

COMPLIANCE AUDIT

City of Hazleton Aggregate Pension Fund

Luzerne County, Pennsylvania
For the Period
January 1, 2013 to December 31, 2014

September 2015



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and City Council
City of Hazleton
Luzerne County
Hazleton, PA 18201

We have conducted a compliance audit of the City of Hazleton Aggregate Pension Fund for the period January 1, 2013 to December 31, 2014. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objective.

The objective of the audit was to determine if the pension fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

Our audit was limited to the areas related to the objective identified above. To determine whether the pension fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, our methodology included the following:

- × We determined whether state aid was properly determined and deposited in accordance with Act 205 requirements by verifying the annual deposit dates of state aid and determining whether deposits were made within 30 days of receipt for all years within the period under audit.
- × We determined whether annual employer contributions were calculated and deposited in accordance with the plans' governing documents and applicable laws and regulations by examining the municipality's calculation of the plans' annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plans as evidenced by supporting documentation.

- × We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plans in accordance with the plans' governing documents and applicable laws and regulations by testing members' contributions on an annual basis using the rates obtained from the plans' governing documents in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plans.
- × We determined whether retirement benefits calculated for the 3 police plan members who retired during the current audit period, and through the completion of our fieldwork procedures, represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the monthly pension benefit due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients. We also determined whether retirement benefits calculated for the 2 police plan members who elected to vest during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the pension benefit due and comparing these amounts to supporting documentation evidencing amounts determined.
- × We determined whether the January 1, 2013 actuarial valuation report was prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2014 in accordance with Act 205 and whether selected information provided on this report is accurate, complete, and in accordance with plan provisions to ensure compliance for participation in the state aid program by comparing selected information to supporting source documentation.
- × We determined whether all annual special ad hoc postretirement reimbursements received by the municipality were authorized and appropriately deposited in accordance with Act 147 by tracing information to supporting documentation maintained by plan officials.
- × We determined whether the pension plans are in compliance with Act 205 for distressed municipalities through inquiry of plan officials and evaluation of the recovery remedies implemented during the audit period and through the completion of our fieldwork procedures.

The City of Hazleton contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2013, which is available at the city's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

City officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the City of Hazleton Aggregate Pension Fund is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. In conducting our audit, we obtained an understanding of the city’s internal controls as they relate to the city’s compliance with those requirements and that we considered to be significant within the context of our audit objective, and assessed whether those significant controls were properly designed and implemented. Additionally and as previously described, we tested transactions, assessed official actions, performed analytical procedures, and interviewed selected officials to provide reasonable assurance of detecting instances of noncompliance with legal and regulatory requirements or noncompliance with provisions of contracts, administrative procedures, and local ordinances and policies that are significant within the context of the audit objective.

The results of our procedures indicated that, in all significant respects, the City of Hazleton Aggregate Pension Fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

As previously noted, the objective of our audit of the City of Hazleton Aggregate Pension Fund was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

Based on the funding data from the city’s non-uniformed and aggregate pension fund’s January 1, 2013, actuarial valuation reports, the Public Employee Retirement Commission (PERC) issued a notification that the City of Hazleton is currently in Level II moderate distress status.

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information or conclude on it and, accordingly, express no form of assurance on it. However, **we are extremely concerned about the historical funding trend information which indicates the police pension plan’s funded ratio went from 69.8% as of January 1, 2007, to a ratio of 48.1% as of January 1, 2013, and the paid firemen’s pension plan’s funded ratio went from 75.5% as of January 1, 2007, to 44.2% as of January 1, 2013, which is the most recent data available. In addition, the city’s annual required contribution to the police pension plan has gone from \$1,078,538 in 2007, to \$1,446,209 in 2014. Similarly, the city’s annual required contribution to the paid firemen’s pension plan has gone from \$380,765 in 2007 to \$810,934 in 2014.**

The changes in the plans' funded status and the increase in the city's required contributions to the plans are due, in part, to the effect of prior arbitration awards and memoranda of understanding granting excess pension benefits to the city's police officers and firefighters and the provision of Act 44 of 2009, which mandated that if a municipality assesses or utilizes the special municipal tax increase to fund other post-employment benefits, the cost of those benefits shall be subject to the actuarial funding and reporting standards of this act.

We encourage city officials to monitor the funding of its police and paid firemen's pension plans to ensure their long-term financial stability and make fiscally responsible decisions as plan fiduciaries that will benefit the City of Hazleton and its taxpayers to ensure the city's pension plans have adequate resources to meet current and future benefit obligations to the city's hard working police officers and firefighters that are determined in accordance with the provisions and the intent of the Third Class City Code.

The contents of this report were discussed with officials of the City of Hazleton and, where appropriate, their responses have been included in the report. We would like to thank city officials for the cooperation extended to us during the conduct of the audit.

August 20, 2015



EUGENE A. DEPASQUALE
Auditor General

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BACKGROUND

On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.). The act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to Pennsylvania's public pension plans. Section 402(j) of Act 205 specifically requires the Auditor General, as deemed necessary, to make an audit of every municipality which receives general municipal pension system state aid and of every municipal pension plan and fund in which general municipal pension system state aid is deposited.

Annual state aid allocations are provided from a 2 percent foreign (out-of-state) casualty insurance premium tax, a portion of the foreign (out-of-state) fire insurance tax designated for paid firefighters and any investment income earned on the collection of these taxes. Generally, municipal pension plans established prior to December 18, 1984, are eligible for state aid. For municipal pension plans established after that date, the sponsoring municipality must fund the plan for three plan years before it becomes eligible for state aid. In accordance with Act 205, a municipality's annual state aid allocation cannot exceed its actual pension costs.

In addition to Act 205, the City of Hazleton Aggregate Pension Fund is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

- Act 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.
- Act 317 - The Third Class City Code, Act of June 23, 1931 (P.L. 932, No. 317), as amended, 53 P.S. § 35101 et seq.

The City of Hazleton Aggregate Pension Fund serves as a common investment and administrative agent for the city's police and paid firemen's pension plans.

The City of Hazleton Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1949, as amended, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established October 10, 1968. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2014, the plan had 37 active members, 2 terminated members eligible for vested benefits in the future, and 42 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

The City of Hazleton Paid Firemen’s Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1913, as amended, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its firefighters. The plan was established July 20, 1968. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2014, the plan had 21 active members, no terminated members eligible for vested benefits in the future, and 34 retirees receiving pension benefits from the plan.

As of December 31, 2014, selected plan benefit provisions for police officers are as follows:

Eligibility Requirements:

Normal Retirement	Eligible with 20 years of service.
Early Retirement	None
Vesting	Member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit Level 1 – Benefit equals 50% of Average Monthly Compensation plus service increment of 5% of compensation for service in excess of 20 years to a maximum of 75%.

Benefit Levels 2 & 3 – Benefit equals 50% of average monthly compensation.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions.
After Retirement Eligibility	A monthly benefit equal to 100% of the pension the member was receiving or was entitled to receive on the day of the member’s death.

Service Related Disability Benefit:

Same as normal retirement benefit.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions for firefighters are as follows:

Eligibility Requirements:

Normal Retirement	Eligible with 20 years of service.
Early Retirement	None
Vesting	Member is 100% vested after 12 years of service.

Retirement Benefit:

Members Hired Prior to January 1, 1988:

Benefit equals 50% of the final average salary of such member at the time of retirement. A service increment of 5% of final average salary for each year of completed service to a maximum of 75% of final average salary after completing 25 years of service.

Members Hired After January 1, 1988 and Prior to September 1, 2000:

Benefit equals 55% of the final average salary of such member at the time of retirement.

Members Hired After September 1, 2000:

Benefit equals 50% of the final average salary of such member at the time of retirement.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions.
After Retirement Eligibility	A monthly benefit equal to 100% of the pension the member was receiving or was entitled to receive on the day of the member's death.

Service Related Disability Benefit:

Less than 20 years of service, the benefit is equal to $1/20^{\text{th}}$ of the normal retirement benefit times years of service to a maximum of 10 years of service (50% of salary).

CITY OF HAZLETON AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

The supplementary information contained on Pages 4-8 reflect the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY -
 POLICE PENSION PLAN

Total Pension Liability	
Service cost	\$ 625,308
Interest	1,869,821
Benefit payments, including refunds of member contributions	(1,602,647)
Net Changes in Total Pension Liability	892,482
Total Pension Liability - 12/31/13	23,548,775
Total Pension Liability - 12/31/14 (a)	\$ 24,441,257
Plan Fiduciary Net Position	
Contributions – employer*	\$ 2,147,054
Contributions – state aid	294,324
Contributions - member	116,492
Net investment income	493,831
Benefit payments, including refunds of member contributions	(1,062,647)
Administrative expense	(170,375)
Net Changes in Plan Fiduciary Net Position	1,278,679
Plan Fiduciary Net Position - 12/31/13	19,424,553
Plan Fiduciary Net Position - 12/31/14 (b)	\$ 20,703,732
Net Pension Liability – Ending (a-b)	\$ 3,738,025
Plan Fiduciary net position as a percentage of the total pension liability (b/a)	84.7%
Covered employee payroll	\$ 2,551,634
Plan’s Net Pension Liability as a percentage of covered employee payroll	148.8%

CITY OF HAZLETON AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CHANGES IN THE NET PENSION LIABILITY -
 PAID FIREMEN'S PENSION PLAN

Total Pension Liability	
Service cost	\$ 271,143
Interest	1,020,605
Benefit payments, including refunds of member contributions	(1,121,534)
	170,214
Net Changes in Total Pension Liability	170,214
Total Pension Liability - 12/31/13	13,047,186
Total Pension Liability - 12/31/14 (a)	\$ 13,217,400
Plan Fiduciary Net Position	
Contributions – employer*	\$ 1,253,128
Contributions – state aid	162,653
Contributions - member	61,233
Net investment income	222,050
Benefit payments, including refunds of member contributions	(1,121,534)
Administrative expense	(94,482)
	483,048
Net Changes in Plan Fiduciary Net Position	483,048
Plan Fiduciary Net Position - 12/31/13	9,429,196
Plan Fiduciary Net Position - 12/31/14 (b)	\$ 9,912,244
Net Pension Liability – Ending (a-b)	\$ 3,305,156
Plan Fiduciary net position as a percentage of the total pension liability (b/a)	75.0%
Covered employee payroll	\$ 1,214,031
Plan's Net Pension Liability as a percentage of covered employee payroll	272.2%

Note* - Since the City utilizes proceeds from the Act 205 special municipal tax to fund other post-employment benefits, the employer contributions included in these schedules include the City's contributions for postemployment benefits in addition to its annual required pension contributions.

CITY OF HAZLETON AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

Sensitivity of the Net Pension Liability to changes in the discount rate

The following is a sensitivity analysis of the net pension liability of the city’s police and paid firemen’s pension plans to changes in the discount rate. The tables below present the net pension liability of the police and firefighters’ pension plans calculated using the discount rate of 8.0% as well as what the plan’s net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (7.0%) or 1 percentage-point higher (9.0%) than the current rate:

	<u>1% Decrease (7.0%)</u>	<u>Current Discount Rate (8.0%)</u>	<u>1% Increase (9.0%)</u>
Net Pension Liability – (Police Plan)	\$ 6,963,289	\$ 3,738,025	\$ 1,052,266

	<u>1% Decrease (7.0%)</u>	<u>Current Discount Rate (8.0%)</u>	<u>1% Increase (9.0%)</u>
Net Pension Liability – (Paid Firemen’s Plan)	\$ 4,879,258	\$ 3,305,156	\$ 1,969,959

CITY OF HAZLETON AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS
 BASED ON ACT 205 MINIMUM MUNICIPAL OBLIGATION (MMO)

POLICE PENSION PLAN

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a Percentage of Covered- employee Payroll
2005	\$ 865,850	\$ 865,850	\$ -	\$ 1,279,796	67.7%
2006	1,030,295	1,180,295	(150,000)	1,556,860	75.8%
2007	1,078,538	1,078,538	-	1,759,320	61.3%
2008	1,155,549	1,380,549	(225,000)	2,080,310	66.4%
2009	1,152,628	1,152,628	-	2,150,212	53.6%
2010	1,123,199	1,123,199	-	2,292,546	49.0%
2011	1,160,376	1,160,376	-	2,371,667	48.9%
2012	1,150,109	1,150,109	-	2,494,207	46.1%
2013	1,451,683	1,451,683	-	2,373,180	61.2%
2014	1,446,209	1,446,209	-	2,511,634	57.6%

PAID FIREMEN'S' PENSION PLAN

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a Percentage of Covered- employee Payroll
2005	\$ 865,850	\$ 865,850	\$ -	\$ 881,193	98.3%
2006	385,955	535,955	(150,000)	1,042,617	51.4%
2007	380,765	380,765	-	1,012,718	37.6%
2008	381,312	606,312	(225,000)	1,010,180	60.0%
2009	531,056	531,056	-	1,052,286	50.5%
2010	606,603	606,603	-	1,137,483	53.3%
2011	628,103	628,103	-	1,121,363	56.0%
2012	637,702	637,702	-	1,120,550	56.9%
2013	648,030	648,030	-	1,154,591	56.1%
2014	810,934	810,934	-	1,214,031	66.8%

CITY OF HAZLETON AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF INVESTMENT RETURNS

Annual money-weighted rate of return, net of investment expenses not funded through the minimum municipal obligation (MMO).

POLICE PENSION PLAN

2014	2.49%
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PAID FIREMEN'S' PENSION PLAN

2014	2.32%
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CITY OF HAZLETON AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF FUNDING PROGRESS

Historical trend information about the plans are presented herewith as supplementary information. It is intended to help users assess the plans' funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other state and local government retirement systems.

The actuarial information is required by Act 205 biennially. The historical information, beginning as of January 1, 2009, is as follows:

POLICE PENSION PLAN

	(1)	(2)	(3)	(4)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)
01-01-09	\$ 13,051,913	\$ 26,587,647	\$ 13,535,734	49.1%
01-01-11	14,421,603	30,695,169	16,273,566	47.0%
01-01-13	17,036,267	35,412,542	18,376,275	48.1%

The market values of the plan's assets at 01-01-09, 01-01-11 and 01-01-13, have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

The plan's actuarial accrued liability at 01-01-09, 01-01-11 and 01-01-13, includes the cost of postemployment benefits funded through the proceeds of the Act 205 special tax.

CITY OF HAZLETON AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF FUNDING PROGRESS – (Continued)

PAID FIREMEN’S PENSION PLAN

	(1)	(2)	(3)	(4)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)
01-01-09	\$ 8,058,703	\$ 17,693,566	\$ 9,634,863	45.5%
01-01-11	8,103,199	19,246,376	11,143,177	42.1%
01-01-13	8,719,067	19,709,578	10,990,511	44.2%

The market values of the plan’s assets at 01-01-09, 01-01-11 and 01-01-13, have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

The plan’s actuarial accrued liability at 01-01-09, 01-01-11 and 01-01-13 includes, the cost of postemployment benefits funded through the proceeds of the Act 205 special tax.

CITY OF HAZLETON AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the actuarial accrued liability as a factor.

Analysis of the dollar amount of the actuarial value of assets, actuarial accrued liability, and unfunded (assets in excess of) actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability (Column 4) provides one indication of the plan's funding status on a going-concern basis. Analysis of this percentage, over time, indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the plan.

CITY OF HAZLETON AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation date follows:

POLICE PENSION PLAN

Actuarial valuation date	January 1, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	12 years
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.5%
Cost-of-living adjustments	3.0%

CITY OF HAZLETON AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

PAID FIREMEN'S PENSION PLAN

Actuarial valuation date	January 1, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 years
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.5%
Cost-of-living adjustments	3.0%

CITY OF HAZLETON AGGREGATE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

City of Hazleton Aggregate Pension Fund
Luzerne County
40 North Church Street
Hazleton, PA 18201

The Honorable Joseph Yannuzzi	Mayor
Mr. John Mundie	Council President
Mr. Thomas Pribula	Acting Director of Administration
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