

# **City of Pontiac General Employees' Retirement System**

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**Financial Report  
with Supplemental Information  
December 31, 2012**

# **City of Pontiac General Employees' Retirement System**

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## Independent Auditor's Report

To the Retirement Board  
City of Pontiac General Employees'  
Retirement System

We have audited the accompanying statement of plan net position and the related statement of changes in plan net position of the City of Pontiac General Employees' Retirement System (the "System") a component unit of the City of Pontiac, Michigan, as of and for the year ended December 31, 2012 and the related notes to the financial statements.

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

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net position of the City of Pontiac General Employees' Retirement System as of December 31, 2012 and the changes in plan net position thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

To the Retirement Board  
City of Pontiac General Employees'  
Retirement System

**Other Matters**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, and pension system schedules of funding progress and employer contributions, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Plante & Moran, PLLC*

June 21, 2013

# City of Pontiac General Employees' Retirement System

## Management's Discussion and Analysis

### Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The financial statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

### Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	2012	2011
Total assets	\$ 424,262,955	\$ 396,300,940
Total liabilities	<u>734,166</u>	<u>1,001,347</u>
Net assets held in trust for pension benefits	<b><u>\$ 423,528,789</u></b>	<b><u>\$ 395,299,593</u></b>
Net investment income (loss)	\$ 50,201,824	\$ (3,085,494)
Net securities lending (loss) income	(16,028)	158,866
Contributions (reinstated members)	-	23,083
Other - Miscellaneous and litigation revenue	23,792	81,465
Retiree pension and annuity benefits	(21,497,123)	(21,037,340)
General and administrative expenses	<u>(483,269)</u>	<u>(720,221)</u>
Net increase (decrease) in net assets held in trust	<b><u>\$ 28,229,196</u></b>	<b><u>\$ (24,579,641)</u></b>

# **City of Pontiac General Employees' Retirement System**

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## **Management's Discussion and Analysis (Continued)**

### **Overall Fund Structure and Objectives**

The City of Pontiac General Employees' Retirement System (the "System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

### **Asset Allocation**

The System has established asset allocation policies that are expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the adopted asset allocation (excluding the collateral pool) as of December 31, 2012:

Domestic equities	55%
Domestic fixed income	18%
International equities and fixed income	15%
Basket Clause Category Securities	8%
Cash	4%

### **Investment Results**

In 2012, the European Central Bank announced a program to save the Eurozone and the U.S. Federal Reserve introduced Quantitative Easing III. This intervention by the central banks provided stability to the capital markets and investors with confidence. Core inflation in the U.S. was below the long-term target at 1.7 percent. Interest rates ended the year nearly unchanged from January 1. The fixed-income market posted modest gains; the Barclay's U.S. Aggregate index returned 4.2 percent for the year. The Standard & Poor's 500 returned 16.1 percent and the MSCI EAFE Index (a proxy for international stocks) returned 17.3 percent. The total plan returned 13.38 percent for the year.

# **City of Pontiac General Employees' Retirement System**

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## **Management's Discussion and Analysis (Continued)**

### **Investment Results (Continued)**

The total System's return must always be considered in a longer-term context. The fund's investment horizon is long-term, corresponding to the long-term nature of the System's liabilities. Therefore, the board of trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the System to pay the benefits promised to members and retirees. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years.

### **Plan Sponsor Financial Condition/Plan Update**

The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently in receivership under Michigan Public Act 436 of 2012. The result is that the State has appointed an Emergency Manager to control the finances of the City. The System is currently overfunded and no employer contributions are required at this time. Should a contribution be required in the future, there is uncertainty regarding the City's ability and intent to make contributions to the System.

# City of Pontiac General Employees' Retirement System

## Statement of Plan Net Position December 31, 2012

<b>Assets</b>	
Cash (Note 4)	\$ 5,523
Investments at fair value (Note 4):	
Money market funds	16,361,862
Government agency notes and debentures	7,226,164
Corporate and other bonds	29,898,640
Equities	269,636,036
Private equities	8,394,480
U.S. government mortgage-backed securities	25,495,667
High-yield bonds	19,874,171
Commercial mortgage pools	7,170,210
Asset-backed securities	5,701,832
Other	33,190,396
Accrued interest and dividends receivable	1,302,349
Accounts receivable - Due from Police and Fire Retirement System	2,670
Accounts receivable - Due from GERS VEBA	2,955
	<hr/>
Total assets	424,262,955
<b>Liabilities</b> - Accounts payable and other	<hr/> 734,166
<b>Net Position Held in Trust for Pension Benefits</b> (a schedule of funding progress is presented in the required supplemental information)	<hr/> <b>\$ 423,528,789</b> <hr/>

# City of Pontiac General Employees' Retirement System

## Statement of Changes in Plan Net Position Year Ended December 31, 2012

### Additions

Investment income:	
Interest and dividend income	\$ 10,657,334
Net increase in fair value of investments	42,324,856
Less investment advisor fees	<u>(2,780,366)</u>
Net investment income	50,201,824
Miscellaneous and litigation revenue	<u>36,349</u>
Total additions	50,238,173

### Deductions

Retirees' pension benefits and retirement incentives	21,497,123
Other expenses	<u>511,854</u>
Total deductions	<u>22,008,977</u>

**Net Increase in Net Position Held in Trust for Pension Benefits** 28,229,196

**Net Position Held in Trust for Pension Benefits - Beginning of year** 395,299,593

**Net Position Held in Trust for Pension Benefits - End of year** \$ 423,528,789

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2012

### Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the City of Pontiac General Employees' Retirement System (the "System") (a contributory single-employer retirement plan) that covers substantially all employees of the City, except police and fire employees.

**Reporting Entity** - The financial statements of the System are also included in the combined financial statements of the City as a pension trust fund. The assets of the pension trust fund include no securities of or loans to the City or any other related party.

**Plan Sponsor Financial Condition** - The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently in receivership under Michigan Public Act 436 of 2012. The result is that the State has appointed an Emergency Manager to control the finances of the City. The System is currently overfunded and no employer contributions are required at this time. Should a contribution be required in the future, there is uncertainty regarding the City's ability and intent to make contributions to the System.

**Basis of Accounting** - The System's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the System.

**Methods Used to Value Investments** - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals or audited financial statements. Investments that do not have an established market value are reported at estimated fair value as determined by the System's management. These estimates are determined using financial statements issued by the private equity companies in which such investments are held, adjusted by management as deemed appropriate based on known circumstances. Approximately 10 percent of the System's assets are not publicly traded, and therefore do not have a readily determinable market value. Because these alternative investments are not readily marketable, their estimated value is subject to uncertainty, and therefore may differ significantly from the values that would have been used had a ready market for these securities existed. The difference could be material.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2012

### Note 2 - Membership Information

At December 31, 2011, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving pension benefits and terminated employees entitled to benefits but not yet receiving them	1,348
Current Employees:	
Fully vested	49
Nonvested	38
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Total current employees	87
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### Note 3 - Plan Description and Contribution Information

**Plan Description** - The System provides retirement benefits, as well as death and disability benefits. Employees may receive cost of living adjustments as a percentage of their base amounts, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by City ordinance and negotiation with the employees' collective bargaining units.

**Contributions** - Plan members are not required to contribute. The City is required to contribute at an actuarially determined rate. In accordance with the actuary recommendation, the City did not make a contribution to the System in the current year. Administrative costs are financed through investment earnings.

**Annual Pension Cost** - The annual contribution for the year ended December 31, 2012 was \$0. The annual contribution for the plan year was determined as part of actuarial valuations at December 31, 2009 using the entry age actuarial cost method. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, (c) additional salary increases of 1.1 percent to 4.9 percent per year based on merit and/or longevity, (d) cost of living adjustments ranging from 2.0 percent to 2.5 percent per year, and (e) inflation of 4.5 percent. Both (a) and (b) are determined by using techniques that smooth the effects of short-term volatility over a five-year period. The unfunded actuarial liability is being amortized as a level of percent of payroll on an open basis. The remaining amortization period is 30 years.

Per the actuarial report dated December 31, 2011, all assumptions have remained consistent.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2012

### Note 3 - Plan Description and Contribution Information (Continued)

**Funded Status and Funding Progress** - As of December 31, 2011, the most recent actuarial valuation date, the System was 153.5 percent funded. The actuarial accrued liability for benefits was \$249,739,988 and the actuarial value of assets was \$383,349,729, resulting in actuarial accrued assets of \$133,609,741. The covered payroll (annual payroll for active employees covered by the System) was \$3,968,743 and the ratio for the unfunded AAL to the covered payroll was 0 percent given the funded status.

The schedule of funding progress, presented as required supplemental information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan net assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Three-year trend information as of December 31 is as follows:

	Fiscal Year Ended December 31		
	2010	2011	2012
Annual pension cost (APC)	\$ -	\$ -	\$ -
Percentage of APC contributed	100.0 %	100.0 %	100.0 %
Net pension obligation	-	-	-

**Reserves** - State law requires employee contributions to be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of December 31, 2012, the System's reserves have been fully funded as follows:

Reserve for employees' contributions	\$ 1,520,912
Reserve for retired employees	213,743,519

### Note 4 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The System is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

# City of Pontiac General Employees' Retirement System

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## Notes to Financial Statements December 31, 2012

### Note 4 - Deposits and Investments (Continued)

The System is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the System's assets exceed \$250 million), debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The System has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all allowable investments under Michigan Public Act 314 of 1965, as amended. The System's deposits and investment policies are in accordance with statutory authority. The System's deposits and investment policies are in accordance with statutory authority.

The System's cash and investments are subject to several types of risk, which are examined in more detail below:

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the System's deposits may not be returned to it. The System does not have a deposit policy for custodial credit risk. At year end, the System had no bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The System continues to evaluate each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

**Interest Rate Risk** - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System's investment policy does not restrict investment maturities,

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2012

### Note 4 - Deposits and Investments (Continued)

At year end, the average maturities of investments are as follows:

Investment	Fair Value	Effective Duration
Asset-backed securities	\$ 5,701,832	1.77 years
Commercial mortgage pools	7,170,210	3.09 years
Corporate and other bonds	49,051,812	4.61 years
Corporate and other bonds	721,000	Unavailable
U.S. governmental bonds	3,060,255	11.56 years
U.S. governmental issued commercial mortgage-backed securities	938,050	3.08 years
U.S. governmental mortgage-backed securities	24,557,617	0.99 years
Other government agencies	2,105,378	5.18 years
Nongovernment-backed CMOs	203,269	1.29 years
Nongovernment-backed CMOs	538,219	Unavailable
Municipal/Provincial bonds	1,670,445	7.72 years
Municipal/Provincial bonds	390,086	Unavailable
Short-term investment funds	17,095,992	Unavailable
Short-term bills and notes	1,938,734	0.19 years

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2012

### Note 4 - Deposits and Investments (Continued)

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System's investment policy limits investments in domestic fixed-income securities to not less than a CCC rating for an overall average quality of each high-yield portfolio; the overall quality rating of each high-grade portfolio must be AA or an equivalent rating; for domestic equity investments, the securities must be the equivalent of Standard & Poor's AI or Moody's P-1; for global bonds, the overall average quality must be AA or higher. As of year end, the credit quality ratings of debt securities are as follows:

Investment	Fair Value	Moody's
Asset-backed securities	\$ 2,601,413	Aaa
Asset-backed securities	856,885	Aa
Asset-backed securities	984,997	A
Asset-backed securities	1,258,537	Unrated
Commercial mortgage-backed securities	6,767,055	Aaa
Commercial mortgage-backed securities	194,753	Aa
Commercial mortgage-backed securities	208,402	Unrated
Corporate bonds	254,347	Aaa
Corporate bonds	2,057,829	Aa
Corporate bonds	11,157,568	A
Corporate bonds	16,474,815	Baa
Corporate bonds	460,688	Ba
Corporate bonds	11,149,940	B
Corporate bonds	7,419,281	Caa
Corporate bonds	798,344	Unrated
Governmental agencies	1,287,933	Aaa
Governmental agencies	817,446	Aa
U.S. governmental agency mortgage-backed securities	53,080	Unrated
Nongovernment-backed CMOs	20,122	A
Nongovernment-backed CMOs	721,366	Unrated
Municipal/Provincial bonds	126,387	Aaa
Municipal/Provincial bonds	1,544,058	Aa
Municipal/Provincial bonds	390,086	Unrated
Short-term investment funds	17,095,992	Unrated

# **City of Pontiac General Employees' Retirement System**

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## **Notes to Financial Statements December 31, 2012**

### **Note 5 - Upcoming Accounting Pronouncements**

In June 2012, GASB Statement No. 67, *Financial Reporting for Pension Plans*, was issued by the Governmental Accounting Standards Board. This new standard, which replaces the requirements of GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and No. 50, *Pension Disclosures*, establishes standards for financial reporting that outline the basic framework for separately-issued pension plan financial reports and specifies the required approach to measuring the liability of employer(s) and certain nonemployer contributing entities, about which information is required to be disclosed. GASB Statement No. 67 is required to be adopted for years beginning after June 15, 2013. For the City of Pontiac General Employees' Retirement System, this standard will be adopted for the year ended December 31, 2014.

## **Required Supplemental Information**

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# City of Pontiac General Employees' Retirement System

## Required Supplemental Information Schedules of Funding Progress and Employer Contributions Year Ended December 31, 2012

The schedule of funding progress is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/06	\$409,983,490	\$266,457,429	\$ (143,526,061)	153.9	\$ 14,996,753	-
12/31/07	433,028,186	257,940,349	(175,087,837)	167.9	13,559,473	-
12/31/08	416,678,512	261,497,756	(155,180,756)	159.3	14,414,481	-
12/31/09	405,193,572	255,720,207	(149,473,365)	158.5	12,553,146	-
12/31/10	399,573,669	253,866,554	(145,707,115)	157.4	9,493,229	-
12/31/11	383,349,729	249,739,988	(133,609,741)	153.5	3,968,743	-

The schedule of employer contributions is as follows:

Year Ended	Annual Required Contribution	Percentage Contributed
12/31/07	\$ -	100.0
12/31/08	-	100.0
12/31/09	-	100.0
12/31/10	-	100.0
12/31/11	-	100.0
12/31/12	-	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2011, the latest actuarial valuation, follows:

Asset valuation method	Market value with five-year smoothing of gains and losses
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	5.6% - 9.4%
Cost of living adjustments	2 percent (2.5 percent Court/MAPE) of original amount, subject to a maximum that varies by group

\*Includes inflation at 4.5%