

COMPLIANCE AUDIT

City of Shamokin Police Pension Plan Northumberland County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

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 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, 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 conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our 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 subsequent to 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 individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to the recipient.
- 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 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.

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.

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 75.7% as of January 1, 2011, to a ratio of 64.1% as of January 1, 2015, 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 former 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.

January 12, 2018

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 Shamokin Police 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 67 - The Third Class City Code, Act of November 24, 2015 (P.L. 242, No. 67), as amended, 11 Pa. C.S. § 10101 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 67. 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, 2016, the plan had 10 active members, no terminated members eligible for vested benefits in the future, and 17 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2016, 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

Status Of Prior Audit Recommendations

· Inconsistent And Unauthorized Pension Benefits

As disclosed in the prior 7 audit reports, the pension plan's governing document, Chapter 20 of the city code, adopted by Ordinance No. 02-01, as amended, contained benefit provisions that conflicted with the collective bargaining agreement (CBA) between the police officers and the city. In addition, the governing document and the CBA contained benefit provisions that were not authorized by the Third Class City Code. Subsequent to the current audit period, municipal officials took 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. The CBA for the period January 1, 2018 to December 31, 2019 removed the benefit provisions that were not authorized by the Third Class City Code. In addition, municipal officials adopted Ordinance No. 17-04, effective January 1, 2018, which brought the governing document into agreement with the CBA and into compliance with the Third Class City Code. While these benefits will be in effect for future retirees, 3 existing retirees continue to receive excess benefits which amounted to \$63,419 during the current audit period. Since the city received state aid based on unit value during the audit period, it did not receive state aid attributable to the excess benefits provided. The Department will continue to monitor the effect of the excess benefits being paid to the existing retirees on the city's future state aid allocations.

· Pension Benefits Not Authorized By The Third Class City Code

As disclosed in the prior 5 audit reports, the city 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 salary used to calculate monthly pension benefits for 5 police officers who retired during prior audit periods. Subsequent to the current audit period, municipal officials took appropriate action to ensure the pension benefit calculated for a police officer who retired February 17, 2017, was in accordance with the provisions contained in the plan's governing document, the collective bargaining agreement, and the Third Class City Code. Furthermore, Ordinance No. 17-06 was adopted which eliminates the inclusion of any unused leave in the pension calculations for retirees after January 1, 2018. However, 5 existing retirees continue to receive excess benefits which amounted to \$57,530 during our current audit period. Since the city received state aid based on unit value during the audit period, it did not receive state aid attributable to the unauthorized pension benefits provided. The Department will continue to monitor the effect of the excess benefits being paid to the existing retirees on the city's future state aid allocations.

CITY OF SHAMOKIN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 4 and 5 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	\$ 91,083	\$ 95,182
Interest	526,272	527,702
Change of benefit terms	65,718	-
Difference between expected and actual experience	311,942	-
Changes of assumptions	65,644	-
Benefit payments, including refunds of member contributions	(601,026)	(601,026)
Net Change in Total Pension Liability	<u>459,633</u>	<u>21,858</u>
Total Pension Liability - Beginning	7,284,299	7,743,932
Total Pension Liability - Ending (a)	<u><u>\$ 7,743,932</u></u>	<u><u>\$ 7,765,790</u></u>
Plan Fiduciary Net Position		
Contributions - employer	\$ 241,297	\$ 231,548
Contributions - state aid	78,417	87,493
Contribution - member	33,073	33,440
Net investment income	(126,781)	191,419
Benefit payments, including refunds of member contributions	(601,026)	(601,026)
Net Change in Plan Fiduciary Net Position	<u>(375,020)</u>	<u>(57,126)</u>
Plan Fiduciary Net Position - Beginning	4,951,818	4,576,798
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 4,576,798</u></u>	<u><u>\$ 4,519,672</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 3,167,134</u></u>	<u><u>\$ 3,246,118</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	59.10%	58.20%
Estimated Covered Employee Payroll	\$ 666,070	\$ 658,096
Net Pension Liability as a Percentage of Covered Employee Payroll	475.50%	493.26%

CITY OF SHAMOKIN POLICE 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 7.0%, 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 (6.0%)	Current Discount Rate (7.0%)	1% Increase (8.0%)
Net Pension Liability - 12/31/15	\$ 4,008,567	\$ 3,167,134	\$ 2,456,963
Net Pension Liability - 12/31/16	\$ 4,090,507	\$ 3,246,118	\$ 2,532,768

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2016	4.48%
2015	-2.74%

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, 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	\$ 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%
01-01-15	4,951,818	7,727,603	2,775,785	64.1%

Note: The market values of the plan’s assets at 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
2011	\$ 157,197	100.0%
2012	161,484	100.0%
2013	207,777	115.7%
2014	206,311	100.0%
2015	319,714	100.0%
2016	319,041	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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	11 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	4.5%

CITY OF SHAMOKIN POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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