

COMPLIANCE AUDIT

City of Philadelphia Municipal Pension Fund Philadelphia County, Pennsylvania For the Period July 1, 2010 to June 30, 2014

September 2015



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DEPASQUALE
AUDITOR GENERAL

The Honorable Mayor and City Council
City of Philadelphia
Philadelphia County
Philadelphia, PA 19102

We have conducted a compliance audit of the City of Philadelphia Municipal Pension Fund for the period July 1, 2010 to June 30, 2014. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the findings contained in our prior audit report; and
2. To determine if the pension fund 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 fund officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. To determine whether the pension fund 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 fund's governing document and applicable laws and regulations by examining the municipality's calculation of the fund's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension fund as evidenced by supporting documentation.
- × For 80 out of 27,065 active fund members, we determined whether annual employee contributions were calculated, deducted, and deposited into the pension fund in accordance with the individual plan's governing documents and applicable laws and regulations by testing members' contributions on an annual basis using the rates obtained from the individual plan's governing documents in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension fund.
- × For 48 of the 5,447 individuals who retired during the current audit period, we determined whether retirement benefits calculated represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the individual plan's governing documents and 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 July 1, 2010, July 1, 2011, July 1, 2012, July 1, 2013 and July 1, 2014 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2011, 2012, 2013, 2014 and 2015, respectively, in accordance with Act 205 and whether selected information provided on these reports is accurate, complete, and in accordance with fund 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 fund officials.

The City of Philadelphia contracted with an independent certified public accounting firm for annual audits of the City of Philadelphia Municipal Pension Fund's 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 Philadelphia Municipal Pension Fund 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 Philadelphia Municipal Pension Fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following findings further discussed later in this report:

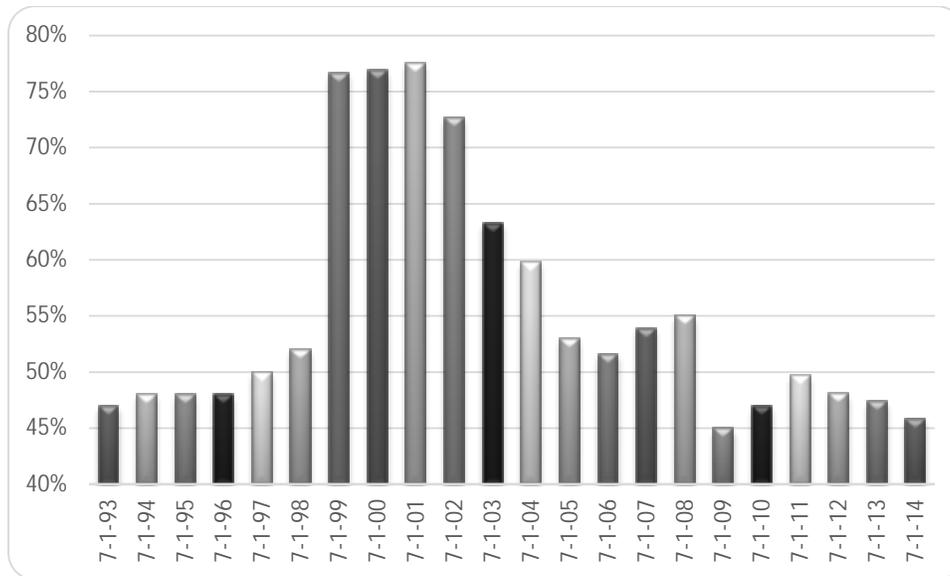
Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 64 Resulting In A Net Underpayment Of The Reimbursements By The Commonwealth For Special 2002 Ad Hoc Postretirement Adjustments

Finding No. 2 – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 490 Resulting In Excess Reimbursements By The Commonwealth For Special 1989 Ad Hoc Postretirement Adjustments

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

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information 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 municipal pension fund. For example, over the past thirteen years, the funded ratio of the city's municipal pension fund went from a high of 77.5% as of July 1, 2001, to a ratio of 45.8% as of July 1, 2014, which is the most recent data available.** This condition will require increased municipal contributions to fund the municipal pension fund in accordance with Act 205 funding standards. We encourage city officials to make responsible decisions when monitoring the funding of the municipal pension fund to ensure its long-term financial stability.

A graphic illustration of the deterioration of the funding status of the city’s municipal pension fund before and after the issuance of a 1.29 billion general obligation bond in 1999, is presented below:



As previously noted, Objective No. 2 of our audit of the City of Philadelphia Municipal Pension Fund is to determine compliance with applicable state laws, 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 data from the July 1, 2014, actuarial valuation reports filed with the Public Employee Retirement Commission (PERC) for the city’s police, firefighters’ and non-uniformed municipal pension funds contained the following aggregated funding data:

<u>Actuarial Valuation of Assets</u>	<u>Actuarial Accrued Liability</u>	<u>Funding Ratio</u>
\$4,814,912,000	\$10,521,835,000	45.8%

Act 44 of 2009 specifically exempts the City of Philadelphia from the mandatory provisions of the new Act 205 recovery program until January 1, 2016. However, based on the funding information noted above, had the City of Philadelphia been subject to the provisions of the distress recovery program, the city would be considered to be in Level III severe distress status.

Act 205 of 1984 established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to Pennsylvania's public pension plans. Through the establishment of mandatory actuarial reporting and funding requirements, and by providing annual allocations of state aid, Act 205 was intended to provide a pathway for Pennsylvania's municipal pension plans to become fully funded. However, in the 30 years since Act 205 was implemented, despite the deposit of proceeds from the issuance of a \$1.29 billion general obligation bond in 1999, not only has the City of Philadelphia Municipal Pension Fund failed to achieve progress towards becoming fully funded, the funding status of the city's pension fund has dramatically deteriorated.

The City has established a new hybrid plan in 2010, has increased member contribution rates, and has incrementally lowered the fund's investment rate of return assumption from 8.25 percent in 2010 to 7.80 percent effective July 1, 2014. Despite these actions and regardless of the available remedies pursuant to Act 205 that the city may be required to implement in the future, given the current funded status of its municipal pension fund, the city should consider all available options in the development of a strategic plan to deal with its pension funding crisis. City officials must realize that there are no short-term fixes and that they must make fiscally responsible decisions as both fund fiduciaries and city officials that will benefit the City of Philadelphia and its taxpayers to ensure the city's pension fund has adequate resources to meet current and future benefit obligations to the city's hard-working police officers, firefighters and non-uniformed employees.

The contents of this report were discussed with officials of the City of Philadelphia 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. The City should also be commended for its reporting on Certification Form AG 490 given the large volume of data that must be annually included by the City.

August 17, 2015



EUGENE A. DEPASQUALE
Auditor General

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BACKGROUND

On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 *et seq.*). The act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to Pennsylvania's public pension plans. Section 402(j) of Act 205 specifically requires the Auditor General, as deemed necessary, to make an audit of every municipality which receives general municipal pension system state aid and of every municipal pension plan and fund in which general municipal pension system state aid is deposited.

Annual state aid allocations are provided from a 2 percent foreign (out-of-state) casualty insurance premium tax, a portion of the foreign (out-of-state) fire insurance tax designated for paid firefighters and any investment income earned on the collection of these taxes. Generally, municipal pension plans established prior to December 18, 1984, are eligible for state aid. For municipal pension plans established after that date, the sponsoring municipality must fund the plan for three plan years before it becomes eligible for state aid. In accordance with Act 205, a municipality's annual state aid allocation cannot exceed its actual pension costs.

In addition to Act 205, the City of Philadelphia Municipal Pension Fund is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code.

The City of Philadelphia Municipal Pension Fund is a multiple-employer cost sharing defined benefit pension fund with a small defined contribution component locally controlled by the provisions of Title 22 of the Philadelphia Code. The fund is also affected by the provisions of collective bargaining agreements between the city and its police officers, firefighters and non-uniformed employees.

The fund was established May 20, 1915. The fund has 3 basic plans, the 1967 plan, the 1987 plan and Plan 10. Plan 10 was established in 2010 and is a hybrid plan with both defined benefit and defined contribution elements. Police officers who are not Plan 10 participants are required to contribute 5 percent of compensation (6% for participants hired after January 1, 2010), but at least 30% and not more than 50% of the total normal cost for uniformed members while Plan 10 participants are required to contribute 5.5% of compensation. Firefighters who are not Plan 10 participants are required to contribute 5 percent of compensation (6% for participants hired after October 15, 2010), but at least 30% and not more than 50% of the total normal cost for uniformed members while Plan 10 participants are required to contribute 5.5% of compensation. Non-uniformed employees who are members of Plan 67 are required to contribute 3.75 percent of compensation to the fund. Non-uniformed employees who are members of Plan 87 are required to contribute 30% of the gross normal cost. Non-uniformed employees who are members of Plan 10 are required to contribute 50% of the gross normal cost. New employees are required to pay an additional 1.5% effective January 1, 2015 and 2.0% effective January 1, 2016, to opt out of Plan 10 and into Plan 87. As of June 30, 2014, the fund had 27,065 active members, 1,224 terminated members eligible for vested benefits in the future, and 36,533 retirees receiving pension benefits from the fund.

BACKGROUND – (Continued)

As of June 30, 2014, selected benefit provisions for police officers reported in the plan's actuarial valuation report are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 10 years of service.
Early Retirement	Age 40 and 10 years of service, or 25 years regardless of age.
Vesting	Member is 100% vested after 10 years of service, as of January 1999 new members (and old members who elect to do so) contribute an additional amount to become vested in 5 years.

Retirement Benefit:

Benefit equals 2.2% of average final compensation times years of credited service, up to a maximum of 20 years, plus 2.0% of average final compensation times years of credited service in excess of 20 years, subject to an overall maximum of 100% of average final compensation. Benefit equals 1.75% of average final compensation times years of credited service to a maximum of 20 years for Plan 10 participants. Under early retirement, the benefit is reduced by one half of 1% for each month prior to normal retirement age, but no reduction is made if member has at least 25 years of service.

Survivor Benefit:

Benefit determined using retirement benefit formula under 100% Joint and Survivor option, using a minimum of 10 years of service.

Service Related Disability Benefit:

Annual benefit of 70% of final compensation, but reduced by worker's compensation.

Non-Service Related Disability Benefit

Benefit determined under retirement formula (using a minimum of 10 years of service). Requires 10 years of service if disability is partial; no service requirement if disability is total.

BACKGROUND – (Continued)

As of June 30, 2014, selected benefit provisions for firefighters reported in the plan's actuarial valuation report are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 10 years of service.
Early Retirement	Age 40 and 10 years of service, or 25 years regardless of age.
Vesting	Member is 100% vested after 10 years of service, as of January 1999 new members (and old members who elect to do so) contribute an additional amount to become vested after 5 years.

Retirement Benefit:

Benefit equals 2.2% of average final compensation times years of credited service, up to a maximum of 20 years, plus 2.0% of average final compensation times years of credited service in excess of 20 years, subject to an overall maximum of 100% of average final compensation. Benefit equals 1.75% of average final compensation times years of credited service to a maximum of 20 years for Plan 10 participants. Under early retirement, the benefit is reduced by one half of 1% for each month prior to normal retirement age, but no reduction is made if member has at least 25 years of service.

Survivor Benefit:

Benefit determined using retirement benefit formula under 100% Joint and Survivor option, using a minimum of 10 years of service.

Service Related Disability Benefit:

Annual benefit of 70% of final compensation, but reduced by worker's compensation.

Non-Service Related Disability Benefit

If at least 5 years of service, benefit determined using the normal retirement formula, using a minimum of 10 years of service.

BACKGROUND – (Continued)

As of June 30, 2014, selected benefit provisions for non-uniformed employees reported in the plan's actuarial valuation report are as follows:

Eligibility Requirements:

Normal Retirement	Plan Y is age 60 and 10 years of service. Plan J is Age 55.
Early Retirement	Age 52 and 10 years of service, or 33 years regardless of age for Plan Y.
Vesting	Member is 100% vested after 10 years of service, as of January 1999 new members (and old members who elect to do so) contribute an additional amount to become vested after 5 years.

Retirement Benefit:

Plan J benefit equals 2.5% of average final compensation times years of credited service up to a maximum of 20 years, plus 2.0% of average final compensation times years of credited service in excess of 20 years, to a maximum of 80% of average final compensation. Plan Y benefit equals 2.2% of average final compensation times years of credited service, up to a maximum of 10 years, plus 2.0% of average final compensation times years of credited service in excess of 10 years, subject to an overall maximum of 100% of average final compensation. Under early retirement, the benefit is reduced by one half of 1% for each month the employee is younger than normal retirement age, but no reduction if member has 33 or more years of service.

Survivor Benefit:

If employee has at least 10 years of credited service or attained age 60, benefit determined using retirement benefit formula under 100% Joint and Survivor option.

Service Related Disability Benefit:

Annual benefit of 70% of final compensation, but reduced by worker's compensation.

Non-Service Related Disability Benefit

If at least 10 years of service, benefit determined using the normal retirement formula.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
STATUS OF PRIOR FINDINGS

Partial Compliance With Prior Audit Recommendations

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

- Incorrect Data On Certification Form AG 64 Resulting In Excess Reimbursements By The Commonwealth For Special 2002 Ad Hoc Postretirement Adjustments

In the prior audit period, the city filed its Certification Forms AG 64 on a fiscal year basis instead of a calendar year basis, resulting in the overpayment of postretirement adjustments received in 2008, 2009 and 2010. It was recommended the city reimburse the overpayments back to the Commonwealth and file future forms on the calendar year basis.

During the current audit period, the city reimbursed \$1,310,913 to the Commonwealth for overpayments received and filed their Certification Forms AG 64 on the calendar year basis. However, the city incorrectly reported the total amount of municipal contributions on the Certification Forms AG 64 submitted in 2011, 2013, 2014 and 2015, which has resulted in an underpayment of the state reimbursements due to the city, as further discussed in Finding No. 1 contained in this report; and

- Incorrect Data On Certification Form AG 490 Resulting In Excess Reimbursements By The Commonwealth For Special 1989 Ad Hoc Adjustments

In the prior audit period, the Certification Forms AG 490 filed by the city contained incorrect data which resulted in the overpayment of postretirement adjustments received in 2008, 2009 and 2010. It was recommended the city reimburse the overpayments back to the Commonwealth and take appropriate action to ensure the accuracy of the information reported in the future.

During the current audit period, the city reimbursed \$9,987 to the Commonwealth for overpayments of the special 1989 ad hoc postretirement adjustments received in 2008, 2009 and 2010. However, the Certification Forms AG 490 submitted in 2011, 2012, 2013, 2014 and 2015, contained discrepancies which has resulted in an overpayment of the reimbursements from the state, as further discussed in Finding No. 2 contained in this report.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 64 Resulting In A Net Underpayment Of The Reimbursements By The Commonwealth For Special 2002 Ad Hoc Postretirement Adjustments

Condition: The city annually files Certification Form AG 64 with the Department of the Auditor General. The data contained on this form determines the annual state reimbursement the city receives for cost of living adjustments paid to retirees pursuant to the provisions of Chapter 4 of Act 147, as amended. The reimbursement is determined, in part, on the total amount of non-employee contributions reported by the city. As disclosed in the Status of Prior Findings section of this report, during the prior audit period, the city filed its Certification Forms AG 64 on a fiscal year basis instead of a calendar year basis, resulting in the overpayment of postretirement adjustments received in 2008, 2009 and 2010. It was recommended the city reimburse the overpayments back to the Commonwealth and file future forms on the calendar year basis. During the current audit period, the city reimbursed \$1,310,913 to the Commonwealth for overpayments received and filed their Certification Forms AG 64 on the calendar year basis. However, fund officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified on all of the Certification Forms AG 64 submitted during and subsequent to the current audit period. The city over-certified \$655,000 of non-employee contributions made to the city's pension fund on the 2011 Certification Form AG 64. The city also under-certified \$153,972,204, \$185,104,476, and \$188,072,271 of non-employee contributions made to the city's pension fund on the Certification Forms AG 64 submitted in 2013, 2014, and 2015.

Criteria: Section 502.1(a)(2) of Act 147 states, in part:

The determination of the reimbursable amount of the amortization contribution requirement attributable to the special ad hoc postretirement adjustment under Chapter 4 in any year shall be calculated as the amortization contribution requirement attributable to the special ad hoc postretirement adjustments under Chapter 4 and reflected in the determination of the financial requirements of the pension fund under Chapter 3 of the Municipal Pension Plan Funding Standard and Recovery Act for the immediate prior year less the product of that amortization contribution requirement multiplied by the ratio of the amount of general municipal pension system State aid allocated to the retirement system in the immediate prior year to the total amount of municipal contributions made to the retirement system from all sources other than employee contributions in the immediate prior year. (Emphasis added)

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

In addition, the instructions for completing Item B of Section II of the Certification Form AG 64 state, in part:

Item B must include all non-employee contributions (municipal contributions and state aid) made to all plans...Also include any municipal contributions or state aid used to fund pension plan debt service payments on bonds or notes or both, issued to fund an unfunded actuarial accrued liability.

Cause: There was a failure to establish adequate internal control procedures between the fund and the city accountants to ensure the accuracy of the data certified.

Effect: The data submitted on these certification forms is used to calculate the reimbursement due the city for ad hoc postretirement adjustments granted pursuant to Chapter 4 of Act 147. The effect of the incorrect certification of pension data on the city’s reimbursements is identified below:

Year	Reimbursement Claimed	Reimbursement Due	Reimbursement Over/(Underpayment)
2011	\$ 5,659,509	\$ 5,658,420	\$ 1,089
2013	6,405,950	6,506,396	(100,446)
2014	5,991,348	6,280,875	(289,527)
2015	6,011,842	6,293,092	<u>(281,250)</u>
		Total underpayment	<u>\$ (670,134)</u>

Although the city will be reimbursed for the underpayment of ad hoc postretirement adjustments due to the city’s certification errors, the full amount of the 2013, 2014, and 2015 ad hoc postretirement adjustments were not available to be deposited timely and therefore were not available to pay operating expenses or for investment.

Recommendation: We recommend that in the future, fund officials establish adequate internal control procedures, such as having at least 2 people review the data certified on all certification forms submitted to the department, to ensure compliance with form instructions and to assist the city in accurately reporting the required pension data.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Management’s Response: Prior to and as a result of the audit, a formal process has been instituted resulting in an enhanced review and analysis by the City Accountants and Pensions of the underlying data required for completion of information necessary for the annual state forms. The enhanced process will result in a more reliable set of data to rely on in completing the state forms.

Additionally, a new Pension system replacing the City’s outdated mainframe system is scheduled for implementation in early 2016 and will integrate data from the City’s Payroll Department, Personnel Department, and Pensions. Accordingly, the possibility of required information not being fully disseminated at any point in the process will be greatly diminished.

Auditor’s Conclusion: Based on the management response, it appears the city is implementing procedures to comply with the finding recommendation. Compliance will be evaluated during our next audit of the pension fund.

Finding No. 2 – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 490 Resulting In Excess Reimbursements By The Commonwealth For Special 1989 Ad Hoc Postretirement Adjustments

Condition: The city annually files Certification Form AG 490 with the Department of the Auditor General. The data contained on this form determines the annual state reimbursement the city receives for cost of living adjustments (COLAs) paid to retirees pursuant to the provisions of Chapter 3 of Act 147, as amended. The reimbursement is determined on the total amount of the COLAs paid to eligible retirees and surviving spouses in the previous year reported by the city. In the prior audit period, the Certification Forms AG 490 filed by the city contained incorrect data which resulted in the overpayment of postretirement adjustments received in 2008, 2009 and 2010. It was recommended the city reimburse the overpayments back to the Commonwealth and take appropriate action to ensure the accuracy of the information reported in the future. As disclosed in the Status of Prior Findings section of this report, the city reimbursed \$9,987 to the Commonwealth for overpayments of the special 1989 Ad Hoc postretirement adjustments received in 2008, 2009 and 2010.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

However, the Certification Forms AG 490 submitted in 2011, 2012, 2013, 2014 and 2015, contained discrepancies which has resulted in an overpayment of the reimbursements from the state, as noted below:

<u>Certification Year</u>	<u>Individuals Improperly Certified</u>	<u>Overpayment of Special Ad Hoc Postretirement Adjustment</u>
2011	2	\$ 157
2012	1	300
2013	6	1,149
2014	10	<u>3,634</u>
Total overpayment		<u>\$ 5,240</u>

A similar condition occurred in the subsequent to the current audit period. The city improperly certified an additional \$4,200 of special Ad Hoc postretirement adjustments for 8 individuals in 2015.

Criteria: Pursuant to Act 147, Certification Form AG 490 should report only the amount of special ad hoc postretirement adjustments paid in the previous year to eligible retirees and/or their surviving spouses.

Cause: The city failed to ensure the accuracy of the data included on Certification Form AG 490.

Effect: The city received excess reimbursements by the Commonwealth in the amount of \$5,240 for the years 2011 through 2014 and will receive an excess reimbursement of \$4,200 in 2015.

Recommendation: We recommend that the total excess reimbursements, in the amount of \$5,240 for the years 2011 through 2014, be reimbursed 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 fund, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 320 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check. In addition, we recommend that the city reimburse the Commonwealth an additional \$4,200 upon receipt of its 2015 special 1989 Ad Hoc reimbursement.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

We also recommend that in the future, fund officials establish adequate internal control procedures, such as having at least 2 people review the data certified on all certification forms submitted to the department, to ensure compliance with form instructions and to assist the city in accurately reporting the required pension data.

Management's Response: The small amount of incorrect data included in this finding is largely due to reliance on an outdated mainframe pension system and a partial manual process. The Special 1989 Ad Hoc information is maintained on a separate database that is not integrated into the mainframe system. As a result, the information is required to be manually transferred onto the Ad Hoc database.

As indicated by the AG's report, "although there were discrepancies noted in the information submitted, the City should be commended for its reporting given the large volume of data that must be annually included on Certification Form AG 490."

Implementation of the new Pension system in early 2016 will resolve the issue by eliminating the need for the separate database and fully integrating all required data.

Auditor's Conclusion: Based on the management response, it appears the city is implementing procedures to comply with the finding recommendation. Compliance will be evaluated during our next audit of the pension fund.

It should also be noted that although there were discrepancies noted in the information submitted, the City should be commended for its reporting given the large volume of data that must be annually included on the Certification Form 490.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

The supplementary information contained on Pages 10-12 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 NET PENSION LIABILITY
 AND RELATED RATIOS
 JUNE 30, 2014

Total Pension Liability

Service cost	\$	136,986,515
Interest (includes interest on service costs)		774,518,750
Changes of assumptions		213,156,725
Benefit Payments, including refunds of member contributions		(808,597,357)
		10,126,155,633
Net change in total pension liability	\$	316,064,633
Total pension liability – beginning		10,126,155,633
		10,442,220,266

Plan Fiduciary Net Position

Contributions – employer	\$	553,178,927
Contributions – employee		53,722,275
Net investment income		681,469,584
Benefit Payments, including refunds of member contributions		(808,597,357)
Administrative expense		(8,291,820)
		471,481,609
Net change in plan fiduciary net position	\$	471,481,609
Plan fiduciary net position – beginning		4,445,223,788
		4,916,705,397
Plan fiduciary net position – ending (b)	\$	4,916,705,397
Net pension liability – ending (a) – (b)	\$	5,525,514,869
Plan fiduciary net position as a percentage of the total pension liability		47.08%
Covered employee payroll	\$	1,429,723,436
Net pension liability as a percentage of covered employee payroll		386.47%

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

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

The following presents the net pension liability of the System, calculated using the 7.85% discount effective June 30, 2014, as well as what the System'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 stated rate:

	1% Decrease (6.85%)	Discount Rate as of June 30, 2014 (7.85%)	1% Increase (8.85%)
Total pension liability	\$ 11,450,769,195	\$ 10,442,220,266	\$ 9,579,091,917
Plan fiduciary net position	4,916,705,397	4,916,705,397	4,916,705,397
Net pension liability	<u>\$ 6,534,063,798</u>	<u>\$ 5,525,514,869</u>	<u>\$ 4,662,386,520</u>
Plan fiduciary net position as a percentage of the total pension liability	42.9%	47.1%	51.3%

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF EMPLOYER CONTRIBUTIONS
 BASED ON ACT 205 MINIMUM MUNICIPAL OBLIGATION (MMO)
 Dollar Amounts in Thousands

Fiscal Year Ended June 30	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered-Employee Payroll	Contributions as a Percentage of Covered- employee Payroll
2005	\$ 293,990	\$ 299,266	\$ (5,276)	\$ 1,270,700	23.55%
2006	306,873	331,765	(24,892)	1,319,400	25.15%
2007	400,256	432,267	(32,011)	1,351,826	31.98%
2008	412,449	426,934	(14,485)	1,461,640	29.21%
2009	438,522	455,389	(16,867)	1,462,451	31.14%
2010*	447,446	312,556	134,890	1,422,987	21.96%
2011*	511,000	470,155	40,845	1,410,207	33.34%
2012	507,021	555,690	(48,669)	1,387,086	40.06%
2013*	491,990	781,823	(289,833)	1,423,417	54.93%
2014	523,368	553,179	(29,811)	1,556,660	35.54%

* - The deficiencies in the contributions due for 2010 and 2011 were due to the amounts the city was permitted to defer pursuant to Act 44 of 2009. The contributions made in 2013 include the repayment of amounts deferred by the city in 2010 and 2011, plus interest.

The City met its Act 205 funding requirements (MMO) for the years covered by the current audit period.

SCHEDULE OF INVESTMENT RETURNS

Annual money-weighted rate of return, net of investment expenses not funded through the minimum municipal obligation (MMO).

2014

15.77%

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF FUNDING PROGRESS

Historical trend information about the fund is presented herewith as supplementary information. It is intended to help users assess the funding status of the city's pension fund 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 July 1, 2009, is as follows (dollars in millions):

	(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)
07-01-09	\$ 4,042.1	\$ 8,975.0	\$ 4,932.9	45.0%
07-01-10	4,380.9	9,317.0	4,936.2	47.0%
07-01-11	4,719.1	9,487.5	4,768.4	49.7%
07-01-12	4,716.8	9,799.9	5,083.1	48.1%
07-01-13	4,799.3	10,126.2	5,326.9	47.4%
07-01-14	4,814.9	10,521.8	5,706.9	45.8%

Note: The market values of the fund's assets have been adjusted to reflect the smoothing of gains and/or losses over a 10-year averaging period. 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.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
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 funding status of the pension fund 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 fund.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
 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:

	Police Officers	Firefighters	Non-uniformed Employees
Actuarial valuation date	July 1, 2014	July 1, 2014	July 1, 2014
Actuarial cost method	Entry age normal	Entry age normal	Entry age normal
Amortization method	Level dollar	Level dollar	Level dollar
Remaining amortization period	16 years	15 years	16 years
Asset valuation method	10-year smoothing, value subject to a corridor between 80-120% of market value.	10-year smoothing, value subject to a corridor between 80-120% of market value.	10-year smoothing, value subject to a corridor between 80-120% of market value.

Actuarial assumptions:

Investment rate of return	7.8%	7.8%	7.8%
Projected salary increases	3.3%	3.3%	3.3%
Cost-of-living adjustments	None assumed	None assumed	None assumed

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
COMMENTS

Deferred Retirement Option Plan (DROP)

The prior audit report contained an observation that the city should continue to review the cost of maintaining its DROP program. We note that the City has prohibited officials elected to office after September 18, 2009, from participating in the DROP. In addition, non-uniformed employees can only participate in the DROP when they are 2 years older than their minimum retirement age. Furthermore, effective January 1, 2012, the interest rate credited to DROP accounts shall be determined annually based on the lesser of the yield then in effect on one year United States Treasury Bonds or one-half of the then-effective interest rate used to calculate the earnings of the reserves of the retirement system.

The City should continue to review the cost of maintaining its DROP program and consider all available options, including termination of the DROP, at its earliest opportunity to do so, to help ensure that benefit obligations to fund members are adequately funded without placing an unfair burden on the taxpayers to meet those benefit obligations.

One Percent Sales and Use Tax Increase Extension

Act 44 of 2009 authorized the City of Philadelphia to temporarily impose a 1% sales and use tax with any monies received from the sales and use tax required to be applied to the toward payment of the City's MMOs and repayment of amounts deferred with interest. The City adopted Bill No. 090244-A, an ordinance imposing the additional 1% sales and use tax for the period August 1, 2009 to June 30, 2014.

In June of 2014, the City adopted Bill No. 140489, an ordinance which increased the sales and use tax by 1% effective July 1, 2014. The distribution of the tax proceeds is determined as follows:

For fiscal year 2015, the first \$120,000,000 shall be distributed to the School District of Philadelphia with the balance going to the City for the pension fund.

For fiscal year 2016, 70% shall be distributed to the School District of Philadelphia and 30% to the City for the pension fund.

For fiscal year 2017, 60% shall be distributed to the School District of Philadelphia and 40% to the City for the pension fund.

For fiscal year 2018, and each fiscal year thereafter, 50% shall be distributed to the School District of Philadelphia and 50% to the City for the pension fund.

CITY OF PHILADELPHIA MUNICIPAL PENSION FUND
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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Commonwealth of Pennsylvania

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Philadelphia County
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Philadelphia, PA 19102

The Honorable Michael A. Nutter	Mayor
Mr. Darrell Clarke	Council President
Mr. Alan Butkovitz	Controller
Mr. Rob Dubow	Director of Finance
Mr. Francis X. Bielli, Esquire	Executive Director
Ms. Shamika Taliaferro	Deputy Pension Director
Mr. Mark J. Murphy	Pension Lead

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