Reading, Pennsylvania
Bill No. 20 of 2014


WHEREAS, upon the petition duly filed with the Commonwealth of Pennsylvania, Department of Community and Economic Development (hereinafter “Department”) pursuant to the Municipalities Financial Recovery Act, Act 47 of 1987 (hereinafter “Act”), the City of Reading was declared a financially distressed municipality on November 12, 2009; and

WHEREAS, the Act provides that a Plan Coordinator be appointed for distressed municipalities and that a Recovery Plan be prepared by the Coordinator; and

WHEREAS, Public Financial Management was appointed as the Plan Coordinator (hereinafter “Coordinator”) on December 7, 2009; and

WHEREAS, the Coordinator prepared in accordance with the Act the Original Recovery Plan, which was adopted by Bill 26-2010 on June 11, 2011; and

WHEREAS, the Coordinator prepared an amendment to the Original Recovery Plan in accordance with the Act and submitted the amendment to the City Clerk on October 27, 2014; and

WHEREAS, the Council of the City of Reading has determined that it is in the City’s best interest to adopt the Amended Recovery Plan at this time.

NOW THEREFORE, be it ordained and enacted by the City of Reading, and it is hereby ordained and enacted by authority of the same as follows:

SECTION 1. The Council of the City of Reading hereby adopts the amendment to the Recovery Plan for the City of Reading as prepared and submitted by the Coordinator on October 27, 2014, including subsequent amendments thereto, if any, pursuant to the Act, as amended. The Council of the City of Reading hereby approves the implementation of the amendment to the Recovery Plan for the City of Reading as
prepared and submitted by the Coordinator on October 27, 2014, including subsequent amendments thereto, if any, pursuant to the Act.

SECTION 2. The City Clerk and City Solicitor are hereby authorized and instructed to prepare for adoption any necessary related ordinances, resolutions, agreements and other documents and revisions to ordinances, resolutions, agreements and other documents necessary to implement the Recovery Plan.

SECTION 3. Council President and the Mayor and other appropriate City officials are authorized and instructed to execute any and all documents necessary to implement the Recovery Plan.

SECTION 4. In the event that any provisions, section, sentence, clause or part of this Ordinance shall be held invalid, such invalidity shall not affect or impair any remaining provision, section, sentence, clause or part of this Ordinance, and the remaining provisions shall remain in full force and effect.

SECTION 5. All Ordinances or parts of Ordinances not in accord with this ordinance are hereby repealed insofar as they conflict hereby.

SECTION 6. This ordinance shall be effective ten (10) days after its adoption and approval by the Mayor, or repassage by City Council over the Mayor’s veto, in accordance with Section 219 of the City of Reading Home Rule Charter, or as set forth in Section 221 of the City of Reading Home Rule Charter.

ORDAINED AND ENACTED into a law by Council on October 27, 2014.

Francis J. Borsa, President of Council

Attest: Linda Kelleher City Clerk
Submitted to Mayor: 11/8/14
Date: 11/8/14
Received by the Mayor’s Office: 11/11/14
Date: 11/12/14
Approved by Mayor: 11/12/14
Date: 11/12/14
Vetoed by Mayor: 11/12/14
Date: 11/12/14

I, LINDA A. KELLEHER, City Clerk of the City of Reading, Pa., do hereby certify that the foregoing is a true and correct copy of the original ordinance passed by the Council of the City of Reading on the 24th day of November, A.D. 2014, Witness my hand and seal of the said City this 24th day of November, A.D. 2014.

CITY CLERK
Municipalities Financial Recovery Act

Amended Recovery Plan

City of Reading
Berks County, Pennsylvania

Prepared on behalf of the

Commonwealth of Pennsylvania
Department of Community and Economic Development
Governor's Center for Local Government Services

As Revised and Filed with the City Clerk on November 21, 2014

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Executive Summary

In the months leading up to the release of this Amended Recovery Plan, there has been much discussion about the magnitude and persistence of City of Reading’s financial challenges. Like the original Recovery Plan, this Amended Plan projects that the City will have annual operating deficits as soon as 2015 unless it takes corrective action to prevent them.

As serious as these financial challenges are, they do not cancel out the progress that Reading has made since it entered Commonwealth oversight five years ago. City government has broken the string of consecutive years with annual operating deficits and built a cash reserve while also improving its day-to-day financial management. The City has finished each of the last three years with its annual revenues balanced against its annual expenditures, or very close to being so, and the Coordinator is optimistic that trend will continue in 2014.

Unfortunately two major factors change the City’s financial trajectory starting in 2015. The recent amendment to the Act 47 statute sets a firmer date for the City to leave this form of oversight and hastens reductions in the earned income tax, leaving the City with less money from this source to fund day-to-day operations. Continual growth in the cost of employee pensions and retired employee health insurance pushes the City’s spending higher, even as its spending on active employee compensation remains level. These two trends, coupled with ongoing erosion in the City’s real estate tax base and the resumption of annual salary increases, push the City’s finances out of balance again.

The Amended Recovery Plan presents a strategy for keeping the City’s finances balanced using the limited tools that are solely within City government’s discretion. It describes preferred alternatives for meeting the same objectives in a way that is less burdensome to taxpayers and current employees, and gives the City’s elected and appointed leaders and employees flexibility to manage toward that end. It provides more funding for the basic improvements to streets, bridges and other core infrastructure that are essential to the financial stability, quality of life and economic vibrancy of any city, regardless of its Act 47 status. And it sharpens the City’s focus on the improvements in management and service delivery that are necessary for the City to successfully exit Act 47 oversight.

Progress since 2010

While the challenges that Reading City government faces remain significant, so has been its progress since entering Act 47 oversight in late 2009.

In November 2009, the Secretary of the Pennsylvania Department of Community and Economic Development (DCED) approved Mayor Thomas McMahon’s petition for the City to be designated as financially distressed according to the criteria listed in Act 47. The Department’s evaluation found Reading’s “pattern of operating deficits [was] unsustainable and if left unabated [would] force the city to significantly reduce or eliminate fundamental services that may adversely affect the health, safety, welfare, and quality of life of the citizens.”

After the Secretary appointed Public Financial Management (PFM) as the City’s Recovery Coordinator, PFM and its partners undertook their own review of the City’s finances. That review confirmed that Reading’s financial problems were real, severe and, if not addressed, would threaten the solvency of City government. The City had a recurring and growing operating deficit, meaning the City was repeatedly spending more money in its major operating fund than it was collecting. The deficit was even larger than apparent in the City’s financial reports because of the City’s reliance on one-time and short-term measures to temporarily address the recurring deficit.

In June 2010 Reading City Council approved and Mayor McMahon signed the original Recovery Plan that was aptly described at the time as strong medicine for an extremely sick patient. The original Recovery Plan required sacrifice from residents in the form of higher real estate and earned income taxes. It required sacrifice from commuters who started paying an earned income tax to the City of Reading to help fund the services they rely upon during the workday. It required sacrifice from active employees in
the form of wage freezes, higher contributions to the cost of their health insurance and reductions in paid holidays. It required sacrifice from new employees who did not work for the City when the Plan was adopted, but have since joined its workforce with lower starting salaries and a more affordable set of retirement benefits.

By implementing the original Recovery Plan and taking other actions, City government broke its string of years with operating deficits and started to gain financial stability. The City went from having a cash deficit in its primary operating fund to having a cash reserve that helped it gain a credit rating upgrade and provides a buffer against unexpected shortfalls. The graph below shows how the City's cash reserves dropped before entering Act 47 and have since rebounded.

**General Fund Cash and Cash Equivalents**
Reading City government has also distanced itself from the mistakes that contributed to its entry into Act 47 oversight. Reading retired the past due contributions to the employee pension plans and has made the annual contributions on time each year since 2010. It repaid the multi-million dollar loan from the Sewer Fund that the City took to sustain operations in 2009. After using an unfunded debt loan at the end of 2010 to sustain operations that year, it has avoided borrowing money to fund basic operations.

The City was able to repay a portion of that loan ahead of schedule. And it has implemented the types of basic financial management tools—cash flow monitoring, budget-to-actual quarterly reports, regular monitoring of position vacancies—that give the City's elected and appointed leaders, residents, credit holders and other stakeholders timely, accurate information on City government's financial condition. It is important to acknowledge the substantial contributions that several parties have made to help City government achieve this progress. Those contributions and others are discussed throughout the Recovery Plan chapters.

It is also important not to overstate this progress. True, full financial recovery for City government means more than reversing the trend of operating deficits and building a cash reserve, though those are requisite parts of financial recovery. True, full financial recovery involves bringing the growth in all expenditures, including the City's obligations for employee pensions and retiree health insurance, into balance with recurring revenues. It involves stabilizing, or even lowering, the tax rates so the City can better attract and retain residents and businesses. It involves having a stable source of funding for resurfacing streets, remediating bridges, repairing dams and renovating municipal government buildings.

In this Amended Recovery Plan, the Coordinator has kept these objectives and the ultimate goal of achieving true, full financial recovery in sight. The Plan has initiatives that will help the City make progress toward these objectives, while still addressing the substantial financial challenges that the City faces in the immediate term.

**Projected deficits: What changed?**
As required under Act 47, the Amended Recovery Plan process begins with a baseline projection of the City's revenues and expenditures in its General Fund, assuming no corrective action is taken or significant external events occur. That baseline projection is shown below.

The projection process, which is described in detail in the Introduction, began with the version of the 2015 budget that Mayor Vaughn Spencer introduced to Council on September 30, 2014. That budget relied on two non-recurring sources of revenue to temporarily bridge next year's deficit. The budget anticipated that the Reading Parking Authority (RPA) would increase its annual contribution to the City from $1.8 million to $6.3 million for one year. The budget also drew down some of the City's reserves to cover its expenditures. In the Amended Recovery Plan baseline scenario, the City would continue to draw down those hard-earned reserves until it exhausts them in 2017 and then falls back into a cumulative deficit in subsequent years.

This projection is striking in its contrast to the previous description of the City's progress. There are several factors that contribute to the reversal, but two have the largest impact.
Major Revenue Factor: Earned income tax rate reduction

Like many other Pennsylvania municipalities, the City of Reading taxes the earned income of its residents. When the City entered Act 47 oversight in 2010, the resident earned income tax (EIT) was 1.7 percent. The Reading School District levied another 1.5 percent, bringing the total resident EIT to 3.2 percent. The original Recovery Plan added 0.4 percent to the City's levy, taking the City EIT to 2.1 percent and the total resident EIT to 3.5 percent where it remains in 2014.

The original Recovery Plan also authorized the City to seek an additional 0.3 percent EIT on commuters who work in Reading. Since many Pennsylvania municipalities levy a 1.0 percent EIT on their own residents, many Reading commuters now pay a total EIT of 1.3 percent - 1.0 percent to their home municipality and 0.3 percent to the City of Reading. Under the terms of Act 47, the City can only levy the commuter EIT if the adopted Recovery Plan authorizes the City to petition the Berks County Court of Common Pleas to do so. City officials then must file an annual petition with the Court and testify in court that the City needs the commuter tax to balance its budget.

The combination of the higher resident tax rate, new commuter tax and better collection process has boosted EIT levels far beyond what they were when the City entered Act 47. The City budgeted $11.8 million in EIT for 2010, the last year before these changes started to take effect. In 2013 EIT revenues surpassed $19 million and this year the EIT could become Reading's largest source of revenue, even larger than the real estate tax.

While the higher EIT revenues have helped City government stabilize its finances, the City must reduce the commuter EIT rate from 1.3 percent to 1.0 percent to exit Act 47 oversight. Nearly all of the revenue from that 1.0 percent commuter tax will return to the person's home municipality. In 2013 the commuter EIT generated $2.6 million but, absent the additional taxing authority provided under Act 47, it would have only generated $120,000.

Shortly before this Plan was released, the Pennsylvania General Assembly passed an amendment to Act 47 that sets a firmer deadline for the City to reduce its commuter tax rate. The City will have to reduce make the reduction by 2019 to meet the statutory deadline for exiting Act 47. As a Home Rule municipality, Reading does not need to reduce its resident EIT to exit Act 47. However, for economic competitiveness and equity reasons, the City's elected leaders do not want to leave the resident rate at 3.6 percent, which is the second highest resident rate in the Commonwealth behind Philadelphia.

The Amended Recovery Plan baseline projection assumes the City will reduce its commuter EIT rate to 1.0 percent and the resident EIT rate to 3.3 percent by 2018, giving the City one year to show it can balance recurring revenues against recurring expenditures before its Act 47 status expires at the end of 2019. Those rate reductions turn the EIT from a source of revenue growth to a source of revenue reduction.

Earned Income Tax, 2011 - 2019 ($Millions)

Major expenditure factor: Rising costs for retired employee obligations

Commonwealth law requires Pennsylvania municipalities to make annual contributions to their employee pension plans to ensure that sufficient money is available when current and future pension recipients retire. The annual contributions are referred to as the minimum municipal obligation (MMO). The MMO is determined by actuarial calculations and results in a net annual contribution by City government after Commonwealth pension aid, investment earnings, and employee contributions have been taken into account.

The City's required pension contribution from its General Fund has doubled from $6.6 million in 2011 to $13.2 million in 2015. The largest part of that contribution funds the pension benefits of retired and current police officers, and that contribution has grown at a faster rate than the City's contribution for other employees. Before the City entered Act 47 oversight, it agreed to an extremely costly set of changes to the police pension plan that allow police officers to retire at a younger age and with a higher
annual payout than authorized in the Commonwealth's Third Class City Code. The Workforce and Retiree Benefits chapters discuss these and other cost growth factors in more detail, but the chart below shows how the City's required pension contribution have grown in recent years.

MMOs will change. Those projections show the MMO staying at the 2015 level with more incremental growth through 2019 instead of the large biennial jumps shown in the chart above. But the actuary also notes that its projections are based on a specific set of assumptions about when employees will retire, what their pensionable income will be, how much the City will gain in investment earnings, etc. Any negative variance from these assumptions – like more employees retiring earlier than assumed or lower interest earnings than assumed – will push the City's required pension contributions even higher. It would not be unusual for the City to have this kind of "experience loss," as reality diverges from the actuarial assumptions. The police plan alone had $15.8 million in experience loss between the 2011 and 2013 valuations.

The City also has a large, unfunded liability for retired employee health insurance. The City provides health care to retired employees and their spouses until they are eligible for Medicare. Many retirees contribute little toward the cost of coverage, other than payments they make when they receive service. The most recent valuation report for this liability indicates it has tripled in only four years.

There are other trends that contribute to the baseline deficit projection. The City's real estate tax base continues to erode, as discussed in the Revenue chapter. The wage freezes enacted under the original Recovery Plan have expired or will soon, so salary costs will start to rise. In 2015 the City will exhaust the large federal grant that supported 21 additional firefighter positions but the City may not drop back down to the pre-grant staffing level for a couple years.

Furthermore the City faces financial challenges that are not as easily quantifiable. The original Recovery Plan was so narrowly balanced that it left no room for capital investments. It is reasonable for cities in severe financial distress to temporarily give capital investments a lower priority until they have solidified their ability to fund day-to-day operations and make scheduled debt payments for prior years' investments.

However, this is not a sustainable long-term strategy as illustrated by recent events. The Pennsylvania Department of Environmental Protection required the City to make repairs to three of its dams, and a retaining wall of the iconic Pagoda on Mount Penn was found to have deteriorated to the point of needing emergency repairs. Unless the City finds a recurring funding source to repave its streets, remediate its bridges and repair its buildings, these types of emergencies will become more common.

Amended Recovery Plan approach: Unpleasant Initiatives, but with options
Under the terms of Act 47, only the Coordinator can write an Amended Recovery Plan after the City adopts the Coordinator's original Recovery Plan. And, as with the original Recovery Plan, this Amended Plan must be adopted by City Council and signed by the Mayor. So the Coordinator has met with the Administration, City Council and elected City Auditor multiple times in the months leading up to the Recovery Plan's release. Outside of the Plan amendment process, those parties convene in biweekly meetings to discuss issues related to the City's financial recovery.

In conducting the operational and financial analysis that informed this Plan, the Coordinator met with other appointed leaders in City government, including numerous department directors and division managers. The Coordinator met twice with leadership from the collective bargaining units that represent Reading's union employees – once before the Amended Recovery Plan was first released on October 27 and then again before the Amended Plan was filed on November 21. The Coordinator participated in multiple public committee meetings held by City Council to discuss the Amended Recovery Plan and the 2015 budget and gave an in depth presentation and conducted a question-and-answer session at a Town Hall meeting hosted by Mayor Spencer in August 2014. The Coordinator also met privately with several organizations that are related to City government (e.g. Reading Parking Authority, the Reading Redevelopment Authority) or those that work closely with it (e.g. Greater Reading Chamber of Commerce and Industry, Berks County Community Foundation).
Through this process, the Coordinator sought a combination of initiatives that would erase the projected baseline deficit and preserve some level of reserves, which is necessary for the City to successfully exit Commonwealth oversight. That combination necessarily includes initiatives that increase the City’s revenues and initiatives that reduce its expenditures, or at least reduce their projected growth. It is not feasible to erase the deficit by only making changes that affect one side of the financial ledger. On the revenue side, Pennsylvania Act 199 of 2014 drives a reduction in the amount of money that the City can collect from the commuter EIT to support day-to-day operations. The City has the authority to increase its resident EIT, but taking that rate higher would make it even harder for the City to retain or attract residents or businesses, which is critical to financial recovery.

Unfortunately that leaves only one other revenue source controlled solely by City government that can reliably generate enough money to help bridge the projected deficits – the real estate tax. The first version of the Amended Recovery Plan that was filed with the City Clerk on October 27 included a 2 mill increase in the real estate tax in 2016 and 1 mill increase in each subsequent year through 2019.

Based on the input received from the Spencer Administration and City Council, the Coordinator has revised the Amended Recovery Plan to rely on a mix of real estate tax increases (one mill each in 2016 and 2018), higher contributions from the Reading Parking Authority and higher lease payments from the Reading Area Water Authority.

On the expenditure side, the Coordinator’s preference is to reduce the growth in retiree benefit costs. Since entering Act 47, the City has successfully controlled the growth in active employee compensation costs. The 2014 budget allocation for employee salaries was essentially the same as the City’s actual spending on salaries in 2011. But the City’s required pension contribution jumped by 50 percent over that same period and will rise again in 2015.

There are very limited options for the Coordinator to reduce pension costs through provisions solely authorized in a Recovery Plan. The Coordinator does not believe the Plan provisions can require changes to pension benefits for employees who have already retired, at least not without the City undergoing lengthy, costly litigation that does nothing to address the immediate challenges. Changing the benefits for new employees is an option, but one that the Coordinator already used in the original Recovery Plan and further changes would have little impact on the existing unfunded liability. Changing the benefits for current employees who have not retired yet would be ideal, particularly for the police officers who can access the costly pension and retiree health care benefits but haven’t done so yet. But that depends on the City and those employees reaching an agreement that makes enough changes to reduce the City’s costs during the Amended Recovery Plan period, or an interest arbitration decision that has the same effect.

Given those limitations, the Coordinator is left to control costs by making changes to the compensation for active employees, primarily through additional wage freezes. Given the variation in pension and retiree health insurance benefits across bargaining units, the Amended Recovery Plan does not apply the same wage pattern to all employees.

- Police officers receive a 3.5 percent wage reduction in 2017, followed by wage freezes in 2018 and 2019. Newer officers who are eligible for annual step increases receive them.
- Firefighters have a wage freeze in 2016, 2017 and 2018 with a one percent increase in 2019. Newer firefighters who are eligible for annual step increases receive them.
- Employees represented by AFSCME 2763 have a wage freeze in 2017, 2018 and 2019.
- Employees represented by AFSCME 3799 and non-represented employees have a wage freeze in 2015, 2016 and 2017 with 1 percent increases in 2018 and 2019.

As with the real estate tax increases, the Coordinator anticipates disappointment and frustration with these wage patterns. Changes to the interaction between Act 47 and Act 111 give the police and firefighters flexibility to negotiate a different wage pattern than described above, so long as the maximum annual compensation for employees in their bargaining unit do not exceed the allocations listed in the Amended Recovery Plan.
The Amended Recovery Plan also has other initiatives that, if successfully implemented, would allow for different wage patterns than those described above. The Fire Department chapter has initiatives that impact how emergency medical service is staffed and how suppression-related overtime is incurred. For the police officers, there are recommended changes that roll back the costly pension and retiree health insurance benefits for those who can still access them, but have not done so yet. There are also initiatives in the Police Department chapter that could reduce overtime spending and provide more money for base wages.

These changes alone are not enough to close the projected deficit. The wage freezes and reductions in particular do not impact the City’s finances until 2016 (firefighters) or 2017 (police and AFSCME 2763). So the Amended Recovery Plan makes targeted position reductions, in addition to the vacant positions eliminated in the 2015 budget. Other Plan initiatives discuss changes in how the City provides certain services (e.g. yard waste collection, recycling collection, business privilege tax collection), but they do not have explicit position reductions associated with them.

The final major piece of the deficit closing strategy is some use of the City’s reserves. Ideally the City would take the reserves that it has accumulated and use them to retire debt ahead of schedule or fund capital projects. Unfortunately the City needs to use some of the reserves to meet its recurring expenditures, otherwise the tax increase, wage freeze/reduction and position cuts provisions would be more severe.

**Beyond closing the deficit**

As noted earlier, full financial recovery involves more than avoiding annual operating deficits. The Amended Recovery Plan requires the City to make progress on other objectives that are critical to the City’s efforts to successfully exit Commonwealth oversight.

**Investing in the City’s capital infrastructure (streets, bridges, buildings)**

Instead of reducing the commuter and resident earned income tax rates as described in the baseline, the Amended Recovery Plan freezes those taxes at the current levels and designates a growing portion of the tax to fund capital improvements. The commuter tax remains at 0.3 percent through 2019, but a third of the current year tax revenue goes toward capital improvements in 2015 and 2016, then two thirds in 2017 and 2018 and then all of it in 2019. Similarly 0.1 percent of the resident EIT goes toward capital improvements in 2015 and 2016, then 0.2 percent in 2017 and 2018 and then 0.3 percent in 2019. This provides a funding source to make investments in activities like street repaving and dam repairs that benefit City residents, commuters and visitors.

The Recovery Plan also requires the City to do a condition assessment of its facilities so the City has a fuller, clearer understanding of the needs and how they should be prioritized. The Coordinator requests grant funding from the Commonwealth to support this important effort.

*Please see the Capital Improvement Plan chapter for more information.*

**Advancing the improvements in financial management**

The City has made great strides in improving its basic financial management techniques, as described in the Administrative Services chapter. More must be done to address the recurring findings in the City’s external audits, to improve the operating budget document that remains a non-descript list of numbers and to put policies in place that inform future decisions about debt and fund balance.

*Please see the Administrative Services chapter for more information.*

**Improving performance management**

Performance management remains an important — and largely unutilized — strategy for City officials to make difficult resource allocation decisions, track the impact of those decisions and make adjustments as needed. Even the wealthiest local governments should monitor the effectiveness of their programs and make reductions in those that do not deliver as much value to their residents, and the need to so is heightened in places like Reading where there are fewer resources. In place of the longer list of
performance management initiatives in the original Recovery Plan, this Amended Plan focuses more on directly on Public Works and Community Development, with related initiatives for the Citizen Service Center.

Please see the Public Works and Community Development chapters for more information.

**Focusing on economic development priorities**
The original Recovery Plan required the City to work with external experts to design and articulate an economic development and housing strategy. The housing strategy is in place and there is an emerging consensus around the community’s priorities and opportunities for economic development. The Amended Plan directs the City to focus on those priorities, including executing the Main Street Plan, taking advantage of the City’s Keystone Community designation, returning the Riverview industrial site to productive use and maintaining a regular cycle for inspecting all rental units in the City.

Please see the Community Development and Economic Development chapters for more information.

**Recovery Plan implementation scenario**
The projection below shows the cumulative impact of the Amended Recovery Plan initiatives when applied to the baseline scenario. As noted above, the City will have to draw down some of its reserves over the next five years to meet its projected obligations. Eliminating the reliance on those reserves in the Plan’s final years remains a priority so the City has a better chance to successfully exit Commonwealth oversight.

**Amended Recovery Plan with Initiatives Applied ($ Millions)**
The Amended Recovery Plan is, in many respects, a continuation of the provisions that began under the original Recovery Plan. There are preferred alternatives to the Plan’s most unpleasant measures that would help keep the City’s finances in balance in a way that is less burdensome to taxpayers and current employees. Because of the progress that the City has made since entering Act 47 and the financial reserves that it has accumulated, there is still time to pursue those alternatives and put the City in a position to successfully exit Commonwealth oversight. The Coordinator is ready to work with the City’s elected and appointed leaders, employees and other stakeholders to that end.