

# COMPLIANCE AUDIT

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## City of Allentown Officers' and Employees' – PMRS Pension Plan

Lehigh County, Pennsylvania  
For the Period  
January 1, 2015 to December 31, 2016

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January 2018



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 Allentown  
Lehigh County  
Allentown, PA 18101

We have conducted a compliance audit of the City of Allentown Officers' and Employees' - PMRS Pension Plan for the period January 1, 2015 to December 31, 2016. 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 finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding 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 finding 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 finding 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 total 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 12 of the 52 plan members<sup>1</sup> 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 retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to recipients. We also determined whether retirement benefits calculated for the 2 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 to retired individuals and comparing these amounts to supporting documentation evidencing amounts determined.
- We determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2014 and 2016, 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 contractual agreement with the Pennsylvania Municipal Retirement System were in accordance with the plan's governing document, if separately stated, and applicable laws and regulations by comparing the terms of the contractual agreement with the plan's governing document, if separately stated, and applicable laws and regulations.

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<sup>1</sup> We selected plan members randomly in order to obtain a representative selection of plan members who retired during the current audit period. While the results of the representative selections may be projected to their respective population, the characteristics present in the population may differ from the characteristics of the items selected.

The City of Allentown Officers' and Employees' - PMRS Pension Plan participates in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's 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 Allentown Officers' and Employees' - PMRS 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 Allentown Officers' and Employees' - PMRS 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 finding further discussed later in this report:

Finding – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

The finding contained in this audit report repeats a condition that was cited in our previous audit report that has not been fully corrected by city officials. We are concerned by the city's failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation noted in this audit report.

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.

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

December 19, 2017

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

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 Allentown Officers' and Employees' - PMRS Pension Plan is also governed by implementing regulations adopted by the former 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 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974  
(P.L. 34, No. 15), as amended, 53 P.S. § 881.101 et seq.

The City of Allentown Officers' and Employees' - PMRS Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 142 of the city's codified ordinances, adopted pursuant to Act 15. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established August 5, 1981. All non-uniformed employees hired after August 5, 1981 are members of this plan. Active members are required to contribute 7.5 percent of compensation to the plan. As of December 31, 2016, the plan had 412 active members, 13 terminated members eligible for vested benefits in the future, and 431 retirees receiving pension benefits.

## **BACKGROUND – (Continued)**

As of December 31, 2016, selected plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	Available upon attainment of age 55.
Early Retirement	A voluntary early retirement is available after 20 years of service. An involuntary early retirement is available after 8 years of service.
Vesting	A member is 100% vested after 12 years of service.

### Retirement Benefit:

Benefit equals 1.25% times service pre-January 1, 1990 plus 1.75% times service from January 1, 1990 to December 31, 1995 and 2.1% times service from January 1, 1996 to date of retirement times the final 5 years' annualized salary.

### Survivor Benefit:

If eligible to retire at the time of death, beneficiary receives present value of accrued benefit. At retirement, member may select a survivor benefit.

### Disability Benefit:

Service Related	A 50% disability benefit is provided to a member who is unable to perform gainful employment regardless of age or service, offset by available Workers' Compensation benefits.
Non-service Related	A 30% disability benefit is provided to a member who has at least 10 years of service and who is unable to perform gainful employment.



CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

The City of Allentown has partially complied with the prior audit recommendation concerning the following:

- Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid

During the current audit period, the city reimbursed \$3,602 to the Commonwealth for the overpayment of state aid received in 2014; however, plan officials again failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data in the years 2016 and 2017, as further discussed in the Finding and Recommendation section of this report.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Partial Compliance With Prior Audit Recommendation - Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid**

Condition: As disclosed in the Status of Prior Finding section of this report, although the city reimbursed the Commonwealth for the overpayment of state aid received in 2014, plan officials again failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data in the years 2016 and 2017. The city certified 2 ineligible police officers (4 units) and 1 ineligible non-uniformed employee (1 unit) on the Certification Form AG 385 filed in 2016. In addition, subsequent to the current audit period, the city certified 1 ineligible police officer (2 units) and certified 5 ineligible non-uniformed employees (5 units) on the Certification Form AG 385 filed in 2017. The data contained on these certification forms is based on prior calendar year information.

Criteria: Pursuant to Act 205, at Section 402(e)(2), in order to be eligible for certification, an employee must have been employed on a full-time basis for at least six consecutive months and must have been participating in a pension plan during the certification year.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the city's state aid allocations were based on unit value, the incorrect certification of pension data affected the city's state aid allocations, as identified below:

Year	Type Of Plan	Units Overstated	Unit Value	State Aid Overpayment
2016	Police	4	\$ 4,375	\$ 17,500
	Non-Uniformed	1	4,375	4,375
			Current period	<u>\$ 21,875</u>
2017	Police	2	\$ 4,588	\$ 9,176
	Non-Uniformed	5	4,588	22,940
			Subsequent period	<u>\$ 32,116</u>
			Total Overpayment of State Aid	<u>\$ 53,991</u>

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

In addition, the city used the overpayments of state aid to pay the minimum municipal obligations (MMOs) due to the police and officers' and employees' - PMRS pension plans; therefore, if the reimbursement to the Commonwealth is made from the pension plans, the plans' MMO(s) will not be fully paid. Furthermore, the city's future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that the total excess state aid, in the amount of \$53,991, plus interest, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

We also again recommend that in the future, plan officials establish adequate internal control procedures, such as having at least two people review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

Furthermore, if the reimbursement to the Commonwealth is made from pension plan funds, we recommend that any resulting MMO deficiencies be paid to the pension plan with interest, at a rate earned by the pension plan.

Management's Response: City officials agreed with the finding without exception.

Auditor's Conclusion: Due to the potential withhold of state aid, the city's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through our next audit of the plan.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
POTENTIAL WITHHOLD OF STATE AID

The finding contained in this audit report cites a total overpayment of state aid to the city in the amount of \$53,991, plus interest. A condition of this nature may lead to a total withholding of state aid in the future unless that finding is corrected. A check in this amount with interest, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania, and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

The supplementary information contained on Pages 7 through 9 reflects 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 AND RELATED RATIOS  
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2016

	<u>2015*</u>	<u>2016*</u>
Total Pension Liability		
Service cost	\$ 3,792,600	\$ 3,121,592
Interest	8,298,621	8,484,310
Difference between expected and actual experience	(31,247)	-
Changes of assumptions	-	2,584,899
Transfers	(42,319)	-
Benefit payments, including refunds of member contributions	(7,706,851)	(8,283,599)
Net Change in Total Pension Liability	<u>4,310,804</u>	<u>5,907,202</u>
Total Pension Liability - Beginning	<u>150,914,149</u>	<u>155,224,953</u>
Total Pension Liability - Ending (a)	<u><u>\$155,224,953</u></u>	<u><u>\$161,132,155</u></u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 1,558,888	\$ 2,230,827
Contribution – member	1,672,158	1,710,952
Net investment income	7,201,360	(36,944)
Transfers	(42,319)	-
Benefit payments, including refunds of member contributions	(7,706,851)	(8,283,599)
Administrative expense	(304,806)	(338,130)
Net Change in Plan Fiduciary Net Position	<u>2,378,430</u>	<u>(4,716,894)</u>
Plan Fiduciary Net Position - Beginning	<u>137,975,741</u>	<u>140,354,171</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$140,354,171</u></u>	<u><u>\$135,637,277</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 14,870,782</u></u>	<u><u>\$ 25,494,878</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	90.42%	84.18%
Estimated Covered Employee Payroll	\$ 22,740,178	\$ 23,067,602
Net Pension Liability as a Percentage of Covered Employee Payroll	65.39%	110.52%

\* The amounts presented for each fiscal year were determined on the measurement date, which is December 31 of the immediately preceding fiscal year.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the city as of December 31, 2015 and 2016, calculated using the discount rate of 5.5%, as well as what the city's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (4.5%)	Current Discount Rate (5.5%)	1% Increase (6.5%)
Net Pension Liability - 12/31/15*	\$ 32,642,240	\$ 14,870,782	\$ (197,454)
Net Pension Liability - 12/31/16*	\$ 44,159,333	\$ 25,494,878	\$ 9,749,682

\* The amounts presented for each fiscal year were determined on the measurement date, which is December 31 of the immediately preceding fiscal year.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

Year Ended December 31*	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered- Employee Payroll**	Contributions as a Percentage of Covered- Employee Payroll
2007	\$ 446,843	\$ 446,843	\$ -		
2008	1,263,532	1,263,532	-		
2009	1,374,389	1,374,389	-		
2010	1,217,945	1,217,945	-		
2011	1,186,454	1,186,454	-		
2012	1,367,093	1,367,093	-		
2013	1,299,757	1,299,757	-		
2014	1,612,483	1,612,483	-		
2015	1,557,908	1,558,888	\$ (980)	\$22,740,178	6.86%
2016	2,230,827	2,230,827	-	23,067,602	9.67%

\* The amounts presented for each fiscal year were determined as of the measurement date, which is December 31 of the immediately preceding fiscal year.

\*\* Due to GASB Statement No. 67, *Financial Reporting for Pension Plans*, being implemented only recently, the amount of Covered-Employee Payroll was not provided for years prior to 2015.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS 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, 2011, 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)
01-01-11	\$ 126,518,465	\$ 132,493,119	\$ 5,974,654	95.5%
01-01-13	139,465,022	149,064,886	9,599,864	93.6%
01-01-15	144,191,417	155,224,953	11,033,536	92.9%



CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS 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 ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS 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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	14 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	5.5%, net of expenses
Projected salary increases *	Age-related scale for merit/ seniority (e.g. age 30 - 6.4%; age 40 - 5.0%; age 50 - 4.1%; age 60 - 3.7%)
Cost-of-living adjustments	3.0%, where applicable

\* Includes inflation at 3.0%

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
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