

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

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

June 30, 2013 and 2012

Howard County Police and Fire Employees' Retirement Plan

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Independent Auditor's Report

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 plan net position as of June 30, 2013 and 2012, and the related statements of changes in plan net position for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Plan 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 our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 net position of the Howard County Police and Fire Employees' Retirement Plan as of June 30, 2013 and 2012, and the changes in its net position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary Schedules of Funding Progress and Employer Contributions as of June 30, 2013, 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 22, 2013

Howard County Police and Fire Employees' Retirement Plan

Statements of Plan Net Position

June 30, 2013 and 2012

	2013	2012
<u>Assets</u>		
Receivables		
Employer contributions	\$ 768,125	\$ 671,198
Employee contributions	240,583	213,017
Interest and dividends	583,685	581,410
Due from sale of investments	998,925	2,424,689
Other	8,965	38,284
	2,600,283	3,928,598
 Investments, at fair value		
Common stocks	91,025,426	76,354,009
Mutual funds	120,464,453	101,082,437
Money market funds	4,539,235	4,474,692
Fixed income	109,179,748	98,234,635
Real estate funds	17,464,744	16,032,339
	342,673,606	296,178,112
 Prepaid insurance	20,409	12,054
	345,294,298	300,118,764
<u>Liabilities</u>		
Investments purchased	853,423	946,783
Accounts payable	301,312	241,925
	1,154,735	1,188,708
 Net position held in trust for pension benefits (A schedule of funding progress is presented on page 15)	\$ 344,139,563	\$ 298,930,056

See notes to financial statements

Howard County Police and Fire Employees' Retirement Plan

Statements of Changes in Plan Net Position

Years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Additions		
Contributions		
Employer	\$ 19,307,076	\$ 18,051,050
Employee	<u>6,202,389</u>	<u>6,009,790</u>
Total contributions	<u>25,509,465</u>	<u>24,060,840</u>
Investment income		
Net appreciation (depreciation) in fair value of investments	26,646,221	(11,405,879)
Interest	2,313,389	2,459,123
Dividends	5,963,000	6,005,291
Other, net	<u>56,381</u>	<u>36,659</u>
	34,978,991	(2,904,806)
Less investment expense	<u>1,152,773</u>	<u>1,071,161</u>
Net investment (loss) income	<u>33,826,218</u>	<u>(3,975,967)</u>
Total additions	<u>59,335,683</u>	<u>20,084,873</u>
Deductions		
Benefits		
Annuities	13,761,384	13,556,447
Refunds of contributions	<u>127,779</u>	<u>264,842</u>
Total benefits	13,889,163	13,821,289
Administration expenses	<u>237,013</u>	<u>255,336</u>
Total deductions	<u>14,126,176</u>	<u>14,076,625</u>
Net change	45,209,507	6,008,248
Net position held in trust for pension benefits		
Beginning of year	<u>298,930,056</u>	<u>292,921,808</u>
End of year	<u><u>\$ 344,139,563</u></u>	<u><u>\$ 298,930,056</u></u>

See notes to financial statements

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements

June 30, 2013 and 2012

Note 1 - Plan Description

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.

At July 1, 2012 and 2011, the Plan's membership consisted of:

	<u>2012</u>	<u>2011</u>	<u>% Change</u>
Active	828	832	-0.5%
Retired and beneficiaries	263	249	5.6%
Disabled	22	21	4.8%
Terminated vested	21	20	5.0%
	<u>1,134</u>	<u>1,122</u>	<u>1.1%</u>

The Plan was established, is operated, and may be amended under the provisions of the Howard County Code, Sections 1.400 and 1.401A to 1.478A. All of the County's full-time career fire fighters and sworn police officers are eligible to participate in the Plan. The Pension Oversight Commission established by Howard County Section 1.482 provides ongoing assessment and evaluation of the Plan's operations.

The Plan provides retirement benefits as well as death and disability benefits and cost-of-living adjustments. Effective January 1, 2003, employees attaining the age of 62 who have completed five 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 officers and from 50% (with 20 years of service) to 70% (with 30 years of service) of average compensation for fire fighters. Participants become vested after five years of eligibility service and are entitled to a benefit beginning at age 62. Terminated vested employees will receive a benefit equal to 2.5% of average compensation times their number of years of creditable service, payable at age 62.

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements - Continued

June 30, 2013 and 2012

An employee who leaves before becoming vested (5 years) is entitled to a refund of his or her employee contributions with interest. Employee contributions are credited with 5% interest, compounded annually, through the end of the fiscal year in which the employee terminates and 2% interest each year thereafter. For employees who terminated prior to July 1, 2006, contributions earn 5% interest for all years.

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.

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 payment is made 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.

Note 2 - Summary of Significant Accounting Policies and Plan Asset Matters

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.

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

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements - Continued

June 30, 2013 and 2012

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.

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, 2013, the Plan had 6.85% of its investments in corporate bonds.

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 plan net position.

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. In the opinion of the Plan administrator, the Plan and its underlying trust have operated within the terms of the Plan and remain qualified under the applicable provisions of the Internal Revenue Code.

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Recently Issued Accounting Pronouncements

In June 2011, the Governmental Accounting Standards Board (GASB) issued Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position" (GASB No. 63) to provide financial reporting guidance for deferred outflows of resources, deferred inflows of resources, and net position in the statement of financial position. GASB No. 63, which is effective for fiscal years beginning after December 15, 2011, specifies that an entity's assets, deferred outflows of resources, liabilities and deferred inflows of resources should be segregated in its statement of financial position with the residual (net) amount reported as "Net Position" rather than "Net Assets."

The Plan adopted GASB No. 63 as of the fiscal year ended June 30, 2013 and has retroactively applied the related changes to the accompanying financial statements by replacing "Net Assets" with "Net Position."

In June 2012, the GASB issued Statement No. 65, "Items Previously Reported as Assets and Liabilities" (GASB No. 65) to provide financial reporting guidance for reclassifying certain items that were previously reported as assets and liabilities as deferred outflows of resources, deferred inflows of resources, or current-period outflows and inflows. GASB No. 65, which is effective for fiscal years beginning after December 15, 2012, had no material effect on the accompanying financial statements.

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, which is effective for fiscal years beginning after June 15, 2013, amends the current 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.

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements - Continued

June 30, 2013 and 2012

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 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.

The Plan is evaluating the impact of GASB No. 67 and GASB No. 68 on its operations and financial statements once these accounting standards become effective.

Subsequent Events

Material subsequent events have been considered for disclosure and recognition in these financial statements through November 22, 2013 (the date the financial statements were available to be issued).

Note 3 - Contributions and Reserves

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. Fire participants are required to contribute 7.7% of their annual compensation to the Plan. Police participants are required to contribute 11.6% of their annual compensation to the Plan. After 30 years of creditable service, participant contributions are no longer required. The County funds the remainder of the cost of employees' participation in the Plan which was 29.6% of covered payroll in fiscal year 2012. In fiscal year 2013, the County contribution to the Plan was 30.5%, determined through an actuarial valuation performed by Bolton Partners, Inc. for the fiscal year starting July 1, 2012. Expenses incurred in the administration and operation of the Plan are funded by the Plan.

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

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - Funded Status and Funding Progress

The funded status of the Plan as of July 1, 2012, the most recent actuarial valuation date, is as follows (dollar amounts in millions):

Actuarial Valuation Date of July 1,	(1) Actuarial Value of Plan Assets	(2) Actuarial Accrued Liability (AAL)	(3) Percentage Funded (1)/(2)	(4) Unfunded Actuarial Accrued Liability (UAAL) (2) - (1)	(5) Annual Covered Payroll	(6) UAAL as a % of Covered Payroll (2) - (1)/(5)
2012	\$ 308.8	\$ 403.7	76.5%	\$ 94.9	\$ 57.6	164.9%

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to financial statements, presents multiyear trend information about whether the actuarial values of Plan assets are increasing or decreasing over time relative to the AALs for benefits. Changes pursuant to the most recent Experience Study are reflected below.

Howard County Police and Fire Employees' Retirement Plan

Notes to Financial Statements - Continued

June 30, 2013 and 2012

Additional information as of the latest actuarial valuation follows:

Valuation date	July 1, 2012
Actuarial cost method	Projected unit credit cost method
Amortization method	Level percentage of payroll that increases 3.0% a year
Remaining amortization period	No more than 10 to 21 years, except for actuarial gains and losses and changes in Plan assumptions which are amortized over a 15-year open amortization period, with payments increasing 3.0% a year
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate-of-return	8%, compounded annually, gross of investment expenses
Projected salary increases	4.5% to 8.25%*
Cost-of-living adjustments (COLAs)	2%, compounded annually

*Includes inflation at 3.0%.

Required Supplementary Information

Howard County Police and Fire Employees' Retirement Plan

Required Supplementary Information

**Schedule of Funding Progress
(Dollar amounts in millions)
(Unaudited)**

June 30, 2013

Actuarial Valuation Date of July 1,	(1) Actuarial Value of Plan Assets	(2) Actuarial Accrued Liability (AAL)	(3) Funded Ratio (1)/(2)	(4) Unfunded Actuarial Accrued Liability (UAAL) (2) - (1)	(5) Annual Covered Payroll	(6) UAAL as a percentage of Covered Payroll (2) - (1)/(5)
2007	\$ 210.8	\$ 270.5	77.9%	\$ 59.7	\$ 43.6	136.9%
2008	\$ 238.4	\$ 300.7	79.3%	\$ 62.3	\$ 46.9	132.9%
2009	\$ 253.6	\$ 322.5	78.6%	\$ 68.9	\$ 52.2	132.1%
2010	\$ 267.0	\$ 348.7	76.6%	\$ 81.7	\$ 53.3	153.3%
2011	\$ 288.4	\$ 378.3	76.2%	\$ 89.9	\$ 55.7	161.6%
2012	\$ 308.8	\$ 403.7	76.5%	\$ 94.9	\$ 57.6	164.9%

Notes to Schedule of Funding Progress:

Analysis of the dollar amounts of Plan assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing the Plan's net assets as a percentage of the actuarial accrued liability provides one indication of the Plan's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the Plan is becoming stronger or weaker. Generally, the greater this percentage, the stronger the Plan. Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded accrued actuarial liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the Plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the Plan.

Howard County Police and Fire Employees' Retirement Plan

Required Supplementary Information - Continued

**Schedule of Employer Contributions
(Unaudited)**

June 30, 2013

<u>Years ended June 30,</u>	<u>Annual Required Contributions</u>	<u>Percentage Contributed</u>
2008	\$ 14,716,609	100%
2009	\$ 14,426,424	100%
2010	\$ 14,106,449 *	105%
2011	\$ 15,676,918	100%
2012	\$ 18,051,050	100%
2013	\$ 19,307,076	100%

*The amount funded by the County for the year ended June 30, 2010 was \$14,880,921.