

# COMPLIANCE AUDIT

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## City of Shamokin Police Pension Plan Northumberland County, Pennsylvania For the Period January 1, 2013 to December 31, 2014

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November 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 Shamokin  
Northumberland County  
Shamokin, PA 17872

We have conducted a compliance audit of the City of Shamokin Police Pension Plan 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 our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the findings contained in our prior audit report; and
2. To determine if the pension plan 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 objectives identified above. To determine if municipal officials took appropriate corrective action to address the findings contained in our prior audit report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. To determine whether the pension plan 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 date 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 plan's governing document and applicable laws and regulations by examining the municipality's calculation of the plan's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plan as evidenced by supporting documentation.
- × We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- × We determined whether retirement benefits calculated for the plan member who retired during the current audit period 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 individual and comparing this amount to supporting documentation evidencing the amounts determined and actually paid to the recipient.
- × We determined whether the January 1, 2011 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, respectively, in accordance with Act 205 and whether selected information provided on these reports 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 the terms of the plan's unallocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contracts with the plan's provisions, investment policies, and state regulations.
- × We determined whether the terms and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation.

The City of Shamokin 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 Shamokin Police Pension Plan 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 objectives, 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 objectives.

The results of our procedures indicated that, in all significant respects, the City of Shamokin Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Inconsistent And Unauthorized Pension Benefits

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Pension Benefits Not Authorized By The Third Class City Code

The findings contained in this audit report repeat conditions that were cited in our previous audit report that have not been corrected by city officials. We are concerned by the city’s failure to correct those previously reported audit findings and strongly encourage timely implementation of the recommendations noted in this audit report.

As previously noted, one of the objectives of our audit of the City of Shamokin Police Pension Plan 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%

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 trend information contained in the schedule of funding progress included in this report which indicates a continued decline of assets available to satisfy the long-term liabilities of the plan. **The police pension plan's funded ratio went from 85.8% as of January 1, 2009, to a ratio of 66.1% as of January 1, 2013, which is the most recent data available. Based on this information, and the funded status of the city's officers' and employees' pension plan, the Public Employee Retirement Commission issued a notification that the city is currently in Level II moderate distress status.** We encourage city officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of the City of Shamokin 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.

October 29, 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 Shamokin Police Pension Plan 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, not limited to, the following:

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 Shamokin Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Chapter 20 of the city code, adopted by Ordinance No. 02-01, as amended, 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 February 7, 1950. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2014, the plan had 10 active members, no terminated members eligible for vested benefits in the future, and 18 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

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

### Eligibility Requirements:

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

### Retirement Benefit:

Benefit equals 50% of average monthly salary at the time of retirement or vesting, or the highest average annual salary received during any 5 years preceding retirement, whichever is higher, plus a monthly service increment of 1/40 of the amount of the retirement allowance multiplied by each year of service beyond 20 years (maximum \$100).

### Survivor Benefit:

A monthly benefit equal to 50% 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 formula.

CITY OF SHAMOKIN POLICE PENSION PLAN  
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

The City of Shamokin has complied with the prior audit recommendations concerning the following:

- Failure To Deposit The Full Amount Of State Aid Into An Eligible Pension Plan

The city deposited the balance of the 2013 state aid allocation, plus applicable interest, into the police pension plan.

- Failure To Pay The Minimum Municipal Obligation Of The Plan

The city paid \$240,481 to fund the 2013 minimum municipal obligation due to the police pension plan, which included interest, in accordance with Act 205 requirements.

- Custodial Account Transactions Not Adequately Monitored By The Municipality

City officials established procedures to monitor the plan's custodial account to ensure the accuracy and propriety of the transactions.

Noncompliance With Prior Audit Recommendations

The City of Shamokin has not complied with the prior audit recommendations concerning the following as further discussed in the Findings and Recommendations section of this report:

- Inconsistent And Unauthorized Pension Benefits

- Pension Benefits Not Authorized By The Third Class City Code

CITY OF SHAMOKIN POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – Noncompliance With Prior Audit Recommendation – Inconsistent And Unauthorized Pension Benefits**

Condition: As disclosed in the prior 6 audit reports, the pension plan’s governing document, Chapter 20 of the city code, adopted by Ordinance No. 02-01, as amended, contains benefit provisions that conflict with the collective bargaining agreement (CBA) between the police officers and the city. In addition, the governing document and the CBA contain benefit provisions that are not authorized by the Third Class City Code, as noted below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Third Class City Code</u>
Compulsory retirement age	Compulsory retirement of all police officers will be required at 70 years of age.	Not provided	Not authorized
Pension benefit	50% of average monthly salary at the time of retirement, or at the time of vesting of his retirement, or 50% of the average annual salary received during any 5 years of service preceding retirement, whichever is higher.	50% of annual pay at the time of retirement, or at the time of vesting his retirement, or 50% of average pay over the highest 5 year period, whichever is higher, plus an additional 3% annuity per year for every year over 20 years, to maximum of 5 years, or 15%.	Up to 50% of the higher of the rate of monthly pay at the date of termination or the highest average annual salary during any 5 years of service.

Criteria: The pension plan’s benefit provisions contained in the plan’s governing document and the collective bargaining agreement should be consistent and in compliance with the provisions of the Third Class City Code.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure compliance with the prior audit recommendation.

CITY OF SHAMOKIN POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – (Continued)**

Effect: During the current audit period, the city determined a pension benefit for a police officer who retired on May 8, 2014, with 22 years of service, based on 56 percent of final monthly compensation, which is in excess of the provisions contained in the Third Class City Code. The retiree is receiving excess benefits of \$502 per month, which totaled approximately \$8,528 from the date of retirement through the date of this audit report. Furthermore, during a prior audit period, the city determined a pension benefit for a police officer who retired on December 31, 2005, with 27 years of service, based on 71 percent of final monthly compensation, which is in excess of the provisions contained in the Third Class City Code and the collective bargaining agreement provisions. The retiree, who died on May 23, 2008, and his surviving spouse have received excess benefits of \$1,321 per month, which have totaled approximately \$155,852 from the date of retirement through the date of this audit report. Finally, during a prior audit period, the city determined a pension benefit for a police officer who retired on August 11, 2008, with 25 years of credited service, based on 65 percent of final monthly compensation, which is in excess of the provisions contained in the Third Class City Code. The retiree is receiving excess benefits of \$820 per month, which totaled approximately \$70,520 from the date of retirement through the date of this audit report.

Providing unauthorized pension benefits increases the plan's pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Since the city received state aid based on unit value for its pension plans during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, the increased costs to the pension plan as a result of the excess pension benefits could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

Recommendation: We again recommend that municipal officials take appropriate action to ensure the plan's benefit provisions contained in the plan's governing document and the CBA are consistent and in compliance with the Third Class City Code at their earliest opportunity to do so.

To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to pay benefits to existing retirees in excess of those authorized by the Third Class City Code, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, such benefits will be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the excess benefits on the city's future state aid allocations and submit this information to the Department.

CITY OF SHAMOKIN POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – (Continued)**

Management's Response: In accordance with the City of Shamokin's Act 47 Recovery plan, the City plans to prospectively change the Police Pension Ordinance and collective bargaining agreement to provide for pension benefits authorized under the Third Class City Code.

Auditor's Conclusion: Based on the management response, it appears that city officials intend to comply with the finding recommendation. Compliance will be evaluated during our next audit of the plan.

**Finding No. 2 – Noncompliance With Prior Audit Recommendation – Pension Benefits Not Authorized By The Third Class City Code**

Condition: As disclosed in the prior 4 audit reports, city officials provided pension benefits in excess of the Third Class City Code. City officials included accumulated unused compensatory time, sick leave, vacation and personal leave that was not earned during the pension computation period in the determination of the highest average annual salary used to calculate monthly pension benefits for 4 police officers who retired on December 31, 2005, August 11, 2008, April 9, 2009, and October 26, 2012, respectively. In addition, during the current audit period, city officials included accumulated unused sick leave and personal leave that was not earned during the pension computation period in the monthly pension benefit determination for a police officer who retired on May 8, 2014.

Criteria: Ordinance No. 02-01, Section 11A, states:

A member who retires after twenty (20) years of service shall receive a retirement allowance of fifty percent (50%) of his average monthly salary at the time of his retirement, or at the time of vesting his retirement, or fifty percent (50%) of the average annual salary received during any five (5) years of service preceding retirement, whichever is higher.

CITY OF SHAMOKIN POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – (Continued)**

Section 4303(a) of the Third Class City Code states, in part:

The basis of the apportionment of the pension shall be determined by the rate of the monthly pay of the member at the date of injury, death, honorable discharge, vesting under section 4302.1 or retirement, or the highest average annual salary which the member received during any five years of service preceding injury, death, honorable discharge, vesting under section 4302.1 or retirement, whichever is the higher, and except as to service increments provided for in subsection (b) of this section, shall not in any case exceed in any year one-half the annual pay of such member computed at such monthly or average annual rate, whichever is the higher.

Furthermore, Section 4309 of the Third Class City Code states:

As used in this subdivision, the term “salary” is defined as the fixed amount of compensation paid at regular, periodic intervals by the city to the member and from which pension contributions have been deducted.

The Department has concluded that lump-sum payments at retirement are not encompassed by “salary” or “rate of the monthly pay” as used in Section 4303(a) of the Third Class City Code, unless the payments were earned during the pension computation period.

Cause: Plan officials failed to establish adequate internal control procedures to ensure compliance with the prior audit recommendation.

Effect: The plan is paying benefits to 5 retirees in excess of those authorized by the Third Class City Code and the plan’s governing document. The retirees are receiving total excess benefits of \$2,397 per month, which have totaled approximately \$167,443 from the dates of their respective retirements through the date of this audit report.

Providing unauthorized pension benefits increases the plan’s pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Since the city received state aid based on unit value for its pension plans during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, the increased costs to the pension plan as a result of the excess pension benefits could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

CITY OF SHAMOKIN POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – (Continued)**

Recommendation: We again recommend that pension benefits be determined in accordance with the provisions of the Third Class City Code. To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to pay benefits to existing retirees in excess of those authorized by the Third Class City Code, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, such benefits will be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the excess benefits on the city's future state aid allocations and submit this information to the Department.

Management's Response: In accordance with the City of Shamokin's Act 47 Recovery Plan, the City plans to prospectively change the police pension ordinance and collective bargaining agreement to provide for pension benefits authorized under the Third Class City Code.

Auditor's Conclusion: Based on the management response, it appears that city officials intend to comply with our recommendation. Compliance will be evaluated during our next audit of the plan.

CITY OF SHAMOKIN POLICE PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

SCHEDULE OF FUNDING PROGRESS

Historical trend information about the plan is presented herewith as supplementary information. It is intended to help users assess the plan's 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:

	(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	\$ 5,642,451	\$ 6,572,732	\$ 930,281	85.8%
01-01-11	5,433,029	7,176,414	1,743,385	75.7%
01-01-13	4,689,433	7,093,758	2,404,325	66.1%

Note: 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 5-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.

CITY OF SHAMOKIN POLICE PENSION PLAN  
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 SHAMOKIN POLICE PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2009	\$ 61,767	100.0%
2010	57,553	100.0%
2011	157,197	100.0%
2012	161,484	100.0%
2013	207,777	115.7%
2014	206,311	100.0%

CITY OF SHAMOKIN POLICE PENSION PLAN  
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:

Actuarial valuation date	January 1, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	15 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.0%

CITY OF SHAMOKIN POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf  
Governor  
Commonwealth of Pennsylvania

City of Shamokin Police Pension Plan  
Northumberland County  
47 East Lincoln Street  
Shamokin, PA 17872

The Honorable William D. Milbrand	Mayor
Mr. Robert Slaby	City Administrator
Ms. Brenda L. Scandle	Treasurer

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