Special Report

Police Retirement Funds

August 1998

City Auditor's Office

City of Kansas City, Missouri

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August 24, 1998

Honorable Mayor and Members of the City Council:

This special report on the two Police retirement systems was initiated by the city auditor pursuant to Article II, Section 13 of the Charter of Kansas City. The review began as a request by Mayor Pro Tem George Blackwood to determine whether the city could reduce annual contributions to both systems by 20 percent without harming their financial health. While seeking an answer to this question, we identified additional information that we felt should be brought to the attention of the Mayor and City Council regarding city contributions to these systems. Consequently, we expanded the scope of our work to develop this special report.

The answer to the Mayor Pro Tem's question is no. The most recent valuation of retirement system assets and benefit obligations precludes the city from reducing current contributions. Accumulated retirement system assets are less than the projected costs to pay for current retirement benefit obligations. We also found recently enacted increases in retirement plan benefits, approved by the state legislature. Increasing benefits increases costs, as does the practice of routinely providing newer benefits to past retirees. These actions make it more difficult to bring the systems to full funding and preclude any reduction in current contributions.

The two Police retirement systems are state agencies, established to provide benefits to police officers and civilian employees, both state employees. Not only does state law establish the required funding the city must contribute to both systems, but the state legislature is responsible for approving all benefit enhancements. Decisions regarding benefit enhancements are made with little city input and city interests do not appear to be a major factor in legislative decisions. As a result, the city is required to provide funding for the Police retirement systems without formal control over costs.

The issue that we believe needs to be corrected is the present disconnect between funding and control. While the state presently retains formal control over approval of benefit changes, these changes are not funded by the state, but are instead funded by the city. Consequently, the state approves benefit changes it does not have to pay and the city pays for benefits without the opportunity to formally approve them. Responsibility for funding and formal control of benefit changes should go hand in hand. The city should not be held responsible for funding benefits that it has no legally established ability to control.

The state's method of funding retirement benefits for its employees by requiring the city to make contributions is part of the state statutes. However, requiring the city to fund increases in benefits occurring after November 1980 results in the state imposing an unfunded mandate on the city, something the Hancock Amendment was intended to prevent. Our interpretation of this amendment is that any changes in the retirement system since 1980 would have to be funded by the state legislature, rather than the city. However, section 86.810 of the Missouri statutes, revised in 1997, suggests that the state has been approving recent retirement benefit amendments with the understanding that the state would not have to fund any cost increases. If the city did not provide the additional funding, neither would the state, so the benefit enhancements would be eliminated, unless another funding source is found.

We recommend the city pursue legislation giving financial responsibility for both Police retirement systems to the state. If that fails, we recommend that the city pursue state legislation altering board composition and requiring formal City Council approval of benefit changes subsequent to their passage in the state legislature. Should the state decline to either fund the systems or provide the city with the means to control costs, we recommend the city consider legal action to eliminate the city's responsibility for benefit enhancements that may be enacted in the future. This action will not result in the city receiving reimbursement of the cost of the enhanced benefits already funded through city contributions that may have been enacted in violation of the Hancock Amendment, and we are not suggesting current benefits be eliminated. Rather, we seek to eliminate the city's responsibility to fund new benefits without a requirement that the City Council formally approve them, absent control of the Police retirement systems being placed with the city.

The draft report was initially sent to the retirement board chairman and the city manager on March 31, 1998, for review and comment. After initial comments, a revised draft was sent on July 16, 1998. Written responses from the chairman and the city manager are included as appendices. The audit team on this project was Douglas Jones and Gary White.

Mark Funkhouser
City Auditor

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Introduction

Report Objectives

This special report on the Kansas City Police Retirement System and the Civilian Employees' Retirement System was initiated by the city auditor pursuant to Article II, Section 13 of the Charter of Kansas City. The review began as a request by Mayor Pro Tem George Blackwood to determine whether the city can reduce annual contributions to both systems by 20 percent without harming their financial health. While seeking an answer to this question, we identified additional information that we felt should be brought to the attention of the Mayor and City Council regarding the city's contributions to both retirement systems. Consequently, we expanded the scope of our work to develop this special report, seeking answers to the following questions:

- What is the current funding status of the two Police retirement systems?

- Are there any regulations that mandate the minimum annual city contributions to the two Police retirement systems?

- What are the potential problems/obstacles to reducing future city contributions?

Scope and Methodology

The report was completed in accordance with applicable government auditing standards for non-audit work. Methods included:

- Reviewing annual retirement system reports, literature, and other documents relevant to the retirement systems.

- Interviewing city staff and representatives of the retirement boards.

- Obtaining and reviewing information on the city employees' and firefighters' retirement systems for comparative purposes.

Originally we intended to compare the financial status of the two Police retirement systems with the status of the city employees and firefighter pension systems over time. In November 1994, the

Governmental Accounting Standards Board (GASB) issued three statements to require greater consistency for the measurement of retirement plan assets and obligations.[1] However, after obtaining comparative information on the four retirement systems, we learned that the two Police retirement systems have only recently adopted the established standards while the standards were adopted for the two city employee systems shortly after the GASB standards were issued. Consequently, we were only able to compare the most recent financial information of the retirement systems.

No information was omitted from the report because it was deemed privileged or confidential.

Background

The city funds four retirement systems. The Kansas City Police Department has two retirement systems for its employees; the Police Retirement System and the Civilian Employees' Retirement System. The two Police retirement systems were established under state statutes which require the city to contribute to both systems. The city also has two retirement systems for its employees; the Employees' Retirement System and the Firefighters' Pension System. The two city retirement systems were established by and operate under city ordinances. The city contributes to all four retirement systems.

The retirement systems have different board structures. The two Police retirement systems are overseen by a single, nine-member board. According to state statutes the retirement board for the police officer retirement system shall consist of four appointed and five elected members.[2] Statutes further state that members of the retirement board for civilian employees shall be the same as the members of the retirement board for police officers.[3] The Police retirement board has appointed a secretary, who is not a member of the board, to oversee the day-to-day operation of the retirement system. There is one staff member in addition to the board secretary.

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[1] Governmental Accounting Standards Board Statements 25, 26, and 27, issued in November 1994. Statements 25 and 26 are effective for all reports prepared for reporting periods after June 15, 1996. Statement 27 is effective for reporting periods after June 15, 1997.

[2] Mo. Rev. Stat. §86.393.

[3] RSMo §86.700.

The city employees' retirement system board also consists of nine members while the firefighters' pension system has seven trustees on its board. Administration of the city retirement systems is performed by the Retirement Division of the Human Resources Department, under the direction of an executive director appointed by the Human Resources director. The division has three staff members in addition to the executive director.

All four retirement systems provide defined benefits. Public retirement systems offer a variety of plans and benefits to their members. All four systems are considered defined benefit plans which promise a specific level of benefits to employees when they retire. The amount of the benefit is determined by multiplying the employee's years of service by a percentage of the employee's final compensation.[4] The percentage used may depend on an employee's marital status. For some systems, a smaller percentage is received by married employees in exchange for "spousal consideration" (spouses receiving a spousal annuity or other spousal benefit from the retirement system). Each system also allows for an annual cost of living adjustment, not to exceed 3 percent. Exhibit 1 details the pension calculation for the four retirement systems as of April 30, 1997.

Exhibit 1. Pension Calculation as of April 30, 1997

Retirement System	Base Pension Formula
Police Officers	(2% of final compensation x years of service) up to 60% of final compensation
Firefighters	(2% of final average compensation x years of service) up to 60% of final average compensation; (1.8% with spousal consideration)
Police Civilians	(2% of final compensation x years of service); (1.8% with spousal consideration)[5]
City Employees	(2% of final average compensation x years of service) up to 60% of final average compensation; (1.8% with spousal consideration)

Sources: Retirement Systems Annual Reports for fiscal year 1997.

[4] All four pension systems compute final compensation using an average of the 24 months in which the pension member earned his/her highest salary. The city employees and firefighter pension systems limit the months eligible for inclusion in the calculation to those in the 10 years prior to retirement. The two Police pension systems consider all years of service.

[5] Effective August 28, 1997, spousal consideration no longer affects the base pension calculation.

Both the city and the retirement system member contribute. The four retirement systems are contributory plans in that funding for retirement benefits is derived in part from city and retirement system member contributions. These contributions are in turn invested and any investment returns are added to the accumulated contributions. Contribution rates are determined by the retirement system actuary,[6] based on the benefits that will accrue to members during the next plan year, an estimate of the benefit costs that will occur in future years, and an estimate of the amount of anticipated investment returns. The city's contribution also includes an amount that amortizes the portion of the estimated retirement costs that have not been funded.[7] The contribution rate is usually expressed as a percentage of the employer's payroll and the retirement member's salary. Exhibit 2 details both the city's and the retirement member's contribution percentages for each retirement system.

Exhibit 2. Contribution Rates as of April 30, 1997

	Retirement System			
Contribution	Police Officers	Firefighters	Police Civilians	City Employees
City retirement	20.60%	21.60%	3.00%	11.70%
City Social Security	1.45%	1.45%	7.65%	7.65%
Member retirement	9.55%	10.55%	5.00%	5.00%[8]
Member Social Security	1.45%	1.45%	7.65%	7.65%

Sources: Retirement Systems Annual Reports for fiscal year 1997.

[6] A consultant employed by the retirement system to calculate contribution requirements using computations involving compound interest on assets, retirement ages, and life expectancy estimates.

[7] On January 16, 1987, the City Council passed Resolution 60466 endorsing police retirement changes and ratifying the agreement reached between the city manager and chief of police. Included was an increase in the city's contribution from 16 to 17 percent effective May 1, 1987; thereafter, each May 1, the city was to increase its contributions by one percent and on May 1, 1991 by 0.6 percent. City contributions have remained at 20.6 percent since 1991.

[8] Ordinance 980525, passed on May 21, 1998, reduced the member's retirement contribution to 4 percent, effective with the pay period beginning on June 7, 1998.

The city's contribution rate to the firefighters system includes a one percent contribution to provide supplemental health benefits. Also, included in the city's contribution to the city employees' retirement system is an additional 2.2 percent to fund a retirement incentive program. This additional contribution is expected to end after December 1998. City contribution rates for the police officers and firefighters retirement systems are higher than those for general employees and police civilians because of differences in benefit structures and contributions to Social Security. For police officers and firefighters hired after April 1, 1986, the city (and the employee) contribute 1.45 percent to the Medicare portion of Social Security.

All employees participate. As a condition of employment, all employees of the Police Department, city, and Fire Department become members of the respective retirement systems. The total membership of each retirement system is comprised of both active employees and retirees.

Assets, contributions, and expenditures. Each retirement system accumulates assets in order to pay benefits to current and future retirees and pay pension administrative costs. Assets are accumulated from three sources - city contributions, employee contributions, and investment returns. Exhibit 3 details the total accumulated assets of the four retirement systems, the 1997 contributions by source, the estimated expenses for 1997, and the total membership.

Exhibit 3. Retirement System Financial Status as of April 30, 1997

	Retirement System			
Type	Police Officers	Firefighters	Police Civilians	City Employees
Total Assets	$459,133,090	$247,315,205	$43,149,985	$463,596,273
1997 contributions:				
City	9,721,985	6,595,898	417,047	12,325,392
Pension member	4,640,441	3,203,154	699,880	5,279,237
Investment returns	60,744,479	26,118,401	5,428,843	46,682,767
1997 Expenditures	22,150,213	14,856,255	1,339,081	18,480,549
1997 Membership	2,145	1,538	604	5,460

Sources: Retirement Systems Annual Reports for fiscal year 1997.

Findings and Recommendations

Summary

Contributions cannot be reduced at this time. Mayor Pro Tem George Blackwood asked whether the city could reduce annual contributions to the two Police pension systems without harming their financial health. The answer to his question is no. The most recent valuation of retirement system assets and benefit obligations precludes the city from reducing current contributions. Accumulated retirement system assets are currently less than the projected costs to pay for current retirement benefits. We also found recently enacted increases in retirement plan benefits, approved by the state legislature, and found that the police retirement board routinely provides newer benefits to past retirees, further increasing pension costs. These increases in benefit costs hamper the city's efforts to contribute sufficient funds to allow the retirement systems to achieve full funding. It also further precludes any reduction in current contributions.

The state determines benefits. The two Police retirement systems are state agencies established to provide benefits to police officers and civilian employees, both state employees. Not only does state law establish the required funding the city must contribute to both systems, but the state legislature is responsible for approving all benefit enhancements. Decisions regarding benefit enhancements are made with little city input and city interests do not appear to be a major factor in legislative decisions. As a result, the city is required to provide funding for the Police retirement systems without formal control over costs.

Recent benefit enhancements increase city costs. Revisions in the calculation of benefits for retired Police civilians and revisions in the amount, duration, and eligibility of supplemental retirement benefits for Police employees increase the total liabilities of the retirement system. Because current pension system assets are inadequate to pay all the anticipated pension costs, these additional liabilities must be funded through future contributions, including those provided by the city. To provide this funding, the city either has to increase annual contributions or extend the period that a portion of the city's annual contributions are used to reduce the balance of pension obligations that remain unfunded. Both methods increase city costs.

Responsibility for approval and funding of benefit changes should go hand in hand. The city should not be held responsible for funding benefits that it has no legally established ability to control. If the state legislature determines that additional benefits are desired for the state's Police employees, the state should fund them. Expecting the city to do it places an unfair burden on the city to provide funding for state activities at the expense of local responsibilities.

Required city funding of recent benefit enhancements may violate the Hancock Amendment. The state's method of funding retirement benefits for its employees by requiring the city to make contributions is part of the state statutes. However, requiring the city to fund increases in benefits occurring after November 1980 appears to result in the state imposing an unfunded mandate on the city, something the Hancock Amendment was intended to prevent. Our interpretation of this amendment is that any changes in the retirement system since 1980 would have to be funded by the state legislature, rather than the city. However, section 86.810 of the Missouri statutes, revised in 1997, suggests that the state has been approving recent retirement benefit amendments with the understanding that the state would not have to fund any cost increases. If the city did not provide the additional funding, neither would the state, so the benefit enhancements would be eliminated, unless another funding source is found.

We recommend the city pursue legislation turning financial responsibility for both Police retirement systems over to the state. If that fails, we recommend that the city pursue state legislation seeking greater city control over the Police retirement systems. Should the state decline to either fund the systems, or provide the city with the means to control costs, we recommend the city consider legal action to eliminate the city's responsibility for benefit enhancements that may be enacted in the future. We are not suggesting that any of the current benefits be eliminated. We are only seeking to eliminate the city's responsibility to fund new benefits without a requirement that the City Council formally approve them subsequent to their passage in the state legislature.

Reductions in City Contributions Cannot Occur at This Time

State law establishes the required funding the city must contribute to both Police retirement systems. Annual contributions are sufficient to fund current benefits and a portion of future benefits not currently funded, however, estimates indicate it will take 30 years for current contribution levels to allow the retirement systems to achieve full funding. Consequently, it appears the city cannot reduce annual contributions below present levels.

Current retirement assets do not cover projected benefit costs. One primary measure of the financial soundness of a retirement fund is the extent to which accumulated assets match the estimated liabilities of the fund. Each year, an estimate of the value of the accumulated retirement assets is expressed as a percentage of the projected costs of providing benefits to the retirement members. This measure is known as the funding ratio. A funding ratio of 100 percent or more represents full funding, however an amount below full funding does not mean that the system is unsound or that current retirees' benefits are in jeopardy, as long as a method to systematically eliminate the unfunded portion of the estimated retirement costs has been developed. Exhibit 4 details the funding ratios of the four retirement systems.

Exhibit 4. Retirement Systems Funding Ratios as of May 1, 1997

	Retirement Systems			
Type	Police Officers	Firefighters	Police Civilians	City Employees
Actuarial Value Of Assets (est.)	$388,984,781	$197,169,200	$37,079,924	$372,402,100
Actuarial Accrued Liability (est.)	456,218,854	255,316,500	39,525,068	391,069,000
Funded Ratio	85.3%	77.2%	93.8%	95.2%

Sources: Reports on retirement systems actuarial valuations as of May 1, 1997.

As indicated, none of the four retirement systems are currently fully funded. Consequently, the city must continue to provide contributions to each system which include an amount which is used to reduce the unfunded portion of the total estimated retirement costs.

Projections based on current contribution rates and benefits estimate it will take five years for the city employees' retirement system to achieve full funding, while the firefighters' system will be fully funded in 26 years. In a recent survey by the Government Finance Officers Association (GFOA), the average time retirement systems would reportedly take to achieve full funding was about 23 years.[9] Projections for the two Police retirement systems estimate it will take 30 years for both systems to achieve full funding, based on current contribution amounts. Any reduction in city contributions means it would take longer to fully fund either retirement system.

The City Must Fund Police Retirement Systems with No Formal Control over Costs

The two Police retirement systems were established by state statutes to provide benefits for police officers and police civilians, who are not employees of the city but are actually state employees. The state legislature also establishes the required funding the city must provide and approves changes in the benefits provided to retirees. The Police retirement board provides recent retirement benefits to past retirees in a manner common to state agencies. City input when the state legislature considers changes in retirement benefits is limited and city interests do not appear to be a major factor in legislative decisions. As a result, the state provides formal approval for benefit changes it will not fund while the city funds benefit changes it has not formally approved.

The Police retirement board has no city staff who are required to serve on the board as ex-officio members. Ex-officio members are included in the retirement boards of the firefighters and city employees and are a common part of retirement boards, according to a 1997 GFOA survey. The inclusion of ex-officio members would balance the interests of those who benefit from the retirement board's decisions with those who provide the funding.

Recent benefit enhancements increase costs. The portion of these costs not paid through member contributions or investment returns must come from the city, as a result of its fiduciary responsibility to ensure

[9] Paul Zorn, *1997 Survey of State and Local Government Employee Retirement Systems*, (Chicago, Illinois: Government Finance Officers Association, 1997), pp. 48 and 49.

that the retirement systems are actuarially sound. To provide this funding, the city either has to increase annual contributions or extend the period that a portion of the city's annual contributions are used to reduce the balance of pension obligations that remain unfunded. Both methods increase city costs.

Formal approval and funding of benefits should be mutual responsibilities. If the state legislature approves additional retirement benefits for the state's Police employees, the state should be responsible for funding them. If the city provides the funding, it should be responsible for formally approving any benefit changes. Expecting the city to provide the funding without such approval places an unfair burden on the city to provide funding for state activities at the expense of local responsibilities.

Funding retirement benefits for state employees by requiring the city to make contributions is part of the state statutes, however, the Hancock Amendment may limit the city's responsibilities to retirement benefits existing in November 1980. Subsequent benefits apparently should be funded by the state legislature. However, according to section 86.810 of the Missouri statutes, recent benefit enhancements were approved by the state with the understanding that the state would not have to pay for them. If the city did not provide the additional funding, neither would the state, so the benefit enhancements would be eliminated, unless another funding source was found.

We recommend the city pursue legislation turning financial responsibility for the retirement systems over to the state. If that fails, we recommend the city pursue legislation requiring formal City Council approval of benefit enhancements subsequent to their passage in the state legislature. We also recommend that the city pursue state legislation altering the board composition to require city officials to serve on the board as ex-officio members. Should the state decline to either fund the systems, or provide the city with the means to control costs, we recommend the city consider legal action to discontinue the city's responsibility to provide funding for benefit enhancements that may be enacted in the future. We are not suggesting current benefits be eliminated. Rather, we seek formal city approval of future benefit changes.

The Police Retirement Systems Are State Entities

The Police retirement systems were established to provide retirement benefits for the employees of the Police Department, an agency of the state government. State statutes determine city contributions to both retirement systems, and approve benefit changes. And although the state constitution prohibits it, the Police retirement system provides newer benefits to past retirees in a manner common to state agencies, demonstrating that in practice, the retirement system operates as a state agency would. City input in the state's legislative process is limited to providing information on the impact of proposed benefit changes on federal, state, and local funds. The city manager reports that while he understands past city managers were briefed on prior proposals, he plans to seek greater city involvement in the future.

State statutes established the retirement systems. The Police retirement system was established by state statutes in 1946, while the civilian system was subsequently established in 1965. Although sections 1(27) and 1(56) of the City Charter provide for a police force and retirement authority as permitted under the constitution and laws of Missouri, the state legislature has usurped that power both in the establishment of the Police Department and the establishment of the retirement systems.

We requested information from the city's Law Department on the establishment and administration of the Police retirement systems. According to the Law Department:

> The City Council has no authority at this time to alter or amend the Police Retirement Systems or consolidate them with the other pension systems of the city. Such amendments must come through the Missouri Legislature. . . The Police Department is an agency of the State government and not of the municipal government of Kansas City. . . . The Kansas City police force consists of employees of the Board of Police Commissioners. The personnel, including the civilian members, are not employees of the City.

State statutes determine city contributions. State statutes obligate the city to contribute to the Police retirement systems and also set the required funding the city must provide. The state statutes determining city contribution to the police officers' retirement system state:

> The city's contribution to the pension fund shall be a percentage of the compensation paid to members of the pension system. . . . The city's contribution shall be such percentage as shall be agreed upon by the board of police commissioners and the city but in no event shall such contribution be less than twelve percent.[10]

Further direction on the required city contribution can be found in another section of the statutes which state:

> The retirement board shall certify to the board of police commissioners the amount of money that will probably be required to comply with the provisions of section 86.477 during the next succeeding fiscal year including administration expenses.[11]

State statutes also require city contributions to the Police civilian retirement system. For this retirement system, the statutes state the city:

> Shall contribute to the retirement pension system such an amount as may be necessary to pay the pensions as they accrue from year to year, and such additional amounts as may be necessary to maintain the system on a sound actuarial basis and as determined by the retirement board.[12]

State legislature approves benefit changes. In addition to establishing the two retirement systems and setting city contributions, the state legislature approves changes to the Police retirement systems, such as benefit enhancements and their associated costs, by amending state statutes. Decisions made by the state legislature regarding benefit enhancements in the Police retirement systems have had no impact on state funds since the benefit increases have been funded by the city, employees covered by the retirement systems, and investment returns.

Changes to the legislation governing the Police retirement systems are made to clarify or change plan rules, make corrections, and enhance benefits. The Police Retirement Board selects possible changes to be proposed to the state legislature. When benefit enhancements are

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[10] RSMo. §86.477.

[11] RSMo §86.480.

[12] RSMo §86.760.

proposed, information on the costs of the proposal and the effect on the retirement system is developed. The board votes on which changes to seek and then prepares the legislation proposing the amendments to the state statutes. Finally, the proposed legislation is sent to the state legislature for introduction, discussion, and a vote for approval. According to the Police Retirement Board Attorney, the board always seeks the city's approval during this process.

Newer Benefits Provided to Past Retirees in a Manner Common to State Agencies

The state constitution prohibits the legislature from providing additional retirement benefits established after a person has retired. In order to circumvent this restriction, the Police retirement system provides newer benefits to past retirees by making them "special consultants," a practice commonly used by retirement systems in Missouri agencies. We found that this method was used to provide past retirees and their spouses with recently enacted supplemental retirement benefits, although the benefits were not included in the description of plan benefits in recent retirement system reports. The use of "special consultants" to provide newer benefits to past retirees suggests that in practice, the Police retirement system also operates as a state agency would.

The state constitution restricts alterations in benefits subsequent to retirement. According to the Missouri Constitution:

> The general assembly shall not have power...to grant or to authorize any county or municipal authority to grant any extra compensation, fee or allowance to a public officer, agent, servant or contractor after service has been rendered or a contract has been entered into and performed in whole or in part.[13]

One effect of this restriction is to limit retirees to the benefits that existed at the time that they retired. However, we found that state agencies routinely established past retirees as "special consultants," to avoid this restriction and allow past retirees to receive benefits established subsequent to their retirement.

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[13] Missouri Constitution, Article III, §39(3).

Supplemental retirement benefits are provided to police and civilian retirees. In 1991, the retirement benefits provided to police officers were enhanced with the establishment of a supplemental retirement benefit that assists retirees with hospitalization, medical care costs and other expenses. For police officers who retired prior to 1991, the retirement board allows members to apply to become "special consultants" on retirement, aging, and other matters. This allows them to receive this benefit and any associated cost-of-living increases. The supplemental retirement benefit is also provided to surviving spouses.

Police civilian employees began receiving a supplemental health insurance benefit in 1992. Members retiring between August 1992 and August 1995, were also made special consultants to receive this benefit, upon application to the retirement board. While eligibility for this benefit expires at age 65 for members who retired prior to August 1996, another amendment to state statutes allows these members to again apply to the retirement board to become a special consultant, reinstating the benefit for life. Members retiring after August 1996, receive this benefit without being made special consultants, apparently for life. The supplemental health benefit is also given to surviving spouses.

The benefit is not clearly disclosed. The 1997 police civilian employees' annual report disclosed a recent change to plan benefits that affected the supplemental health benefit. However, none of the police officers' annual reports issued for fiscal years 1995 through 1997 list the supplemental retirement benefit, include this benefit in the description of plan benefits, or indicate that retirees are hired as "special consultants" on retirement matters. In the police officers retirement system's annual reports, we found an administrative fee identified as "Retiree special services expense" in the *Statement of Net Assets Available for Plan Benefits*. According to the Police retirement board secretary, this expense reflects the costs of the special consultants. In 1995, this expense totalled over $765,000, increasing to $927,000 in 1996. By 1997, the expense was more than $1.3 million.

Police retirement board members report use of "special consultants" is a practice common to state retirement systems. According to Police retirement board representatives, retirement systems for members of the state troopers and state teachers also provide new benefits to past retirees. Our research confirmed prior retirees are made "special consultants" to receive additional benefits in both the highway patrol and state officers and employees retirement system. For teachers and school employees, prior retirees receive additional benefits as "special school advisors/supervisors" or "school consultants." We found similar special provisions also made in the statutes for retired members of the state General Assembly,[14] and judges.[15] We also found enhanced health benefits authorized for retired state employees, officials, and surviving spouses.[16] Based on comments from Police retirement board representatives and our research, it appears this practice is common among state agencies and the Police retirement system operates as a state agency would.

City Input in the Legislative Process Is Limited

The city's primary role in the state's legislative process of considering changes to the Police retirement systems has been providing information to the state on the impact of the proposed changes on federal, state, and local funds. Identified as "fiscal notes," requests for this information are sent to the retirement systems, Board of Police Commissioners, and the city. In reviewing recent "fiscal notes," we found that the only funds routinely affected by the proposed legislation are local funds. Police retirement board representatives note that the city has the opportunity to represent itself at state legislative hearings regarding the proposed retirement system changes, but the city rarely does.

We were told by Police retirement board representatives that copies of the proposed legislation are sent to the Board of Police Commissioners, the police chief, and the city manager for review and comment. Copies of correspondence were also provided. These included letters from city manager David Olson to state representatives following passage of Resolution 60466. That resolution, passed by the City Council in 1987, endorsed legislation changing some employee benefits and raising city contributions to the police officers retirement system to current levels.

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[14] RSMo §104.370, (1994).

[15] RSMo §476.601, (1994).

[16] RSMo §103.115, (1994).

The current city manager reports that he has been assured that communications took place with his predecessors and retirement board representatives, although the city manager's staff could not locate records of these communications. In a written memorandum on the issue, the city manager states:

> I am not aware of how many of these proposed changes were actually reviewed and approved by the City Council prior to proposed legislation being filed in Jefferson City.[17]

While he is confident that discussions took place with past city managers prior to the proposed legislation being filed, the current city manager challenges the adequacy of such meetings in providing the city with the opportunity to review and approve benefit changes. In the same memorandum, the city manager states:

> Under a Council Manager form of government, I question the ability of the City Manager to actually approve such changes. At the most, the City Manager can recommend approval to the City Council.[18]

Proposed legislation was recently presented to the City Council, after being filed with the state. The city manager further reports that since becoming city manager, he did request and the Police retirement board did agree to present to the City Council the proposed changes in benefits recently approved by the General Assembly, but vetoed by the governor. (See pages 26 - 27.) The city manager states:

> This presentation took place in a business session approximately three to four months ago. Unfortunately, the legislation was already filed in Jefferson City and was in committee by the time the Council had its opportunity to hear about it. Since the legislation was vetoed, I would anticipate that the Pension Board will have another opportunity to bring this matter before the Council and seek its endorsement prior to filing this proposal again.[19]

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[17] Memorandum from Robert Collins, City Manager, to Mark Funkhouser, City Auditor, June 17, 1998.

[18] Memorandum from Robert Collins, City Manager, to Mark Funkhouser, City Auditor, June 17, 1998.

[19] Memorandum from Robert Collins, City Manager, to Mark Funkhouser, City Auditor, June 17, 1998.

City interests do not appear to be a major factor in state legislative decisions. Police retirement board representatives assert that the city's approval of proposed changes is needed if the changes are to pass in the state legislature. They further assert that during legislative hearings, they are routinely asked what the city's position is. However, despite the lack of city representation at legislative hearings, retirement board representatives could only recall one instance in which proposed legislative changes were not approved. In 1996, proposed legislation did not complete the legislative process. Board representatives state, however, the problem was not with the proposed legislation but due to internal difficulties within the legislature that prevented the proposed legislation from being heard during the session.

In June 1998, the governor vetoed a proposal that would have established minimum pension benefits for members and surviving spouses, increasing costs by approximately $4.5 million. The measure was vetoed not on its merits with respect to the Police retirement system, but because the state legislature had added an amendment including a 33 percent increase in pensions for legislators. (See page 27.)

City manager seeks greater involvement by the City Council. When asked about the city's involvement with changes in pension benefits, the city manager notes that during his tenure, new legislation altering current pension benefits has not been proposed. However, when these requests are received, he intends to bring them before the City Council, offering only his recommendations. According to his June 17, 1998 memorandum:

> I consider changes to pension benefits to be a policy issue deserving City Council attention, particularly if the change in benefits increases or decreases the employer or employee contribution to the pension system or if it impacts the funded status of the system or the amortization period of any unfunded pension liability. It is my preference and recommendation that the City Council review and comment on all proposed changes to the Police and Civilian pension system prior to any proposal being filed with the state legislature. The City Council must approve changes to the City Employees' and Firefighters' pension systems. I see no reason why they should not have the same responsibility and

act as ex-officio member, and the other to serve for a term of two years; and five elected by the members of the retirement system for three-year terms or to fill an expired term. Included among those elected by the membership must be a retired officer, a current officer who has not achieved the rank of sergeant or higher, and a Police Department civilian employee. The appointed positions also have political party requirements.[21]

Prior to 1991, the Police retirement board consisted of seven members, three of which were elected by participants in the system. In 1991, the number of board members elected by the membership increased to five and the board as a whole increased to nine persons.

City retirement boards include city staff as ex-officio members. In contrast, the board of the city employees retirement system consists of seven appointments by the mayor[22] and two city staff who serve as ex-officio members - the director of finance and the director of human resources. The board for the firefighter pension system includes three elected members and four ex-officio members. In addition to the finance and human resources directors, the ex-officio board members include the city's director of fire and the city treasurer.

Ex-officio board members are not appointed or elected to the board, but instead serve because of the position they hold, in this case as a member of city management staff. Having city staff serve as ex-officio board members provides these boards with expertise that might be lacking among the appointed or elected members. For example, because of their positions in city government, as pension board members, these personnel could provide information on city fiscal conditions or other matters that could be useful when the board is considering retirement system initiatives. At the same time, their involvement in retirement system activities increases their ability to meet their fiduciary responsibilities to protect the interests of the city as a funding agent for the pension systems.

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[21] RSMo §86.393.

[22] The mayor's appointments should consist of four recognized business leaders with a background in investments or employee benefits, one retiree and two active employees who are members of the retirement system.

Many retirement boards include ex-officio members. The use of ex-officio members is not limited to the two city pension systems. According to the 1997 GFOA survey,[23] on average, the retirement boards surveyed consisted of eight members: three appointed to the board, three elected to the board, and two ex-officio members. (See Exhibit 5.)

Exhibit 5. Composition of Retirement Boards

Selection Method	Retirement System			
	Police	Firefighters	City Employees	GFOA Average
Appointed	4	0	7	3
Elected	5	3	0	3
Ex-Officio	0	4	2	2
Total	9	7	9	8

Sources: RSMo §86.393; 1997 Retirement System Annual Reports; *GFOA 1997 Survey of State and Local Government Employee Retirement Systems.*

The average board composition identified by the GFOA survey includes elected, appointed, and ex-officio members. As a result, the interests of those who receive benefits are balanced by the interests of those who provide at least part of the funding. To provide a similar balance in the board of the Police retirement system, we recommend the city seek legislation to change the composition of the Police retirement board to require the inclusion of city staff as ex-officio board members.

Recent Benefit Enhancements Increase Overall City Costs

Recently enacted benefit enhancements adversely affect city costs. Revisions in the calculation of the police civilian base pension will increase the base pension future retirees will receive. These revisions, combined with the recent expansion of the Police civilian's

[23] Paul Zorn, *1997 Survey of State and Local Government Employee Retirement Systems*, p. 22.

supplemental health benefits will increase pension costs by approximately $816,000 during the next three years alone, according to retirement board staff. The police officer supplemental retirement benefit, established in 1991 at $50 per month, has increased to $230, $90 more than what firefighters receive. In addition to being more generous than what is received by staff in the city retirement systems, the police officers receive this benefit longer and have no restrictions on its use.

More significantly, in 1998, the state legislature approved a proposal to increase the minimum pension for certain police officers and the establishment of a minimum pension for their surviving spouses. These changes were expected to increase total retirement system liabilities by $4.5 million, had the proposal not been vetoed by the governor. (See page 27.) The governor's veto of the measure was not based on its merits but due to the inclusion of a pension increase for state legislators.

Changes to Police civilian employees base retirement formula increase benefits. The civilian employees' system has seen three changes to the calculation of the base retirement amount during the last decade. Each change increased the base retirement the civilian employee would receive. To demonstrate the impact of each change on the base pension, we calculated the pension received by a married Police employee retiring with 30 years of service whose highest three years of salary were $49,253, $51,716 and $56,887, received during the last three years of employment. Exhibit 6 shows the calculation methods used and the base pension received, starting with the method used and pension received prior to the last three changes.

Exhibit 6. Changes in Calculation of Police Civilian Base Pension Benefits

Effective Periods	Calculation Method/Calculated Base Pension
Prior to 1990	1.5% of final compensation (calculated using the highest three years of salary out of the ten years preceding employment termination) **x** years of service of 20 or less; 2% of highest annual salary (based on three years) **x** years of service in excess of 20 years 1.5% **x** (($49,253+$51,716+$56,887)/3) **x** 20 years + 2.0% **x** (($49,253+$51,716+$56,887)/3) **x** 10 years = $26,310 (base pension)
1990 to 1991	2% percent of final compensation (based on three highest years of salary, 1.8% with spousal consideration), **x** years of service, regardless of the service length 1.8% **x** (($49,253+$51,716+$56,887)/3) **x** 30 years = $28,414 (base pension)
1992 to 1996	2% percent of final compensation (based on **two** highest years of salary, 1.8% with spousal consideration), **x** years of service, regardless of the service length 1.8% **x** (($51,716+$56,887)/2) **x** 30 years = $29,323 (base pension)
1997	2% percent of final compensation (based on two highest years of salary), regardless of spousal consideration 2.0% **x** (($51,716+$56,887)/2) **x** 30 years = $32,581 (base pension)

Sources: RSMo §86.600 and §86.650 (1976) (repealed); RSMo §86.650 (1990) (repealed); RSMo §86.600 (1992); RSMo §86.650 (1997); Civilian Employees' Retirement System Annual Reports for 1996 and 1997; and City Auditor's Office calculations.

Using our example, each change increased the retiree's base pension amount. As indicated in Exhibit 6, the first change, effective in 1990 and 1991, increased the service years subject to the higher percentage (2.0% or 1.8% vs. 1.5%) to include all years of service. The subsequent change involved the calculation of final compensation. Previously based on an average of the highest three years of salary, the retirement system began calculating final compensation based on only two years of highest annual salary. This change would also be expected to increase the base pension, unless the employee's highest annual salary remained unchanged for three years or more.

The third change involved the removal of the reduction of benefits in return for spousal consideration. This change makes selection of that option by the retiree more likely. In addition, once the option is selected, the retirement system becomes obligated to provide pension benefits for the life of both the retiree and the spouse, increasing the system's total liability. Estimates of the cost increase from this revision in the base retirement formula were approximately $193,000 in 1998, $203,000 in 1999 and $213,000 in the year 2000.[24] Future costs are expected to increase in direct proportion with future changes in covered payroll.

The 1991 supplemental retirement benefit continues to be enhanced. The police officers' retirement system was amended in 1991 to add a supplemental retirement benefit. When established, the benefit was $50 per month, in addition to the retirement benefits already received. Since then, the benefit has increased and now totals $230 per month. (See Exhibit 7.) Each increase raises the total liabilities of the retirement system which must be paid out of future contributions. A similar benefit, provided to Police civilians, firefighters, and city employees has not experienced as much growth, and limits usage of this benefit to health-related expenditures. Police officers receive higher supplemental benefits, in some cases receive the benefit longer, and have no restrictions on their use of these funds.

[24] Fiscal notes for Missouri House Bill 331, estimated net effect on local funds, fiscal years 1998 - 2000.

Exhibit 7. Monthly Supplemental Retirement Benefits, 1991 through 1997 (rounded to nearest dollar)

Member	1991	1992	1993	1994	1995	1996	1997
Police Officer	$50	$70	$80	$90	$140	$180	$230
Firefighter	---	100	110	115	138	138	138
City Employee	50	50	53	53	55	55	55
Police Civilian	---	50	50	50	50	50	50

Sources: Police retirement system staff, city retirement staff, and Retirement System Annual Reports.

Benefits to police civilian employees have also increased. The supplemental health benefit for police civilians, established at $50 per month in 1992, remains at $50 per month today. However, this benefit was also recently expanded. In 1995, the civilians' system provided this benefit to retirees only until they reached 65. In 1997, the benefit was amended to be provided for the remainder of the member's life and was also provided to qualified surviving spouses. Again, this change obligates the retirement system to provide the benefit to both the retiree and spouse for the rest of their lives, increasing the system's total liability. The cost increase associated with the 1997 change was an estimated $66,000 in 1998, $69,000 in 1999, and $72,000 in the year 2000.[25] Future costs are also expected to increase in direct proportion with future changes in covered payroll.

Similar benefits are provided in the city systems, but costs have not substantially increased. As indicated in Exhibit 7, the two city retirement systems also began receiving a similar benefit in 1991 and 1992. In 1991, city employees received $50 per month and by 1997 the amount they receive has increased to $55. When the benefit was established in 1992, firefighters received $100 per month, $30 more than police officers received in that year. By 1997, while the amount firefighters receive has increased to $137.80, this amount is about $90 less than what police officers now receive.

[25] Actuarial estimate of the increase in cost for fiscal years 1998 - 2000, provided by the Police retirement system actuary, in a letter dated February 7, 1997.

No restrictions on supplemental police officer benefits. The supplemental retirement benefit provided to police officers is given to assist retirees with hospitalization, medical care costs, or other expenses. The supplemental benefits provided to police civilians, firefighters, and city employees are specifically identified as supplemental health benefits. The two city systems have additional benefit conditions. For example, city employees receive this benefit until age 65 and must enroll in the city's health insurance plan; adjustments are tied to health care premium increases and this benefit is not transferred to a surviving spouse. For firefighters, the board of trustees for the firefighters' pension system annually determines the amount of this benefit, however, the city and firefighters each contribute an additional 1 percent of salaries to fund it. In contrast, police officers now receive $230 per month ($2,760 per year) and have no restrictions on its use. Police officers receive this benefit for life, and upon their death, the benefit is passed on to their surviving spouse.

Revisions to change pension benefits for police officers and their surviving spouses were recently approved by the state legislature. In early 1998, the Police retirement board introduced a proposal to:

- Establish a minimum pension benefit of $600 per month for all members who have at least 25 years of service (normal retirement) or who have been permanently incapacitated as a result of an on-the-job accident or injury. The $600 amount includes any supplemental retirement benefits and cost-of-living adjustments (COLAs).

- Establish a minimum pension of $600 per month for the surviving spouses of members entitled to the same minimum pension.

- If a member dies while in service, the surviving spouse receives a base pension of 40 percent of the member's final compensation with COLAs.

- If the member retires and dies after commencement of benefits, the surviving spouse receives a base pension of 80 percent of the member's pension amount, with COLAs but no supplemental retirement benefits.

Currently, the highest minimum pension is $1,200 per year for an officer with 25 or more years of service. The proposal increases that minimum by 600 percent. The current pension for the surviving spouse equals 40 percent of the officer's final compensation and COLAs regardless of whether the officer died before or subsequent to retirement. In contrast, the pension benefits for the surviving spouse of a firefighter is generally based on the accrued pension benefits of the firefighter. Spouses of firefighters generally receive 50 percent of the firefighter's accrued pension but not less than 25 percent of the firefighter's final average compensation. The Police retirement system proposal established a minimum pension ($600 per month) for surviving spouses, and changed the method of calculating the amount surviving spouses would receive if the officer died following retirement (exclusive of the supplemental retirement benefits). If it had been signed by the governor, the changes in police officer and spouse pensions was expected to increase future retirement system liabilities by $4.5 million.[26]

Governor vetoed the proposal, but not on its merits. On June 5, 1998, the proposal was vetoed by Missouri's governor because it was amended to include a 33 percent increase in pensions for members of the state legislature. According to *The Kansas City Star*, providing a pension for the widows of police officers was something nobody could oppose. However, providing an increase in legislators' pensions was something voters rarely applaud. Consequently, the governor had to veto the bill and promise to look out for the widows next year. A spokesman for the governor stated, "It's unfortunate the provisions that would help the widows of police officers were a casualty of this bill."[27]

Benefit enhancements affect city costs, either now or in the future. Funding benefit enhancements can be accomplished through the use of investment returns; by increasing the contribution percentage of the city, the retirement member or both; or by extending the amortization period for payment of the unfunded pension obligations. All these methods could impact the city by preventing reductions in the amount of city retirement contributions.

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[26] Fiscal note detailing the estimated net effect of the proposed retirement system changes on local funds.

[27] Matthew Schofield, "Carnahan vetoes bill on legislative pensions," *The Kansas City Star*, June 6, 1998, Metropolitan, Section C, pp. 1 and 4.

The city is directly impacted by benefit enhancements whether or not they are funded through increases in current city contributions because the city has sole fiduciary responsibility for assuring all benefit costs are funded. Benefit enhancements increase costs. Costs do not equal contributions. All costs not covered through member contributions or investment returns must be provided by contributions from the city because the state does not contribute.

Even if the enhancements are paid out of current investment revenues or member contributions, the city would ultimately be affected by the change as the enhancements also increase future retirement costs, which must be paid out of future contributions. The costs of benefit enhancements could also be deferred, to be paid out of future contributions. This also impacts the city, because a portion of the city's annual contributions is used to reduce the difference between retirement assets and estimated retirement costs (the unfunded liability). Any increase in benefits expected to be paid out of future contributions would increase the retirement system's unfunded liability. Similarly, if investment returns that once provided funding for benefit enhancements decline so much that they are no longer sufficient to continue paying for these benefit increases, the increased costs would add to the unfunded liability, unless another source of funding is found. In turn, this either adds to the number of years the city must contribute funding to reduce the liability (extending the estimated amortization period) or results in the city having to increase annual contributions.

The $4.5 million increase in retirement costs which would have been incurred from the approval of the early 1998 proposal to establish minimum amounts for members and surviving spouses was expected to be paid through an increase in the unfunded liability. Contributions would not increase as a result if the amortization period for the unfunded liability was lengthened to pay these increased costs. Because current contributions do not equal anticipated costs, benefit enhancements widen the gap between estimated retirement benefit costs and the available retirement assets, potentially increasing future city payments to cover costs not paid by other sources of Police retirement system funding.

The disconnect between funding and control needs to be corrected. While the state presently retains formal control over approval of benefit changes, these changes are not funded by the state, but are instead funded by the city. Consequently, the state approves benefit changes it does not have to pay and the city pays for benefits without the opportunity to formally approve them. Responsibility for funding and formal control of benefit changes should go hand in hand. The city should not be held responsible for funding benefits that it has no legally established ability to control.

We recommend the city manager take steps to ensure the City Council is fully briefed on any proposed changes to the Police retirement systems. We further recommend state legislation that provides that future benefit enhancements for the two police retirement systems that are authorized, not mandated, by the General Assembly must be implemented by the City Council before becoming a part of the pension of any retirement system member.

Required City Contributions Represent an Unfunded Mandate

The state statutes and state constitution may provide the city with relief from some of the mandated costs associated with the Police retirement systems. It appears that one of the purposes of the Hancock amendment was to prevent the state from requiring local governments to fund increases in state activities. Requiring the city to fund ever increasing enhancements in retirement benefits without City Council approval appears to result in the state imposing an unfunded mandate on the city, something the Hancock Amendment was intended to prevent. If the city continues to voluntarily fund benefit enhancements without the opportunity to exercise some oversight and control over these funds, the city may be funding state activities to the detriment of local responsibilities.

If the state legislature approves additional retirement benefits for the state's Police employees, the state should be responsible for the funding. Expecting the city to provide the funding without the ability to exercise some oversight unfairly places state activities above local responsibilities. If the state refuses to accept financial responsibility for its Police retirement system or refuses to allow the city to assume greater control over future retirement system decisions, we recommend legal action to eliminate the city's responsibility to provide funding for benefit enhancements that may be enacted in the future. We are not suggesting current benefits be eliminated. Rather, we seek formal city approval of future benefit changes.

State constitution provides the city with some protection against unfunded benefit increases. The Missouri constitution provides that the state cannot require any political subdivision to increase the level of service for an activity required by the state (such as a retirement system established for state employees) without paying for the increase out of state appropriations. According to the Missouri Constitution:

> The state is hereby prohibited from reducing the state financed proportion of the costs of any existing activity or service required of counties and other political subdivisions. A new activity or service or an increase in the level of any activity or service beyond that required by existing law shall not be required by the general assembly or any state agency of counties or other political subdivisions, unless a state appropriation is made and disbursed to pay the county or other political subdivision for any increased costs.[28]

The above passage is part of legislation known as the Hancock Amendment, which was adopted by the voters on November 4, 1980. If it is determined that all benefit enhancements enacted subsequent to its passage represent increases in service, the city would not be obligated to pay for these service increases. The only obligation of the city would be to continue providing contributions necessary to fund the level of retirement benefits that existed at the time the Hancock Amendment was passed. For example, the city would no longer be responsible for funding the supplemental retirement benefit enacted for police officers in 1991. Similarly, calculation of the city's contribution to the base retirement for police civilian retirees, could revert to the calculation method for the city contribution used in 1980.

Retirement benefits have increased. We found several examples of benefit changes since 1980, including our earlier example of a married police employee, retiring after thirty years of service with highest annual salaries of $49,253, $51,716, and $56,887. If the employee were a police officer, the base pension would be $32,581 using the current calculation method. Based on the calculation method used prior to November 1980, the base pension would be over $1,000 **less**, or $31,571. (See Exhibit 8.) For a police civilian, the base pension under the current method would also be $32,581. However, under the method used before November 1980, the base pension for the civilian employee would only be $26,310, a difference of almost $6,300. (See Exhibit 9.)

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[28] Missouri Constitution, Article X, §21.

The base retirement amount for a police officer has slightly increased. Upon retirement, the base pension amount is determined by multiplying a percentage of the average of the employee's highest annual salary by the number of years of service. If the employee receiving the above salary were a police officer, the amount of his/her base pension would equal two percent of the highest average salary, however, the average highest salary prior to November 1980 would be based on the three highest years of pay. Today, the average is based on an average of the two highest years. Exhibit 8 details the factors used in the calculation and the base pension that the officer would receive using each calculation method.

Exhibit 8. Calculation of Police Officer Base Pension Benefits, 1980 versus 1997

	Calculation as of November 4, 1980	Current Calculation
Calculation method	Two percent of final compensation times years of service. Final compensation based on highest three years salary.[29]	Two percent of final compensation times years of service. Final compensation based on highest twenty-four months of salary.[30]
Computation	2% **x** (($49,253+$51,716+$56,887)/3) **x** 30 years	2% **x** (($51,716+$56,887)/2) **x** 30 years
Calculated base pension	$31,571	$32,581

Sources: 1997 Police Officer Retirement System Annual Report; RSMo §86.370 and §86.433; and City Auditor's Office calculations.

Using the method in effect prior to November 1980, the police officer would receive a base pension of over $1,000 less than would be received under current pension calculation methods.

The base retirement amount for a police civilian has significantly increased. Upon retirement, the base pension calculation for police civilians is also based upon a percentage of average highest salary and years of service. However differences in the calculation method used prior to November 1980 and today would have a profound impact on

29 RSMo §86.370 (1957) (repealed) and §86.433 (1972) (repealed).

30 RSMo §86.370 and §86.433.

the base pension the civilian employee would receive. Exhibit 9 details the factors and calculations used to determine the base pensions that the civilian employee would receive.

Exhibit 9. Calculation of Police Civilian Base Pension Benefits, 1980 versus 1997

	Calculation as of November 4, 1980	Current Calculation
Calculation method	One and five-tenths percent of the member's final average compensation times the first twenty years of service; plus two percent of the member's final average compensation times the years in excess of twenty years of service. Final average compensation based on highest three years of salary out of the ten years before employment termination.[31]	Two percent of final average compensation times years of service. Final average compensation based on highest twenty-four months of salary.[32]
Computation	1.5% **x** (($49,253+$51,716+$56,887)/3) **x** 20 years + 2.0% **x** (($49,253+$51,716+$56,887)/3) **x** 10 years	2.0% **x** (($51,716+$56,887)/2) **x** 30 years
Base pension	$26,310	$32,581

Sources: 1997 Police Civilian Retirement System Annual Report; RSMo §86.600 and §86.650; and City Auditor's Office calculations.

A civilian employee retiring after 30 years of service under the November 4, 1980 rules would receive an annual retirement of $26,310. The same employee, retiring after 30 years of service under current rules, would receive an annual retirement of $32,581.[33]

Hancock may provide formal control to the city for future benefit changes. An intention of the Hancock Amendment is defeated if the state could increase state functions at the city's expense. It is not

[31] RSMo §86.600 (9) and §86.650, (1976) (repealed).

[32] RSMo §86.600 (9) and §86.650, (1997) (Supp.).

[33] This figure does not include the $50 per month supplemental health benefit.

simply the amount of money spent, or the percentage devoted to the activity, but whether the state is expanding its activities by funding those activities through the city. We are not suggesting current benefits be eliminated. Instead, we are only seeking to establish formal city approval over all future benefit changes.

If additional retirement benefits are desired for state employees, such as employees of the Police Department, the state should be responsible for funding those benefits through, for example, increased employee contributions, better investments, or state appropriations, unless the city chooses to voluntarily support the new retirement benefits. Apparently, the state has recently been approving benefit enhancements with the understanding that the state will never have to fund them. According to a 1997 amendment to the state statutes:

> Any political subdivision which funds such retirement system, shall have standing to seek a declaratory judgement concerning the application of article X, section 21 of the Missouri Constitution to the provisions of this act. In the event a final judgement is rendered by a court which judgement determines that any provision of this act constitutes a new activity or service or increase in the level of an activity or service beyond that required by existing law . . . . that provision of this act shall be void ab initio and any new benefit or feature required by such provision of this act shall be deemed not to have accrued and shall not be payable to members.[34]

The state of Missouri, through this recent legislation and through the actions of the Police retirement boards, has put the city in the position of either challenging the retirement benefits of men and women who serve to protect us, or devoting an increased proportion of funds to Police retirements without providing a method for the city to fund these increases. By increasing the city's required support costs, without a mechanism for the city to exercise some control, the state has slowly eroded the discretion held by the City Council to effectively budget the activities of the city.

Should the state decline to assume financial responsibility for the Police retirement systems or provide the city with the means to control costs, we recommend the city be prepared to institute legal action to

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[34] RSMo §86.810.

determine through the courts whether any new benefit enhancements approved by the state legislature represent new activities or service increases. The City Council could also choose to obtain a declaration from the courts on the validity of benefit enhancements that have already been enacted. Such litigation may face a defense that the city should have taken this action when the benefits were first approved by the General Assembly, but allowed the benefits to be increased, and in fact, paid the increased benefits voluntarily.

We are not suggesting current benefits be eliminated. Rather, we seek to eliminate the city's responsibility to fund new benefits without a requirement that the City Council formally approve them, absent control of the Police retirement systems being placed with the city.

Recommendations

1. The city manager should prepare for council consideration a resolution requesting the state to assume full responsibility, including funding, for the Police Retirement System and the Civilian Employees' Retirement System of the Police Department. This resolution should be included among the legislative priorities sent to the state capitol.

2. If the state does not assume financial responsibility, we recommend the city manager prepare for council consideration resolutions requesting:

   a. state legislation to change the composition of the Police retirement board to require inclusion of two city officials, the director of finance and the director of human resources, as ex-officio members.

   b. state legislation that provides that benefit enhancements for the two Police retirement systems that are authorized, not mandated, by the General Assembly must be implemented by the City Council before becoming a part of the pension of any system member.

3. Should the state decline to accept financial responsibility for the Police retirement systems or enable the city to exercise more control over the pension systems, we recommend the city be prepared to file suit to seek a declaratory judgement on the validity of any new benefit enhancements, in accordance with section 86.810 of the Missouri statutes.

Regardless of the outcome of recommendations 1 through 3, we recommend:

4. The city manager take steps to ensure that the City Council is fully briefed on any proposed Police retirement systems plan changes, benefit enhancements, and associated costs before legislation is presented to or passed by the state legislature.

Appendix A

Police Retirement Board Chairman's Response

NOTE: City Auditor's comments regarding the Police Retirement Board Chairman's response can be found in Appendix B. They include corrections to page numbers referenced in the board chairman's response based on an earlier draft which included text subsequently removed from the final report.

August 19, 1998

RESPONSE TO REPORT OF CITY AUDITOR, AUGUST 1998,
FROM
POLICE RETIREMENT SYSTEM OF KANSAS CITY
AND
CIVILIAN EMPLOYEES RETIREMENT SYSTEM OF THE POLICE DEPARTMENT OF KANSAS CITY

The Police Retirement System of Kansas City and the Civilian Employees Retirement System of the Police Department of Kansas City (hereinafter called the "Police System," the "Civilian System," or, collectively, the "Retirement Systems") furnish this Response to the report of the City Auditor dated August 1998 on "Police Retirement Funds." A draft of said Report was delivered to us on August 10, 1998, to which this Response is directed. In that draft, the Auditor included "red-lining" which showed omissions and additions from a prior draft. While such red-lining was helpful to us, it leaves the result that page references in this Response refer to the pages in said draft delivered to us on August 10, and will therefore probably differ somewhat from the page numbering in the Auditor's final draft.

See page 53 Comment 1

The draft of the Auditor's Report delivered to us on August 10 is extraordinarily repetitious. For example, his three principal recommendations are repeated, generally with full explanations and arguments, at least seven times in a 38-page report. We do not mention this as a criticism, for the Auditor is of course free to use whatever style of writing he finds most appropriate. However it appears that the rolling rhythm of the repetitions has somewhat mesmerized the Auditor and his staff themselves, with an unfortunate net consequence.

The net consequence is, to use an old fashioned phrase, that the Auditor and his staff have failed to see the forest for all the trees.

The "forest" in this case is the single, simple point of this Response:

THE CITY ALREADY CAN DO EVERYTHING THE AUDITOR RECOMMENDS. NO NEW STATUTE IS NEEDED.

I. THE AUDITOR'S THREE RECOMMENDATIONS ARE PARTS OF A SINGLE CONCERN.

The Auditor's Report repeatedly presents a set of three recommendations:

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1. The state should pay for the city's police protection.

2. The city should have more control over the Retirement Systems.

3. The city should bring a lawsuit under the Hancock Amendment to challenge retirement benefits enacted in the future.

Upon closer examination, however, it will be seen that all of these recommendations are really parts of the Auditor's concern reflected in his second recommendation, namely that the Auditor recommends the city should have more control over the Retirement Systems.

<u>Recommendation to Have State Fund Retirement Systems</u>. For example, the Auditor's first recommendation is the somewhat quixotic suggestion that the state should assume full funding responsibility for the Retirement Systems.

The Auditor's justification for this recommendation is primarily semantic. He argues that police officers and civilian employees of the Police Department are all "state employees."

However in the only substantive discussion of this point, the Auditor on page 12 quotes the city Law Department in language which contradicts the Auditor's own assertion. The Law Department identifies such employees as specifically "employees of the Board of Police Commissioners" -- not state employees. See page 53 Comment 2

More important than semantics, the Auditor nowhere confronts the moral or philosophical principle underlying his point. There is no question that the sole mission of the active members of the Retirement Systems is to provide police protection exclusively for the citizens of Kansas City. Given that clear and limited function, it becomes clear that the city properly has the responsibility to fund the Retirement Systems for such members. See page 53 Comment 3

Apart from semantics, however, the Auditor makes clear that his real concern is not any abstract unfairness in requiring the city to fund the benefits of the Retirement Systems but rather that such funding is required in a context which the Auditor perceives as lacking sufficient control by the city over the enhancement of retirement benefits.

For example, on the first page of the cover letter to the Auditor's Report and at several other places throughout the Report, the Auditor states:

> "The issue that we believe needs to be corrected is the present disconnect between funding and control. . . . Responsibility for funding and formal control of benefit changes should go hand in hand. The city should not be held

responsible for funding benefits that it has no legally established ability to control."

Accordingly it seems clear that the Auditor does not challenge the fairness of having the city bear retirement costs, but rather makes his first suggestion as simply one of the manifestations of his concern with what he perceives as a lack of control by the city.

<u>Recommendation that the City Bring Legal Action Under the Hancock Amendment</u>. The Auditor's third recommendation is that the city bring legal action under the Hancock Amendment to "eliminate" the city's responsibility for funding future retirement benefit enhancements of the Retirement Systems.

However his supportive explanations of this recommendation condition the very recommendation itself upon the premise that the city has not otherwise been provided "with the means to control costs."

For example, in the second page of the cover letter to the Auditor's Report, and similarly at numerous other places throughout the Report, the Auditor states:

> "Should the state decline to either fund the systems or provide the city with the means to control costs, we recommend the city consider legal action. . . . [W]e are not suggesting current benefits be eliminated. Rather, we seek to eliminate the city's responsibility to fund new benefits without a requirement that the City Council formally approve them, absent control of the Police retirement systems being placed with the city."

Thus it is clear that the Auditor, even in his own recommendations, is not primarily bent upon litigation to attack benefits, but rather is primarily concerned with what the Auditor perceives as a lack of adequate controls by the city over potential enhancements of retirement benefits under the Retirement Systems. See page 53 Comment 4

<u>Control is the Auditor's Only Real Concern</u>. Accordingly it becomes clear that throughout the 38 pages of miscellaneous points in the Auditor's Report, his sole real concern is his perception that the city should have more control over the Retirement Systems. He would not press his recommendation for state funding if the city is granted such control as he deems needed; and he would not suggest any Hancock litigation if the city is granted such control. Thus it is really only the "control" issue that needs detailed response.

II. CONTROL

The Auditor is seriously concerned that the city is being subjected, under current statutes, to some sort of taxation without representation, because the city is required to fund Retirement Benefits for persons providing city police protection, without what the Auditor considers adequate control over what benefits are promised to retirees.

City Has in Fact Had Full Control. From the first contact by the Auditor in February concerning his current examination, the Retirement Systems have attempted to demonstrate to him that the city has always had full control by veto power over all statutory changes.

In every instance but one, city clearance has been obtained before filing any legislation. If the city objected to one or more proposals, the objectionable portions were dropped.

In the one exception, timing exigencies required filing in Jefferson City in order to get proposed legislation on the legislative docket prior to securing city approval, but a full formal report was made directly to the City Council before any legislative hearings were held in Jefferson City. So far as the Retirement Systems have been informed, the City Council raised no objection to any part of the proposed legislation. If it had done so, the Retirement Systems would have withdrawn the legislation.

Auditor Has Denied that Such Control Has Existed, Despite Documentary Evidence. The Auditor, without directly challenging the truthfulness of Retirement Systems' assertions, has apparently remained unconvinced that city approval has in fact been secured before any such legislation has been heard in Jefferson City, even though several items of documentation have been furnished him evidencing such clearances. Indeed the most important legislative change of the last two decades (establishing city contribution rates to the Retirement Systems) was actually ratified by a formal City Council Resolution. (In the draft of his Report delivered to us on August 10, the Auditor does acknowledge the existence of such Resolution in a footnote on page 4.)

See page 53
Comment 5

For example, the Auditor seems to imply that the city may not even know about legislative proposals, because the city rarely appears at state legislative hearings on such legislation (page 17). In fact, however, on the same page the Auditor acknowledges that the state notifies the city of such legislation, by sending to the city requests for "fiscal notes," inviting the city to identify the cost effects on the city of any proposed legislation.

See page 54
Comment 6

It seems clear that the city's absence at legislative hearings is in fact supportive evidence that the city's approval of legislative proposals has been obtained prior to submission to the legislature. Because of such prior approvals by the city, there has been no need for the city to incur the expense of having its lobbyist or some other city representative appear at legislative hearings on legislation which the city has already approved.

The Auditor acknowledges some of the documentation which has been furnished him showing that city approvals were obtained, but stresses that records of many such approvals have not been located by the staff of the new city manager among city records.

It is true that the Retirement Systems have such documentation of city notice and concurrence only for several years but not for all. Throughout their history the Retirement Systems have attempted to function as a part of a city team, working in friendly and cooperative fashion with the rest of city government to operate the Retirement Systems. With no anticipation of an adversarial relationship such as that raised by the Auditor's Report, the Retirement Systems have not been as careful to retain all documentation as the Auditor's current attitude would suggest they perhaps should have been. However the Retirement Systems have readily agreed with the current City Manager to take care that all notifications will be in writing in the future, and the Retirement Systems certainly plan to keep records of all such writings carefully in the future.

Legislation Imposing Costs on the City Would Not Pass in Jefferson City Without City Approval. The Retirement Systems have similarly continuously advised (but apparently not convinced) the Auditor that the state legislature would not pass legislation enhancing benefits for the Retirement Systems without city approval.

For example the Auditor notes that even without city appearances at legislative hearings, legislative proposals by the Retirement Systems are virtually always passed. However again, this circumstance in fact evidences the result of having secured city approval in advance of all legislative proposals. In many cases, as the documentation furnished the Auditor shows, the city has "appeared" at legislative hearings through letters from the city manager confirming the city's approval of the legislative proposal. Moreover if there were any instances when such letters had not reached the legislative committee, the representatives of the Retirement Systems at the legislative hearings could testify to the city approval, because such approval had been secured.

To further support his disbelief in our assertion that legislation affecting the Retirement Systems would not pass without city approval, the Auditor states that St. Louis legislation was passed in 1997 over opposition by both the city and the trustees of the St. Louis Retirement Systems. The Auditor states that such passage shows the legislature gives little weight to the concerns of the city required to fund benefits.

St. Louis Example Merits Detailed Attention. Because the Auditor obviously believes that the St. Louis example supports the conclusion just stated, the St. Louis circumstances need to be fully described. In doing so, the Retirement Systems expressly disclaim any implication of deliberate misstatement on the Auditor's part. However because the Auditor is not fully informed about those circumstances, he is not aware that the 1997 St. Louis legislation in fact provides a "case study example" proving that concerns of the funding city are controlling as to whether legislation passes in Jefferson City.

See page 54 Comment 7

On page 19 of the draft of the Auditor's Report furnished us on August 10, the Auditor describes his understanding of the 1997 St. Louis legislation as follows:

> "We also found an instance in early 1997 where a change in the St. Louis Police Department Retirement system was approved by the state's house and senate, despite being opposed by both the city of St. Louis and the Board of Trustees of the Retirement System. [Footnote omitted.] According to the 'fiscal notes,' the increased contributions required by St. Louis to fund the new provisions could reach $1.2 million a year."

Because provisions amending the Kansas City statutes were included in the same bill, the Retirement Systems have a copy of the fiscal note request on said bill which included the legislation as originally proposed by the proponents of the St. Louis portion of the bill. (The Retirement Systems do not know who the proponents were; but because the Auditor states that the bill was opposed by both the city and the Retirement System of St. Louis, we assume the proponents probably were members of the St. Louis chapter of the Fraternal Order of Police.) The original request for changes in the St. Louis statute included the following:

(1) Sec. 86.260-2: A 50% increase in the benefit for dependent children of retirees on "ordinary disability retirement."

(2) Sec. 86.267-4: Provision to repay 100% of the member contributions of each new retiree who retires for "accidental disability" or on permanent and total disability from an accident in line of duty, payable upon such retirement and without reduction of such member's regular disability pension. [A totally new benefit.]

(3) Sec. 86.267-5: Provision for the new benefit proposed under subsection 4 to be paid to all current disability

retirees by creation of "consultancies." [A totally new benefit.]

(4) Sec. 86.280-(1): A 40% increase in the benefit for a widow of a member who dies before retirement, and a 50% increase in the benefit for each dependent child of such a member.

(5) Sec. 86.280-(2): Provision for the increases proposed in subsection (1) to be paid all currently pensioned widows and dependent children of such members by creation of "consultancies."

(6) Sec. 86.280-(3): Provision to extend the increases under subsections (1) and (2) which would otherwise be payable to a widow, to be payable to dependent children if there is no widow living.

(7) Sec. 86.283-(1): A 40% increase in the benefit for a widow of a member who dies after retirement, and a 50% increase in the benefit for each dependent child of such a member.

(8) Sec. 86.283-(2): Provision for the increases proposed under subsection (1) to be paid to all currently pensioned widows and dependent children of members who died after retirement, by creation of "consultancies."

(9) Sec. 86.283-(3): Provision to extend the increases under subsections (1) and (2) which would otherwise be payable to a widow, to be payable to dependent children if there is no widow living.

(10) Sec. 86.287-(1): A 50% increase in the benefit for dependent children of a member who died from an accident in line of duty.

(11) Sec. 86.287-(2): Extension of the increases proposed under subsection (1) to such dependent children currently drawing benefits, by creation of "consultancies."

Although we do not have a copy of the St. Louis response to the Fiscal Note Request on this legislation, the Auditor reports that both the city and the Retirement System of St. Louis opposed this bill.

<u>Following such opposition, ALL of the described benefit increases were stricken from the bill</u>.

In the final House Bill 331 which passed by the lopsided majorities reported in the Auditor's footnote, the <u>only</u> St. Louis benefit increase was a provision (by creation of "consultancies") for repayment of contributions solely to retirees who retire because of permanent and total incapacity caused by an accident in line of duty.

Although the Retirement Systems do not have knowledge on this point, the lopsided majorities approving House Bill 331 strongly suggest that the city and the Retirement System of St. Louis agreed to the modest new benefit for duty disability retirees, after all other proposed benefit increases were stricken.

Thus the example which the Auditor believed showed that retirement legislation could be passed over city disapprovals in fact shows exactly the opposite. As the Retirement Systems have repeatedly told the Auditor from the outset of his examination, a funding city such as Kansas City in fact has a full veto power to block any benefit increases to which it does not agree.

Hancock Amendment Will Maintain Such City Control in the Future. While the Retirement Systems, as previously noted, have historically been good citizens and have functioned as a cooperative part of a city team, the city's control and veto power does not have to rely upon having similarly well motivated retirement trustees in the future. The Hancock Amendment requires city approval of cost increases, and will require such approval in the future as well.

Accordingly the city has full assurance that the Retirement Systems will continue to seek advance city approval of any proposed legislation.

Moreover, if some retirement board failed to secure such approval in the future, the legislature would not pass it, as the St. Louis example shows.

Even beyond that, if some legislature did attempt to pass legislation which the city had not approved, such legislation would be invalid under the Hancock Amendment.

THEREFORE THE CITY ALREADY HAS ALL THE PROTECTION NOW THAT THE AUDITOR RECOMMENDS. NO NEW STATUTE IS NEEDED.

Discussion of Manner of Securing City Approvals May Be in Order. The Auditor's Report suggests some potential question as to whether approvals of legislative proposals which have been secured in the past from city managers are valid city approvals.

This question is academic concerning approvals obtained in the past, because the Auditor has made explicitly clear that he does not recommend any reduction in current benefits. However discussion of the manner of securing city approvals may be helpful, because the Auditor has recommended the state statute be amended to require formal City Council action on any proposed changes in the future.

In the past, the Retirement Systems have contacted the city manager to advise of legislative proposals.

The Retirement Systems have not been privy to how a given city manager deals with a given City Council.

Obviously City Manager Olson in 1986-1987 took the agreement setting present contribution rates to the Council for ratification in a formal Resolution.

Whether at other times city managers may have considered that they were authorized to approve some given proposal of less significance, or whether some proposals have been brought to the full Council for instruction to the manager, the Retirement Systems simply do not know.

It is clear, of course, that all benefit increases for the Police System have required no increase in the contribution rates established by the 1986 agreement -- unlike benefit increases for other city retirement plans which have caused increases in contribution rates.

See page 54
Comment 8

The Retirement Systems consider that the operating procedures between a given manager and a given Council are strictly within the jurisdiction of those parties. The Retirement Systems will be pleased to follow whatever procedures are set, as this year they were pleased to comply with the request of City Manager Collins to present a personal briefing on 1998 legislative proposals to the full Council at a business session.

As a matter of governmental organization, obviously the Council can direct a city manager to follow whatever procedures the Council desires. It would seem entirely possible that some Councils might prefer for a city manager to exercise some discretion, in approving minor retirement system changes without formal Council action. On the other hand, if a given Council desires to have every proposed change reported to the Council and considered approved only if the Council takes affirmative action to approve it -- or alternatively, if a given Council prefers to require the city manager to report all proposed changes to the Council but to be authorized to approve those which the manager believes not significant enough to require formal Council action -- the Council can direct the manager as to any of those or any other operating procedures which the Council wants.

Accordingly under present statutes, the Hancock Amendment requires city approval of any benefit increases, and each respective Council has the power to direct whatever procedures it wishes to follow in granting city approval of proposed legislation.

<u>THUS THE CITY COUNCIL ALREADY CAN CONTROL EVERYTHING THE AUDITOR RECOMMENDS. NO NEW STATUTE IS NEEDED</u>.

Indeed fixing some given procedural requirement in a state statute which only Jefferson City could thereafter change would only restrict the powers of the City Council. Any new Council wanting to direct some different operating procedures for securing city consent would be hamstrung by the state requirements, while now each Council can direct any procedures it wants to have followed.

<u>As Part of His Recommendation for Increased "Control," the Auditor Recommends a State Statute Changing the Composition of the Retirement Board</u>. The Auditor proposes that the state statute constituting the composition of the Retirement Board be amended to require the city members to be constituted ex-officio. In particular the Auditor recommends that the city members on the Retirement Board be the Director of Finance and the Director of Human Resources.

<u>City Council Could Appoint Such Members Now if It Wants</u>. On pages 20-21 of the draft Report delivered August 10, the Auditor notes some respectable reasons for including ex-officio city staff members on retirement boards.

What the Auditor fails to acknowledge in his presentation is that the City Council can appoint such persons to the boards of the Retirement Systems under the current statute, if the Council finds it appropriate to do so.

See page 55 Comment 9

Indeed, the present state statute even goes so far as to suggest that the City Finance Director might be ex-officio a board member. However the Auditor's arguments have apparently not appealed to recent City Councils, as they have not named a city staff officer to the board in recent years.

If the Auditor's arguments ever do appeal to some new City Council, no statutory change will be required to permit such appointments.

<u>The Change Proposed by the Auditor Would Decrease City Council Control Rather Than Increase It</u>. At present the City Council has the right to appoint city staff members or any other appointees as selected by the Council, whichever the Council chooses. If the statute is changed to designate specific city staff officers as board members, the Council would lose its present right to exercise its own choice. Instead, the city manager would be making the appointments, by naming his department heads.

However if some new Council wanted to accept the Auditor's arguments for ex-officio members, or wanted simply to appoint department heads who had been appointed by the city manager, such new Council would have full power to appoint such persons under the present statute.

THUS AGAIN, THE CITY ALREADY CAN DO EVERYTHING THE AUDITOR RECOMMENDS. NO NEW STATUTE IS NEEDED.

III. RESPONSES TO SPECIFIC RECOMMENDATIONS

To respond specifically to each of the Auditor's Recommendations in turn, we shall identify them by the numbers assigned to them by the Auditor.

1. The Auditor wants the City Council to request the state to assume full funding responsibility for the Retirement Systems. The Retirement Systems believe that the practical significance of any such action would be such as not to merit further time or space discussing it. We would note, as explained previously in this Response, that the Auditor has made clear elsewhere in his Report that his real objective of this Recommendation is to tie funding responsibility and control of benefits together. Accordingly the Auditor's objective for this Recommendation is met by retaining in the City Council the control over benefit increases which the Council already has.

2. The Auditor recommends that the City Council pass resolutions requesting:

a. "state legislation to change the composition of the Police retirement board to require inclusion of two city officials, the director of finance and the director of human resources, as ex-officio members." We have previously noted that the recommended change would actually decrease rather than increase the control of the City Council over the Retirement Systems. If the City Council wishes to appoint those two city officials, or any other city officials, to the boards of the Retirement Systems, the City Council can do so under present statutes, so there is no need for new state legislation.

b. "state legislation that provides that benefit enhancements for the two Police retirement systems that are authorized, not mandated, by the General Assembly must be implemented by the City Council before becoming a part of the pension of any system member." Assuming that proposed legislation which has been approved by the City Council may be deemed appropriate for adoption, which approval is to be secured under whatever operational policies may be promulgated by each successive Council, then for all the reasons explained at length in this Response the City Council already has the protection that no retirement legislation can be adopted by the state without the approval of the City Council. Accordingly again there is no need for any new state legislation to provide the City Council with such control.

3. The Auditor recommends that the city be prepared to file litigation under the Hancock Amendment if the state should "decline to . . . enable the city to exercise more control over the pension systems." As we have explained at length in this Response, the city already has complete and full control over any new benefit enhancements. It would be difficult to envision how the state or anyone else could give the city any "more control." The existence of the Hancock Amendment would make any new legislation unlawful if it imposed a new retirement cost on the city without the city's approval. For this reason, the legislature would not pass any such legislation. If for some reason the entire legislative system completely broke down and an unlawful statute were passed, of course the city could always file litigation to have a court declare such a statute unlawful. However all of the principles upon which a court would rely in making such a declaration are already in place, so again no new state legislation would be required to achieve the result desired by the Auditor.

<u>Summary</u>. In summary, the Auditor's Report has simply failed to grasp that under present statutes the city already has full control over any retirement benefit enhancements that might be passed by the state legislature. To restate one final time the point of this Response:

<u>THE CITY ALREADY CAN DO EVERYTHING THE AUDITOR RECOMMENDS. NO NEW STATUTE IS NEEDED</u>.

Major Richard D. Easley, Chairman

POLICE RETIREMENT SYSTEM OF KANSAS CITY
and
CIVILIAN EMPLOYEES RETIREMENT SYSTEM OF THE POLICE DEPARTMENT OF KANSAS CITY

Appendix B

City Auditor's Comments Regarding the Police Retirement Board Chairman's Response

The following are the city auditor's comments regarding the response from the chairman of the Police retirement board, dated August 19, 1998. The numbers listed for each comment refer to specific passages in the Police Retirement Board Chairman's response, found in Appendix A of this report.

1. The draft provided to the Police retirement board included bold, italic, strikeout, and redlined text to differentiate text changes resulting from meetings with the retirement board. We have added references to the correct pages within this appendix when they differ from the page numbers quoted in the response.

2. The issue of whether or not employees of the Kansas City Police Department work for the city or the state was raised by members of the Police Retirement Board during discussions of the report's conclusions. In response, we sought further clarification on this issue from the city's Law Department. Included in this appendix is a written memorandum from the Law Department regarding this issue.

3. While we agree the Police Department's sole responsibility is to provide police protection for the citizens of Kansas City, one of the main objectives of this report and earlier efforts by this office is to increase city control and oversight over the costs of this protection. This was the basis for our earlier efforts to obtain the right to audit the activities of the Police Department and continues in this report as we recommend the city seek greater control over decisions regarding Police employee benefits. While our first recommendation seeks to turn full financial responsibility for the Police pension systems over to the state, the city manager in his response indicates that he believes that as service providers to the citizens of Kansas City, the city continues to bear some obligation for the funding of the Police officers and civilian retirement systems.

4. Further discussion of the impact of the Hancock Amendment on the Police retirement systems can also be found in our attached memorandum from the Law Department.

5. We also mention the resolution on page 16. We received documents from the Police retirement board related to changes in retirement benefits. As a result, we have modified the report to include the City Council's passage of the 1987 resolution setting

the current city contributions to the police officer's retirement system and to reflect the documentary evidence of correspondence between former city managers, the former police chief and members of the state legislature regarding the Police retirement system. With the exception of the resolution passed in 1987, this evidence demonstrates the involvement of the city manager in retirement system matters but little involvement by the City Council. The current city manager believes that city support for legislative initiatives by the Police Retirement Board should only come from the City Council. We concur and seek to increase City Council involvement and support in future retirement system initiatives.

6. This can be found on page 16.

7. Because the specifics of the state legislature's actions regarding the retirement system for St. Louis Police officers could not be adequately determined, the text detailing the example was removed from the final report.

8. The increase in city contributions ratified in 1987 increased city contributions significantly beyond what was required to keep the Police retirement system actuarially sound. However, over the years increases in benefit costs have slowly eroded the excess in city contributions. This is indicated in the schedule of employer contributions from the Police retirement system's *Report on the Actuarial Valuation for the Plan Year Ending April 30, 1998* which compares required and actual city contributions:

Exhibit B-1. Schedule of Employer Contributions, 1992 through 1997

Year Ended	Annual Required City Contribution	Actual City Contributions	Percent Contributed
4/30/92	$6,108,839	$8,713,583	143%
4/30/93	$7,709,970	$8,953,982	116%
4/30/94	$7,602,692	$9,196,647	121%
4/30/95	$8,346,925	$9,293,708	111%
4/30/96	$8,587,324	$9,478,903	110%
4/30/97	$8,716,539	$9,721,985	112%

Source: Police Retirement System of Kansas City, Missouri, *Report on the Actuarial Valuation for the Plan Year Ending April 30, 1998.*

City contributions were raised to current levels on May 1, 1991. Since then, contributions have remained above those required to maintain the retirement system on a sound actuarial basis, but the excess in contributions is slowly being eliminated as benefits are increased.

9. We mention the City Council's current option of appointing the Director of Finance to the Police Retirement Board on page 19.

Office of the City Attorney

RECEIVED
AUG 5 1998
CITY AUDITOR'S OFFICE

TO: Mark Funkhouser, City Auditor
FROM: William D. Geary, Assistant City Attorney
SUBJECT: Police pension systems
DATE: August 5, 1998

We have recently discussed a technical issue exposed during your office's preparation of a special report for the City Council on the pension systems for police officers and civilian employees of the Police Department. The question is whether the Board of Police Commissioners is "the State." This question is important because it frames consideration of possible challenges under the Hancock Amendment to future changes in benefits imposed by the General Assembly but funded by the City.

You have been informed by a representative of the Police Retirement System and the Civilian Employees' Retirement System of the Police Department of Kansas City that the "Board is not 'the state,' but rather is a Board created by law for the sole mission of providing police protection and law enforcement for the citizens of Kansas City."

First, I do not understand you to suggest that the Board of Police Commissioners does not provide a service to the citizens of Kansas City. However, but for the existence of the Board - mandated by Missouri statute, the responsibility to provide police protection would be assumed by the City Council. The City Charter, §32, is clear:

> When the laws of the state do not prohibit, there shall be a department of police, the head of which shall be the director of police. The council shall prescribe by ordinance the powers and duties of the department and may make such other regulations as may be necessary.

I also do not understand you to suggest that the City should not fund its police protection. My understanding is that you suggest that if future changes in benefits, not controlled by the City, are required by the State, then the State should fund those benefits. As with the Firefighters' Pension System and the City Employees' Pension System, you suggest the entity funding the system should have some control in the benefits to be paid. I do not understand you to suggest that benefits paid to police officers and civilian employees are necessarily inappropriate, but that such decision is never made by the entity charged with funding the benefits.

This philosophy is consistent with the Hancock Amendment. If the State of Missouri requires the City to perform a new function or increases the level of support for a function, it must pay for that mandated increase. The City can, of course, always choose to increase the level of its functions within its budget, without approval of the State.

For example, an increase in a particular activity, such as bridge repair, could be handled in at least three ways. First, if additional money is available it could be spent for the increased repairs. Second, if additional money is not available, budget priorities could be evaluated and money from a second activity could be moved to bridge repair. Third, citizens could impose on themselves a tax or fee to pay for the increased bridge repair. However, if the State of Missouri by statute or rule required the City to increase its bridge repair program by $1 million annually, the State would be responsible for providing that mandated amount of money.

The Hancock Amendment provides that "the state is prohibited from requiring any new or expanded activities by counties and other political subdivisions without full state financing, or from shifting the tax burden to counties and other political subdivisions." This rule is stated a second way in the Constitution:

> A new activity or service or an increase in the level of any activity or service beyond that required by existing law shall not be required by the general assembly or any state agency of counties or other political subdivisions, unless a state appropriation is made and disbursed to pay the county or other political subdivision for any increased costs.

I am aware of no reported cases in which the issue of whether either of the two police pension systems is "the state" was decided. However, there are a number of discussions of the character of the Board of Police Commissioners.

In a dispute over the amount of money the City was required to budget for the Board of Police Commissioners the Supreme Court in 1955 described the "Kansas City police system as an agency of the state." It has been said that the Board, although it provides police protection for the City, is "obligated as a legal subdivision of the state" and that it "is a branch of the State government." Courts have also looked at the nature of the St. Louis Board of Police Commissioners, established by statutes similar to those controlling Kansas City. Both boards were characterized by the United States Court of Appeals as "creatures of the state government, wholly independent of the cities which they serve." The Board is said to be "under state control."

Officers are considered "officers of the State of Missouri and of Kansas City, Missouri." It is my understanding that police officers are "officers of Kansas City" because of their State-imposed obligation to enforce City ordinances. They are not City employees and could not be officers of the City for any employment related reason. They are officers of the State because the Board of Police Commissioners is a State agency.

The relationship of the citizens of the City to the Board of Police Commissioners has been best described this way:

> Every resident of Kansas City, as a taxpayer, has an interest in this area because his tax dollars are expended to maintain the Department. But that interest gives the City

> (beyond its budgetary function) and the taxpayers no control over the Department's operations or obligation (except financial) for its administrative acts.

Furthermore, when the St. Louis Board of Police Commissioners sought increased funding of the police department beyond that established when the Hancock Amendment was adopted, the Supreme Court wrote:

> The Police Board is also in error in its assertion that [the Hancock Amendment] does not apply to state agencies that are not a part of the state budgetary appropriation process. [It] employs the words "any state agency." When the word "any" is used in a constitutional provision, its meaning is "all-comprehensive, and is equivalent to "every."

It is my opinion the Board should be considered the State. The fact that the Board's responsibilities are limited to protecting the people of Kansas City reflects a State decision to remove the police department from local control, and place it within the authority of the State.

The police pension systems are also established by Missouri statute. They are organized according to statute and their operation is defined by statute. The City cannot adopt an ordinance that would be inconsistent with the police pension system statutes. The systems are designed to provide for retired employees of a state agency. Furthermore, the General Assembly has recognized the character of the pension systems as state agencies by enacting a statute that states the pension boards or the City may seek a declaratory judgment under the Hancock Amendment to determine if new benefits are unfunded State mandates. The State also indicates that if the new benefit requires State funding the benefit is repealed. That is, if a new benefit falls to the State for funding, the State will not fund it.

Finally, that there are representatives of the City on the pension system boards does not render the actions of the boards those of the City. The Court of Appeals has noted that "the Mayor's presence as an ex officio member [of the Police Board] does not change the basic character or functions of the Board, or the authority of and restrictions upon the City with relation to the Police Department."

For these reasons, it is my opinion that the Board of Police Commissioners and by analogy the pension systems, are considered "the State" for purposes of determining their relationship to the City.

Will Geary

William Geary
Assistant City Attorney

cc: Walter O'Toole, City Attorney

Appendix C

City Manager's Response

Office of the City Manager

DATE: August 20, 1998

TO: Mark Funkhouser, City Auditor

FROM: Robert L. Collins, City Manager

SUBJECT: Response to Special Report on Police Pension Funds

I have thoroughly reviewed your special report on Police pension funds and provide the following responses to the recommendations contained in the report:

The City Manager should prepare for Council consideration a resolution requesting the state to assume full responsibility, including funding, for the Police Retirement System and the Civilian Employees' Retirement System of the Police Department. This resolution should be included among the legislative priorities sent to the state capitol.

I firmly believe that the City has an obligation to all persons working for it to assure that they and their surviving spouses have the opportunity to benefit from a reasonable retirement system and that there be no reduction in existing benefit levels. While the report makes a compelling argument that Police Department employees are state employees, as service providers to the citizens of Kansas City, I believe that the City continues to bear some obligation for the funding of the Police and Civilian Pension Systems. However, I concur, that as the agency that authorizes improvements to the benefits paid by the pension system, the State should accept greater responsibility for these retirement systems particularly in those cases where the state authorizes benefits beyond those provided by the City Employees' and Firefighters' Pension Systems and in those instances where these benefit enhancements have an impact on the City's budget by requiring an increase in contributions or prohibiting a reduction in contribution rates. "Hancock" limitations on unfunded mandates makes the state's participation in the funding of the pension systems all the more logical and quite possibly mandatory.

It is my intent to work with the City's legal staff, the Board of Police Commissioners, and the Police Retirement Board in drafting a resolution that would request the state to accept a greater level of responsibility for the two retirement systems with this responsibility including some level of funding for the systems; particularly the funding of enhancements authorized since the enactment of the "Hancock Amendment" in 1980 and for all future enhancements.

If the State does not assume financial responsibility, we recommend the City Manager prepare for Council consideration resolutions requesting:

a) **State legislation to change the composition of the police retirement board to require inclusion of two city officials, the Director of Finance and the Director of Human Resources as *ex-officio* members.**

I concur with this recommendation. The Finance Director and Human Resources Director would bring knowledge of the City's fiscal condition, investment procedures, and operation and administration of the City's other pension systems to the Police Retirement Board. This arrangement would also be consistent with the structure of the City Employees' and Firefighters' Pension Boards. I would hope that consideration would be given to this recommendation even if the State does assume financial responsibility for the systems, as I believe the participation of both the Finance and Human Resources Directors would be beneficial to the State as well as to the City.

b) State legislation that provides that benefit enhancements for the two police retirement systems that are authorized, not mandated, by the General Assembly must be implemented by the City Council before becoming a part of the pension of any system member.

I concur with this recommendation. The City Council has acted prudently and conscientiously in assuring that the benefits provided to members of the City Employees' and Firefighters Pension Systems are reasonable and that appropriate contribution rates are maintained. It seems only proper that, as the body that must fund the contributions to the pension systems and approve the City's annual budget, the City Council would have an opportunity to vote its approval or disapproval of implementing enhancements to police and civilian retirement benefits authorized but not mandated by the General Assembly.

I would foresee a process by which the Police Retirement Board would fully brief the City Council of any proposed pension enhancement prior to filing the proposal with the General Assembly. Any enhancement endorsed by the City Council would be forwarded to the General Assembly for its authorization. Council implementation of the proposal would follow authorization by the General Assembly. This implementation should be little more than a formality unless the original proposal is amended on the floor of the State Capitol.

Should the State decline to accept financial responsibility for the Police Retirement Systems or enable the City to exercise more control over the pension systems, we recommend the City *be prepared to* file suit to seek a declaratory judgment on the validity of *any new* benefit enhancements in accordance with section 86-810 of the Missouri Statutes.

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It is clearly my intent to resolve any and all points of contention regarding the administration and funding of the pension systems through maintaining open communications with the Police Retirement Board, the Board of Police Commissioners, the City Council and the State General Assembly. Positive strides are already being made in this direction. I do not believe that seeking a declaratory judgment is a productive means of resolving this issue. However, at a time when mandates and other obligated expenditures comprise a substantial and apparently growing portion of the City's budget, I cannot rule-out any possible means of recourse, no matter how remote the likely use of that remedy might be, and, as City Manager it is my responsibility to fully inform the City Council of all alternatives available to it. Applying the Hancock limitation only to new benefit enhancements is the only reasonable course to take if a declaratory judgement is sought. As was previoiusly stated, it should not be the City's intent to reduce the level of existing benefits.

The City Manager should take steps to ensure that the City Council is fully briefed on any proposed plan changes, benefit enhancements, and associated costs before legislation is presented to or passed by the State Legislature.

I am committed to this, and, as was indicated in the previous response, positive strides are being made. I appreciate the efforts made by the Police Retirement Board to keep me better informed of its plans so that I may keep the City Council better informed on these issues. I also appreciate the Board's willingness to meet with the Council to discuss proposed changes to the Police and Civilian pension plans. It is my opinion that City Council involvement in setting policies related to the police pension systems comparable to the Council's policy making involvement with the City Employees' and Firefighters' systems will only improve the integrity of the systems and improve the likelihood that these proposals will receive authorization from the General Assembly.

Robert L. Collins

RLC:emm
cc: Rich Noll, Assistant City Manager

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