

**Employee Retirement System of
the City of Lawton, Oklahoma**

Financial Statements

June 30, 2013

(With Independent Auditors' Report Thereon)



**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

Board of Pension Commissioners
Employee Retirement System of the City of Lawton, Oklahoma

Report on the Financial Statements

We have audited the accompanying financial statements of the Employee Retirement System of the City of Lawton, Oklahoma (the "System"), a component unit of the City of Lawton, Oklahoma, which comprise the statement of plan net position as of June 30, 2013, and the related statement of changes in plan net position for the year then ended, 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; 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.

Auditors' 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditors' 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 auditors consider 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.

(Continued)

INDEPENDENT AUDITORS' REPORT, CONTINUED

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of the System as of June 30, 2013, and the changes in its net position for the year then ended in accordance with accounting principles generally accepted in the United States.

Emphasis of Matter

As discussed in Note 2 to the financial statements, in 2013 the System adopted new accounting guidance, Statement No. 63 of the Governmental Accounting Standards Board (GASB), *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages I-1 through I-6 and the schedule of funding progress and the schedule of contributions from the employer and other contributing entities on pages 14 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB, who 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 supplementary information in accordance with auditing standards generally accepted in the United States, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 17, 2014, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.



Shawnee, Oklahoma
January 17, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's discussion and analysis (MD&A) of the Employee Retirement System of the City of Lawton, Oklahoma's (the "System") financial performance provides an overview of the financial activities and funding condition for the fiscal year ended June 30, 2013.

The System is classified as a Pension Trust Fund and is reported as a component unit of the City of Lawton (the "City"). The Pension Trust Fund accounts for the activities of the System, which accumulates resources for pension benefit payments to qualified retirees and future retirees. Since the System is also reported as a component unit of the City, the financial statements and related note disclosures are also incorporated into the City's Annual Financial Report. The accompanying basic financial statements of the System are reported on an accrual basis of accounting and are reported in conformity with accounting principles generally accepted in the United States. Under the accrual basis of accounting, revenues are recognized when earned instead of when actually received and expenses are recognized when incurred instead of when actually paid.

Please review the MD&A in conjunction with the basic financial statements.

Financial Highlights

- The net position restricted for pensions for fiscal year 2013 increased by \$2,648,063 (or 5.90%). All of the net position restricted for pensions are available to meet the System's ongoing obligations to members and their beneficiaries.
- Employer contributions for fiscal year 2013 increased by \$126,253 (or 5.97%) compared to 2012.
- The net investment income for fiscal year 2013 increased by \$2,711,654 (or 375.94%) compared to 2012 due to an increase in the net appreciation in the fair value of investments that occurred during fiscal year 2013 compared to fiscal year 2012.
- Benefit payments increased by \$320,646 (or 9.97%) during the fiscal year ended June 30, 2013.
- During fiscal year 2013, there were 213 retirees and 560 general employees paying into the System or receiving benefits.

Using the Annual Financial Report

The basic financial statements reflect the activities of the System and are reported in the Statement of Plan Net Position, the Statement of Changes in Plan Net Position, and the Notes to the Financial Statements. All activities are recorded using an accrual basis of accounting and the economic resources measurement focus. The accrual basis of accounting recognizes increases and decreases in economic resources as soon as the underlying event or transaction occurs. Transactions are recognized when earned and incurred regardless of the timing of cash flows.

The Statement of Changes in Plan Net Position of the System focuses on changes in economic resources during the period. Net position (total assets less total liabilities) is used as a practical measure of economic resources. Accordingly, the System's Statement of Changes in Plan Net Position includes all transactions and events that increase or decrease net position, such as additions and deductions.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Statement of Plan Net Position

The Statement of Plan Net Position shows the financial position of plan assets and liabilities by investment and accounting categories. The excess of assets over liabilities is reported as “net position restricted for pensions.” Over time, increases or decreases in net position restricted for pensions may serve as a useful indicator of whether the financial position of the System is improving or deteriorating. The following condensed comparative summary of the Statements of Plan Net Position as of June 30, 2013 and 2012, demonstrates that the System is primarily focused on the cash, receivables, investments, liabilities, and net position restricted for pensions.

	<u>2013</u>	<u>2012</u>	<u>% Increase (Decrease)</u>
Cash and cash equivalents	\$ 925,786	1,544,885	(40.1)%
Receivables	349,145	188,561	85.2%
Investments	<u>46,322,445</u>	<u>43,155,893</u>	7.3%
Total assets	<u>47,597,376</u>	<u>44,889,339</u>	6.0%
Liabilities	<u>60,055</u>	<u>81</u>	74042.0%
Net position restricted for pensions	<u>\$ 47,537,321</u>	<u>44,889,258</u>	5.9%

At June 30, 2013, cash decreased by \$619,099 (or 40.1%). This decrease was due to the purchase of investments, and as result, investments at fair value increased by \$3,166,552 (or 7.3%) during the fiscal year ended June 30, 2013.

Statement of Changes in Plan Net Position

The Statement of Changes in Plan Net Position itemizes additions, deductions, and net change in position restricted for pensions. The Statement of Changes in Plan Net Position demonstrates how the System's assets have increased during the fiscal year ended June 30, 2013. The following condensed comparative summary of the Statement of Changes in Net Position reflects the activities of the System in regards to employee and employer contributions, net investment income, benefits paid, refunds, administrative expenses, and the changes in net position restricted for pensions.

MANAGEMENT’S DISCUSSION AND ANALYSIS, CONTINUED

Statement of Changes in Plan Net Position, Continued

	<u>2013</u>	<u>2012</u>	<u>% Increase (Decrease)</u>
Additions:			
Contributions:			
Employer	\$ 2,239,852	2,113,599	6.0%
Employee	1,420,509	1,343,379	5.7%
Net investment income	<u>3,432,960</u>	<u>721,306</u>	375.9%
Total additions	<u>7,093,321</u>	<u>4,178,284</u>	69.8%
Deductions:			
Benefits	3,537,261	3,216,615	10.0%
Refunds	886,201	803,816	10.2%
Administrative expenses	<u>21,796</u>	<u>30,177</u>	(27.8)%
Total deductions	<u>4,445,258</u>	<u>4,050,608</u>	9.7%
Changes in net position	<u>\$ 2,648,063</u>	<u>127,676</u>	1974.0%

Collections of employee and employer retirement contributions, as well as earnings from investments, provide the reserves necessary to finance retirement benefits and cover administrative expenses. Contributions and net investment income totaled \$7,093,321 during the fiscal year ended June 30, 2013, which is a \$2,915,037 (or 69.8%) increase in total additions from what was reported the previous fiscal year.

Employer contributions are based on a percentage of an employee’s pay and increased \$126,253 (or 6.0%) in 2013; the City’s contribution rate was 10%. The amount of employee contributions increased 5.7% in fiscal year 2013. Contribution levels are established by the Lawton City Code, Section 17-3-4-339 and may be amended by the Board of Pension Commissioners (the “Board”), with confirmation by the City Council. Effective June 27, 2011, covered employees are required to contribute 6.3% of their base salary or wages to the System. The City contributed an additional 10% of contributions in both fiscal year 2013 and fiscal year 2012.

Net investment income was \$3,432,960 for fiscal year 2013, or a \$2,711,654 increase, due mainly to the appreciation in fair value of investments of \$2,128,832. Interest received was \$90,600 (or 9.9%) lower during fiscal year 2013. Dividends received were \$252,190 (or 55.7%) higher during fiscal year 2013. Net appreciation in the fair value of investments was \$2,612,873 (or 539.8%) higher during fiscal year 2013.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Statement of Changes in Plan Net Position, Continued

The primary deductions of a retirement system include the payment of benefits to retirees and beneficiaries, the refund of contributions to former members, and the cost of administering the retirement system. The benefits paid increased by \$320,646 (or 10.0%) during fiscal year 2013, mainly due to an increased number of retirees receiving benefits. Refunds typically represent a return of a nonvested portion of an employee's contribution made to the retirement system, which varies from year to year. Administrative expenses, as of June 30, 2013, were \$21,796, or \$8,381 lower when compared to the previous fiscal year.

Analysis of Financial Position and Changes in Net Position

In order to analyze the System's financial position and changes in net position during the reporting periods, the following topics are presented: membership, funding and reserves, actuarial assumptions and methods, and asset allocation.

Membership

As of July 1, the System's members from the actuary report were as follows:

	<u>2013</u>	<u>2012</u>
Retirees and beneficiaries receiving benefits	213	192
Terminated employees entitled to benefits not yet received	9	-
Current active employees:		
Vested	160	189
Nonvested	<u>400</u>	<u>376</u>
Total members	<u><u>782</u></u>	<u><u>757</u></u>

Funding and Reserves

Funds are derived from the excess of additions over deductions and are accumulated to meet future benefit obligations to retirees and beneficiaries. This accumulated balance is referred to as the net position restricted for pensions in the Statement of Plan Net Position and the Statement of Changes in Plan Net Position presented in the financial statements. In addition to the basic financial statements and various note disclosures, defined benefit plans are also required to provide two schedules of long-term actuarial data. The two required supplementary information schedules are the Schedule of Funding Progress and the Schedule of Contributions from Employer and Other Contributing Entities, which are presented immediately following the notes to the financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Funding and Reserves, Continued

The Schedule of Funding Progress compares the actuarial value of plan assets, which is based on the fair value of assets, to the actuarial accrued liability, as of the last day of the fiscal year. The Schedule of Funding Progress is presented for the past 10-year period. The actuary determines the actuarial accrued liability. It is a measure of the present value of actuarial accrued liabilities estimated to be payable in the future to current retirees, beneficiaries, and employees for service earned to date. The percentage, computed by dividing the actuarial value of net position available for benefits by the actuarial accrued liability, is generally referred to as the "funding ratio." This ratio provides an indication of the funding status of the System on a going-concern basis and generally, the greater the percentage, the stronger the retirement system. A high level of funding gives members a greater degree of assurance that their pension benefits are secure.

The Schedule of Funding Progress shows that the System has a 10-year history of being underfunded. As of June 30, 2013, the System was 62.5% funded. The unfunded actuarial accrued liability as a percentage of covered payroll for fiscal year ended June 30, 2013, was 131.7%.

The Schedule of Contributions from Employer and Other Contributing Entities shows the annual required contribution and what percentage of the annual required contribution that the City has contributed. For the fiscal years 2007–2013, contributions made by the City have been less than the annual required contribution. For the fiscal year ended June 30, 2013, the City contributed 70.4% of the annual required contribution.

Actuarial Assumptions and Methods

The July 1, 2013, actuarial valuation is used to determine the level of annual required contributions (ARC) based on actuarial assumptions approved by the Board. The Entry Age Normal Cost Method was utilized by the actuary to calculate the actuarial accrued liability. The actuarial value of plan assets is compared to the actuarial accrued liability, resulting in either an unfunded actuarial accrued liability or a surplus. This difference is allocated on a level basis over the future earnings of members who are still employed as of the valuation date. The actuarial accrued liability is an actuarial rather than an accounting liability and, therefore, is not reported as a liability in the financial statements. Actuarial gains and losses are reflected in the actuarially determined annual required contribution rate. The main actuarial assumptions and methods include:

- The assumed rate of return on investment was 6.75%.
- The mortality rates are taken from the RP-2000p Mortality Tables fully projected for cohort mortality improvement.
- No provision has been made for automatic post-retirement cost-of-living adjustments. (This is consistent with the provisions, which do not provide automatic post-retirement cost-of-living adjustments.)
- The actuarial value of assets is based on the market value of assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

Asset Allocation

On November 15, 2007, both the investment objectives and the money manager were changed. On October 25, 2012, the asset allocation was changed from 65% bonds and 35% equities to 50% each. The asset allocation on June 30, 2013, was in the middle of the upper end of the new equity permissible range at 46% bonds and 54% equities. The investment performance goal from the Investment Policy is benchmarked by a blend of 65% Lehman Brothers Aggregate Bond and 35% S&P 500 Total Return Index. The portfolio's goal is to earn at least 100% of the benchmark for at least two of the preceding time periods of 1 year, 3 years, and 5 years. For the fiscal year ended June 30, 2013, the portfolio partially met the performance goal. It exceeded the 1-year goal but was slightly short of the 3- and 5-year goals.

Significantly, the past 1-year performance of 8.01% and the 3-year performance of 7.83% per year exceeded the requirement of 6.75% used by the actuary. Since November 15, 2007, when the new policy went into effect, through the fiscal year ended June 30, 2013, net portfolio appreciation is \$10,028,282 for a cumulative return of 27.48%, or 4.41% per year. For the fiscal year ended June 30, 2013, net portfolio appreciation was \$3,337,142, or 8.01%.

Market Environment and Results

Investment market conditions were improved during the fiscal year ended June 30, 2013. The net position restricted for pensions of the System increased from \$44.89 million to \$47.54 million from July 1, 2012, to June 30, 2013. Over the 10-year period ended June 30, 2013, the funded ratio has varied from a low of 62.5% to a high of 81.5%; the current funded ratio of 62.5% reflects the effects of the stock market as it continues to recover in 2013, and equals the lowest funded ratio over the past 10 years.

Major Initiatives

The Board worked closely with the City's Finance and Human Resources Departments, as well as the City Attorney's office, in an effort to address the unfunded liabilities and the reduction in the percentage funded (which was down to 62.5%) with the City's Pension Program. The Board hired a firm that specializes in pension actuaries to present several alternatives to address the projected shortfalls in the System. The firm presented several alternatives which required either increased contributions or decreased benefits in order to make the System solvent long-term. The Board reviewed the alternatives with each of the departments mentioned above and decided on a plan going forward that incorporates both an increase in contributions, as well as a decrease in benefits for all new-hires joining the City's general employee group beginning July 1, 2011. The approval of these System changes will help ensure that the System will remain solvent for many years into the future.

Most recently, the Board recommended that each employee be more informed about the status of their individual pension account. Therefore, the Human Resources Department agreed to budget for and hire the same firm who performed the actuary studies to prepare a statement for each individual employee regarding the status of their pension. These statements would be provided once a year to the employee either at the end of the fiscal year or at the end of the calendar year.

Contacting the System's Financial Management

This financial report is designed to provide citizens, taxpayers, members, and others with a general overview of the System's finances and to show accountability for money it receives, disburses, and is entrusted with. Questions concerning any data provided in this report or requests for additional information should be directed to the City of Lawton, 212 S.W. 9th Street, Lawton, Oklahoma 73501.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

STATEMENT OF PLAN NET POSITION

June 30, 2013

Assets

Cash and cash equivalents	\$ 925,786
Receivables:	
Employer's contributions	119,547
Employees' contributions	79,697
Accrued interest	127,425
Prepaid investment expense	22,476
Total receivables	<u>349,145</u>
Investments, at fair value:	
U.S. government securities and agencies	17,431,181
Common stock	4,981,923
Mutual funds	21,742,129
Total investments, at fair value	<u>44,155,233</u>
Investments, at book value:	
Other investments	<u>2,167,212</u>
Total investments, at book value	<u>2,167,212</u>
 Total investments	 <u>46,322,445</u>
 Total assets	 <u>47,597,376</u>
 Liabilities	
Current liabilities:	
Accounts payable	<u>60,055</u>
 Total liabilities	 <u>60,055</u>
 Net position restricted for pensions	 <u><u>\$ 47,537,321</u></u>

See Independent Auditors' Report.
See accompanying notes to financial statements.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

STATEMENT OF CHANGES IN PLAN NET POSITION

Year Ended June 30, 2013

Additions:

Contributions:

Employer	\$ 2,239,853
Employee	1,420,508
Total contributions	<u>3,660,361</u>

Investment income:

Net appreciation in fair value of investments	2,128,832
Interest	825,164
Dividends	704,732
Total investment income	<u>3,658,728</u>
Less investment expense	<u>(225,768)</u>
Net investment income	<u>3,432,960</u>

Total additions 7,093,321

Deductions:

Benefits paid to retirees and beneficiaries	3,537,261
Refunds of contributions	886,201
Administrative expenses	<u>21,796</u>

Total deductions 4,445,258

Changes in net position 2,648,063

Net position restricted for pensions:

Beginning of year 44,889,258

End of year \$ 47,537,321

See Independent Auditors' Report.
See accompanying notes to financial statements.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS

June 30, 2013

(1) DESCRIPTION OF THE SYSTEM

On November 1, 1970, the City of Lawton, Oklahoma (the “City”) established the Employee Retirement System of the City of Lawton, Oklahoma (the “System”) and a related Pension Trust to accumulate funds to provide retirement benefits for eligible employees of the City. The System, a single-employer defined benefit pension plan, was restated in its entirety by City Ordinance Number 692 on November 1, 1975. The last amendment was signed on July 1, 1998. The System is administered by the Board of Pension Commissioners (the “Board”). The Commissioners are appointed by the City for 5-year terms.

The following provides only general information. Participants should refer to the Pension Trust Agreement, City Ordinance Number 692, and the amendments in City Ordinance Number 90.26, Section 17-339 for a more complete description of the System’s provisions.

Covered Employees

Covered employees include all full-time employees of the City, excluding persons compensated on a contractual or fee basis, and police officers or firefighters eligible and participating in the State of Oklahoma Police or Fire Pension systems. At June 30, 2013, there were 213 retirees receiving benefits, 560 current active members, and 9 terminated employees entitled to benefits not yet received.

Benefits

Benefits are established by the Lawton City Code, Section 17-3-4-339 and may be amended by the Board, with confirmation by the City Council. The amount of the monthly benefit payable to a member who retires on or after July 1, 1998, is equal to 2.3% of the member’s average monthly compensation multiplied by the member’s total number of years of creditable service. Upon retirement on an early retirement date, the member may receive a monthly benefit which will commence on the next day after his last day of City service and be payable on the last day of each month thereafter during his lifetime. The amount of each monthly payment shall be computed in the same manner as for a normal retirement benefit, reduced by 5/12% for each complete month by which the member’s early retirement date precedes his normal retirement date. Disability retirement benefits for a member who prior to eligibility for normal retirement becomes totally and permanently disabled may also be paid subject to certain requirements. The System is evaluated every 2 years for the possibility of cost-of-living increases.

See Independent Auditors’ Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(1) DESCRIPTION OF THE SYSTEM, CONTINUED

Funding Policy

The City's funding policy requires that the System be funded by meeting the accruing normal cost of the System (that is, the cost attributable to the service rendered by participants during the year) and amortize the unfunded actuarial liability of the System over a period of 30 years.

Vesting

Participants are immediately vested in their contributions plus earnings calculated at 2% over the U.S. Treasury bill rate, not to exceed 6% per annum thereon. Vesting in the City's contribution portion is based on years of service, with a participant becoming 100% vested after 10 years of credited service.

Deferred Vested Benefit

A participant of any age who has completed at least 10 years of creditable service is entitled to a monthly benefit determined in the same manner as early retirement for consideration of service and compensation to date of termination. The benefit is deferred to a normal retirement date, but a reduced benefit may be paid within the 10-year period preceding normal retirement date. The reduction is the same as for early retirement. A participant entitled to the deferred vested benefit may elect to receive a lump sum amount equal to that employee's contribution accumulation plus earnings thereon and the City's contribution portion in lieu of the monthly benefit.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The System's financial statements are prepared using the accrual basis of accounting. Participant contributions are recognized in the period in which the contributions are due. Employer contributions to the System 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.

See Independent Auditors' Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Recent Accounting Pronouncements

In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB 62). The objective of GASB 62 is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedures.

The requirements in GASB 62 will improve financial reporting by contributing to GASB's efforts to codify all sources of accounting principles generally accepted in the United States for state and local governments so that they derive from a single source. GASB 62 is effective for financial statements for periods beginning after December 15, 2011. The System adopted GASB 62 effective July 1, 2012. There were no significant changes to the financial statements as a result of implementing GASB 62.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (GASB 63). The objective of GASB 63 is to provide guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures. The pronouncement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2011. The System adopted GASB 63 effective July 1, 2012. The adoption of the statement required the System to adopt the term "net position" as required. In addition, as required by GASB 63, the System determined that as of June 30, 2013, there were no items of deferred outflows of resources or deferred inflows of resources, as presently defined, to be reported.

See Independent Auditors' Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Recent Accounting Pronouncements, Continued

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). The objective of GASB 65 is to establish accounting and financial reporting standards that reclassify certain items that were previously reported as assets or liabilities as deferred outflows of resources or deferred inflows of resources; and recognize certain items that were previously reported as assets and liabilities as outflows of resources or inflows of resources. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans* (GASB 67). GASB 67 addresses reporting by pension plans that administer benefits for governments, outlines basic framework for the separately issued financial reports of defined benefit pension plans, and details note disclosure requirements for defined benefit and defined contribution pension plans. This statement is effective for financial statements for periods beginning after June 15, 2013.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68). The primary objective of GASB 68 is to improve accounting and financial reporting by state and local governments for pensions. For defined benefit pensions, GASB 68 identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. This statement is effective for financial statements for periods beginning after June 15, 2014.

Investment Valuation and Income Recognition

The System's investments in U.S. government securities and agencies, money markets, marketable common stocks, and cash equivalents are stated at fair value, which is determined by quoted market prices. The System's investments in judgments are valued at original judgment value, less principal collected, since no quoted market price is available. Purchases and sales of securities are recorded on a trade date basis, while interest income is recorded on the accrual basis.

The System presents in the statement of changes in plan net position, the net appreciation in the fair value of its investments, which includes realized gains and losses and unrealized gain and losses on those investments.

See Independent Auditors' Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Use of Estimates

The preparation of the System's financial statements in conformity with accounting principles generally accepted in the United States requires the administrator to make significant estimates and assumptions that affect the reported amounts of net position restricted for pensions at the date of the financial statements and the actuarial information included in Exhibits I, II, and III, included in the required supplementary information (RSI) as of the benefit information date, the changes in plan net position during the reporting period and, when applicable, the disclosures of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Risks and Uncertainties

Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the risks associated with certain investment securities, it is at least reasonably possible that changes in the value of investment securities will occur in the near term and that such changes could materially affect participants' account balances and amounts reported in the statement of plan net position.

Contributions to the System and the actuarial information included in the RSI are reported based on certain assumptions pertaining to interest rates, inflation rates, and employee compensation and demographics. Due to the changing nature of these assumptions, it is at least reasonably possible that changes in these assumptions may occur in the near term and due to the uncertainties inherent in setting assumptions, that the effect of such changes could be material to the financial statements.

Income Tax Status

The Internal Revenue Service has determined and informed the System by a letter dated August 11, 2011, that the System is designed in accordance with applicable sections of the Internal Revenue Code.

Date of Management's Review of Subsequent Events

Management has evaluated subsequent events through January 17, 2014, the date which the financial statements were available to be issued, and determined that no subsequent events have occurred which require adjustment to or disclosure in the financial statements.

See Independent Auditors' Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(3) CONTRIBUTIONS

The contribution rate for employees through June 26, 2011, was 5.3%. Contribution levels are established by the Lawton City Code, Section 17-3-4-339 and may be amended by the Board, with confirmation by the City Council. The City's contribution rate was 9.0% from July 1, 2010, to June 26, 2011. Effective June 27, 2011, covered employees are required to contribute 6.3% of their base salary or wages to the System and the City is required to contribute 10.0%. Contributions are subject to certain limitations. Administrative costs are paid by the System.

The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations.

(4) DEPOSITS AND INVESTMENTS

Deposit Custodial Credit Risk

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 requires that financial institutions pledge collateral securities to secure the deposits of the System in each institution.

At June 30, 2013, total bank balances of the System's deposits were \$1,196,130, of which \$630,432 was uninsured and uncollateralized. Deposit balances up to \$250,000 in each institution are insured by the Federal Depository Insurance Corporation. Included in the System's total deposits were money market cash accounts of \$65,698. The System has not suffered any losses due to bank failures.

Investment Custodial Credit Risk

For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of the System's investments in government agencies and common stock are held by the investment's counterparty, in the name of the System. The System's investments in U.S. government obligations are not considered to have credit risk. The credit rating for the government agency investments was AA+ as assigned by the credit rating agency Standard & Poor's.

See Independent Auditors' Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(4) DEPOSITS AND INVESTMENTS, CONTINUED

Concentrations of Credit Risk

The System places no limit on the amount the System can invest in any one type of issuer. For disclosure purposes, investments in mutual funds and common stock are excluded. Investments by issuer that account for 5% or more of the System’s total investments are listed below.

U.S. Treasury bills	\$ 3,134,785
Federal Home Loan Mortgage Corporation (FHLMC)	5,741,021
Federal National Mortgage Association (FNMA)	5,793,860
Government National Mortgage Association (GNMA)	2,761,515

The net change in fair value of investments shown in the financial statements takes into account all changes in fair value that occurred during the year. Fair value amounts for individual investments fluctuate based on changes in the market interest rates available to investors.

Investment Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses from increasing interest rates. Investments in mutual funds are not subject to investment interest rate risk. The System’s investments and their maturity dates at June 30, 2013, were:

	<u>Rating</u>	<u>Years</u>				<u>Total Fair Value</u>
		<u>Less than 1</u>	<u>1 or More Less than 5</u>	<u>5 or More Less than 10</u>	<u>10 or More</u>	
Government agency investments:						
U.S. Treasury bills	AA+	\$ 1,799,946	-	492,754	842,085	3,134,785
FHLMC	AA+	-	-	-	5,741,021	5,741,021
FNMA	AA+	-	-	-	5,793,860	5,793,860
GNMA	AA+	-	-	-	2,761,515	2,761,515
		<u>\$ 1,799,946</u>	<u>-</u>	<u>492,754</u>	<u>15,138,481</u>	<u>17,431,181</u>

Other Investments

Other investments of \$2,167,212 as of June 30, 2013, consisted of judgments rendered against the City which have been purchased by the System. The System purchases the judgments directly from the claimants. Since there is no quoted market price available for valuing these judgments, they are valued in the financial statements at original purchase price less principal collected to date. One-third of the original judgment amount is payable, with interest, each year. The post judgment interest rate was 5.25% as of June 30, 2013.

See Independent Auditors’ Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(5) FUNDED STATUS OF THE SYSTEM

The funded status of the System as of the most recent valuation date includes the following:

Actuarial valuation date	July 1, 2013
Actuarial value of assets	\$ 47,537,321
Actuarial accrued liability (AAL)	76,013,611
Total unfunded actuarial accrued liability (UAAL)	28,476,290
Actuarial value of assets as a percentage of the actuarial accrued liability (funded ratio)	62.5%
Annual covered payroll	21,615,172
Ratio of the unfunded actuarial liability to annual covered payroll	131.7%

The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AAL's for benefits.

Additional information about the latest actuarial valuation date follows:

Valuation date	July 1, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	30-year rolling
Asset valuation method	Market value

Actuarial assumptions:

Interest rate	6.75%
Annual pay increase assumption	4.25%
Retirement rates	Experience
Mortality	RP2000p
	fully projected for cohort mortality improvement

See Independent Auditors' Report.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(5) FUNDED STATUS OF THE SYSTEM, CONTINUED

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial calculations reflect a long-term perspective. The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to actuarial accrued liabilities for benefits.

Projections of benefits are based on the types of benefits provided under the substantive plan at the time of each valuation and on the pattern of sharing of benefit costs between the employer and members to that point. The projections of benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and members in the future.

(6) TERMINATION OF THE SYSTEM

In the event that the System is terminated, after payment of all debts, expenses, and obligations of the System, any remaining cash and/or property shall be distributed on a pro rata basis to the System's participants based upon each participant's contributions.

(7) CONTINGENCIES

The System's actuary estimated that a City contribution of 14.92% of participant payroll would be needed to meet the statutory funding standard for the year ended June 30, 2013. The City's contribution rate of 10.0% is far short of this standard. Increased employee contributions could also be used to replace some of the deficiency. The growing unfunded actuarial liability of the System illustrates that there is little chance that the City's contribution rate and the employee contribution rate can maintain the System over the lifetime of the participant group. Future contribution requirements will become higher and higher if the contribution rate is not increased. Benefits for employees hired after June 30, 2011, were changed from a final average pay formula to a career average pay formula using the 2.3% multiplier.

(8) TRANSACTIONS WITH THE CITY

Employer contributions received from the City were \$2,239,852 for the year ended June 30, 2013, and are shown on the statement of changes in plan net position. Employer contributions receivable from the City were \$119,547 and are shown on the statement of plan net position. Other investments of \$2,167,212 as of June 30, 2013, consisted of judgments rendered against the City which have been purchased by the System.

See Independent Auditors' Report.

**SUPPLEMENTARY INFORMATION
REQUIRED BY
GOVERNMENTAL ACCOUNTING STANDARDS BOARD
STATEMENTS NO. 25 AND 50**

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

SCHEDULE OF FUNDING PROGRESS

June 30, 2013

Actuarial Valuation Date	Method*	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (a-b)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
July 1, 2013	(EAN)	\$ 47,537,321	76,013,611	(28,476,290)	62.5%	21,615,172	131.7%
July 1, 2011	(EAN)	44,761,581	71,637,254	(26,875,673)	62.5%	22,095,022	121.6%
July 1, 2009	(EAN)	37,963,510	60,084,860	(22,121,350)	63.2%	19,845,649	111.5%
July 1, 2007	(EAN)	36,850,006	53,258,078	(16,408,072)	69.2%	18,344,200	89.4%
July 1, 2007	(PUC)	36,850,006	49,038,912	(12,188,906)	75.1%	18,344,200	66.4%
July 1, 2005	(PUC)	38,405,760	47,101,375	(8,695,615)	81.5%	15,889,024	54.7%

* See notes to required supplementary information.

See Independent Auditors' Report.

See accompanying notes to required supplementary information.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

**SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER AND
OTHER CONTRIBUTING ENTITIES**

June 30, 2013

Year Ended June 30,	Annual Required Contributions	Total Amount Contributed	Percentage Contributed
2013	\$ 3,182,857	2,239,853	70.4%
2012	3,182,857	2,113,599	66.4%
2011	2,965,333	1,920,223	64.8%
2010	2,965,333	1,717,252	57.9%
2009	2,376,870	1,628,972	68.5%
2008	2,376,870	1,553,635	65.4%
2007	1,790,694	1,412,087	78.9%

See Independent Auditors' Report.
See accompanying notes to required supplementary information.

**EMPLOYEE RETIREMENT SYSTEM OF
THE CITY OF LAWTON, OKLAHOMA**

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2013

CHANGES IN ACTUARIAL METHODS, ASSUMPTIONS, AND DATA

Prior to July 1, 2007, the actuarial accrued liability was reported using the Projected Unit Credit cost method (PUC). Paragraph 37 of GASB 25 requires that the actuarial cost method used for funding the System, which is the Entry Age Normal cost method (EAN), be used for this purpose. For the July 1, 2007, valuation, both cost methods are shown; the first line (EAN) is the official value. The PUC value is only shown for comparative purposes.

See Independent Auditors' Report.



**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Pension Commissioners
Employee Retirement System of the City of Lawton, Oklahoma

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Employee Retirement System of the City of Lawton, Oklahoma (the "System"), a component unit of the City of Lawton, Oklahoma. The financial statements consist of the statement of plan net position as of June 30, 2013, and the related statement of changes in plan net position for the year then ended, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated January 17, 2014. Our report includes an explanatory paragraph disclaiming an opinion on required supplementary information. Our report also includes an explanatory paragraph to emphasize the adoption of Governmental Accounting Standards Board Statement No. 63 by the System.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

(Continued)

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS, CONTINUED**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Finley + Cook, PLLC

Shawnee, Oklahoma
January 17, 2014