

COMPLIANCE AUDIT

City of Pittston Police Pension Plan Luzerne County, Pennsylvania For the Period January 1, 2012 to December 31, 2013

May 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 Pittston
Luzerne County
Pittston, PA 18640

We have conducted a compliance audit of the City of Pittston Police Pension Plan for the period January 1, 2012 to December 31, 2013. We also evaluated compliance with some requirements for the year 2014 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 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 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 1 plan member who retired during the current audit period, represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the monthly pension benefit due to retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient.
- × We determined whether the January 1, 2011 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, respectively, in accordance with Act 205 and whether selected information provided on these reports is accurate, complete, and in accordance with plan provisions to ensure compliance for participation in the state aid program by comparing selected information to supporting source documentation.
- × We determined whether the terms of the plan's 1 unallocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contract with the plan's provisions, investment policies, and state regulations.

The City of Pittston 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 Pittston 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 Pittston 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 findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Pension Provision Not In Compliance With Third Class City Code

Finding No. 2 – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Finding No. 1 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.

As previously noted, one of the objectives of our audit of the City of Pittston Police Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information or conclude on it and, accordingly, express no form of assurance on it. However, we are extremely concerned about the funded status of the plan contained in the

schedule of funding progress included in this report, which indicates a decline of assets available to satisfy the long-term liabilities of the plan. **For example, the plan's funded ratio went from 54.2% as of January 1, 2009, to a ratio of 47.0% as of January 1, 2013, which is the most recent data available.** Based on this information, and the funding status of the city's officers and employees and paid firemen's pension plans, the Public Employee Retirement Commission issued a notification that the city is currently in Level II moderate distress status. We encourage city officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

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

April 21, 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 Pittston 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 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 Pittston Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of the File of Council No. 1 of 1974, as amended, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established January 1, 1960. Active members are required to contribute 2 percent of compensation to the plan. As of December 31, 2013, the plan had 8 active members, 1 terminated member eligible for vested benefits in the future, and 10 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	20 years of service
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit equals 50% of average monthly compensation based on higher of final rate of pay or the 5 highest years average, plus an incremental monthly pension (maximum of \$100) of 1/40th of the basic pension benefit times years of service over 20 earned prior to age 65.

Survivor Benefit:

For death not in the line of duty and before completing 10 years of service, death benefit is 25% of pay. For death in the line of duty or after completing 10 years of service, death benefit is 50% of pay. If retired, benefit is 100% of monthly pension benefit.

Service Related Disability Benefit:

Benefit equals 50% of compensation.

CITY OF PITTSTON POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

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

- Pension Benefit Not In Compliance With Third Class City Code

CITY OF PITTSTON POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Pension Provision Not In Compliance With Third Class City Code

Condition: As disclosed in the prior audit report, the pension plan’s governing document, File of Council No. 1 of 1974, as amended, fails to contain a provision that is in compliance with the Third Class City Code. The specific inconsistency is noted below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Third Class City Code</u>
Member’s contributions upon rehire	No provision	If any such member shall have returned to him the amount contributed, and shall afterward again become a member of the police force, he shall not be entitled to the pension designated until twenty years after his reemployment, unless he shall return to the pension fund the amount withdrawn, in which event the period of twenty years shall be computed from the time the member first became a member of the police force, excluding there from any period of time during which the member was not employed by the police force.

Criteria: The police pension plan’s benefit structure should be in compliance with the Third Class City Code.

Cause: Plan officials have failed to adopt adequate internal control procedures to ensure compliance with the prior audit recommendation.

Effect: Police officers may not properly reimburse the plan for member contributions previously reimbursed to them.

Recommendation: We again recommend that the city take appropriate action to ensure the plan’s governing document is in full compliance with the Third Class City Code at its earliest opportunity to do so.

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 PITTSTON POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: Plan officials did not fully pay the minimum municipal obligation (MMO) of the police pension plan for the year 2014, as required by Act 205. The municipality had determined a \$334,650 MMO due to the plan for 2014; however, the city only deposited \$38,786 of state aid into the plan, leaving an unpaid balance of \$295,864 for the year 2014.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

Cause: The city lacked the financial resources to fully fund the plan in 2014.

Effect: The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the 2014 MMO by the December 31, 2014, deadline, the municipality must add the 2014 MMO balance to the current year's MMO and include interest, as required by Act 205.

CITY OF PITTSTON POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Furthermore, the city's future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that the municipality pay the MMO due to the police pension plan for the year 2014, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the city for examination during our next audit of the plan.

Furthermore, we recommend that in the future, plan officials pay the full MMO due to the plan in accordance with Act 205 requirements.

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

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

CITY OF PITTSTON POLICE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

A condition such as that reported by Finding No. 2 contained in this audit report may lead to a total withholding of state aid in the future unless that finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 316-D Finance Building, Harrisburg, PA 17120.

CITY OF PITTSTON 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	\$ 2,503,410	\$ 4,616,681	\$ 2,113,271	54.2%	\$ 343,886	614.5%
01-01-11	2,476,895	4,625,273	2,148,378	53.6%	350,221	613.4%
01-01-13	2,330,256	4,955,153	2,624,897	47.0%	334,180	785.5%

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 over a 5-year averaging period. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

CITY OF PITTSTON 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 PITTSTON 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	\$ 191,593	100.0%
2009	185,214	100.0%
2010	185,877	100.0%
2011	257,000	100.0%
2012	245,511	100.0%
2013	313,765	100.0%

CITY OF PITTSTON 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	11 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	4.0%

CITY OF PITTSTON POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

City of Pittston Police Pension Plan
Luzerne County
35 Broad Street
Pittston, PA 18640

The Honorable Jason C. Klush Mayor

Mr. Joseph Moskovitz City Manager

This report is a matter of public record and is available online at www.PaAuditor.gov. 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@PaAuditor.gov.