

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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**THE MINNEAPOLIS FIREFIGHTERS'  
RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**FOR THE YEAR ENDED DECEMBER 31, 2006**

## **Description of the Office of the State Auditor**

The mission of the State Auditor's Office is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

**Audit Practice** - conducts financial and legal compliance audits of local governments;

**Government Information** - collects and analyzes financial information for cities, towns, counties, and special districts;

**Legal/Special Investigations** - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

**Pension** - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

**Tax Increment Financing** - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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This document can be made available in alternative formats upon request. Call 651-296-2551 [voice] or 1-800-627-3529 [relay service] for assistance; or visit the State Auditor's web site: [www.auditor.state.mn.us](http://www.auditor.state.mn.us).

**THE MINNEAPOLIS FIREFIGHTERS'  
RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**For the Year Ended December 31, 2006**



**Audit Practice Division  
Office of the State Auditor  
State of Minnesota**

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

TABLE OF CONTENTS

	<u>Reference</u>	<u>Page</u>
<b>Introductory Section</b>		
Organization		1
<b>Financial Section</b>		
Independent Auditor's Report		2
Management's Discussion and Analysis		4
Basic Financial Statements		
Statement of Plan Net Assets	Exhibit A	8
Statement of Changes in Plan Net Assets	Exhibit B	9
Notes to the Financial Statements		10
Required Supplementary Information		
Schedule of Funding Progress	Schedule 1	25
Schedule of Contributions from the Plan Sponsor and Other Contributing Entities	Schedule 2	25
Notes to the Required Supplementary Information		26
<b>Management and Compliance Section</b>		
Schedule of Findings and Recommendations	Schedule 3	27
Report on Internal Control Over Financial Reporting and Legal Compliance		33
Additional Client Findings, Conclusions and Determination Relating to Unit Values		

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

ORGANIZATION  
DECEMBER 31, 2006

	Term of Office	
	From	To
<u>Board of Trustees</u>		
Active Elected Members		
Walter C. Schirmer	December 1986	December 2008
Tim Davison	December 2006	December 2008
Retired Elected Members		
John W. George	December 1991	December 2009
Wallace O. Amundsen	December 1992	December 2007
Joseph D. Quinn	December 1993	December 2008
Robert E. Wetherille	April 1996	December 2008
Frank Boerboon	December 2002	December 2009
Richard A. Quarnstrom	December 1999	December 2007
Arnold J. Reese	December 2000	December 2009
David R. Pierson	December 2001	December 2007
City of Minneapolis Appointed Representatives		
Jack Qvale	July 2003	December 2007
LeaAnn Stagg	April 2006	December 2007
Heather Johnston	November 2005	March 2006
 <u>Officers</u>		
Walter C. Schirmer	Executive Secretary	
Frank Boerboon	President	
Wallace O. Amundsen	Vice President	
David R. Pierson	Assistant Executive Secretary	
Joseph D. Quinn	Treasurer	
Arnold J. Reese	Assistant Treasurer	

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REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

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## INDEPENDENT AUDITOR'S REPORT

Board of Trustees  
Minneapolis Firefighters' Relief Association

We have audited the basic financial statements of the Minneapolis Firefighters' Relief Association as of and for the year ended December 31, 2006, as listed in the table of contents. These basic financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the Minneapolis Firefighters' Relief Association as of December 31, 2006, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis and other required supplementary information referred to in the table of contents are not required parts of the basic financial statements but are required by the Governmental Accounting Standards Board. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
DECEMBER 31, 2006  
(Unaudited)**

This Management's Discussion and Analysis (MD&A) of the Minneapolis Firefighters' Relief Association's (Association) financial performance provides an overview of the Association's financial activities for the fiscal year ended December 31, 2006. Please read it in conjunction with the basic financial statements, which follow this discussion.

**FINANCIAL HIGHLIGHTS**

The Association's funding objective is to meet benefit obligations through investment income. As of December 31, 2006, the funded ratio was 87.5 percent. Minnesota statutes require full funding of the Association's unfunded accrued liability by December 31 of the year occurring 15 years later.

Due to fair market conditions, the plan net assets administered by the Association during 2006 increased \$10.5 million more than was earned during 2005. This increase is net of the investment returns we used to pay 2006 monthly benefit payments in the amount of \$21.4 million.

Additions for the year were \$33 million. The lion's share of these additions consist of net investment gains of \$30.2 million, City of Minneapolis contributions of \$1.3 million, fire state aid of \$373,785, insurance surcharge of \$847,376, general account receipts of \$78,122, and political account receipts of \$64,825.

Deductions increased from the prior fiscal year from \$21.9 million to \$22.2 million, or about one percent.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This annual financial report consists of two financial statements: the Statement of Plan Net Assets (Exhibit A) and the Statement of Changes in Plan Net Assets (Exhibit B). These financial statements report information about the Association as a whole and about its financial condition that should help answer the question: Is the Association, as a whole, better off or worse off as a result of this year's activities? These statements include all assets and liabilities using the accrual basis of accounting. Under the accrual basis of accounting, all revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Plan Net Assets presents all the Association's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets measure whether the Association's financial position is improving or deteriorating. The Statement of Changes in Plan Net Assets presents how the Association's net assets changed during the most recent fiscal year. These two statements should be reviewed along with the Schedule of Funding Progress and Schedule of Employer Contributions to determine whether the Association is becoming financially stronger, weaker, or is holding a steady pace of progress and also to understand the reasons for changes in the funded status of the Association over a given period of time.

## FINANCIAL ANALYSIS

Association total assets as of December 31, 2006, were \$271.2 million and were mostly comprised of cash, investments, and accrued investment income. Total assets increased \$9.4 million, or 3.6 percent, from 2005.

Total liabilities as of December 31, 2006, were \$5 million and were comprised of amounts held in escrow, security purchases payable, and accounts payable. Total liabilities decreased \$1.5 million, or 23 percent, between fiscal years 2005 and 2006, primarily due to a decrease in security purchases payable.

The Association's assets exceeded its one-year liabilities, not including pension benefits, by \$266 million at the close of fiscal year 2006. Total net assets held in trust for pension benefits increased by \$10.8 million, or 4.3 percent, between fiscal years 2005 and 2006.

	<b>Net Assets</b>	
	<b>(In Thousands)</b>	
	<u>2006</u>	<u>2005</u>
<b>Assets</b>		
Cash	\$ 1,992	\$ 2,304
Receivables	897	2,965
Investments	<u>268,275</u>	<u>256,545</u>
<b>Total Assets</b>	<u>\$ 271,164</u>	<u>\$ 261,814</u>
<b>Liabilities</b>		
Accounts payable	\$ 252	\$ 269
Escrow account for health insurance	2,659	2,561
Security purchases payable	<u>2,112</u>	<u>3,656</u>
<b>Total Liabilities</b>	<u>\$ 5,023</u>	<u>\$ 6,486</u>
<b>Total Net Assets</b>	<u>\$ 266,141</u>	<u>\$ 255,328</u>

## Revenues--Additions to Plan Net Assets

The vast majority of reserves needed to finance pension benefits are accumulated primarily through earnings on investments with additional contributions provided by the employer and the State of Minnesota. Total additions for 2006 were \$33 million, which is comprised of investment gains of \$30.2 million, City of Minneapolis contributions of \$1.3 million, fire state aid of \$373,785, insurance surcharge of \$847,376, general account receipts of \$78,122, and political account receipts of \$64,825.

Total contributions from the City of Minneapolis and the State of Minnesota decreased between fiscal years 2005 and 2006 by \$4.1 million. The greater part of the decrease is from the City of Minneapolis contributions. Investment income, net of investment fees, was \$30.2 million. This is a \$14.8 million increase from fiscal year 2005 and was due to fair stock market conditions over the previous year. The net appreciation in fair value of investments was \$23.4 million for the year ended December 31, 2006, compared to net appreciation of \$11.5 million for fiscal year 2005.

## Expenses--Deductions from Plan Net Assets

The primary expenses of the Association include the payment of pension benefits and the cost of administering the plan. Total deductions for fiscal year 2006 were \$22.2 million, an increase of \$266 thousand, or approximately one percent from fiscal year 2005 deductions. An increase of approximately one percent in pension benefit expenses resulted from a 2006 payment of back pay. Administrative expenses decreased by \$81 thousand between fiscal years 2005 and 2006.

### Changes in Net Assets (In Thousands)

	2006	2005
Additions		
Contributions	\$ 2,570	\$ 6,664
Net investment income	30,232	15,462
Other sources	169	103
Total Additions	<u>\$ 32,971</u>	<u>\$ 22,229</u>
Deductions		
Benefits	\$ 21,421	\$ 21,120
Administrative expenses	587	668
Other expenses	150	103
Total Deductions	<u>\$ 22,158</u>	<u>\$ 21,891</u>
Net Increase	<u>\$ 10,813</u>	<u>\$ 338</u>

## **THE ASSOCIATION IN GENERAL**

The Association's net assets have experienced moderate increases over the last several years. These moderate increases were primarily due to appropriate use of diversification by the trustees during difficult stock market performance. Our funding level was held to only moderate increase mostly due to the establishment of new and more accurate mortality tables.

The change in mortality tables instituted in 2005 increased the actuarial accrued liability (payment of pension benefits to our members, retired and not retired) by about \$26 million. If the mortality tables had not been changed, the funded ratio as of December 31, 2005, would have been 96.4 percent. As of December 31, 2006, we are 87.5 percent funded. Because of the implementation of much more accurate mortality tables, a much more accurate evaluation of the Association's financial condition can be obtained.

In 2005, the Board of Trustees believed that with continued growth in the markets and continued diligent investment procedures, the Association would be fully funded by the end of 2007. The market has not performed up to the levels required to make the full funding level as we had hoped for by the end of 2007. We did, however, perform well enough to provide the first post-retirement benefit in a long while and we will work hard and diligently to continue that distribution in the future.

The Board of Trustees believes our current financial position has improved greatly due to the hiring of several new money managers presented to us by our Investment Consultant and a slightly more positive investment market. This type of prudent investment program and strategic planning will continue to provide the kinds of investment returns required for the Association to meet its goal of total self-reliance sooner than later. It is the Board's feeling that our Association will meet the state's funding requirement of 2018 much sooner than the required time lines currently in place.

## **BASIC FINANCIAL STATEMENTS**

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**EXHIBIT A**

**STATEMENT OF PLAN NET ASSETS  
DECEMBER 31, 2006**

<b>Assets</b>	
<b>Cash and deposits</b>	
Cash and deposits in pension account	\$ 1,882,810
Cash and deposits in general account	104,033
Cash and deposits in political account	<u>5,419</u>
<b>Total cash and deposits</b>	<b>\$ 1,992,262</b>
<b>Receivables</b>	
Accrued interest and dividends	\$ 543,174
Sale of securities	321,594
Prepaid expenses	3,591
Other	<u>28,732</u>
<b>Total receivables</b>	<b>\$ 897,091</b>
<b>Investments, at fair value</b>	
Certificates of deposit in general account	\$ 646,467
Corporate obligations	5,181,041
Corporate stock	132,465,967
Corporate stock in general account	116,583
Mutual funds	43,165,696
TBA mortgage-backed securities	1,366,202
U.S. government obligations	38,910,705
Investment pools	
Bond market account (State Board of Investment)	12,087,287
Common stock index account (State Board of Investment)	12,252,795
Short-term cash equivalents	22,058,398
Short-term cash equivalents in general account	<u>24,063</u>
<b>Total investments, at fair value</b>	<b>\$ 268,275,204</b>
<b>Total Assets</b>	<b>\$ 271,164,557</b>
<b>Liabilities</b>	
Accounts payable	\$ 251,748
Escrow account for health benefits	2,658,996
Security purchases payable	<u>2,112,646</u>
<b>Total Liabilities</b>	<b>\$ 5,023,390</b>
<b>Net Assets</b>	
Net assets held in trust for pension benefits (a Schedule of Funding Progress is presented on page 25)	\$ 265,244,602
Net assets restricted for general account	891,146
Net assets restricted for political account	<u>5,419</u>
<b>Total Net Assets</b>	<b>\$ 266,141,167</b>

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**EXHIBIT B**

**STATEMENT OF CHANGES IN PLAN NET ASSETS  
FOR THE YEAR ENDED DECEMBER 31, 2006**

<b>Additions</b>	
<b>Contributions</b>	
<b>Employer</b>	
City of Minneapolis	\$ 1,348,855
State of Minnesota	<u>1,221,161</u>
<b>Total contributions</b>	<b>\$ <u>2,570,016</u></b>
<b>Investment income (loss)</b>	
Net appreciation (depreciation) in fair value of investments	\$ 23,396,649
Interest and dividends	<u>7,976,213</u>
<b>Total investment income (loss)</b>	<b>\$ 31,372,862</b>
Less: direct investment expense	<u>(1,141,368)</u>
<b>Net investment income (loss)</b>	<b>\$ <u>30,231,494</u></b>
Other	\$ 26,220
Receipts to general account	78,122
Receipts to political account	<u>64,825</u>
<b>Total Additions</b>	<b>\$ <u>32,970,677</u></b>
<b>Deductions</b>	
Benefits and refunds paid to participants	\$ 21,420,769
Administrative expenses	586,587
Other - general account	88,445
Other - political account	<u>61,826</u>
<b>Total Deductions</b>	<b>\$ <u>22,157,627</u></b>
<b>Net Increase (Decrease)</b>	<b>\$ 10,813,050</b>
<b>Net Assets - January 1</b>	<u>255,328,117</u>
<b>Net Assets - December 31</b>	<b>\$ <u><u>266,141,167</u></u></b>

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2006**

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1. Financial Reporting Entity

The Minneapolis Firefighters' Relief Association was incorporated on November 24, 1886, to provide financing for and the payment of service, disability, or dependency pensions to its eligible members and dependents. The Association is governed by a Board of Trustees consisting of 12 persons. Ten trustees are elected by the members, and two are appointed by the City of Minneapolis. The Board bi-annually elects a president, vice president, executive secretary, assistant secretary, treasurer, and assistant treasurer.

The Association is not a component unit of the City of Minneapolis (employer), and its financial statements are not included with the City's financial statements because the City does not appoint a voting majority of the Board, and the Association is legally a separate entity and fiscally independent of the City.

2. Plan Description

A. Membership Information

Firefighters of the City of Minneapolis are members of the Minneapolis Firefighters' Relief Association. The Association is the administrator of a single-employer, defined benefit pension plan available to firefighters hired prior to June 15, 1980, and operated under the provisions of its bylaws and Minnesota State Law. Firefighters hired after June 15, 1980, are members of the Minnesota Public Employees Retirement Association Police and Fire Fund.

At December 31, 2006, the membership of the Minneapolis Firefighters' Relief Association consisted of:

Retirees and beneficiaries currently receiving benefits	592
Terminated employees entitled to benefits but not yet receiving them	-
Active plan participants – vested	<u>31</u>
Total	<u><u>623</u></u>

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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2. Plan Description (Continued)

B. Pension Benefits

Authority for payment of pension benefits is established in Minn. Stat. § 69.77, and ch. 423C, as enacted by 2001 Minn. Laws, 1st Sp. Sess., ch. 10, art. 15, and may be amended only by the Minnesota State Legislature.

Normal Service Pensions

Each member who is at least 50 years of age and has five years of service with the Minneapolis Fire Department is eligible to receive a service pension, monthly, for the remainder of the member's life. All benefits are based on a plan of a number of units. A unit is 1/80th of the maximum current monthly salary of a first grade firefighter. Pensions are based on current fire department payroll and are fully escalated for all persons receiving a pension benefit. Each vested member also receives a lump sum amount, at the time of separation, from the General Fund based on the number of years the member has belonged to the Association. Units paid per month are based on the percentage that the actuarial value of assets of the special fund equal the actuarial accrued liabilities of the special fund according to the most recent annual actuarial valuation of the relief association prepared in accordance with Minn. Stat. §§ 356.215 and 356.216 and the number of years of service on the Minneapolis Fire Department. The service pension schedules in terms of units is identified in Minn. Stat. § 423C.05, subd. 2(b).

Retirement Benefit Options and Survivor Spouse Pensions

The surviving spouse of a service pensioner, who was married to the service pensioner for at least one year at the date of retirement or who has been married to the pensioner for at least two years after retirement, is entitled to a survivor spouse pension.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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2. Plan Description

B. Pension Benefits

Retirement Benefit Options and Survivor Spouse Pensions (Continued)

The surviving spouse of an active plan member is entitled to an Option 1 - 100 percent Joint and Survivor Spouse Annuity survivor spouse pension, as described below.

During 1997, the Association amended the plan provisions to include several annuity options available to retiring, married members.

- Normal Retirement Benefit

Described in detail for normal service pensioners previously, a surviving spouse receives a pension of 22 units per month for life.

- Option 1 - 100% Joint and Surviving Spouse Annuity

This option pays the retiree a reduced monthly benefit and, upon death, continues to pay a like amount for the life of the surviving spouse.

- Option 2 - 75% Joint and Surviving Spouse Annuity

This option is similar to Option 1, except upon death of the retiree, the surviving spouse pension is reduced to 75 percent of previous benefit level.

- Option 3 - 50% Joint and Surviving Spouse Annuity

This option is similar to Options 1 and 2, except upon the death of the retiree, the monthly benefit payable to the surviving spouse is reduced by 50 percent.

- Option 4 - Options 1, 2, or 3 with Bounce-Back Provision

Options 1, 2, or 3 can be chosen with a "bounce-back" provision. This option would further reduce the monthly benefit but, should the retiree's spouse die first, the monthly benefit amount would increase or "bounce-back" to what the amount would have been had the Normal Retirement Benefit option been chosen at retirement.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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2. Plan Description

B. Pension Benefits

Retirement Benefit Options and Survivor Spouse Pensions (Continued)

During 2002, the Association amended the plan provisions to include an annuity option available to retiring, unmarried members.

- Option 5

This option allows for an offset to the married members whose surviving spouse receives a survivor spouse benefit upon their death since the surviving spouse benefit has an actuarial impact to the fund and its remaining members. This option provides that a member submitting an application for a service pension who was not legally married on September 1, 1997, and remained unmarried on October 25, 2001, may, if the member had obtained 25 years of service credit on or before October 25, 2001, select a service pension of 42.3 units in lieu of a regular 42-unit service pension. This additional fraction of a unit helps to blend out the cost of the surviving spouse benefit and provides for a more equal distribution of pension benefits to all members.

Survivor Children Pensions

The dependent children of a deceased active member or service pensioner each receive a pension of eight units until age 18 or until age 22 if they are a full-time student. The combined pension benefits for one member's surviving spouse and children may not exceed 42 units.

Disability Pensions

Whenever an active member becomes temporarily disabled because of sickness or injury, on or off the job, the member will receive a temporary disability pension of 40 units, provided the member has expired all leaves of absence.

Whenever an active member becomes permanently disabled because of sickness or injury, the member will be entitled to a permanent disability pension of 41 units. Disability arising from employment other than the Minneapolis Fire Department will cause a member to forfeit entitlement to a disability pension.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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2. Plan Description

B. Pension Benefits (Continued)

Post-Retirement Benefit

On or about June 1 annually following a year in which the Association's average time weighted total rate of return earned in the most recent five years exceeds by two percent the average percentage increase in the current monthly salary of a top grade firefighter in the most recent five years, the Association pays a post-retirement benefit to eligible pensioners. The amount of the post-retirement distribution is equal to the excess investment income earned in the previous year. Excess investment income is defined as the amount by which the average time weighted total rate of return in the most recent five years exceeds the average percentage increase in the current monthly salary of a top grade firefighter in the most recent five years plus two percent. Excess investment income may not exceed one-half of one percent of the total assets of the Association. Payment to each eligible member is calculated by dividing the total number of pension units paid to the member during the previous year by the excess investment income available for distribution; however, each payment may not exceed the monthly pension amount received by the member in the prior year.

If the Association had excess investment income in the previous year *and* the actuarial value of the Association's assets according to the most recent annual actuarial valuation is greater than 102 percent of its actuarial accrued liabilities, then excess investment income may not exceed one and one-half percent of the total assets of the Association. When this occurs, payment to each eligible member is calculated by dividing the total number of pension units paid to the member during the previous year by one and one-half percent of the total assets of the Association.

When the special fund's actuarial funding level exceeds 110 percent, up to 20 percent of the assets greater than 110 percent will be distributed to eligible pensioners based on a proportionate number of units each member received in the prior year compared to the total number of units received.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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3. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying financial statements are presented in accordance with Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and with Statement No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*, as amended.

B. Basis of Accounting

The basis of accounting is the method by which additions and deductions to plan net assets are recognized in the accounts and reported in the financial statements. The Association uses the accrual basis of accounting. Under the accrual basis of accounting, additions are recognized when they are earned, and deductions are recognized when the liability is incurred. Resources are derived from investment earnings and contributions from the City of Minneapolis, the Association's active membership, and the State of Minnesota. Benefits are recognized when they are due and payable in accordance with the terms of the plan.

C. Net Assets

Net assets consist of the following:

- Net Assets Held in Trust for Pension Benefits represent the portion of net assets to be used to provide benefits for retirement, death, and disability payments of appropriate amounts and at appropriate times in the future.
- Net Assets Restricted for General Account represent the portion of net assets derived from membership contributions and certain investment income to be used for the good and benefit of the Association as determined by Association bylaws.
- Net Assets Restricted for Political Account represent the portion of net assets derived from membership contributions to be used for contributions to political candidates.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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3. Summary of Significant Accounting Policies (Continued)

D. Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Investments that are regularly traded in the market are valued at last reported sales price at the current exchange rates. The values of other investments for which there is no active market are determined by the asset managers, Association's Board of Trustees, or other external sources.

Net appreciation (depreciation) in fair value of investments includes net unrealized and realized gains and losses. Purchases and sales of securities are recorded on a trade-date basis.

Interest and dividends are recorded when earned.

E. Capital Assets

The Association follows a policy of expensing capital assets at the time of purchase. At December 31, 2006, the Association owned capital assets costing \$44,237. This amount is not shown in the accompanying Statement of Plan Net Assets (Exhibit A).

F. Liabilities

The escrow account for health benefits represents amounts contributed and earnings thereon of active plan members with over 25 years of service on the City of Minneapolis Fire Department. The Association holds the funds in escrow until retirement when members will receive periodic distributions from their accounts to offset health insurance costs. The escrow account for health benefits is not available for the payment of pension benefits.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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4. Deposits and Investments

A. Deposits

Authority

Minn. Stat. § 356A.06, subd. 8a, authorizes the Association to deposit cash and to invest in certificates of deposit in financial institutions designated by the Board of Trustees. Minnesota statutes require that all pension plan deposits be covered by deposit insurance, surety bond, or pledged collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit plus accrued interest at the close of the financial institution's banking day, not covered by insurance or bonds.

Authorized collateral includes treasury bills, notes and bonds; issues of U.S. government agencies; general obligations rated "A" or better, revenue obligations rated "AA" or better; irrevocable standby letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the financial institution furnishing the collateral.

Custodial Credit Risk for Deposits

Custodial credit risk is the risk that in the event of a financial institution failure, the Association's deposits may not be returned to it. The Association's policy for custodial credit risk is to maintain compliance with Minnesota statutes that require the Association's deposits be protected by insurance, surety bond, or pledged collateral. As of December 31, 2006, \$5,233 of the Association's bank balance of \$740,419 was exposed to custodial credit risk. This exposure to custodial credit risk is related to the Association's general account deposits.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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4. Deposits and Investments (Continued)

B. Investments

Authority

Minn. Stat. §§ 356A.06, subs. 6 and 7, and 69.77, subd. 9, authorize the types of, and restrictions on, securities available to the Association for investment. The Association is authorized to invest its funds in the following:

- (a) Government obligations provided the issue is backed by the full faith and credit of the issuer or is rated among the top four quality rating categories by a nationally recognized rating agency. Such obligations may include: (1) guaranteed or insured issues of the United States or its agencies, instrumentalities, or organizations created and regulated by an act of Congress; (2) guaranteed or insured issues of Canada and its provinces; or (3) guaranteed or insured issues of states and their municipalities, political subdivisions, agencies, or instrumentalities.
- (b) Corporate obligations issued or guaranteed by a corporation organized under the laws of the United States or any state thereof, or the Dominion of Canada or any province thereof, provided they are rated among the top four quality categories by a nationally recognized rating agency.
- (c) Corporate stock or convertible issues of any corporation organized under the laws of the United States or states thereof, the Dominion of Canada or its provinces, or any corporation listed on the New York Stock Exchange or the American Stock Exchange under specified conditions.
- (d) TBA or "to-be-announced" mortgage-backed securities transactions. These are a basic mechanism for trading federal agency mortgage pass-through securities on a delayed delivery and settlement basis. They do not represent a separate type or class of mortgage-backed securities. A TBA transaction is a purchase or sale of mortgage pass-through securities with settlement agreed upon for some future date. The purchase of pass-throughs on a TBA basis creates a long position in the underlying security on the trade date with associated market risk in the position. The securities to be delivered are described in general detail at the time of trade but are not specifically identified until shortly prior to settlement. TBA transactions may involve newly-issued or existing agency mortgage pass-throughs.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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4. Deposits and Investments

B. Investments

Authority (Continued)

- (e) Venture capital investment businesses through participation in limited partnerships and corporations, subject to limitations.
- (f) Regional and mutual funds through bank-sponsored collective funds and open-end investment companies registered under the Federal Investment Company Act of 1940, subject to limitations.
- (g) Real estate ownership interests or loans secured by mortgages or deeds of trust through investment in limited partnerships, bank-sponsored collective funds, trusts, and insurance company commingled accounts, including separate accounts, subject to limitations.
- (h) Resource investments through limited partnerships, private placements, and corporations, subject to limitations.
- (i) Bankers' acceptances, certificates of deposit, deposit notes, commercial paper, mortgage participation certificates and pools, asset-backed securities, repurchase agreements and reverse repurchase agreements, guaranteed investment contracts, savings accounts, and guaranty fund certificates, surplus notes, or debentures of domestic mutual insurance companies, if they conform to specified provisions.

Custodial Credit Risk for Investments

The custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the Association will not be able to recover the value of the investment or the collateral securities in the possession of an outside party.

A third-party safekeeping agent appointed as custodian holds 99.7 percent of the securities purchased by the Association.

The Association has no custodial credit risk for investments at December 31, 2006.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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4. Deposits and Investments

B. Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price.

The Association manages its exposure to fair value of loss arising from changing interest rates by having fixed income investments managed by external money managers. The Association employs four managers who invest in fixed income investments. The investment guidelines for each manager require that the manager be responsible for determining the maturities for all fixed income securities within their portfolio.

For these asset managers, the duration of the overall portfolio must be managed to have a targeted duration around the duration of the Lehman Brothers Aggregate Bond Index of 4.46 years, as this is the benchmark for all these portfolios. All managers were in compliance with the duration guidelines for the year ended December 31, 2006.

The following table shows the interest rate risk by manager.

<u>Bond Manager</u>	<u>Fair Value of Fixed Income Securities Managed</u>	<u>Account Duration (in years)</u>
AllianceBernstein Institutional Investments	\$ 7,307,620	4.3
US Bancorp Asset Management	8,324,819	4.5
RiverSource Investments, LLC	5,391,844	4.2
Mairs and Power, Inc.	13,788,154	3.8

The Association has \$12,252,795 in the Minnesota State Board of Investment (SBI) Supplemental Investment Fund Bond Market Account. This account invests the large majority of its assets in high quality government and corporate bonds and mortgage securities that have intermediate to long-term maturities, usually 3 to 20 years. The managers of this account also may attempt to earn returns by anticipating changes in interest rates and adjusting holdings accordingly. This account is invested entirely in fixed income securities.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

4. Deposits and Investments

B. Investments (Continued)

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. Minnesota statutes provide for the types of fixed income investments that a pension plan can make. In addition, the Association establishes other restrictions that are set forth in the investment guidelines for the management of the Association's fixed income assets.

This risk is measured by the assignment of a rating by a nationally recognized statistical rating organization.

The following table shows the Association's investments by type and credit quality rating at December 31, 2006.

Investment Type	Fair Value	Standard and Poor's Quality Ratings				
		AAA	AA	A	BBB	Unrated
Corporate Obligations	\$ 5,076,031	\$ 22,013	\$ 60,043	\$ 40,044	\$ 904,387	\$ 4,049,544
Foreign Obligations	105,011	-	5,147	-	-	99,864
GNMA	185,125	-	-	-	-	185,125
Mortgage-Backed Securities	10,719,705	16,404	-	32,023	318,795	10,352,483
PIMCO Total Return Mutual Fund	71,021	-	-	-	-	71,021
SBI Bond Market Account	12,087,287	-	-	-	-	12,087,287
TBA Mortgage-Backed Securities	1,366,202	-	-	-	-	1,366,202
U.S. Government Agencies	14,731,245	-	-	53,507	-	14,677,738
U.S. Treasury Obligations	13,274,629	-	304,283	-	10,005	12,960,341*
Totals	<u>\$ 57,616,256</u>	<u>\$ 38,417</u>	<u>\$ 369,473</u>	<u>\$ 125,574</u>	<u>\$ 1,233,187</u>	<u>\$ 55,849,605</u>

\*Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

4. Deposits and Investments

B. Investments (Continued)

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates of foreign currencies relative to the U.S. dollar adversely affect the fair value of an investment or a deposit. The Association limits this risk in several ways. Minnesota statutes limit certain investments to a total portfolio limit of no more than 35 percent of the market value of the portfolio. Both international equities and international bonds are in this category. Other items include venture capital, real estate, and partnerships.

The Association's investments managed by several of its managers include either equities or debt securities or combination of equities and debt securities exposed to foreign currency risk.

Risk of loss arises from changes in currency exchange rates. The Association's exposure to foreign currency risk at December 31, 2006, is presented in the following table.

<u>Currency</u>	<u>Total</u>	<u>Fixed Income Security</u>	<u>Stocks in ADR</u>	<u>Stocks</u>
Australian Dollar	\$ 447,505	\$ -	\$ 447,505	\$ -
Bermudan Dollar	2,622,156	-	1,609,651	1,012,505
Brazilian Real	1,307,327	-	875,800	431,527
British Pound	8,676,541	33,048	2,555,213	6,088,280
Canadian Dollar	2,752,136	51,943	1,253,005	1,447,188
Caymanian Dollar	378,502	-	-	378,502
Chinese Yuan Renminbi	80,088	-	80,088	-
Euro	11,456,987	-	1,803,629	9,653,358
Israel Shekel	195,804	-	195,804	-
Mexican Peso	637,220	20,020	-	617,200
Norwegian Krone	255,466	-	38,901	216,565
South Korean Won	258,903	-	258,903	-
Swiss Franc	1,774,079	-	1,465,180	308,899
Taiwan Dollar	247,061	-	247,061	-
Totals	<u>\$ 31,089,775</u>	<u>\$ 105,011</u>	<u>\$ 10,830,740</u>	<u>\$ 20,154,024</u>

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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4. Deposits and Investments

B. Investments

Foreign Currency Risk (Continued)

In addition, of the Association's holdings in mutual funds totaling \$43,165,696, the following are international equity mutual funds:

<u>Mutual Fund</u>	<u>Fair Value</u>
Dodge and Cox International Stock	\$ 23,966,747
Ivy Global Funds	14,664,868
Leuthold Weeden Capital Management (various funds within account)	639,862
Manning & Napier	<u>1,214,960</u>
Total	<u>\$ 40,486,437</u>

Concentration of Credit Risk

The Association's investment policy limits investments in any one issuer to not more than five percent, unless the manager has received prior approval, or the increase is a result of market price increase. U.S. Treasuries and agencies are exempted. The Association's investments as of December 31, 2006, were below these limits.

5. Contributions

Authority for contributions to the pension plan is established by Minn. Stat. § 69.77 and may be amended only by the Minnesota State Legislature.

The Association's funding policy provides for contributions from the City of Minneapolis, the State of Minnesota, and active plan members. City contributions are actuarially determined pursuant to Minn. Stat. § 69.77, subd. 4, and ch. 423C. Minn. Stat. § 423C.15, subd. 3, requires full funding of the Association's unfunded accrued liability by December 31 of the year occurring 15 years later. Active plan members contribute annually an amount equal to eight percent of the maximum first grade firefighter's salary from which pension benefits are determined. The State of Minnesota annually contributes fire state aid pursuant to Minn. Stat. §§ 69.021 and 297I.10. The City of Minneapolis and the State of Minnesota provided statutory contributions in 2006. Since all active plan members have achieved 25 years of service, active member contributions are no longer required.

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

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6. Risk Management

The Association is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to members. The Association manages its risk of loss through the purchase of commercial insurance. There were no significant reductions in insurance from the previous year, nor have there been any settlements in excess of insurance coverage for any of the past three years.

7. Contingencies

In connection with the normal conduct of its affairs, the Association is involved in various claims, litigation, and judgments. It is expected that the final settlement of these matters will not materially affect the financial statements of the Association.

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**REQUIRED SUPPLEMENTARY INFORMATION**

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

Schedule 1

**SCHEDULE OF FUNDING PROGRESS**

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Plan Assets (a)</b>	<b>Actuarial Accrued Liability (AAL) - Entry Age (b)</b>	<b>Unfunded AAL (UAAL) (b-a)</b>	<b>Funded Ratio (a/b) (%)</b>	<b>Annual Covered Payroll (Previous Fiscal Year) (c)</b>	<b>UAAL as a Percentage of Covered Payroll ((b-a)/c) (%)</b>
2001	\$ 304,887,000	\$ 293,396,000	\$ (11,491,000)	103.9	\$ 5,888,000	(195.2)
2002	255,194,000	292,678,000	37,484,000	87.2	5,540,000	676.6
2003	236,991,000	293,955,000	56,964,000	80.6	4,397,000	1295.5
2004	248,546,000	275,513,000	26,967,000	90.2	3,142,000	858.3
2005	269,426,000	312,563,000	43,137,000	86.2	2,933,000	1470.7
2006	263,276,000	300,926,000	37,650,000	87.5	2,489,000	1512.7

**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

Schedule 2

**SCHEDULE OF CONTRIBUTIONS FROM THE PLAN SPONSOR  
AND OTHER CONTRIBUTING ENTITIES**

<b>Fiscal Year</b>	<b>Annual Required Contributions</b>	<b>City Contributions</b>	<b>City Percentage Contributed (%)</b>	<b>State Contribution</b>	<b>State Percentage Contributed (%)</b>
2001	\$ 1,232,251	\$ 326,969	26.53	\$ 905,282	73.47
2002	1,030,019	5,907	0.57	1,024,112	99.43
2003	1,333,171	4,270	0.32	1,328,901	99.68
2004	1,950,098	2,670	0.14	2,146,934	110.09
2005	6,651,403	4,737,705	71.23	1,913,951	28.78
2006	2,570,016	1,348,855	52.48	1,221,161	47.52

Note:

The annual required contributions are actuarially determined. The city and state are required by statute to make contributions, all of which have been made.

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION  
SCHEDULES 1 AND 2  
FOR THE YEAR ENDED DECEMBER 31, 2006

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Actuarial Methods and Assumptions

The actuarial accrued liability is determined as part of an annual actuarial valuation on December 31, 2006. Significant methods are as follows:

- The most recent actuarial valuation date is December 31, 2006.
- Actuarial cost is determined using the Entry Age Normal Cost Method.
- The amortization method is determined using the level annual dollar approach.
- The actuarial value of assets is book value plus the average unrealized gain for the last three years minus excess investment income as defined by state law.
- The unfunded accrued liability is amortized over a 15-year period.

Significant actuarial assumptions are as follows:

- Investment rate of return is six percent per annum.
- Projected salary increase is four percent annually, adjusted by the terms of a collective bargaining agreement.
- Post-retirement benefit increases are not projected.
- There is no inflation rate assumption.
- Mortality assumptions use the 1983 GAM Mortality Table set forward two years for females.

There have been no significant changes to plan provisions and actuarial methods and assumptions in the last six years, except the following:

- The salary scale, which has been adjusted to reflect new collective bargaining agreements.

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**THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
MINNEAPOLIS, MINNESOTA**

**Schedule 3**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2006**

**I. INTERNAL CONTROL**

**ITEM ARISING THIS YEAR**

**06-1 Preparation of Financial Statements**

The Minneapolis Firefighters' Relief Association (Association) is required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). The preparation of the financial statements is the responsibility of the Association's management. Financial statement preparation in accordance with GAAP requires internal control over both (1) recording, processing, and summarizing accounting data (maintaining internal books and records); and (2) preparing and reporting the appropriate basic financial statements, including the related notes to the financial statements.

The Association has established controls and procedures for recording, processing, and summarizing its accounting data used in the preparation of its basic financial statements.

As is the case with many small and medium-sized entities, however, the Association has relied on its independent external auditors to assist in the preparation of the basic financial statements, including notes to the financial statements, as part of its external financial reporting process. Accordingly, the Association's ability to prepare financial statements in accordance with GAAP is based, at least in part, on its reliance on its external auditors, who cannot, by definition, be considered part of the Association's internal control.

We recommend the Association obtain the training and expertise to internally prepare its annual financial statements in accordance with GAAP. If the Association still intends to have staff from the Office of the State Auditor assist in preparation then, at a minimum, it must identify and train individuals to obtain the expertise that can sufficiently review, understand, and approve the financial statements, including notes. As an alternative, the Association could consider hiring an outside consultant to assist in preparing its basic financial statements.

Client's Response:

*The Association's management was not aware of this requirement in time to provide the necessary training, expertise, and completed financial statements required for the 2006 audit. The MFRA Trustees were made aware of the MFRA management's responsibility to prepare and provide its financial statements on an ongoing basis and to present these statements to the State Auditor upon request for the preparation of the 2007 and future audits of the Association. The MFRA management will provide whatever training and/or assistance required to accomplish this task.*

**II. COMPLIANCE**

**PREVIOUSLY REPORTED ITEM NOT RESOLVED**

03-1 Components of Unit Value

Pension benefits for the Minneapolis Firefighters' Relief Association (Association) are based on a unit value. Minn. Stat. § 423C.01, subd. 28, and the Association's bylaws define a unit as 1/80th of the maximum monthly salary of a first grade firefighter on the first day of the month in which pension benefits are paid.

Following is a schedule of the calculation of per unit value used at December 31, 2006:

<u>Component</u>	<u>Hourly Rate</u>	<u>Number of Hours</u>	<u>Annually</u>	<u>Monthly</u>	<u>Per Unit</u>
Base wages	\$ 20.28	2,848	\$ 57,785.40	\$ 4,815.45	\$ 60.19
Selection premium	.73	2,848	2,081.55	173.46	2.17
Clothing and equipment	-	-	967.00	80.58	1.01
Longevity	2.49	2,848	7,109.20	592.43	7.41
Health club dues	-	-	343.63	28.64	.36
Sick leave buy back	23.50	144	3,384.05	282.00	3.53
Vacation cash out	23.50	48	1,128.02	94.00	1.18
FLSA overtime	11.75	84.46	993.31	82.78	1.03
Overtime (@1.5)	35.25	136	4,794.08	399.51	4.99
Work out of grade	-	-	661.97	55.16	.69
Holiday pay	11.75	34	400.45	33.37	.42
Total			<u>\$ 79,648.66</u>	<u>\$ 6,637.39</u>	<u>\$ 82.97</u>

The sum of the hourly rate for base wages, selection premium, and longevity is the rate used to calculate the unit value for hours of sick leave buy back, vacation cash out, FLSA overtime, holiday pay, and overtime components. Work out of grade refers to

*Schedule 3*  
*(Continued)*

compensation firefighters are eligible to receive when they perform the duties of a higher job classification, and is calculated by taking the pay differential between a firefighter's regular rate of pay and the hourly rate payable if he or she had been permanently promoted to the higher rank with at least a five percent increase in this differential.

The Association's bylaws identify that the components of salary be included to the extent they are payable under a collective bargaining agreement. Those salary components added after the 1995 Settlement Agreement between the Association and the City of Minneapolis should be included at the average amount paid to those first grade firefighters who received the compensation item. Therefore, actual payroll practices of the City of Minneapolis have been reviewed to determine that the salary components used by the Association in the unit value calculation were not inconsistent with payments to active firefighters.

The actual payroll practice of the City of Minneapolis, for work out of grade, 48 hours of vacation cash out, 144 hours of sick leave buy back, and 34 hours of holiday pay, is that these components of pay are not paid at a rate which includes selection premium. The City's practice is consistent with the terms of the collective bargaining agreement in that selection premium is paid only on hours worked as a firefighter. Therefore, the unit value calculation for the Association should not include selection premium in those components because they do not represent hours worked. The unit value is overstated by approximately \$.16/unit, or \$80.64 per year per beneficiary at the maximum 42 units.

The 1995 Settlement Agreement states that salary includes "an average of overtime actually worked in excess of FLSA overtime amounts by firefighters with 25 years or more of service, up to a maximum of 136 hours, in the immediately preceding year." The Association uses the maximum 136 hours of overtime in its unit value calculation. However, there is no indication that any actual average overtime amounts of eligible firefighters paid by the City are reflected in this amount. The Association maintains that 136 hours of overtime was intended to be the agreed-upon amount to remain unchanged as negotiated during the 1995 Settlement Agreement. This is not what the express language of that agreement reflects. The actual City of Minneapolis payroll records indicate the following:

- For 2003, only four firefighters were at Step 7 with more than 25 years of service. Two of these four firefighters worked 12 hours of overtime each. The average overtime worked for the four qualifying firefighters is 6 hours.

**Schedule 3**  
**(Continued)**

- For 2005, there were five firefighters at Step 7 with more than 25 years of service. Two of these worked one hour of overtime each, and two firefighters worked three hours each. The average overtime worked for the five qualifying firefighters is 1.6 hours.
- For 2006, there were only two firefighters at Step 7 with more than 25 years of service. These two firefighters worked 64 and 110 hours of overtime each. The average overtime worked for the two qualifying firefighters is 87 hours.

Substituting 87 hours of overtime for 136 hours, an \$82.97 unit value is overstated by approximately \$1.79/unit, or \$902 per year per beneficiary at the maximum 42 units.

In the 2003 audit, we recommended the Association review and analyze components of unit value. The Association and its legal counsel have reviewed its methods and calculations of monthly salary used to calculate unit value and have concluded they are proper and reasonable. They obtained payroll data from the City of Minneapolis and formulated a methodology for accumulating averages, which were then used to calculate average hours for certain components of pay, including vacation cash out, work out of grade, and holiday pay. The Association has included those amounts in its subsequent unit value calculations.

We recommend the unit value reflect compliance with the terms of the 1995 Settlement Agreement and the collective bargaining agreement. The City of Minneapolis and the Association should agree on the methodology for determining relevant averages for the components of pay to be included in the unit value calculation. The actual payroll practice of the City of Minneapolis should be followed for the components of salary that are used by the Association as the basis for calculating the unit value for pension benefits to ensure consistency. This matter is in litigation.

Client's Response:

*The Trustees provided the auditor with a comprehensive communication regarding the Association's review of this issue relating to the components of unit value in connection with the 2004 audit. At its meeting on June 7, 2005, the Association adopted the Findings, Conclusions and Determination Relating to Unit Values for the Period of October 15, 2002 to October 15, 2004 (the "Findings"). The Findings were provided to the auditor in a letter dated June 8, 2005. The auditor's office has acknowledged the receipt of the Findings, and they were included as part of the 2004 audit and the 2005 audit.*

Schedule 3  
(Continued)

*Specifically, the auditor criticizes the Association's inclusion of 136 hours of overtime in the definition of salary. The Association addressed this issue in its Finding 16. The Association's interpretation of the 1995 Settlement Agreement and use of 136 hours of overtime has been consistent and longstanding.*

*The auditor's office offers an interesting new insight into this issue. The 2006 audit points out that according to its research the average overtime worked in 2003 by 25-year firefighters was six hours, 1.6 hours in 2005, and 87 hours in 2006. Had the MFRA adopted the approach recommended by the OSA after the 2003 audit, the MFRA would have created a roller coaster of benefits for its retirees and widows, many of whom are well over 80 years of age. Concomitantly, the OSA interpretation would have also created a roller coaster of liabilities for the City of Minneapolis that would have resulted in significant liability swings into the tens of millions of dollars from year to year. While that might create an interesting and enjoyable amusement ride, it is no way to run a railroad, a business, or a pension fund.*

*These new insights into this issue persuade the Association even more so to maintain that its position on this issue is correct and most prudent. The Association believes the 1995 settlement agreement is and has been implemented as it was originally intended since 1995.*

*The auditor also criticizes the inclusion by the Association of selection premium pay in the calculation of the value of vacation cash out, sick leave buy back, and holiday pay. Selection premium pay existed at the time of the 1995 Settlement Agreement and has been appropriately included in each of those items based on the terms of the 1995 Settlement Agreement. (See Finding 18 in the 2004 audit and the 2005 audit.) The \$.17 per hour has been built into the regular pay of every firefighter.*

*The Board of Trustees stands by the determinations provided to the auditor in the Findings. Further, the Board believes that if there were any dispute to the 1995 Settlement Agreement, either the State Auditor's Office or the City of Minneapolis would have brought that dispute forward immediately, not eleven years after the 1995 Settlement Agreement was completed, agreed to, and put into effect by both the Association and the City of Minneapolis.*

*On June 7, 2005, the Association adopted the Findings, Conclusions and Determination Relating to Unit Values for the Period of October 15, 2002 to October 15, 2004 (the "Findings"). The Findings were provided to the auditor in a letter dated June 8, 2005.*

**Schedule 3**  
**(Continued)**

*The auditor's office has acknowledged the receipt of the Findings, and they were included as part of the 2004 audit and the 2005 audit. These Findings have since been updated, and the MFRA Trustees respectfully request that the updated findings be made a part of this year ending 2006 audit for future reference and issue clarification.*



REBECCA OTTO  
STATE AUDITOR

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## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND LEGAL COMPLIANCE

Board of Trustees  
Minneapolis Firefighters' Relief Association

We have audited the basic financial statements of the Minneapolis Firefighters' Relief Association as of and for the year ended December 31, 2006, and have issued our report thereon dated August 31, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Minneapolis Firefighters' Relief Association's internal control over financial reporting as a basis for designing our auditing procedures 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 Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Association's ability to initiate, authorize,

record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Association's financial statements that is more than inconsequential will not be prevented or detected by the Association's internal control over financial reporting. We consider the deficiency described in the accompanying Schedule of Findings and Recommendations as item 06-1 to be a significant deficiency in internal control over financial reporting.

### Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* covers three categories of compliance to be tested in audits of relief associations: deposits and investments, conflicts of interest, and relief associations. Our study included all of the listed categories.

In addition, we reviewed for compliance with other statutes, bylaws, and administrative rules that we deemed necessary. This review did not include all possible regulatory provisions which may be applicable and was not intended to provide assurance of full compliance with all regulatory provisions.

The results of our tests indicate that, for the items tested, the Minneapolis Firefighters' Relief Association complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as item 03-1.

The Minneapolis Firefighters' Relief Association's written response to the significant deficiency and legal compliance finding identified in our audit has not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Trustees, management, and others within the Minneapolis Firefighters' Relief Association and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

August 31, 2007

**FINDINGS, CONCLUSIONS AND DETERMINATION  
OF THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION  
RELATING TO OCTOBER 15, 2005 AND OCTOBER 15, 2006 UNIT VALUE**

**FINDINGS**

1. The Minneapolis Firefighters' Relief Association ("MFRA") Board of Trustees is required to administer the pension fund pursuant to the laws governing the MFRA, including specifically the laws to determine pension benefits payable to recipient beneficiaries and salary contribution amounts from active members. See Minn. Stat. Chapters 317A and 423C.
2. The MFRA hereby incorporates by reference findings 1 through 45 from the Findings, Conclusions and Determination of the Minneapolis Firefighters' Relief Association Relating to Unit Values for the Period from October 15, 2002 to October 14, 2005, dated June 2, 2005 (the "2005 Findings").
3. The City of Minneapolis and International Association of Fire Fighters Local 82 ("Local 82") have entered into an agreement for a new collective bargaining agreement for the period of October 15, 2005 to December 31, 2006 ("the CBA"). The CBA has been ratified by Local 82 and has been approved by the City's Executive Committee and the Ways and Means Committee of the City Council. It is expected that the CBA will be ratified by the full City Council on November 17, 2006.
4. The MFRA requested its attorneys, Rice, Michels & Walther, LLP, to examine the terms of the new CBA and relevant personnel data from the Minneapolis Fire Department, calculate unit values based on such data and propose adjustments to the unit value as determined by the 2005 Findings.
5. Records available to the MFRA and its attorneys indicate that: using the "rolling average" method described in the 2005 Findings, eligible top grade firefighters have obtained

payment for an average of 35.28 hours of holiday pay as of the calendar year prior to October 15, 2005. (See Exhibit 1).

6. Records available to the MFRA and its attorneys indicate that: using the “rolling average” method described in the 2005 Findings, eligible top grade firefighters have averaged 10.88 shifts per year working out of grade as Fire Motor Operators and 6.89 shifts per year working out of grade as Captains as of the calendar year prior to October 15, 2005. (See Exhibit 1).

7. The compensation payable under the CBA for out of grade work is the differential between a firefighter’s regular hourly rate and the hourly rate payable if he/she had been permanently promoted to the higher rank. Based on this calculation, the average monthly amount of out of grade compensation as of October 15, 2005, for those top grade firefighters who received work out of grade pay is \$59.39. (See Exhibit 2).

8. The clothing allowance payable to a first grade firefighter for the year prior to October 15, 2005 is \$906.

9. Records available to the MFRA and its attorneys indicate that: using the “rolling average” method described in the 2005 Findings, eligible top grade firefighters have obtained payment for an average of 34.08 hours of holiday pay as of the calendar year prior to October 15, 2006. (See Exhibit 1).

10. Records available to the MFRA and its attorneys indicate that: using the “rolling average” method described in the 2005 Findings, eligible top grade firefighters have averaged 10.39 shifts per year working out of grade as Fire Motor Operators and 7.05 shifts per year working out of grade as Captains as of the calendar year prior to October 15, 2006. (See Exhibits 1).

11. The compensation payable under the CBA for out of grade work is the differential between a firefighter's regular hourly rate and the hourly rate payable if he/she had been permanently promoted to the higher rank. Based on this calculation, the average monthly amount of out of grade compensation as of October 15, 2006, for those top grade firefighters who received work out of grade pay is \$55.16. (See Exhibit 2).

12. The clothing allowance payable to a first grade firefighter for the year prior to October 15, 2006 is \$967.

13. Based on the terms of the new CBA and the aforementioned records available to the MFRA and its attorneys, the attached tables assigning a value for each item of compensation as of October 15, 2005 have been prepared. (See Exhibit 3).

14. Based on the terms of the new CBA and the aforementioned records available to the MFRA and its attorneys, the attached tables assigning a value for each item of compensation as of October 15, 2006 have been prepared. (See Exhibit 4).

15. The MFRA incorporates the attached Exhibits into this report.

16. The MFRA incorporates the prior determinations set forth in the 2005 Findings as to other items of compensation that are included in the calculation of unit value.

17. The Board of Trustees of the MFRA has carefully exercised its fiduciary duties to its members, the City and the State.

18. The Board of Trustees of the MFRA believes that the items of compensation to be included in the definition of salary are reasonable and proper. The Board also believes that the methods and calculations employed in arriving at the amounts to be included in the monthly salary are reasonable and proper, consistent with the methodology described in the 2005 Findings, fair to the members and fair to the City because they have the effect of leveling the

potential for dramatic fluctuations both upward and downward in the elements of compensation that constitute "monthly salary;" particularly in light of the declining number of active top grade firefighters.

## CONCLUSIONS

1. Based on the 1995 Settlement Agreement between the MFRA, the City of Minneapolis and Hennepin County (the "Settlement Agreement"), the MFRA has correctly included Non-FLSA overtime in the calculation of unit value based on 136 hours per year at an hourly rate that is one and one-half the hourly rate of a first grade firefighter inclusive of selection premium pay, longevity and base wages.
2. Based on the Settlement Agreement, the MFRA has correctly included FLSA overtime in the calculation of unit value based on 84.536 hours per year at an hourly rate that is one-half the hourly rate of a first grade firefighter inclusive of selection premium pay, longevity and base wages.
3. Based on the Settlement Agreement, the MFRA has correctly included Sick Leave Credit Pay in the calculation of unit value based on 144 hours per year at an hourly rate that includes selection premium pay, longevity and base wages in the definition of monthly salary.
4. Based on the Settlement Agreement, the MFRA has correctly included selection premium pay in the calculation of unit value based on 109.2 hours bi-weekly at the hourly rate specified in the CBA.
5. Based on the Settlement Agreement the MFRA, the MFRA has correctly included Health Club Membership Dues in the calculation of unit value based on the dues paid by the City.

6. Based on the new CBA and the newly obtained payroll data, the number of hours of holiday pay to be used for determining the October 15, 2005 and October 15, 2006 unit value should be adjusted as set forth in Findings 5 and 9, respectively.

7. Based on the new CBA and the newly obtained payroll data, the monthly amount of out of grade compensation should be adjusted as set forth in Findings 7 and 11, respectively.

8. The tables attached hereto as Exhibits 3 and 4 correctly calculate the unit value payable as of the date specified thereon and correctly reflect the established amounts payable for all other components of compensation pursuant to the CBA and the Settlement Agreement.

9. A copy of these Findings shall be forwarded by certified mail to the President of Local 82, Office of the State Auditor, the Mayor of Minneapolis and the City Finance Officer.

#### **DETERMINATION AS TO UNIT VALUE**

Based on the foregoing, the MFRA Board of Trustees determines:


1. Upon confirmation that the CBA has been ratified by the City Council, the unit value for pension and benefit recipients of the MFRA shall be \$82.61 per unit as of October 15, 2005.
2. Upon confirmation that the CBA has been ratified by the City Council, the unit value for pension and benefit recipients of the MFRA shall be \$82.97 per unit as of October 15, 2006.
3. Upon confirmation that the CBA has been ratified by the City Council, the monthly salary upon which pension contributions by active MFRA members are based shall be \$6,608.50 per month as of October 15, 2005.
4. Upon confirmation that the CBA has been ratified by the City Council, the monthly salary upon which pension contributions by active MFRA members are based shall be \$6,637.39 per month as of October 15, 2006.
5. Upon confirmation that the CBA has been ratified by the City Council, the Executive Secretary shall adjust the benefits payable to members and beneficiaries and the contributions by active members in accordance with the

beneficiaries and the contributions by active members in accordance with the above determinations.

Further, the Executive Secretary will make the necessary calculations for back pay to all benefit recipients and any estate to which a benefit is owed for the period from October 15, 2005 to November 30, 2006. Such adjustments and back pay shall be implemented for checks to be issued on or about December 1, 2006, or as soon thereafter as is possible; and such adjustments as to contributions shall be effective as soon as such data can be implemented by the City's payroll personnel.

Adopted on December 15, 2006

  
\_\_\_\_\_  
MFRA Executive Secretary

  
\_\_\_\_\_  
MFRA President

## ROLLING AVERAGE CALCULATIONS

<b>WORK OUT OF GRADE SHIFTS</b>						
<b>Year</b>	<b>Total FMO Shifts</b>	<b># of FF</b>	<b>Avg. FMO Shifts for Year</b>	<b>Running Total</b>	<b>Running Total of FFs</b>	<b>Running Avg. FMO Shifts</b>
1999	109.00	19	5.74	109.00	19	5.74
2000	266.10	18	14.78	375.10	37	10.14
2001	110.75	9	12.31	485.85	46	10.56
2002	100.20	6	16.70	586.05	52	11.27
2003	26.82	4	6.71	612.87	56	10.94
2004	18.00	2	9.00	630.87	58	10.88
2005	13.00	4	3.25	643.87	62	10.39

<b>Year</b>	<b>Total Capt Shifts</b>	<b># of FF</b>	<b>Avg. Capt Shifts for Year</b>	<b>Running Total</b>	<b>Running Total of FFs</b>	<b>Running Avg. Capt Shifts</b>
1999	85.00	19	4.47	85.00	19	4.47
2000	134.95	18	7.50	219.95	37	5.94
2001	69.77	9	7.75	289.72	46	6.30
2002	57.00	6	9.50	346.72	52	6.67
2003	31.64	4	7.91	378.37	56	6.76
2004	21.00	2	10.50	399.37	58	6.89
2005	45.00	5	9.00	444.37	63	7.05

<b>HOLIDAY SHIFTS</b>						
<b>Year</b>	<b>Total Holidays</b>	<b># of FF</b>	<b>Avg. Holidays</b>	<b>Running Total</b>	<b>Running Total of FFs</b>	<b>Running Avg. Holidays</b>
1999	11.00	8	1.38	11.00	8	1.38
2000	11.56	7	1.65	22.56	15	1.50
2001	-	0		22.56	15	1.50
2002	1.00	1	1.00	23.56	16	1.47
2003	-	0		23.56	16	1.47
2004	-	0		23.56	16	1.47
2005	2	2	1.00	25.56	18	1.42

# MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION

## SUMMARY OF WORK OUT OF GRADE COMPENSATION

### FOR UNIT VALUES EFFECTIVE OCTOBER 15, 2005 AND OCTOBER 15, 2006

	15-Oct-05	Bi-Weekly	Hourly	Hourly Differential	Daily Differential	Daily Differential	Rolling Average	Rolling Annual Compensation	Monthly Compensation	Monthly	Unit
FF	2204	20.91									
FMO	2480	22.64	1.73	41.57	10.88	452.13	37.68	0.4710			
Capt	2463	22.48	1.58	37.84	6.89	260.57	21.71	0.2714			
		21.74				712.70	59.39	0.74			
						TOTAL					

	15-Oct-06	Bi-Weekly	Hourly	Hourly Differential	Daily Differential	Daily Differential	Rolling Average	Rolling Annual Compensation	Monthly Compensation	Monthly	Unit
FF	2214	21.00									
FMO	2480	22.64	1.64	39.47	10.39	409.86	34.16	0.4269			
Capt	2463	22.48	1.49	35.74	7.05	252.11	21.01	0.2626			
						661.97	55.16	0.69			
						TOTAL					

# MINNEAPOLIS FIRE RELIEF ASSOCIATION

## CALCULATION OF PER UNIT VALUE

Effective October 15, 2005

	Annual	Bi-Weekly	Hourly Rate	Monthly	Per Unit	Increase
Base Wages	57524.40	2204.00	20.18	4793.70	59.9213	1.85%
Selection Premium	2072.23	79.40	0.73	172.69	2.1586	1.83%
Clothing & Equipment	906.00	34.71		75.50	0.9438	0.00%
Longevity	7077.36	271.16	2.48	589.78	7.3722	1.83%
Health Club Dues	343.63	13.17		28.64	0.3579	0.00%
Sick Leave Buy Back	3368.79	129.07	23.39	280.73	3.5092	1.78%
Vacation Cash Out	1122.93	43.02	23.39	93.58	1.1697	1.78%
FLSA Overtime	988.83	37.89	11.70	82.40	1.0300	1.91%
Overtime	4772.45	182.85	35.09	397.70	4.9713	1.78%
Work Out of Grade	712.70	27.31		59.39	0.7424	29.67%
Holiday Pay	412.68	15.81	11.70	34.39	0.4299	1.78%
<b>TOTAL</b>	<b>79301.98</b>	<b>3038.39</b>		<b>6608.50</b>	<b>82.6062</b>	<b>2.01%</b>

AMENDED  
EXHIBIT 3

# MINNEAPOLIS FIRE RELIEF ASSOCIATION

## CALCULATION OF PER UNIT VALUE

Effective October 15, 2006

	Annual	Bi-Weekly	Hourly Rate	Monthly	Per Unit	Increase
Base Wages	57785.40	2214.00	20.28	4815.45	60.1931	0.45%
Selection Premium	2081.55	79.75	0.73	173.46	2.1683	0.45%
Clothing & Equipment	967.00	37.05		80.58	1.0073	6.73%
Longevity	7109.20	272.38	2.49	592.43	7.4054	0.45%
Health Club Dues	343.63	13.17		28.64	0.3579	0.00%
Sick Leave Buy Back	3384.05	129.66	23.50	282.00	3.5251	0.45%
Vacation Cash Out	1128.02	43.22	23.50	94.00	1.1750	0.45%
FLSA Overtime	993.31	38.06	11.75	82.78	1.0347	0.45%
Overtime	4794.08	183.68	35.25	399.51	4.9938	0.45%
Work Out of Grade	661.97	25.36		55.16	0.6896	-7.12%
Holiday Pay	400.45	15.34	11.75	33.37	0.4171	-2.96%
<b>TOTAL</b>	<b>79648.66</b>	<b>3051.67</b>		<b>6637.39</b>	<b>82.9674</b>	<b>0.44%</b>

AMENDED  
EXHIBIT 4