

COMPLIANCE AUDIT

City of Reading Police Pension Plan Berks County, Pennsylvania For the Period January 1, 2011 to December 31, 2013

December 2014



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 Reading
Berks County
Reading, PA 19601

We have conducted a compliance audit of the City of Reading Police Pension Plan for the period January 1, 2011 to December 31, 2013. 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 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. Our methodology addressed determinations about the following:

- Whether state aid was properly determined and deposited in accordance with Act 205 requirements.
- Whether employer contributions are determined and deposited in accordance with the plan's governing document and applicable laws and regulations.
- Whether employee contributions are required and, if so, are determined, deducted, and deposited into the pension plan and are in accordance with the plan provisions and applicable laws and regulations.

- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.
- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and 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.
- Whether the special ad hoc postretirement adjustment granted to eligible pensioners is in accordance with applicable laws and regulations and whether the ad hoc reimbursement received by the municipality was treated in accordance with applicable laws and regulations.
- Whether benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.
- Whether the pension plan is in compliance with state regulations for distressed municipalities.
- Whether the terms and methodologies of the issuance of bonds by the municipality, and any restrictions are in compliance with plan provisions and state regulations.
- Whether Deferred Retirement Option Plan (DROP) participants' benefit payments are properly determined in accordance with the provisions of the DROP and any other applicable laws and regulations.

The City of Reading contracted with an independent certified public accounting firm for annual audits of its basic financial statements which are 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 Reading 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, 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.

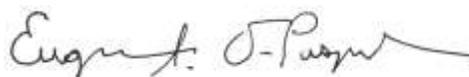
The results of our tests indicated that, in all significant respects, the City of Reading Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further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

Finding - Late Filing Of Actuarial Valuation 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. 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. For example, **the plan's funded ratio went from 73.7% as of January 1, 2009, to a ratio of 63.7% as of January 1, 2013**, which is the most recent date available. As noted in the Appendix included in this report, the City of Reading has been declared a distressed municipality pursuant to the provisions of Act 47. We encourage city officials to continue its efforts in the development of a long-term strategic plan 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 Reading 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.

November 13, 2014



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 Reading 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 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.

Act 317 - The Third Class City Code, Act of June 23, 1931 (P.L. 932, No. 317), as amended, 53 P.S. § 35101 et seq.

The City of Reading Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article No. 183 of the Codified Ordinances of the City of Reading, 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 December 15, 1926. Active members hired prior to January 1, 2012 are required to contribute 6.5 percent of base salary, plus \$1 per month to the plan, and active members hired on or after January 1, 2012 are required to contribute 5 percent of base salary plus \$1 per month to the plan. As of December 31, 2013, the plan had 141 active members, 3 terminated members eligible for vested benefits in the future, and 312 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2013, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Pre-2012 hires: 20 years of service. Hired on or after 1/1/2012: Age 50 and 20 years of service.
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

Retirement Benefit:

Pre-2012 hires: 60% of Average Monthly Salary (the greater of final monthly Salary or the monthly average of any 5 calendar years of Salary) plus 2% of Average Monthly Salary for each year of Service in excess of 20 years to a maximum of 5 years with an additional benefit of 2.5% of the pension benefit for each year of Service in excess of 20 years to a maximum of \$500 per month.

Hired on or after 1/1/2012: 50% of Average Monthly Pay plus service increment.

Survivor Benefit:

Pre-2012 hires: If service-related or if member has 10 or more years of service as of date of death, full retirement benefit payable as of the date of death. For members with less than 10 years of service whose death is considered nonservice-related, eligible beneficiaries receive 50% of the full retirement benefit payable at the date of death.

Hired on or after 1/1/2012: If killed-in-service or for death after retirement eligibility, 50% of the normal retirement benefit.

Disability Benefit:

Service-Related	Normal retirement benefit.
Nonservice-Related	(Pre-2012 hires only) Before 10 years of service: 50% of normal retirement benefit. After 10 years of service: normal retirement benefit.

CITY OF READING POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

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

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

During the current audit period, municipal officials established adequate internal control procedures to ensure compliance with the instructions that accompany Certification Form AG 385 and accurately reported the required pension data.

- Incorrect Data On Certification Form AG 490 Resulting In An Overpayment Of State Aid

During the current audit period, the city reimbursed \$3,946 to the Commonwealth for the overpayments of state aid received in 2010 and 2011.

- Pension Benefit Payments Made To Deceased Beneficiary

During the current audit period, the Pension Fund Solicitor pursued and received reimbursement for the improper payments.

Status of Prior Audit Recommendation

- Pension Benefits In Excess Of The Third Class City Code

The audit report for the period January 1, 2009 to December 31, 2010, contained a finding that the pension plan's governing document and the collective bargaining agreement between the police officers and the city contained benefit provisions not authorized by the Third Class City Code. The city amended the plan's governing document and collective bargaining agreement to eliminate benefits in excess of the Third Class City Code for police officers hired after December 31, 2011. However, excess benefits are still being paid to existing retirees. 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 impact of the excess benefits being paid to the existing retirees on the city's future state aid allocations.

CITY OF READING POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding - Late Filing Of Actuarial Valuation Report

Condition: Actuarial valuation report form PC-202C for the city's police pension plan with a valuation date of January 1, 2013, was not submitted to the Public Employee Retirement Commission (PERC) by the March 31, 2014, deadline, as required by Act 205. The actuarial valuation report was not received by PERC until July 2, 2014.

Criteria: Section 201(a) of Act 205 states, in part:

Each municipality which has established or maintains a pension plan for its employees, including any municipality which participates in the Pennsylvania Municipal Retirement System, shall cause to be made actuarial valuation reports. Actuarial valuation reports shall be made biennially, unless the applicable municipality is applying or has previously applied for supplemental State assistance pursuant to Section 603, whereupon actuarial valuation reports shall be made annually.

Furthermore, Section 201(b) of Act 205 states, in part:

The biennial actuarial valuation report required pursuant to subsection (a) shall be made as of the beginning of each plan year occurring in an odd-numbered calendar year and shall be filed with the executive director of the commission no later than the last business day of March occurring in the following calendar year.

In addition, Section 204 of Act 205 provides:

If a complete actuarial valuation report or experience investigation is not filed in a timely fashion, any and all financing which is provided to the municipality by the Commonwealth and is dedicated for pension plan purposes shall be withheld until the report or investigation is filed.

Finally, Section 402(e)(7) of Act 205 states, in part:

Any municipality which has not filed with the commission on a timely basis, pursuant to the applicable municipal pension plan actuarial reporting law, an actuarial report for each of the municipal pension plans which it has established or maintains shall be entitled to receive as general municipal pension system State aid, at such time as compliance with the actuarial reporting requirement occurs, the adjusted amount of general municipal pension system State aid per unit

CITY OF READING POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding - (Continued)

Cause: The untimely submission of the actuarial valuation report occurred because of delays accompanying administrative staff and actuarial firm changes made during 2014.

Effect: Although the city did not receive an underpayment of state aid due to the untimely filing of the actuarial valuation report, the untimely submission of actuarial valuation reports could result in the withholding of a municipality's state aid allocation until the necessary reports are filed and could result in a lower state aid allocation based on adjusted unit value.

Recommendation: To ensure that future actuarial filing deadlines are met in a timely manner and to improve pension plan administration, we recommend that plan officials develop and implement internal control procedures, such as a calendar listing the various reporting and filing deadlines required by Act 205, including the actuarial valuation report filing date.

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

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

CITY OF READING 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)	(5)	(6)
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)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-09	\$ 86,700,006	\$ 117,589,174	\$ 30,889,168	73.7%	\$ 11,349,615	272.2%
01-01-11	91,040,541	130,699,482	39,658,941	69.7%	8,233,579	481.7%
01-01-13	93,326,524	146,570,469	53,243,945	63.7%	11,125,785	478.6%

Note: The market value of the plan's assets at 01-01-13 has been adjusted to reflect the smoothing of gains and/or losses which will be limited to a maximum of 120 percent and a minimum of 80 percent of the fair market value of assets. Furthermore, the market values of the plan's assets at 01-01-09 and 01-01-11 have been adjusted to reflect the smoothing of gains and/or losses which will be limited to a maximum of 130 percent and a minimum of 70 percent of the fair market values of assets. These methods will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

The Actuarial Accrued Liabilities as of 01-01-09, 01-01-11, and 01-01-13 reflect increases in the plan's benefit provisions made in 2007.

CITY OF READING 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.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF READING POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2008	\$ 1,705,470	100.0%
2009	2,428,329	100.0%
2010	2,607,362	100.0%
2011	3,932,110	100.0%
2012	3,663,429	100.0%
2013	6,057,188	100.0%

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

The information presented in the required 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	14 years
Asset valuation method	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	None assumed

CITY OF READING POLICE PENSION PLAN
APPENDIX

On September 10, 2009, the Department of Community and Economic Development (DCED) received a request for Determination of Municipal Financial Distress under the Municipalities Financial Recovery Act (Act of 1987 P.L. 246, No. 47) from the Mayor of the City of Reading. This Act empowers DCED to declare certain municipalities as financially distressed; provides for the restructuring of debt of financially distressed municipalities; limits the ability of financially distressed municipalities to obtain government funding; authorizes municipalities to participate in Federal debt adjustment actions under certain circumstances; and provides for consolidation or merger of contiguous municipalities to relieve financial distress.

DCED issued a report titled “Municipalities Financial Recovery Act Consultative Evaluation” on the City of Reading dated October 14, 2009, which contained the following recommendation:

Based on our analysis of the City’s fiscal condition, tax base and revenue trends, debt service obligations, current and projected 2008 financial position, expenditure and workforce trends, pension obligations, use of inter-fund transfers, socio-economic and demographic trends and administrative and financial management practices, it is our recommendation that the City of Reading be declared distressed under Act 47.

Clearly the City is and has been experiencing ongoing financial challenges over the past several years. These conditions make it difficult for the City to continue to fulfill its responsibilities to provide for the health, safety and welfare of its citizens. Our recommendation is based upon a pattern of:

- Increasing year-end deficits;
- Increasing negative fund balances;
- Decline of tax revenue in constant dollars taking inflation into account;
- Increasing annual costs particularly in public safety departments and employee benefits; and
- Use of one-time revenue strategies that are not sustainable.

Given Reading’s current fiscal position there are serious questions and uncertainty as to its ability to maintain municipal services without an adverse impact on the health, safety and welfare of residents of the City. In our opinion, Reading is exhibiting symptoms of distress that support a distress determination under Act 47.

CITY OF READING POLICE PENSION PLAN
APPENDIX

On May 6, 2010, a Municipalities Financial Recovery Act Recovery Plan for the City of Reading prepared on behalf of DCED was filed with the Reading City Clerk's Office. In the Executive Summary of this report it was noted that:

The City of Reading is in a severe financial crisis and it must take immediate action to preserve its fiscal health while continuing to provide basic services to residents, businesses and visitors. Failure to act now will soon be catastrophic. The depth and immediacy of the crisis cannot be overstated.

In addition, the City of Reading Financial and Compliance Audit Report for the year ended December 31, 2013, contains the following information noted in the Management's Discussion and Analysis Section under the heading Act 47 Status:

The City maintained its status within Act 47 for the fiscal year ending December 31, 2013. In partnership with the City's Act 47 coordinator, Public Financial Management (PFM), the City continued to take positive steps to reduce spending and improve revenues. However, the City still faces significant financial challenges which will force difficult choices to overcome long-term structural deficits.

Among the most pressing areas of concern are: 1) expected yearly increases in the City's Minimum Municipal Obligation, which totaled approximately \$11.0 million in 2013, 2) year-over-year increases in the cost of Public Safety operations, of which the City experienced an 11% increase in 2013, and 3) legal expenses related to ongoing litigation.

CITY OF READING POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of Reading Police Pension Plan
Berks County
815 Washington Street
Reading, PA 19601

The Honorable Vaughn Spencer	Mayor
Mr. Francis Acosta	Council President
Mr. David Cituk	City Auditor

This report is a matter of public record and is available online at www.auditorgen.state.pa.us. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 231 Finance Building, Harrisburg, PA 17120; via email to: news@auditorgen.state.pa.us.