COMPLIANCE AUDIT

City of Warren
Police Pension Plan
Warren County, Pennsylvania
For the Period
January 1, 2014 to December 31, 2015

June 2016

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 Warren
Warren County
Warren, PA 16365

We have conducted a compliance audit of the City of Warren Police Pension Plan for the period January 1, 2014 to December 31, 2015. 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 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 2 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 determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the 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 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.

The City of Warren contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ending December 31, 2014 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 Warren 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 Warren 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 finding further discussed later in this report:

Finding – Noncompliance With Prior Audit Recommendation - Failure To Provide A Killed In Service Benefit

The finding contained in this audit report repeats a condition that was cited in our previous audit report that has not been 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 Warren 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.

May 25, 2016

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 Warren 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, but not limited to, the following:

Act 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1158, No. 177), as amended, 53 Pa.C.S. § 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 Warren Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1669, as amended. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established May 7, 1945. Active members are required to contribute 2 percent of compensation to the plan. As of December 31, 2015, the plan had 15 active members, no terminated members eligible for vested benefits in the future, and 22 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2015, selected plan benefit provisions are as follows:

Eligibility Requirements:

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

Retirement Benefit:

Benefit equals 50% of final 36 months average compensation, plus a monthly service increment equal to 1/40th of the retirement allowance for each year of service in excess of 20 years, up to a maximum of $500 per month.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
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:

Benefit equals 50% of the final 36 months average compensation prior to disablement.

CITY OF WARREN POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

The City of Warren has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Failure To Provide A Killed In Service Benefit

Finding – Noncompliance With Prior Audit Recommendation – Failure To Provide A Killed In Service Benefit

Condition: As disclosed in our prior audit report, on January 21, 2013, the city passed Ordinance No. 1822, effective January 1, 2013, which repealed the killed in service benefit for its police officers previously provided by Section 4.01 of Ordinance No. 1669.

Criteria: Section 4301 of the Third Class City Code states, in part:

Section 4301. Police Pension Fund.--(a) Cities shall establish, by ordinance, a police pension fund.

(b) The following shall apply to a police pension fund established pursuant to this section:

(1) The fund shall be maintained by an equal and proportionate monthly charge against each member of the police force, which shall not exceed annually four per centum of the pay of the member and an additional amount not to exceed one per centum of the pay of the member to be paid by the member or the municipal corporation to provide sufficient funds for payments required by subsection (f) of section 4303 to surviving spouses even if they remarry, or if no spouse survives or if such person survives and subsequently dies, then to the child or children under the age of eighteen years, of members of the police force or of members retired on pension or who die in service. (Emphasis added)

Furthermore, Section 4303(b) 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....(Emphasis added)

Finding – (Continued)

In addition, Section 4303(e) of the Third Class City Code states, in part:

> The spouse of a member of the police force or a member who retires on pension who dies or if no spouse survives or if such person survives and subsequently dies or remarries, then the child or children under the age of eighteen years of a member of the police force or a member who retires on pension who dies on or after August 1, 1963, shall, during the lifetime of the surviving spouse, even if the surviving spouse remarries, or until reaching the age of eighteen years in the case of a child or children, be entitled to receive a pension calculated at the rate of fifty per centum of the pension the member was receiving or would have been receiving had the member been retired at the time of the member's death and may receive the pension the member was receiving or would have been receiving had the member been retired at the time of the member's death.

Finally, Section 4308(c) of the Third Class City Code states:

> In the event of the death of a member of the police force <u>not in the line of service</u> before the member becomes entitled to a pension and if the member is not survived by a spouse or family entitled to payments as provided in this subdivision, the total amount of contributions paid into the pension fund by the member shall be paid over to the member's estate. (Emphasis added)

Based on these sections of the Third Class City Code taken as a whole, the Department has concluded that the Code mandates the provision of a benefit for survivors of police officers killed in service.

<u>Cause</u>: The city contends that the Third Class City Code makes no reference to a killed in service benefit; therefore, the benefit is not mandated.

<u>Effect</u>: Act 51 of 2009 mandates that the Commonwealth of Pennsylvania pay a killed in service benefit in an amount equal to the officer’s final monthly salary, less any workers’ compensation or pension or retirement benefits paid to such survivors. The city’s failure to provide a killed in service benefit could result in excess benefit payments having to be paid by the Commonwealth.

<u>Recommendation</u>: We again recommend that the municipality review the plan’s killed in service benefit obligation with its solicitor in conjunction with Act 51 of 2009, to ensure the plan’s benefit provisions are in compliance with the Third Class City Code at its earliest opportunity to do so.

Finding – (Continued)

Management's Response: Municipal officials disagreed with the recommendation. The City of Warren believes that the Third Class City Code makes no reference to a killed in service benefit.

Auditor's Conclusion: It is the position of the Department that the Third Class City Code mandates a benefit for survivors of police officers killed in service; therefore, based on the criteria previously cited, the finding and recommendation remain as stated.

CITY OF WARREN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The supplementary information contained on Pages 7 thru 9 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 AND RELATED RATIOS
FOR THE YEAR ENDED DECEMBER 31, 2014

Total Pension Liability		
Service cost	$	354,316
Interest		1,022,304
Benefit payments, including refunds of member contributions*		(954,655)
Net Change in Total Pension Liability		421,965
Total Pension Liability – Beginning		6,772,003
Total Pension Liability - Ending (a)	$	7,193,968
Plan Fiduciary Net Position		
Contributions – employer	$	221,701
Contribution – member		16,650
Net investment income		556,254
Benefit payments, including refunds of member contributions*		(479,551)
Administrative expense		(31,571)
Net Change in Plan Fiduciary Net Position		283,483
Plan Fiduciary Net Position – Beginning		7,551,807
Plan Fiduciary Net Position - Ending (b)	$	7,835,290
Net Pension Liability - Ending (a-b)	$	(641,322)
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability		108.9%
Estimated Covered Employee Payroll	$	782,344
Net Pension Liability as a Percentage of Covered Employee Payroll		(82.0%)

*See Note on following page.

CITY OF WARREN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

Note: The first benefit payment amount is actuarially determined in arriving at the actuarial value of the total pension liability. The second benefit payment amount agrees to the financial statement schedule of the audited financial statements, which is used to determine the net position of the plan. The two amounts will not agree as one is an actuarially determined number and the other is the actual benefit payments made during the year.

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

The following presents the net pension liability of the city, calculated using the discount rate of 7.5%, 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 (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Net Pension Liability	$ 156,414	$ (641,308)	$ (1,313,158)

Note: The Net Pension Liability on the preceding schedule was determined to be $641,322. The determination for this schedule was adjusted to reflect the proper net position as the actuary did not use the proper net position figure on the preceding schedule. No adjustment was made to the 2014 financial statements.

SCHEDULE OF INVESTMENT RETURNS

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

2014	7.57%

CITY OF WARREN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
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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	$ -	$ -	$ -	$ -	N/A
2008	-	-	-	697,393	N/A
2009	-	-	-	-	N/A
2010	-	-	-	813,673	N/A
2011	174,963	188,423	(13,460)	-	-
2012	174,099	174,099	-	864,627	20.1%
2013	181,370	181,370	-	-	-
2014	221,701	221,701	-	782,344	28.3%
2015	188,168	188,168	-	733,809	25.6%

* 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 2007, 2009, 2011 and 2013.

CITY OF WARREN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
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(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	$ 6,152,280	$ 6,346,882	$ 194,602	96.9%
01-01-13	6,494,538	6,772,003	277,465	95.9%
01-01-15	7,358,838	6,908,001	(450,837)	106.5%

Note: The market values of the plan's assets at 01-01-11, 01-01-13 and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period which will be limited to a maximum of 120 percent and a minimum of 80 percent of the fair market value of assets. 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 WARREN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(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 WARREN 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	N/A
Remaining amortization period	N/A
Asset valuation method	4-year smoothing, the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return *	7.5%
Projected salary increases *	5.0%
Cost-of-living adjustments	3.0%

* Includes inflation at 3.0%

CITY OF WARREN POLICE PENSION PLAN
COMMENT

The city adopted a home rule charter pursuant to the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. §2901 et seq. (previously 53 P.S. §1-101 et seq.). The 6 prior audits for the city's police pension plan covering the years 1994 through 2007 disclosed that the pension plan's governing document includes provisions which are not in compliance with the Third Class City Code. It was noted in the prior audit reports that certain provisions are in excess of Third Class City Code requirements, and certain provisions provide for lesser benefits than mandated by the Third Class City Code. The prior audit report for the period January 1, 2006, to December 31, 2007, recommended that the city restrict pension benefits to those authorized by the Third Class City Code for all employees who began full-time employment on or after January 24, 2001 (the date *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee* was issued) upon the renewal, extension, or renegotiation of the collective bargaining agreement. To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to provide benefits in excess of those authorized by the Third Class City Code to employees who began employment on or after January 24, 2001, 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, to the extent that the city has failed to provide benefits which are mandated by the Third Class City Code, it was recommended that the city increase those benefits for all active plan members to the levels prescribed by the Code at its earliest opportunity to do so.

The City of Warren has maintained that pension benefits are subject to collective bargaining and interest arbitration processes. In addition, the city has argued that these matters have been the subject of litigation, which included an appeal and Memorandum Opinion issued by the Commonwealth Court. In particular, certain retired firefighters and the International Association of Firefighters appealed the fact that retired firefighters were receiving benefits below the levels established by the Third Class City Code. In concluding that the pension benefits below those required by the Third Class City Code were not void as against public policy, the Court concluded that the retirees and the Union, "through collective bargaining, bargained away their pension rights." This is particularly true, according to the Court when the parties, as here, negotiated the issue of compliance with the Third Class City Code and, ultimately agreed to lesser benefits which cost less than if the plan were entirely Third Class City Code compliant. Furthermore, the City of Warren had an actuarial cost study done of its plan provisions and the cost to bring them into compliance with the Third Class City Code. That cost study revealed that for the police and firefighter plans it would be more expensive to comply with the Third Class City Code (and the Department's recommendations) than it would to leave the benefits unchanged.

During the current audit period, the city negotiated a new collective bargaining agreement with its police officers covering the period January 1, 2015, to December 31, 2017, and the plan's governing document remains not in compliance with the Third Class City Code, as noted in the prior audit reports.

CITY OF WARREN POLICE PENSION PLAN
COMMENT

The Department recognizes that the city is unable to make any unilateral changes to its pension plans due to collective bargaining agreements that have been negotiated. In addition, the Department also recognizes that all of the benefit provisions that deviate from the Third Class City Code do not result in increased pension costs and, to the extent that the city has provided pension benefits which are less than those mandated by the Third Class City Code, it has consequently resulted in lower annual pension costs for the city. However, it remains the Department's position that the city restrict pension benefits to those authorized by the Third Class City Code for all employees who began full-time employment on or after January 24, 2001 (the date *Monroeville* was issued) upon the renewal, extension, or renegotiation of the collective bargaining agreement and to the extent that the city has failed to provide benefits which are mandated by the Third Class City Code, we again recommend that the city increase those benefits for all active plan members to the levels prescribed by the code at its earliest opportunity to do so. Since the city received its state aid allocations based on unit value during the current audit period, the city did not receive any state aid attributable to pension benefits that deviate from the Third Class City Code. We will continue to monitor the city's compliance with the prior audit recommendations and the effect of providing pension benefits not in compliance with the Third Class City Code on the city's state aid allocations during future audits of the plan.

CITY OF WARREN POLICE PENSION PLAN
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This report was initially distributed to the following:

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