City of Pontiac
Police and Fire Retiree Prefunded Group Health and Insurance Trust

Financial Report

with Supplemental Information

December 31, 2011

plante moran

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Contents

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Independent Auditor's Report

To the Board of Trustees
City of Pontiac Police and Fire Retiree Prefunded
Group Health and Insurance Trust

We have audited the accompanying statement of trust net assets of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (a component unit of the City of Pontiac, Michigan) (the "Trust") as of December 31, 2011 and the related statement of changes in trust net assets for the year then ended. These financial statements are the responsibility of the board of trustees of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust as of December 31, 2011 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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

Plante & Moran, PLLC

September 20, 2012

Using this Annual Report

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

Condensed Financial Information

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

	Fiscal Year Ended	
	December 31, 2011	December 31, 2010
Total assets	$ 28,208,268	$ 34,292,801
Total liabilities	938,272	3,508,142
Net trust assets	**$ 27,269,996**	**$ 30,784,659**
Net investment (loss) gain	$ (377,111)	$ 4,813,711
Contributions - Employer	-	1,671,578
Contributions - Employee	35,875	10,423
Retiree health benefits paid	(3,129,737)	(2,385,475)
Benefits paid in excess of contributions	(3,093,862)	(703,474)
Ratio of contributions to benefits paid	1.1%	70.5%
General and administrative expenses	(43,690)	(28,040)
Net (decrease) increase in trust net assets	**$ (3,514,663)**	**$ 4,082,197**

Overall Fund Structure and Objectives

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") exists to pay healthcare benefits to members retiring on or after August 22, 1996. Benefits currently being paid are significantly less than contributions currently being received. The excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

Asset Allocation

The Trust has established asset allocation policies, which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Trust. The following is a summary of the asset allocation as of December 31, 2011:

Domestic equities	51%
Domestic fixed income	28%
Mutual funds and cash equivalents	19%
International equities	2%

Investment Results

The sovereign debt crisis in Europe and disappointing economic growth globally dominated the capital markets during 2011. Central banks maintained very accommodative policies and interest rates tended to decline around the world. Core inflation in the U.S. was near long-term targets at 3.0 percent while commodity prices tended to fall. The decline in interest rates drove the fixed-income markets higher; the Barclays U.S. Aggregate returned 7.8 percent for the year. The equities markets were volatile. After posting nice gains in the first quarter, stocks suffered a significant sell-off over the summer; a recovery late in the year helped offset those losses. The Standard & Poor's 500 rose 2.1 percent, the Russell 2000 Index (a proxy for U.S. small cap stocks) declined 4.2 percent, and the MCSI EAFE Index (a proxy for international stocks) dropped 12.1 percent. The total Trust gained 0.21 percent for the year ended December 31, 2011 (measured using the time weighted return on each component of the total Fund).

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

Plan Contributions

Given the financial condition of the plan sponsor (discussed at length in Note 1), contributions were not made into the Plan during the both the current and prior years and thus have not been reflected in the financial statements. It is unknown at this time whether these contributions as well as contribution requirements for future years will be forthcoming.

City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Statement of Trust Net Assets
December 31, 2011

Assets	
Cash	$ 51,714
Investments at fair value (Note 2):	
Fixed income	8,038,515
Equity mutual fund	4,181,379
Equities	14,667,744
Private equities	1,268,916
Total investments	28,156,554
Total assets	28,208,268
Liabilities	
Due to City of Pontiac	778,142
Due to City of Pontiac Police and Fire Retirement System	119,443
Accounts payable	40,687
Total liabilities	938,272
Trust Net Assets	**$ 27,269,996**

The Notes to Financial Statements are an Integral Part of this Statement.

City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Statement of Changes in Trust Net Assets
Year Ended December 31, 2011

Additions	
Employee contributions	$ 35,875
Investment income (loss):	
Interest and dividend income	765,625
Net decrease in fair value of investments	(1,044,683)
Investment advisor fees	(98,053)
Net investment loss	(377,111)
Total additions - Net	(341,236)
Deductions	
Retirees' health benefits	(3,129,737)
Other expenses	(43,690)
Total deductions	(3,173,427)
Net Decrease in Trust Net Assets	(3,514,663)
Trust Net Assets - January 1, 2011	30,784,659
Trust Net Assets - December 31, 2011	**$ 27,269,996**

The Notes to Financial Statements are an Integral Part of this Statement.

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") has established an irrevocable prefunded group health and insurance trust fund for health, optical, dental, and life insurance benefits for retirees who are members of the Police and Fire Retirement System of the City of Pontiac and who retired on or after August 22, 1996. All such benefits are paid out of the Trust. City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The Police and Fire Retirement System (the "Retirement System") performs the Trust's accounting function.

Reporting Entity - The Trust is a component unit of the City of Pontiac, Michigan. The Trust does not hold securities of or make formal loans to the City.

Plan Sponsor Financial Condition - The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently operating under Michigan Public Act 4 of 2011. The result is that the State has appointed an emergency manager to control the finances of the City. Uncertainty exists regarding the City's ability to continue to make contributions to the Pension and Healthcare Trust Plans. Contributions that were scheduled to be made to the plan for the years ended December 31, 2011 and 2010 in the amount of $2,635,156 and $2,104,382, respectively, were not remitted to the plan by the City.

During 2011, as a result of the City not making the 2010 contributions, the Trust filed and won a lawsuit against the plan sponsor to demand a judgment levy be placed on the tax roll in order to satisfy these outstanding contributions. Subsequently, an injunction was then filed to cease the tax collection process; the taxes collected under this judgment levy, which were previously held in escrow by the City, have now been refunded to the taxpayers. As the legal proceedings are still pending, with significant uncertainty existing as to the anticipated outcome (and thus ultimate collectibility of these contributions), the contributions for 2011 and 2010 have not been reflected in the Trust's 2011 or 2010 financial statements. As a result, we have reported the funded status of the plan using the actuary's 5 percent alternate investment return assumption as opposed to the 7.5 percent assumption that was used for disclosure purposes for the year ended December 31, 2009.

Note 1 - Summary of Significant Accounting Policies (Continued)

Basis of Accounting - The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Insurance costs are recognized when due and payable in accordance with the terms of the Trust.

Investments - Investments are reported at fair value. Money market funds and mutual fund investments are valued at net asset value. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded as earned on an accrual basis. In accordance with the policy of stating investments at fair value, net unrealized appreciation or depreciation for the year is reflected in the statement of changes in trust net assets.

Federal Income Taxes - The Trust is exempt from income tax under Section 501(a).

Note 2 - Investments

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

A retiree healthcare fund is also authorized by Michigan Public Act 314 of 1965 (the "Act"), as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

Note 2 - Investments (Continued)

The Trust has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in mutual or commingled funds, but not the remainder of state statutory authority as listed above. The Trust's deposits and investment policies are in accordance with statutory authority.

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

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Trust's investment policy does not restrict investment maturities. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
Corporate:		
Asset-backed	$ 320,748	9.84 years
Bonds	2,370,661	5.82 years
Collateralized mortgage obligations	704,184	31.44 years
Foreign bonds	247,404	6.35 years
U.S. government:		
Agency	65,354	7.78 years
Mortgage-backed	3,268,826	28.47 years
Treasuries, notes, and bonds	832,607	.96 years

Note 2 - Investments (Continued)

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Trust has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Corporate:			
Asset-backed	$ 254,506	AAA	S&P
Asset-backed	30,352	A	S&P
Asset-backed	35,889	Not rated	N/A
Bonds	52,184	AA	S&P
Bonds	740,614	A	S&P
Bonds	1,499,424	BBB	S&P
Bonds	78,440	BB	S&P
Collateralized mortgage obligations	78,773	AAA	S&P
Collateralized mortgage obligations	254,830	A	S&P
Collateralized mortgage obligations	75,204	BBB	S&P
Collateralized mortgage obligations	295,377	Not rated	N/A
Foreign bonds	74,869	A	S&P
Foreign bonds	172,536	BBB	S&P
U.S. government:			
Agency	65,354	A	S&P
Mortgage-backed	3,268,826	Not rated	N/A
Treasuries, notes, and bonds	832,607	Not rated	N/A

Note 2 - Investments (Continued)

Foreign Currency Risk

Foreign currency risk is the risk that an investment denominated in the currency of a foreign country could reduce its U.S. dollar value as a result of changes in foreign currency exchange rates. The Trust places no limit on the amount of international stock funds. The following securities contained within the international stock fund are subject to foreign currency risk:

	Fair Market Value
European euro	$ 1,793,809
Japanese yen	589,574
British pound	761,010
Latin American peso	255,064
Other	531,034

Note 3 - Trust Contribution Information

The Trust is primarily funded by employer contributions. The trustees voted to implement funding at the actuarial recommended rate beginning July 1, 2006. Effective July 1, 2010, employees in one of the three bargaining units covered by this Trust are required to contribute 1.0 percent of covered wages; however, the other two bargaining units along with the covered nonunion members continue to have no employee contribution requirements. Employer contributions to the Trust for the City's fiscal year ended June 30, 2011 were determined as part of the December 31, 2009 actuarial valuation, which recommended an employer contribution of 42.06 percent of police and fire wages. However, scheduled contributions after July 1, 2010 and continuing through 2011 were not paid to the Trust by the City. See Note 1 for the status of outstanding contributions due to the Trust in light of the City's financial condition.

Note 4 - Trustees

Two trustees of City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust as of December 31, 2011 were elected by the membership, two sit by virtue of their position, and one is appointed by the other trustees.

Note 5 - Membership Data

At March 1, 2012, the date of the most recent actuarial valuation, membership data consisted of the following:

Retirees and beneficiaries currently receiving benefits	231
Terminated employees entitled to benefits, but not yet receiving them	161
Current employees:	
Fully vested	-
Nonvested	-
Total current employees *	-

* As of March 1, 2012, there were no active employees

During 2011, a partial termination of the Pension Plan for Police and Fire Employees was deemed to have occurred. This resulted from the termination of various active employee positions at the City under executive orders issued by the emergency manager. The impact of membership composition is reflected above, with the impact of the funded status of the healthcare trust being demonstrated in Note 6 below.

In addition, effective March 1, 2012, the remaining fire employees ceased to be employees of the City. As such, the plan is effectively closed for active or new participants.

Note 6 - Postemployment Benefits

Plan Description - The City provides retiree healthcare benefits to eligible employees and their spouses through the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust. This is a single-employer benefit plan administered by the City of Pontiac Police and Fire Retirement System.

The plan's financial statements are also included in the City of Pontiac's financial report and can be obtained by writing to 47450 Woodward Ave., Pontiac, MI 48342.

Note 6 - Postemployment Benefits (Continued)

Funding Policy - The City is required by ordinance to contribute on a percentage of covered payroll which the trustees have deemed to be based on actuarial recommended amounts. During the City's fiscal year ended June 30, 2011, the City did not make any contributions into the Trust, which is reported in the City's financial statements as a pension and other employee benefit trust fund. The City has not yet made the minimum contribution to the Trust of $2,635,156 for the plan period ended December 31, 2011; however, the City anticipates that this payment will be forthcoming and thus the Trust has reflected these contributions in the current year financial statements.

Plan Changes - Subsequent to year end, an executive order modifying the terms of health care insurance for all retirees that are eligible and currently receiving these benefits was issued by the City's emergency manager pursuant to the provisions of Public Act 152 of 2011 (PA 152). The executive order includes various plan changes, the most significant being that pre-age 65 retirees pay, by deduction from their pension checks, the amount above the "hard-cap" (as defined by PA 152), or 20 percent of the annual rates, whichever is higher, to be effective July 1, 2012.

The funding progress of the plan as of March 1, 2012 (the most recent valuation date, based on the 5 percent alternate investment return assumption, and as revised for the impact of PA 152) is as follows:

Actuarial value of assets	$ 29,667,807
Actuarial accrued liability (AAL)	$ 137,140,392
Unfunded AAL (UAAL)	$ 107,472,585
Funded ratio	21.63%
Annual covered payroll	$ -
Ratio of UAAL to covered payroll	n/a

Actuarial Methods and Assumptions - Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend.

Note 6 - Postemployment Benefits (Continued)

Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The required schedule of funding progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the March 1, 2012 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5 percent investment rate of return as well as an alternate 5 percent investment rate of return compounded annually (net of administrative expenses). The financial statements reflect the use of the alternate 5 percent investment rate of return. The valuation also included a 10 percent medical care inflation rate assumption related to healthcare cost increases in the first year, decreasing in increments of 0.5 percent over the next 12 years to the ultimate 4 percent assumption. The actuarial value of assets is set to equal actuarial accrued value as of December 31, 2011. The UAAL is being amortized as a level dollar of projected payroll on closed basis. The remaining amortization period at March 1, 2012 was 30 years.

Required Supplemental Information

City of Pontiac
Police and Fire Retiree Prefunded Group Health and Insurance Trust

Required Supplemental Information
Schedule of Analysis of Funding Progress

Actuarial Valuation Date *	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/06	$ 25,534,993	$ 79,788,465	$ 54,253,472	32.0%	$ 12,831,719	422.81%
12/31/07	30,185,216	73,171,572	42,986,356	41.3%	11,066,828	388.43%
12/31/08	31,405,001	113,221,193	81,816,192	27.7%	9,749,807	839.16%
12/31/09	32,313,276	125,406,797	93,093,521	25.8%	7,405,796	1,257.04%
12/31/10	34,821,105	115,446,247	80,625,142	30.2%	6,667,866	1,209.16%
3/1/12 **	29,667,807	137,140,392	107,472,585	21.6%	-	N/A

* Beginning with the 12/31/08 valuation and thereafter, actuarial valuation information was derived from the actuary's 5 percent alternate return assumption.

** Outstanding contributions related to 2010 and 2011 that were not remitted by the plan sponsor were removed from the asset value in the 3/1/12 valuation

City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Required Supplemental Information
Schedule of Employer Contributions

Year Ended June 30	Annual Required Contribution	Amount Contributed *
2009	$ 5,594,865	$ 2,678,324
2010	4,553,185	3,158,681
2011	3,915,371	-

* GASB Statement No. 45 was adopted by the City for the City's fiscal year ended June 30, 2009. As such, the amount contributed corresponds to the City's fiscal year end (pursuant to GASB Statement No. 45) as opposed to the plan's calendar year end.