

called the full actuary rate. As of June 30, 2003, the valuation year used to compute the annually required contribution, there were 18 years remaining in the amortization period. As discussed above, the 30 year closed amortization period was restarted in fiscal year 2005 pursuant to the Gleason Settlement. Beginning with the valuation dated June 30, 2007, the normal cost and UAAL amortization cost will be determined using the Entry Age Normal actuarial method, the result of which will cause the UAAL to increase in fiscal year 2009.

The following table shows the City's annual pension cost ("APC") and the percentage of APC contributed for the fiscal year ended June 30, 2005 and two preceding years (in thousands):

| Fiscal Year Ended June 30 | APC | Percentage Contributed | Net Pension Obligation |
|------------------------------|-----------|---------------------------|------------------------|
| 2003 | \$ 90,454 | 64.84% | \$ 163,050 |
| 2004 | 138,488 | 49.83% | 232,536 |
| 2005 | 179,743 | 67.92% | 290,190 |

Net Pension Obligation

Net Pension Obligation (NPO) is the cumulative difference, since the effective date of GASB 27 (fiscal year 1998), between the annual pension cost and the employer's contributions to the Plan. This includes the pension liability at transition (beginning pension liability) and excludes short term differences and unpaid contributions that have been converted to pension-related debt. As of June 30, 2005, the City's NPO is approximately \$290,000 and is reported in accordance with GASB 27. See table above.

The change to NPO is derived by first calculating the City's Annual Required Contribution ("ARC"). The ARC is calculated by actuarially determining the cost of pension benefits accrued during the year (normal cost) and adding to that the annual amount needed to amortize the UAAL (amortization cost) as reported by the actuary, in accordance with the amortization period and method selected. The ARC is then increased by interest accruing on any outstanding NPO (NPO Interest) and then reduced by the amortization of the UAAL that is related to the NPO (ARC Adjustment).

The following shows the calculation for NPO based on the actuarial information provided to the City (in thousands):

| | |
|---|--------------------------|
| ARC [Fiscal Year 2005] | \$ 181,284 |
| Contributions Adjusted for Health Expenses [Fiscal Year 2005] | (122,089) |
| Interest on NPO | 18,604 |
| ARC Adjustment | (20,145) |
| Change in NPO | <u>57,654</u> |
| NPO Beginning of Year [Fiscal Year 2004] | 232,536 |
| NPO End of Year [Fiscal Year 2005] | <u><u>\$ 290,190</u></u> |

NPO Components related to Retiree Health

The City's annual contribution to SDCERS pension trust fund, for the fiscal years ended June 30, 2005, 2004, and 2003, included amounts that were contributed to the 401(h) Fund for healthcare benefits and are reported net of this contribution. Annual realized earnings, as determined by the SDMC Sections 24.1501 and 24.1502, in the pension trust fund were withdrawn and used to offset the portion of the City's contribution that went to healthcare benefits instead of being retained in the pension trust fund. This funding mechanism is an alleged violation of the Internal Revenue Code (IRC) Section 401(a). SDCERS hired counsel to make a filing to the IRS to correct this