FIRE AND POLICE DISABILITY AND RETIREMENT:
Improvements resulted from 2006 Charter reforms, but significant fiscal challenges remain

June 2011

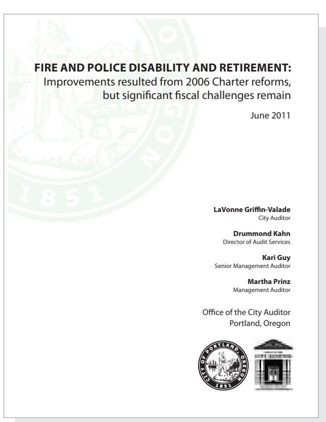
LaVonne Griffin-Valade
City Auditor

Drummond Kahn
Director of Audit Services

Kari Guy
Senior Management Auditor

Martha Prinz
Management Auditor

Office of the City Auditor
Portland, Oregon


FIRE AND POLICE DISABILITY AND RETIREMENT:
Improvements resulted from 2006 Charter reforms, but significant fiscal challenges remain

June 2011

LaVonne Griffin-Valade
City Auditor

Drummond Kahn
Director of Audit Services

Kari Guy
Senior Management Auditor

Martha Prinz
Management Auditor

Office of the City Auditor
Portland, Oregon

Production / Design
Robert Cowan
Public Information Coordinator

CITY OF PORTLAND

OFFICE OF THE CITY AUDITOR
ENSURING OPEN AND ACCOUNTABLE GOVERNMENT

Office of City Auditor LaVonne Griffin-Valade

Audit Services Division
Drummond Kahn, Director
1221 S.W. 4th Avenue, Room 310, Portland, Oregon 97204
phone: (503) 823-4005
web: www.portlandoregon.gov/auditor/auditservices

CITY OF PORTLAND, OREGON 1851

June 22, 2011

TO: Mayor Sam Adams
Commissioner Nick Fish
Commissioner Amanda Fritz
Commissioner Randy Leonard
Commissioner Dan Saltzman
Linda Jefferson, Director, Fire and Police Disability and Retirement Fund

SUBJECT: Audit Report – Fire and Police Disability and Retirement: Improvements resulted from 2006 Charter reforms, but significant fiscal challenges remain (Report #408)

The attached report contains the results of our audit of the Fire and Police Disability and Retirement Fund (FPDR). In 2006, voters approved reforms to FPDR that changed how disability claims are handled, and shifted new police and fire employees to the City's main retirement system. We assessed whether implementation of these Charter reforms achieved the intended results.

We found that the 2006 Charter reforms are almost fully implemented, and have resulted in a more fiscally sound retirement system and improvements to disability management. However, costs to taxpayers continue to increase. Without further action there is a risk that the increasing FPDR tax payments will result in a decrease in revenues for other local government services. We make a number of recommendations to the Commissioner-in-charge and FPDR to further reduce program costs and continue administrative improvements.

We ask FPDR to provide us with a status report in one year, through the Commissioner-in-charge, detailing steps taken to address the recommendations in this report.

We appreciate the cooperation and assistance we received from the FPDR Board of Trustees, Director, and staff as we conducted this audit.

L. Griffin-Valade

LaVonne Griffin-Valade
City Auditor

Audit Team: Drummond Kahn
Martha Prinz
Kari Guy
Bob MacKay

Attachment

Table of Contents

Summary

Before 2006, concerns had grown about the costs and fairness of Portland's Fire and Police Disability and Retirement Fund (FPDR). The fund's retirement plan was increasingly expensive for Portland taxpayers, and the disability plan was perceived as overly generous.

In 2006, Portland voters approved reforms to FPDR with the goal of creating a system that is fair to public safety officers, accountable to voters, and fiscally responsible to taxpayers. These reforms shifted new police and fire employees to the City's main retirement system. The reforms also changed how disability claims are handled, removing claims decisions from the FPDR Board of Trustees and giving greater authority to a professional claims administrator.

We conducted this audit to determine whether the Charter changes have been implemented, whether the pension system is now fiscally sound, and whether the disability system was made more professional and independent. We found that almost all Charter requirements have been fully implemented.

These changes made the pension system more fiscally sound in the long term, and improved disability claims management. The changes also appear to meet the intent of voters from the 2006 Charter changes.

Figure 1 Status of 2006 City Charter Changes

Charter Change	Status
Administration	
Board structure revised	Implemented
FPDR established as separate bureau	Implemented
Fund administrator to be qualified disability expert	Implemented
Pension	
New police and fire hires moved to funded retirement system (PERS)	Implemented
Disability Claims	
Claims determined by fund administrator rather than Board	Implemented
Independent hearings officers and panel decide appeals	Implemented
Increased focus on restoring injured workers physically and economically to self-sufficient status	Implemented
Recovery of costs from third parties authorized	Implemented
Disability claims must be kept in a manner comparable to the City's Workers' Compensation records	In process
Initial baseline audit and subsequent audit required	Implemented

Source: Audit Services Division analysis

Despite these improvements, significant fiscal challenges remain beyond the Charter changes. While the City shifted new employees away from the pay-as-you-go retirement system in 2007, the unfunded liability of existing police and fire beneficiaries is estimated at over $2.5 billion. During the transition from a pay-as-you-go system to a funded retirement system – until at least 2055 – taxpayers will bear the added financial burden of simultaneously funding two generations of retirees. The City anticipated this many-decade challenge, even noting to voters in 2006 that costs would continue to increase for 26 years before savings began to be achieved.

The City's FPDR disability system, while improved, may still be more expensive than it needs to be. In retaining FPDR as a separate entity from the City's primary Workers' Compensation program, which covers all other City employees, the City is operating two separate disability programs. In addition to this duplication of programs, FPDR operates under some rules that may be expensive for the City.

While the 2006 Charter changes were a positive first step, those changes increased costs to taxpayers in the next 20 to 25 years. In this audit we make a number of recommendations to the Commissioner-in-charge and FPDR to further reduce costs and continue administrative improvements.

Chapter 1 **Background**

History of FPDR

The City of Portland Fire and Police Disability and Retirement (FPDR) system was created by the voters in 1948 for the benefit of sworn officers of the Bureaus of Police and Fire and their families. The program structure, funding, benefits, and administration were defined in City Charter. FPDR was included in the City Auditor's Office budget, and administered by an 11-member Board of Trustees.

Prior to the 2006 Charter amendments, the FPDR pension plan was a "pay-as-you-go" retirement system. Unlike a funded retirement plan, a pay-as-you-go plan does not set aside funds to pay for future retirements. Instead, FPDR must collect sufficient revenues through a dedicated property tax in each fiscal year to pay all of the annual costs. Because the pay-as-you-go system does not reserve revenues for future retirements, FPDR has an "unfunded liability" for future retirees. Unfunded liability is the current value of promised future retirement benefits, minus any assets available for those benefits. As of June 30, 2010 FPDR's unfunded liability was estimated at $2.5 billion.

Under FPDR's previous disability system, claims, including appeals, were approved or denied by a vote of FPDR's Board of Trustees. Board members, who were not required to be disability experts, included several firefighters and police officers.

In 2005, an outside consultant found Portland's disability costs per claim for police officers and firefighters were 70 percent higher than for other City of Portland employees. In five comparison cities, the consultant found no such discrepancies. Denial rates under FPDR were low compared to typical Workers' Compensation denial rates.

In addition, there were perceptions that the percentage of police officers and firefighters out on disability was too high and that benefits were overly generous.

FPDR funded by dedicated property tax levy

A series of property tax measures in the 1990s changed how property taxes are calculated in Oregon. Property assessed value was fixed, and assessed value growth was limited to 3 percent per year. Real market value may increase or decrease according to market conditions, but tax rates are applied against assessed value. Assessed value cannot exceed real market value.

The property tax measures provided for a fixed, permanent tax rate applied to assessed value for each local government's General Fund operations. The City's General Fund pays for most basic city services, such as police, fire, parks, and planning. Combining the permanent rate with the limit on growth in assessed value means that a property owner's tax bill for the City's General Fund cannot increase at greater than 3 percent per year.

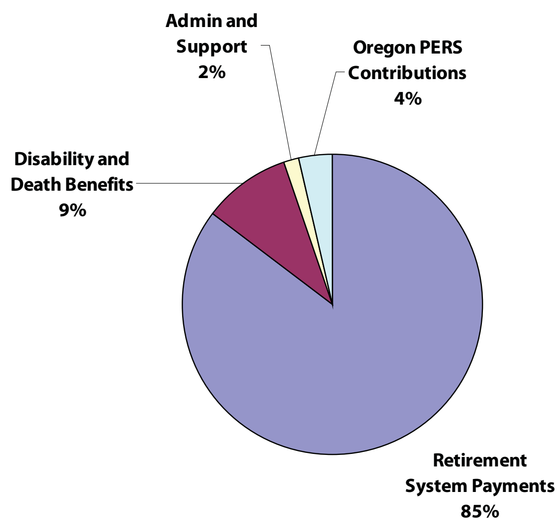
Certain types of tax levies, including FPDR, were not included in the local government permanent tax rate. Each year the FPDR Board determines the amount of money needed to pay administrative, disability, and pension costs in the succeeding fiscal year. The City's economist then determines the levy rate depending on the total dollars required and the City's current assessed value. This is a separate item on the property tax bill, and the tax rate may change each year depending on the estimated costs of FPDR. The FPDR collections may grow at a faster rate than General Fund tax collections, but the rate may not exceed a $2.80 per $1,000 of real market value cap set in City Charter and State Law. If the rate reaches the $2.80 cap, any additional funds needed to pay FPDR annual costs must be paid by the General Fund.

However, there is an additional limit on total local government tax rates of $10 per $1,000 of real market value. Included in this limit are all local government property tax rates, including FPDR, City of Portland, Multnomah County, Metro, and local option levies such as the Children's Levy and Library Levy. This limit is calculated by the tax assessor for each property. If the limit is exceeded, property taxes are "compressed" for that property to fit within the $10 cap. Local option levies are reduced first, to zero if necessary. If further reductions are needed, regular levies such as FPDR and the County and City's permanent rates are proportionally reduced.

FPDR budget

For FY 2010-11, FPDR budgeted approximately $110 million. The majority of this amount is to pay pension benefits (see Figure 2)

Figure 2 **FPDR Budget, Fiscal Year 2010-11**



Source: City of Portland FY 2010-11 Adopted Budget

Multiple reform efforts led to 2006 Charter changes

In January 2006 the City Council appointed a committee to draft reform recommendations addressing the pension and disability systems. Creation of the committee was motivated by concerns about accountability of the disability system, and the impacts of not pre-funding the retirement system. Building on the work of several committees over the preceding decade, this committee recommended moving all new public safety hires to Oregon's pre-funded pension program, the Public Employees Retirement System (PERS). The committee offered two alternatives for the disability program: either reform the disability program within FPDR or shift public safety officers to the City's Workers' Compensation program.

In July 2006, Council referred proposed Charter amendments to the voters. The Charter amendments significantly changed the FPDR Board structure and the processing of disability claims by FPDR. The amendments also shifted new hires to Oregon PERS. Measure 26-86 was approved by the voters on November 7, 2006, with an 81% yes vote. We conducted this audit to determine whether the Charter changes have been implemented, whether the pension system is now more fiscally sound, and whether the disability system was made more professional and independent

Chapter 2 **Charter changes implemented**

FPDR administrative structure changes completed

With the Charter changes, FPDR became a separate City bureau in January 2007. It is now administered by a Fund Administrator, who is required to be a qualified disability expert, reporting to the Mayor and the FPDR Board of Trustees. The Mayor has assigned responsibility for FPDR to a City Commissioner. The Charter changes shifted authority for much of the operations and decision-making of FPDR from the Board to the Fund Administrator, and shifted the Board to a policy-setting role. Most significantly, the Board no longer has the authority to approve or deny disability claims.

The Charter reforms also changed the FPDR Board membership. Previously, the Board consisted of eleven members: the Mayor, the City Treasurer, the City Auditor, the Chief Engineer of Fire/Chief of Police (rotating position), two members each of the Fire and Police Bureaus, and three members of the public, one of whom was appointed by the elected Board members of the Police and Fire Bureaus.

As of 2007, the Board consists of five members: the Mayor or his/her designee subject to City Council approval, one member of the Fire Bureau, one member of the Police Bureau, and two City of Portland residents with relevant experience in pension or disability matters nominated by the Mayor and approved by the City Council.

With the new City Charter in place, the Board adopted updated administrative rules to be consistent with the revised City Charter, and the FPDR Fund Administrator developed a detailed procedures manual. These more detailed rules and procedures help staff members provide more consistent and fair decisions related to disability claims and pension calculations.

In some cases, these rule and procedure changes have increased costs of the Fund. For example, changes made to how final pay is determined in pension calculations may affect both members' retirement decisions and long-term costs to the FPDR fund. In another example, the Board adopted a standard for determining whether a disability claim should be approved that is more generous than Workers' Compensation programs. This practice was cited by FPDR staff as the reason FPDR continues to have relatively low claim denial rates, even post-Charter reform. FPDR staff did not estimate the costs of these changes for the Board to consider when making decisions.

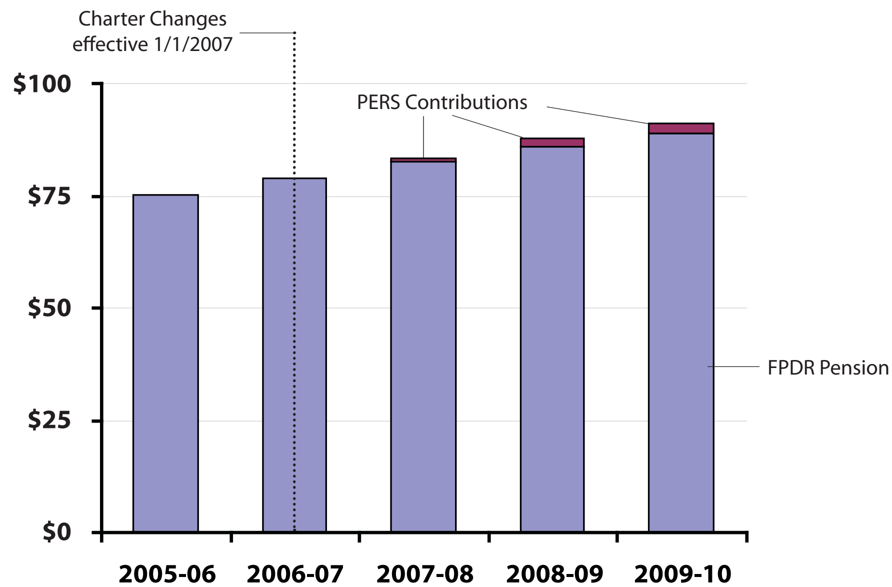
Pension changes reduce costs in the long term

New employees moved to funded pension plan

All police officers and firefighters sworn on or after January 1, 2007 are enrolled in the Oregon Public Employees Retirement System (PERS). PERS is a funded plan, which sets aside and invests funds each year to pay for future retirements. Shifting new FPDR members to the PERS funded plan reduces long-term costs to the City due to decreased benefit levels and the potential for investment earnings. As of June 30, 2010 there were 3,257 members and beneficiaries covered by FPDR under the old pay-as-you-go system, and 279 members enrolled in the new PERS retirement system. The number of police officers and firefighters in PERS will grow as additional employees are hired to replace retiring employees.

Annual pension costs continue to increase, as the FPDR levy pays both retirement costs for current retirees and PERS contributions for new hires. Pension expenditures for the past five years are shown in Figure 3.

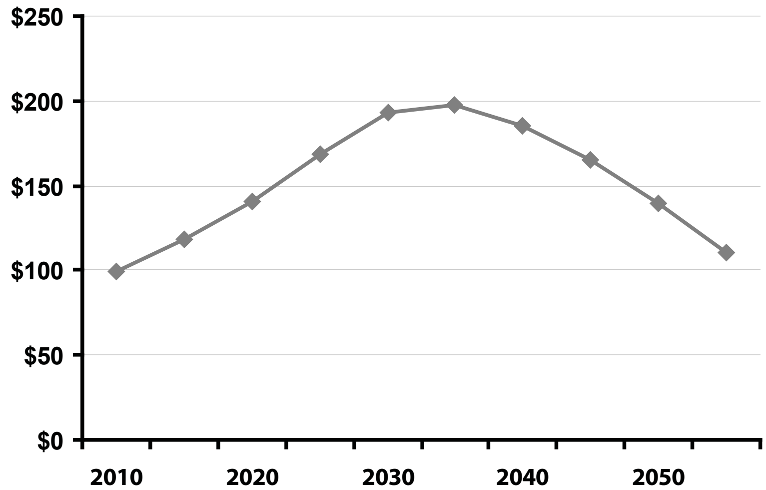
Figure 3 **Pension expenditures by fiscal year** (millions, adjusted)



Source: Audit Services' graph of data from FPDR financial audits

A July 2010 study by FPDR's external actuary estimates that payments under the pay-as-you-go plan will continue to increase for the next 20 to 25 years as more existing police officers and firefighters retire, to a peak of close to $200 million per year. The subsequent decline is gradual, with annual expenditures for the pay-as-you-go plan members approaching current levels in 2055, as shown in Figure 4. These projections are consistent with the estimates in the Voters' Guide for the 2006 Charter amendments, which stated that costs would increase for the next 26 years before beginning to decline.

Figure 4 Estimated pay-as-you-go pension costs (millions, not adjusted)



Source: Audit Services' graph of data in FPDR July 2010 Actuarial Valuation (Mercer)

Retirement system audit recommendations implemented

In July 2008 FPDR staff discovered an error in calculating pension benefits, resulting in overpayments to members of almost $3 million. After consulting with the Internal Revenue Service, the FPDR Board opted to recover the overpayments from FPDR members. Although not required by the Charter changes, the Board requested a performance audit of the retirement program. FPDR hired an external consultant to complete the assessment of the policies, procedures, and data collection tools used by FPDR. The assessment identified both strengths and weaknesses of the retirement program. The highest risk recommendations focused on FPDR's outdated computer system.

As of January 2011, most of the recommendations in the retirement system assessment had been implemented, with implementation of most of the remaining recommendations tied to the FPDR computer system. In January 2011 the FPDR Board voted to replace the existing database, which FPDR staff stated will resolve the remaining audit recommendations.

Disability claims management now professional and independent

By shifting claims decisions from the FPDR Board to a qualified Fund Administrator, FPDR's disability claims management process changed considerably. The Fund Administrator hired staff analysts with disability expertise in line with that required to work under Oregon Workers' Compensation standards.

Beneficiaries are now required to appeal FPDR's claims decisions to a Hearings Officer, rather than to the FPDR Board. The Hearings Officer is required by Charter to be a member of the Oregon State Bar with relevant disability training and expertise, and FPDR contracted with State of Oregon Administrative Law Judges to serve in this capacity.

If the disputed claim is not resolved by the Hearings Officer, any subsequent appeals are now heard by an independent panel, which must also consist of members of the Oregon State Bar with relevant disability training and experience.

Claims processing audits find improvements, although not all issues resolved

The Charter amendment specified that an independent expert in disability systems conduct an initial audit of the disability system within nine months of January 1, 2007, with a subsequent audit to be completed 12 months later. The City hired Marsh, which issued a series of reports in 2008 and 2009. In its reports, Marsh noted that FPDR was unusual in being separate from Workers' Compensation, a point that had been made by other consultants and reviewers in the past.

Marsh conducted an initial baseline audit that identified problems with FPDR's pre-reform disability claims management. Some of the claims Marsh reviewed in this report took place after Charter reforms were in place. Examples of problems were the timeliness of claims decisions, a lack of investigation of claims or focus on costs, a lack of follow-up on outside employment information, and a lack of tracking of third party payments, such as from an insurance company. Marsh also found FPDR's record keeping to be inconsistent and confusing.

Subsequent reports compared FPDR to peer entities and assessed FPDR's compliance with best practices. Marsh noted that FPDR had a very low claim denial rate compared to peer entities and, among other things, recommended that FPDR adopt the same threshold as Workers' Compensation for approving disability claims. Marsh also recommended that FPDR begin "reserving," which is setting aside an estimated amount for each claim, based on the typical costs of similar claims.

In its final audit of FPDR, Marsh found that FPDR had improved its management of disability claims, including reviewing new claims for cost recovery from third parties. FPDR had also improved its file organization, and had made improvements in claim action plans. However, Marsh pointed out that complete comparisons to other disability programs were not possible because the program was still different in so many respects. FPDR has adopted many of Marsh's recommendations.

While the Charter changes did not require ongoing external audits of the disability system, regular audits would help provide ongoing oversight.

Claims management continues to improve

Disability claims are now medically managed by a professional claims staff, who review medical paperwork and investigate claims when necessary. According to staff, the decision making process on individual claims used by FPDR's claims analysts is very similar to that used under Workers' Compensation. Several analysts at FPDR have backgrounds in Workers' Compensation, and have the same certifications as required by analysts in Workers' Compensation. Prior to Charter reform, FPDR staff did not always have these certifications.

FPDR staff includes an analyst who focuses on returning employees to work, vocational rehabilitation, and pursuing payments from third parties. Disability benefits can be partially offset by earnings from outside employment. FPDR has done some work with Fire and Police Bureau staff to get employees back to work, and regularly follows up on cases in which a member who might be able to return to work has not yet done so. Vocational rehabilitation plans must be approved by the Fund Administrator. Members can have their benefits denied or reduced if they do not cooperate with return to work and vocational rehabilitation efforts, or fail to report outside income. However, some rules could be tightened. For example, no tax return is required by FPDR to verify that a police officer or firefighter has no outside income.

Some progress made towards keeping disability records in a manner comparable to the City's Workers' Compensation program

As required by the 2006 Charter changes, FPDR has made some progress on making its records comparable to the records kept by the City's Workers' Compensation program. FPDR staff interpret this Charter requirement to apply to both electronic and paper records.

FPDR staff told us they could not fully meet this goal without an upgrade in their computer system, which they described as a "patch-work" system that runs on a very old platform. In January 2011, the FPDR Board voted to replace the existing database, which will help FPDR keep better records and follow some procedures common in Workers' Compensation.

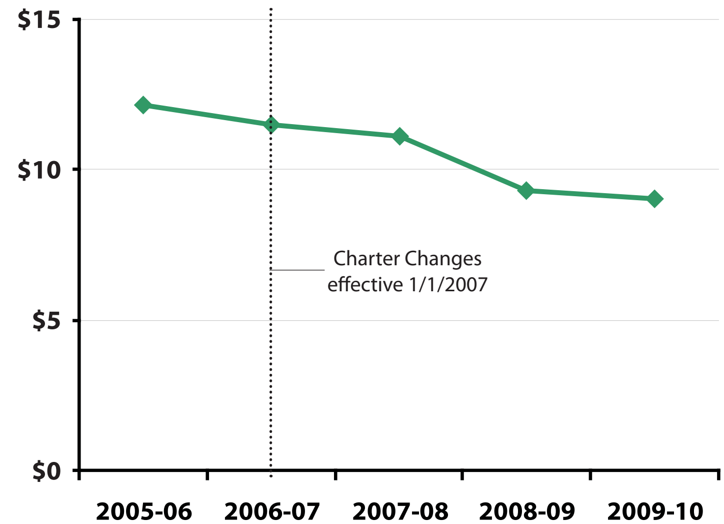
Collecting better data will make it easier for FPDR to make additional improvements to its disability program, and allow better comparison with other disability systems and with the City's Workers' Compensation program. Examples of data that might be useful to FPDR were it collected include information on partial denials of claims, average length of time on disability, and numbers of disabled workers who are released to return to work but could not find positions. FPDR staff said that with a new system, they would be able to perform such functions as "drilling down" into data to see claims for certain fire stations or supervisors, for example, to see if there are root causes of injuries.

Disability costs continue to decline

With the exception of medical expenses, disability costs have shown a steady decline (Figure 5). This decline began before the Charter changes in 2007. The 2006 Actuarial Valuation attributes the decrease in disability costs to more aggressive cost controls, back to work programs, and increased supervisory attention by Fund Trustees, the Mayor, and the City Council. These decreases have continued each year, and may be attributed to both improvements in disability program management and the retiring of older members on long-term disability.

However, medical expenses are projected to increase due to a number of factors. In addition to medical inflation, in 2009 the State legislature expanded the list of cancers presumed to be work-related for firefighters. City voters also removed limitations on medical expense reimbursements after retirement in 2007.

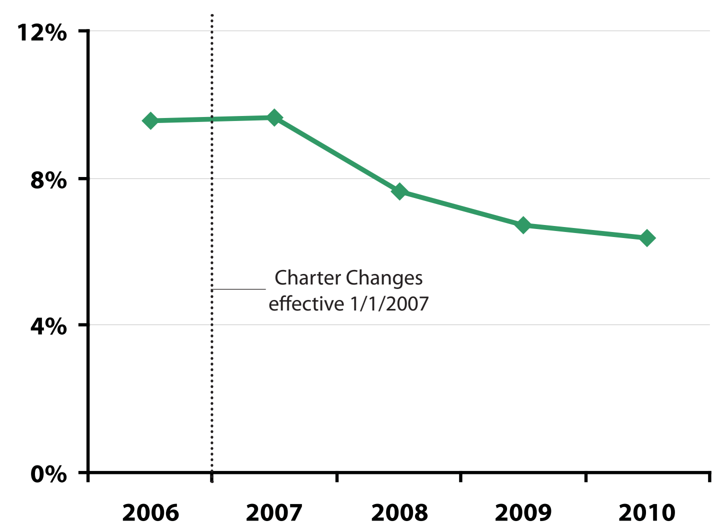
Figure 5 **Total disability costs** (millions, adjusted)



Source: Audit Services' graph of data from FPDR financial audits

The percentage of police officers and firefighters out on disability - in particular long-term disability - has shown a steady decline as well, declining from by 9.5 percent in 2005-06 to 6.4 percent in 2009-10 (see Figure 6).

Figure 6 **Percent of force out on disability** (as of June 30)



Source: FPDR Data

Chapter 3 Despite improvements, significant challenges remain

Full implementation of Charter changes will not reduce costs in the near-term

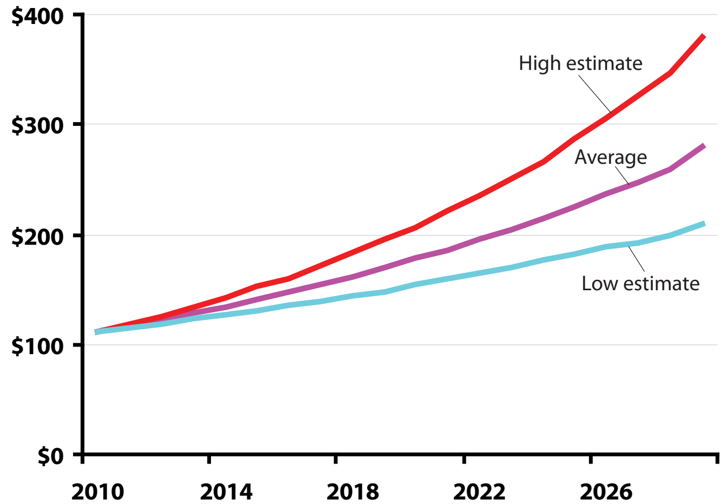
The 2007 Charter changes made the FPDR pension system more fiscally sound in the long term. However, these changes increased costs to taxpayers for the next 20 to 25 years. Changes to the disability system were also a positive first step, decreasing disability costs and providing greater controls over the system. But it remains unclear whether a separate police and fire disability system is cost effective for taxpayers.

FPDR property tax levy will continue to increase

Current taxpayers will bear the responsibility for simultaneously funding two separate pension systems for at least the next 45 years. While the pay-as-you-go portion will peak in 20 to 25 years and begin to decline, the PERS payments will continue to increase.

The Levy Adequacy Model presented to the FPDR Board in January 2011 estimates that total annual costs, including pay-as-you-go retirement payments, PERS contributions, administrative costs and disability costs, will reach $280 million by 2029 (not adjusted for inflation). There is considerable variation in the later years of the forecast, with estimates ranging from $209 million to $379 million per year, as shown in Figure 7.

Figure 7 **Range of estimates, total cost for items funded by FPDR levy**
(in millions, not adjusted)



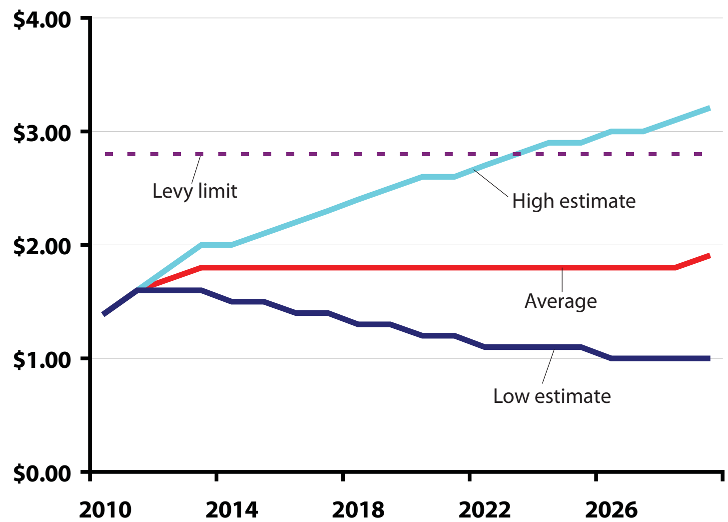
Source: Audit Services' graph of data in FPDR Levy Adequacy Model, January 2011 (Mercer)

Increases in the FPDR levy rate result in less money for other local government services

Any increase in the FPDR levy rate is likely to increase tax compression. Generally, tax compression increases as real market value declines in a market downturn, or when rates for individual levies are increased. According to the Multnomah County Tax Supervising and Conservation Commission, from FY 2010 to FY 2011, local government levy losses due to compression increased 28 percent. In FY 2011 the Children's levy lost almost $5 million and the Library levy lost almost $11 million to compression. Two of the main drivers behind the increased compression and levy losses were declines in real market value and increases in the FPDR levy.

FPDR's Levy Adequacy Model predicts that the FPDR levy rate will increase over the next three years, and then level out for the remainder of the forecast period in 2029. However, there is increasing variability in the later years of the forecast. The report notes that in a bad economy, low real market value growth and low investment results may lead to increases in the FPDR levy rate. According to the actuary, by 2023 there is a 5 percent chance that the rate will exceed the levy limit, as shown in Figure 8. If the levy reaches the limit, FPDR costs in excess of the levy are the responsibility of the City's General Fund. While the risk of exceeding the limit may be small, any increase in the FPDR levy rate may increase compression losses to other local government levies.

Figure 8 **Estimate of FPDR levy rate per $1,000 of real market value**



Source: Audit Services' graph from data in FPDR Levy Adequacy Model, January 2011 (Mercer)

In FY 2009-10, the FPDR levy accounted for 25 percent of total City of Portland property tax collections. Increases in the levy rate will increase FPDR's share of City property tax dollars, increase tax compression, and decrease tax collections of special levies and other taxing districts.

In addition to this report, we plan to issue a report on the City's financial condition and sustainability. This will include a discussion of FPDR in the context of the City's overall financial health.

Separate FPDR property tax creates disconnect that discourages cost control

Unlike other City employees, firefighters' and police officers' base pay and retirement and disability pay are paid for from two different City funds, from two different property tax assessments. Base pay is paid by the General Fund, and retirement and disability costs are paid by the FPDR Fund. This disconnect may make it more difficult to control costs. Council decisions on Police and Fire hiring and pay may not reflect the true costs of employment, because the FPDR Fund is paying pension and disability costs. In addition, because disability costs are not paid out of the base General Fund budgets of the Police and Fire Bureaus, there is little financial incentive for the bureaus to control disability costs.

Maintaining two disability systems may be more expensive

Despite improvements to the FPDR disability system, the City continues to operate two separate disability systems. In many other U.S. cities, public safety employees are covered by Workers' Compensation. As noted by Health and Disability Management Solutions, Inc., in a 2005 report about FPDR, "as a basic business practice, [maintaining two systems] is not cost-effective or administratively efficient for the volume of claims generated by a mid-sized employer with approximately 5,000 employees." The City should provide disability benefits as economically as possible. There are some clear downsides to maintaining FPDR as a separate disability system. For example:

- By maintaining the current system, the City is forgoing State subsidies for returning injured police officers and firefighters to work. These subsidies are only available for employees covered by Workers' Compensation. Instead, FPDR subsidizes 75 percent of a member's wage for two years when they return to work in a restricted position.
- Unlike City employees covered by Workers' Compensation, disabled police officers and firefighters do not have reinstatement or reemployment rights with any other City bureaus. This may limit opportunities to return disabled police officers or firefighters to work.
- Once sworn, a police officer or firefighter trainee who gets injured while still on probation, and as a result of the injury

is permanently restricted from police officer or firefighter work, is eligible for FPDR disability benefits until mandatory retirement age. In addition, these injured trainees are not eligible for return to work placements at the Police or Fire bureaus, since they were on probation when the injury occurred, nor do they have reinstatement or reemployment rights with any other City bureau, since they are not covered by Workers' Compensation.

- Under Workers' Compensation, there is a formal process to determine if there is a permanent disability. Once that determination is made, the injured worker may receive a monetary reward, or pay-out, and the case is closed. Under FPDR, there is no such permanent disability reward, and injured workers and trainees may receive disability benefits on an ongoing basis until retirement.

There are no easy solutions to address the unfunded liability or increasing costs to taxpayers

Cities and states across the country are grappling with unfunded pension liabilities for public employees. Portland's unfunded pension FPDR liability and disability system grew out of policies initiated over 60 years ago, and those costs are only beginning to be addressed by the 2006 Charter changes.

It is extremely difficult to modify the terms of a public pension plan for existing employees or retirees because of legal and contractual obligations. For this reason, the most common public pension reform is to create a new benefit system for new hires, as was done through the 2006 Charter changes for FPDR. While these changes certainly help, the changes do not address the increasing costs to taxpayers for both pension and disability expenses for the many current and prior employees.

Options for addressing the unfunded liability and disability costs will have to either control benefit costs or find alternative funding sources. Consistent with the goals of the 2006 Charter changes, any changes should be fair to public safety officers and responsible to taxpayers.

Controlling costs

Controlling costs by restructuring employee benefits would decrease long-term liabilities. As mentioned above, it is extremely difficult to revise promised benefits to current employees or retirees. However, it may be possible to reach agreement with employee groups on methods to control or reduce costs without adversely affecting members.

A number of reforms to both the pension plan and the disability program could better control costs. Pension options raised during the course of our audit include revising how final pay is calculated and authorizing lump sum payments to retirees. For the disability plan, the most significant reform would be to shift the bulk of the program to the City's Workers' Compensation program. Short of that, other potential reforms include adopting the same standards as Workers' Compensation for determining whether a disability claim should be approved, and changing coverage for injured trainees. A work group began looking at a range of potential Charter changes in 2010, some of which could reduce long-term costs.

Another method to control costs is to carefully consider the long-term impact on the FPDR Fund from decisions related to FPDR rulemaking and Council contract negotiations. Rules and procedures adopted by the FPDR Board for both the disability and pension programs may have long-term cost impacts to the fund and taxpayers. In the rulemaking we reviewed, there was no discussion of costs to taxpayers. Similarly, when Council reviews and approves contracts for police officers and firefighters, salary agreements in those contracts have long-term implications for the FPDR Fund. Financial impact information would allow both Council and the FPDR Board to better balance the needs of beneficiaries with the responsibility to taxpayers.

Finding alternative funding sources

Finding alternative funds is equally difficult. The 2006 Charter reform committee considered pre-funding the pensions for police officers and firefighters already enrolled in the pay-as-you-go system, but rejected the option as it would be too costly to taxpayers.

Another option is to shift the PERS and/ or disability payments from the FPDR Fund to the City General Fund. This could be done for the entire program at one time or incrementally as new public safety officers are hired. Over time the FPDR property tax levy would decrease significantly, also lessening the impact of the FPDR levy on tax compression and other government services. This change would better link Council decisions about police and firefighter salaries to the impact on retirement costs, and could provide a financial incentive to bureaus to control disability costs. However, shifting these costs to the General Fund could displace other City services over time.

One option some governments have used to fund pension debt is to issue pension obligation bonds. The success of pension obligation bonds depends on the premise that investment returns are higher than the costs of financing the debt. This may not be true in the current economic climate, which would make bonding a high-risk solution.

No single action of the FPDR Board or City Council will erase an unfunded liability that grew over 60 years. However, smaller actions to control costs and identify alternative funding sources could moderate the projected levy increases. If no action is taken, property taxes will increase and other government services will continue to be eroded as FPDR requires an increasing share of local government tax dollars.

Chapter 4 **Recommendations**

The 2006 City Charter amendments were a positive first step towards addressing the costs of the City's Fire and Police Disability and Retirement System. We found implementation of the Charter changes has resulted in a pension system that is more fiscally sound, and a disability system that is professional and independent.

However, the 2006 Charter changes increased costs to taxpayers for the next 20 to 25 years. To continue the improvements started with the 2006 Charter changes, we recommend that the Commissioner-in-charge of FPDR:

1. **Present alternatives to Council to reduce the expected increases in the FPDR tax levy, including both alternative funding sources and methods to control pension and disability costs.**

   Development of these alternatives may require input from FPDR, the City Office of Management and Finance, and other interested parties.

2. **Ensure that Council review the fiscal impact to the FPDR Fund when approving Police and Fire Bureau spending and labor contracts.**

To ensure the needs of beneficiaries are balanced with costs to taxpayers, we recommend that FPDR:

3. **Submit fiscal impact information to the FPDR Board with all future suggested administrative rule changes.**

4. **Review all existing rules and procedures for opportunities to control costs.**

5. **Improve its disability claims processing information system to maximize accountability, and improve comparability to the City's Workers' Compensation system and other disability systems.**

6. **Once comparable record keeping has been achieved, prepare a cost analysis of shifting the bulk of FPDR's disability program to the City's Workers' Compensation system.**

7. **Implement periodic independent audits of the disability and pension systems.**

Chapter 5 **Objectives, scope and methodology**

The objectives of this audit were to determine whether the voter-approved Charter changes in 2006 were fully implemented, whether the pension system is now fiscally responsible, and whether the disability system was made more professional and independent.

To accomplish these objectives, we reviewed the reports of the 2005 and 2006 Charter reform committees, the language in the 2006 ballot measure and voters guide, and the City Charter pre- and post-2006 Charter changes. We reviewed meeting minutes of the FPDR Board from before and after Charter changes. We also reviewed the administrative rules and policies and procedures developed in response to Charter changes, and external audits completed post-reform of the pension and disability systems. We conducted additional research into pension funding.

We reviewed the FPDR annual financial reports for the years immediately preceding and following the Charter changes to determine Charter change impacts on pension and disability costs. We also reviewed FPDR budgets and financial plans, and actuarial reports with projections of future FPDR payments.

We interviewed FPDR management and staff, FPDR Board members, Bureau of Fire and Police FPDR liaisons, and City Attorneys. We also interviewed experts on property tax and pension valuation.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESPONSES TO THE AUDIT

CITY OF
PORTLAND, OREGON

Dan Saltzman, Commissioner
1221 S.W. 4th Avenue, Room 230
Portland, Oregon 97204
Telephone: (503) 823-4151
Fax: (503) 823-3036
dan@ci.portland.or.us

To: Auditor LaVonne Griffin-Valade

From: Dan Saltzman Dan

Date: June 6, 2011

Subject: Fire & Police Disability & Retirement Audit, June 2011

Thank you for the opportunity to comment on your audit of the Fire & Police Disability & Retirement Fund (FPD&R). I appreciate your thorough review of the implementation of the comprehensive reforms approved by the voters in 2006.

I am pleased that you found that the implementation of the voter-approved reforms has made the pension system more fiscally sound and created a disability system that is professional and independent. The City Council had both of those goals in mind when we forwarded the proposed Charter changes to voters in 2006.

I appreciate your recommendations to continue improvements to the FPD&R Fund. I will work to implement your suggestions regarding the presentation of cost impacts to the FPD&R Fund resulting from labor contracts, and the presentation of possible cost saving mechanisms to my Council colleagues.

City of Portland, Oregon

BUREAU OF FIRE AND POLICE DISABILITY AND RETIREMENT

1800 SW First Ave., Suite 450, Portland, OR 97201 · (503) 823-6823 · Fax: (503) 823-5166

Linda L. Jefferson, CPDM, Director **fpdr@portlandoregon.gov**

Date: June 7, 2011

To: LaVonne Griffin-Valade, City Auditor

From: Linda Jefferson, Director, Bureau of Fire & Police Disability & Retirement

Re: Fire & Police Disability & Retirement Audit

Thank you for the opportunity to review and respond to the Fire & Police Disability & Retirement audit.

I appreciate that the report recognizes that the 2006 City Charter changes are almost fully implemented. We are working to migrate FPDR's database to a current software platform and, once that is completed, will work to produce disability information that is comparable to the City's Workers' Compensation records. The migration will be completed in 2012; subsequent enhancements for comparability will likely extend into 2013.

I also appreciate the report's recognition of the decrease in disability expense since the Charter change, as well as the lack of easy solutions to the expected future cost increases of the Fire & Police Disability, Retirement and Death Benefit Plan. FPDR's staff strives to professionally administer the Plan's benefit programs in a cost-effective manner.

Finally, I look forward to discussing the audit recommendations for FPDR with the Board of Trustees at their June 28 meeting. I understand your audit staff will be available to present the report to the Board then.

Please extend my compliments to your staff for their work on this report.

cc: Shannon Callahan, Commissioner Saltzman's Office

Audit Services Division
Office of the City Auditor
1221 SW 4th Avenue, Room 310
Portland, Oregon 97204
503-823-4005
www.portlandoregon.gov/auditor/auditservices

Fire and Police Disability and Retirement: Improvements resulted from 2006 Charter reforms, but significant fiscal challenges remain

Report #408, June 2011

Audit Team: Kari Guy, Martha Prinz, Bob MacKay

LaVonne Griffin-Valade, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

Police Property Evidence Division: Internal controls and physical security strong; tracking system needs improvement (#403, April 2011)

Spending Utility Ratepayer Money: Not always linked to services, decision process inconsistent (#398, March 2011)

Percent for Art: Progress made, but consistency can be improved (#401, February 2011)

This report is intended to promote the best possible management of public resources. This and other audit reports produced by the Audit Services Division are available for viewing on the web at: www.portlandoregon.gov/auditor/auditservices. Printed copies can be obtained by contacting the Audit Services Division.