

COMPLIANCE AUDIT

City of Farrell Firemen's Pension Plan Mercer County, Pennsylvania For the Period January 1, 2012 to December 31, 2013

December 2014



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



**Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
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**EUGENE A. DePASQUALE
AUDITOR GENERAL**

The Honorable Mayor and City Council
City of Farrell
Mercer County
Farrell, PA 16121

We have conducted a compliance audit of the City of Farrell Firemen's Pension Plan for the period January 1, 2012 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 conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the 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. 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 terms of the contractual agreement with the Pennsylvania Municipal Retirement System are in accordance with the plan's governing document, if separately stated, and applicable laws and regulations.
- 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.

The City of Farrell Firemen's Pension Plan participates in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's 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 Farrell Firemen's 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.

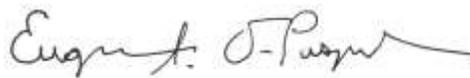
The results of our tests indicated that, in all significant respects, the City of Farrell Firemen's Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

As previously noted, one of the objectives of our audit of the City of Farrell Firemen's 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 **the plan's funded ratio is 47.4% as of January 1, 2013**, which is the most recent date available. Based on this information, the funded status of the city's non-uniformed plan, and the funded status of the city's police plan (which we did not audit due to lack of activity) the Public Employee Retirement Commission issued a notification that the city is currently in Level I minimal distress status. We encourage city officials to monitor the funding of the firemen's pension plan to ensure its long-term financial stability.

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



EUGENE A. DEPASQUALE
Auditor General

November 24, 2014

CONTENTS

	<u>Page</u>
Background.....	1
Status of Prior Finding.....	3
Supplementary Information	4
Report Distribution List	8

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 Farrell Firemen's 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 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974 (P.L. 34, No. 15), as amended, 53 P.S. § 881.101 et seq.

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.

The City of Farrell Firemen's Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 0-1-2010, adopted pursuant to Act 15. The plan was established October 13, 1964. Active members are required to contribute 5 percent of pay, plus \$1 per month until age 65, to the plan. As of December 31, 2013, the plan had 2 active members, no terminated members eligible for vested benefits in the future, and 10 retirees receiving benefits funded through annuities purchased with plan assets.

BACKGROUND – (Continued)

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

Eligibility Requirements:

Normal Retirement	Available upon attainment of age 50 with 10 years of service if hired prior to January 24, 2001; age 50 with 12 years of service if hired on or after January 24, 2001.
Early Retirement	Age 45 with 20 years of service if hired prior to January 24, 2001; none available if hired on or after January 24, 2001.
Vesting	A member is 100% vested after 10 years of service if hired prior to January 24, 2001; 100% vested after 12 years of service if hired on or after January 24, 2001.

Retirement Benefit:

Benefit equals 2.0% times credited service times Final Average Salary (FAS), but in no event is the basic benefit greater than 50% of FAS. FAS based upon the greater of final 1 year of employment or highest 5 consecutive years annualized salary. In addition to the basic benefit allowance, a service increment for each year of service in excess of 25 years, not to exceed \$100 per month.

Survivor Benefit:

If eligible to retire or if retired at the time of death, spouse receives 100% of member's benefit.

Disability Benefit:

Service Related	A 50% disability benefit is provided to a member who is unable to perform gainful employment regardless of age or service, offset by available Workers' Compensation benefits.
Non-service Related	Available only to members hired before January 24, 2001, with at least 25 years of service and unable to perform gainful employment. Benefit is 50% of monthly salary, reduced by 5% of monthly salary for each year before normal retirement, and increased by 5% of monthly salary for each year of service in excess of 25 years, with a maximum benefit of 45% of monthly salary.

CITY OF FARRELL FIREMEN'S PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

The City of Farrell has complied with the prior audit recommendation concerning the following:

- Incorrect Data On Certification Form AG 64 Resulting In An Excess Reimbursement For Special 2002 Ad Hoc Postretirement Adjustment

During the current audit period, the city returned \$2,259 to the Commonwealth for the excess reimbursement received in 2012.

CITY OF FARRELL FIREMEN'S 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	\$ 1,200,497	\$ 1,809,536	\$ 609,039	66.3%	\$ 84,648	719.5%
01-01-11	1,018,488	2,100,541	1,082,053	48.5%	88,677	1,220.2%
01-01-13	987,975	2,084,256	1,096,281	47.4%	93,518	1,172.3%

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses over a 4-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 FARRELL FIREMEN'S 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 FARRELL FIREMEN'S PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2008	\$ 71,297	100.0%
2009	71,832	100.0%
2010	63,626	100.0%
2011	71,394	100.0%
2012	71,838	100.0%
2013	157,493	100.0%

CITY OF FARRELL FIREMEN'S 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, closed
Remaining amortization period	13 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	5.5%, net of expenses
Projected salary increases *	Age-related scale for merit/ seniority (e.g. age 30 - 6.4%; age 40 - 5.0%; age 50 - 4.1%; age 60 - 3.7%)
Cost-of-living adjustments	3.0%, where applicable

* Includes inflation at 3.0%

CITY OF FARRELL FIREMEN'S PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of Farrell Firemen's Pension Plan
Mercer County
500 Roemer Boulevard
Farrell, PA 16121

The Honorable Olive M. McKeithan Mayor

Mr. Michael L. Ceci City Manager

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.