provides retirement benefits as well as death and disability benefits and cost-of-living adjustments.

Participants become vested after 5 years of eligibility service and are entitled to a benefit beginning at age 62. Terminated vested employees with less than 20 years of service will receive a benefit equal to 2.5% of average compensation times the number of years of creditable service, payable at age 62. If an employee leaves employment or dies before 5 years of eligibility service, accumulated employee contributions plus interest are refunded to the employee or the designated beneficiary. A participant who becomes totally and permanently disabled may retire prior to normal retirement and receive a benefit. Both disability and death benefits vary if incurred in the line of duty.

# Howard County Police and Fire Employees' Retirement Plan

## Notes to Financial Statements June 30, 2014 and 2013

Employees attaining the age of 62 who have completed 5 years of eligibility service and employees who have completed 20 years of eligibility service are entitled to a normal retirement benefit. The amount will vary, based on the number of years of creditable service, from 50% (with 20 years of service) to 80% (with 30 years of service) of average compensation for police; and from 50% (with 20 years of service) to 70% (with 30 years of service) of average compensation for firefighters.

Annually, the benefits are adjusted for cost-of-living adjustment ("COLA"). The Plan uses the Consumer Price Index ("CPI-U") for the Washington/Baltimore area as published by the Bureau of Labor Statistics to calculate the change in retiree allowances each July. Maximum annual COLA is 2%.

### **Contributions**

The Plan is authorized to establish or amend the obligations to make contributions under the provisions of the Howard County Code, Sections 1.423A and 1.465A. The Plan's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. Participant contributions are 11.6% of base pay for participating Police Department Employees and 7.7% of base pay for participating Fire Department Employees. The County funds the remainder of the cost of employees' participation in the Plan, which was 31% and 30.5% of covered payroll in fiscal years 2014 and 2013, respectively. The County contribution to the Plan is determined through an actuarial valuation performed by Bolton Partners, Inc. for each fiscal year. Expenses incurred in the administration and operation of the Plan are funded by the Plan.

### **Note 2 - Summary of significant accounting policies and plan asset matters**

#### **Method used to value investments**

The Plan's investments are reported at fair market value. Short-term investments consisting of money market funds are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at either the last reported sales price, evaluated bid, broker quoted, or pool-specific pricing. The fair value of real estate investments is approximated by the net asset value of the Plan's share of ownership of the co-mingled real estate investment funds. Fair value of other securities is determined by the mean of the most recent bid and asked prices as obtained from dealers that make markets in such securities.

#### **Basis of accounting**

The Plan's financial statements are prepared using the accrual basis of accounting. Employer and employee contributions are recognized as revenue in the period in which employee services are performed and expenses and refunds are recorded when the corresponding liabilities are incurred, regardless of when payment is made. Benefits are recorded when the payments are made.

# Howard County Police and Fire Employees' Retirement Plan

## Notes to Financial Statements June 30, 2014 and 2013

### **Use of estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

### **Income taxes**

The Internal Revenue Service issued a determination letter on November 7, 1996, which stated that the Plan and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from Federal income taxes. Although the Plan has been amended since receiving the determination letter, in the opinion of the Plan administrator, the Plan and its underlying trust are designed and are being operated in compliance with the applicable provisions of the Internal Revenue Code; therefore, the Plan is qualified and the related trust is tax exempt.

### **Reclassifications**

Certain prior year balances have been reclassified to conform to the current year presentation.

### **Recently issued accounting pronouncements**

In June 2012, the GASB issued Statement No. 67, "Financial Reporting for Pension Plans" ("GASB No. 67") and Statement No. 68, "Accounting and Financial Reporting for Pensions" ("GASB No. 68") to improve financial reporting by state and local governmental pension plans administered through trusts that meet the specified criteria and to improve accounting and financial reporting by state and local governments for pensions, respectively.

GASB No. 67 amends the previous standards (GASB No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" and GASB No. 50, "Pension Disclosures") for pension plans administered through trusts or equivalent arrangements that meet the specified criteria by revising the financial statements presentation for pension plans, specifying the required approach to measuring the pension liability of employers and non-employer contributing entities for benefits provided through pension plans (the net pension liability) and stipulating incremental note disclosures and RSI in the separately issued financial reports for pension plans. The Plan adopted GASB No. 67 as of fiscal year ended June 30, 2014 and has applied the related changes to the accompanying financial statements.

GASB No. 68, which is effective for fiscal years beginning after June 15, 2014, amends the current standards (GASB No. 27, "Accounting for Pensions by State and Local Governmental Employers," and GASB No. 50, "Pension Disclosures") for employers with defined benefit pension plans by requiring employers to shift from a "funding approach," in which pension liability is not reported if employers make the annual required contribution, to an "earnings approach," where pension liability is reported as employees earn their pension benefits and changes in pension liability are recognized immediately as pension expense or as deferred outflows/inflows of resources to be amortized over future periods by establishing the standards for measuring and recognizing Net Pension Liability, identifying

## Howard County Police and Fire Employees' Retirement Plan

### Notes to Financial Statements June 30, 2014 and 2013

the methods and assumptions that should be used to determine Total Pension Liability and stipulating incremental note disclosures and RSI in the financial reports for employers with defined benefit pension plans.

#### Subsequent events

Material subsequent events have been considered for disclosure and recognition in these financial statements through November 20, 2014 (the date the financial statements were available to be issued).

#### Note 3 - Investments

##### Investment policy

The Plan's policy in regard to the allocation of invested assets is established and administered by the Retirement Plan Committee. Specific investment goals stated in the policy shall be reviewed at least annually and, when appropriate, new goals and standards shall be adopted by the Retirement Plan Committee. The policy is expected to provide diversification of assets in an effort to maximize investment return to the Plan consistent with prudent market and economic risk. All of the Plan's assets are to remain invested at all times in the asset classes as designated by the policy. The Plan's strategic asset allocation policy as of June 30, 2014, is as follows:

<u>Asset Class</u>	<u>Target Allocation</u>
Equities	45.0%
Alternative investments	17.5%
Fixed income	32.5%
Real estate funds	<u>5.0%</u>
Total	<u><u>100.0%</u></u>

##### Concentrations

The Plan held investments in the following organizations that represent 5% or more of the pension plan's fiduciary net position: Dimensional (7%), Doge and Cox (15%), Invesco (8%), LSV (8%), Mondrian (6%), PIMCO (11%), Pyramis (9%), and Westfield (7%).

##### Concentration of credit risk

The Plan's investment policy does not establish any limitation on the percentage that the Plan may have with any one issuer, other than to state that the Plan's assets are to be diversified in accordance with Modern Portfolio Theory. At June 30, 2014, the Plan had 7% of its investments in corporate bonds.

##### Rate of return

For the year ended June 30, 2014, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 15.62%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amount actually invested.

**Howard County Police and Fire Employees' Retirement Plan**

**Notes to Financial Statements  
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**Investments purchased and due from sales of investments**

Investment transactions are recorded on a trade plus three days or less timetable resulting in an amount due to and due from State Street Bank (the "Plan's Trustee") at year end.

**Risks and uncertainties**

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statements of fiduciary net position.

**Note 4 - Reserves**

The Plan has not established any legally required reserves; therefore the net assets are held in trust to fund current and future benefit obligations.

**Note 5 - Deferred retirement option program**

The Plan offers a program called Deferred Retirement Option Plan ("DROP"). This is a voluntary benefit program which offers qualified active Police Participants, who would be entitled to retire and receive benefits, the option to continue working. An individual DROP account is created and is credited with the monthly retirement benefits that would have been paid during the DROP period had the participant actually retired. Adjustments are made for cost-of-living increases awarded to retirees and additional sick leave earned. The DROP account is paid to the employee, in addition to the benefit payment entitled under the defined benefit plan based on the earlier years of service, when the employee eventually retires. Participating members may elect distribution as one lump sum payment, a rollover or in monthly payments. The sum of the Plan's DROP accounts as of June 30, 2014 was \$7,929,547.

**Note 6 - Net pension liability of the County**

The components of the net pension liability of the County at June 30, 2014, were as follows:

Total pension liability	\$ 492,249,932
Plan fiduciary net position	<u>410,270,616</u>
County's net pension liability	<u>\$ 81,979,316</u>
Plan fiduciary net position as a percentage of the total pension liability	83.35%

# Howard County Police and Fire Employees' Retirement Plan

## Notes to Financial Statements June 30, 2014 and 2013

### Actuarial assumptions

The total pension liability in the July 1, 2013 actuarial valuation rolled forward to June 30, 2014 was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0 percent
Salary increases	Varies by service, 4.5 to 8.25 percent, including inflation
Investment rate of return	7.75 percent, net of pension plan investment expense, including inflation

Mortality rates were based on the RP-2000 Combined Healthy tables with generational projection by Scale AA, set forward by two years.

The actuarial assumptions used in this valuation, for GASB 67 purposes, were generally based on the 2009 Experience Study covering the period from July 1, 2005 through June 30, 2009.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

Best estimates of geometric real rates of return for each major asset class, included in the Plan's target allocation as of June 30, 2014 (see note 3), are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Rate of Return</u>
Equities	4.90%
Alternative investments	5.71%
Fixed income	1.75%
Real estate funds	5.25%

### Discount rate

The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that the County contributions will be made at rates equal to the difference between actuarially determined contribution rates and the employee rate. Based on those assumptions, the Plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments

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**Notes to Financial Statements  
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was applied to all periods of projected benefit payments to determine the total pension liability. The discount rate was changed from 8% to 7.75% for fiscal year ended June 30, 2014.

**Sensitivity of the net pension liability to changes in the discount rate**

The following presents the net pension liability of the County, calculated using the discount rate of 7.75%, as well as what the County's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.75%) or 1 percentage point higher (8.75%) than the current rate:

	<u>1% Decrease (6.75%)</u>	<u>Current Discount Rate (7.75%)</u>	<u>1% Increase (8.75%)</u>
County's net pension liability	<u>\$ 148,935,936</u>	<u>\$ 81,979,316</u>	<u>\$ 26,560,368</u>

**Required Supplementary Information**

## Howard County Police and Fire Employees' Retirement Plan

### Required Supplementary Information

#### Schedule of Changes in the County's Net Pension Liability and Related Ratios (Dollar amounts in thousands)

	FY 2014*
<b>Total pension liability</b>	
Service cost	\$ 17,535
Interest	33,630
Change of benefit terms	-
Difference between expected and actual experience	-
Changes of assumptions	14,989
Benefit payments - including refunds of employee contributions	(15,679)
<b>Net change in total pension liability</b>	50,475
<b>Total pension liability - beginning</b>	441,775
<b>Total pension liability - ending</b>	\$ 492,250
<b>Plan fiduciary net position</b>	
Contributions - employer	\$ 20,822
Contributions - employee	6,526
Net investment income	54,733
Benefit payments - including refunds of employee contributions	(15,680)
Administrative expenses	(271)
Other	-
<b>Net change in plan fiduciary net position</b>	66,131
<b>Plan fiduciary net position - beginning</b>	344,140
<b>Plan fiduciary net position - ending</b>	\$ 410,271
<b>County's net pension liability - ending</b>	\$ 81,979
<b>Plan fiduciary net position as a percentage of the total pension liability</b>	83.35%
<b>Total covered employee payroll (FY 2014)</b>	\$ 80,035
<b>County's net pension liability as a percentage of covered employee payroll</b>	102.43%
<b>Expected average remaining service years of all participants</b>	9

\* Information for FY 2013 and earlier is not available

See Independent Auditor's Report.

## Howard County Police and Fire Employees' Retirement Plan

### Required Supplementary Information

#### Schedule of County Contributions (Dollar amounts in thousands)

	FY 2014
Actuarially determined contribution	\$ 20,822
Contributions in relation to the actuarially determined contribution	20,822
Contribution deficiency (excess)	\$ -
Covered-employee payroll <sup>1</sup>	\$ 80,035
Contributions as a percentage of covered-employee payroll <sup>1</sup>	26.02%

<sup>1</sup>Amounts shown are based on total compensation and not just pensionable earnings only.

#### Notes to Schedule

##### Valuation Date:

The actuarial valuation date is the beginning of the fiscal year (July 1, 2013).

##### Methods and assumptions used to determine contribution rates:

Actuarial cost method	Projected Unit Credit (Entry Age used for GASB 67 purposes)
Amortization method	Level percent of pay increasing 3% per year
Remaining amortization period	Remaining amortization periods range from 9 to 30 years
Asset valuation method	5-year smoothed market
Inflation	3.0%
Salary increases	Varies by service; 4.5% to 8.25%, including inflation
Investment rate of return	7.75%, net of pension plan investment expense, including inflation
Retirement age	Rates vary by participant age and service and (for GASB purposes only) set at 100% DROP entry (or expected entry) Normal Cost (for GASB 67 purposes) ceases for Police members when they enter DROP
Mortality	RP-2000 Combined Healthy Annuitant Mortality Table with generational projection by Scale AA, set forward two years
Cost of Living Adjustment ("COLA")	2.0%

See Independent Auditor's Report.

**Howard County Police and Fire Employees' Retirement Plan**

**Required Supplementary Information**

**Schedule of Investment Returns**

<u>Fiscal Year Ended</u>	<u>Annual money-weighted rate of return, net of investment expenses</u>
June 30, 2014	15.62%
June 30, 2013	11.33%
June 30, 2012	-1.21%
June 30, 2011	20.56%
June 30, 2010	15.42%
June 30, 2009	-16.21%
June 30, 2008	-14.44%
June 30, 2007	17.62%
June 30, 2006	12.19%
June 30, 2005	10.66%