



July 12, 2002

**Internal Audit Report 2002-8
 First Five Year Review of Operation of
 Police & Fire Retiree Medical Funding Program
 Executive Director, Police & Fire Retiree Medical Trust
 Employee Relations Department**

Introduction. In December 1994, the Anchorage Municipal Assembly (Assembly) passed Assembly Ordinance (AO) 94-222(S-1), an ordinance establishing the Retiree Medical Funding Program for Police Officers and Firefighters (Anchorage Municipal Code [AMC] 3.87). This program provides that the Municipality of Anchorage (Municipality) make monthly contributions to a Trust account on behalf of eligible Police and Fire Retirement System retirees. Funds in the Trust can be used by the participant to purchase health insurance coverage. The initial Municipal contribution amount in 1995 was \$490 per month. The ordinance provides for increases in the contribution amounts based on percentage increases in the National Medical Consumer Price Index (MCPI). The ordinance also established different tiers for the increased amount as follows:

<u>Retirement Age</u>	<u>or</u>	<u>Service at Retirement</u>	<u>Annual Adjustment</u>
60 Years or Older		25 Years	75% of MCPI
55-59 Years			50% of MCPI
50-54 Years		20-24 Years	50% of MCPI (6% of maximum)
Less Than 50 Years		0-19 Years	25% of MCPI (3% of maximum)

The increase in Municipal contributions since inception has been 21.3%. The increase for insurance premiums since inception has been 34%. The Assembly may increase the contributions to the amount of the insurance premiums, they can average premiums over the previous three-year period, or they can lower the contributions to \$490, whichever is greater.

AMC 3.87.080 states, *“every five years from January 1, 1995, the assembly will review the operation of the program including the amount of the initial monthly contribution established in section 3.87.050 to be made by the Municipality.”*

Scope. The objective of this audit was to review the operation of the Police and Fire Retiree Medical Funding Program, including the amount of the initial monthly contribution made by the Municipality. The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of June through July 2002. The audit was requested by the Assembly in response to the five year review requirement.

Overall Evaluation. Overall, the Police and Fire Retiree Medical Funding Program is operating as intended. The Police/Fire Retiree Medical Liability Fund (313) has been funded each year as specified by the actuarial study, with the contribution split between Areawide General Fund (101), Anchorage Fire Service Area Fund (131), and Anchorage Metro Police Service Area Fund (151). Additionally, funds in Fund 313 are currently being properly appropriated to make the monthly contributions to the Expendable Police and Fire Retiree Medical Trust Fund (713). A misunderstanding in prior years regarding monthly contributions from Fund 313 has resulted in an Interfund Payable to the General Fund of \$1,933,995 at the end of 2001 as well as possible inaccurate contribution rates in the actuarial study. The misunderstanding was pointed out to the Executive Director, Police and Fire Retiree Medical Trust (Executive Director), in 2001 by Internal Audit and the contributions are now properly made out of fund 313 instead of the General Cash Pool. The current monthly insurance premiums exceed the contribution rate for all four tiers. We also found no evidence that funds have been clearly designated for the \$9.8 million balloon contribution in 2006.

FINDINGS AND RECOMMENDATIONS

1. Funds Not Designated for \$9.8 Million Balloon Contribution in 2006.

- a. **Finding.** Funds had not been clearly designated or otherwise identified for the \$9.8 million contribution required in 2006. Assembly Memorandum (AM) 210-96 states:

“In the year 2006, maturing Certificates of Participation will also provide a cash infusion of approximately \$11 million to the Debt Service Fund.”

Further, the 1999 actuarial funding analysis from William M. Mercer for Fund 313 states:

“Our analysis indicates that the Municipality of Anchorage can reduce the annual contribution to the Trust from \$1.7 million to \$1.3 million per year. The contribution is lower than our original projection due to a higher rate of return on Trust assets and a smaller number of participants retiring than expected. We developed this contribution amount based on the following assumptions: The Municipality of Anchorage will continue to contribute a level amount for the remainder of the 20-year funding period (i.e., until 2015). In 2006, the Municipality of Anchorage will contribute an additional \$9.8 million to the Trust from the proceeds of an annuity purchase contract.”

We did not find any documentation that designates Fund 719 for the \$9.8 million contribution in 2006 to the Police/Fire Retiree Medical Liability Fund. The description of Fund 719 in the Comprehensive Annual Financial Report states that,

“The Retirement Certificates of Participation Fund accounts for an annuity investment and related income; the proceeds of which are used to pay rents on certain Certificates of Participation.”

- b. **Recommendation.** The Executive Director should request that the Finance Department clearly designate a balance in Fund 719 to meet the 2006 obligation of \$9.8 million for the Police and Fire Retiree Medical Liability Fund.
- c. **Management Comments.** Management concurred and stated, “A meeting is being scheduled with Finance to discuss the designation of a balance in Fund 719 to meet the 2006 obligation of \$9.8 million for the Police and Fire Retiree Medical Liability Fund.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Monthly Medical Insurance Premium Exceeds Contribution Rate.**

- a. **Finding.** The current monthly insurance premium exceeds the contribution rate for all four tiers. The contributions range from \$522.74 to \$594.45, while the premium is \$697.27.
- b. **Recommendation.** The Executive Director should advise the Assembly of the deficit contribution rate and recommend that action be taken to increase the contribution rate to cover the insurance premiums.
- c. **Management Comments.** Management concurred and stated, “The Assembly was advised on June 25, 2002 of the deficit contribution rate and a recommendation was

made that action be taken to increase the contributions rate to cover the insurance premiums of \$697.27 per month.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Participants’ Monthly Trust Contributions Not Always Calculated Accurately.**

- a. **Finding.** During our review of the monthly contributions, we found that the index changes to the MCPI for the Trust Contributions were not correctly calculated. Even though the errors totaled only 0.4%, each successive year is based upon the prior year’s contribution amount, adjusted annually in accordance with the MCPI factor, resulting in an accumulation of errors since the initial miscalculation of \$1,145. The differences appear to have resulted from the method of rounding the annual MCPI computations for all but one year.
- b. **Recommendation.** The procedure for calculating the MCPI changes should be standardized to include the number of decimal places to be rounded. In addition, the Executive Director should evaluate whether account balances should be adjusted for the minor errors found in the prior years.
- c. **Management Comments.** Management concurred and stated, “A policy will be recommended to the Police and Fire Retiree Medical Board of Trustees to standardize the rounding of the calculations for the MCPI. The Board will determine what adjustment shall be made for the minor errors found in prior years.”

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- d. Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on July 3, 2002.

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