# COMPLIANCE AUDIT

# City of Erie Aggregate Pension Fund

## Erie County, Pennsylvania

For the Period
January 1, 2013 to December 31, 2014

October 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 Erie
Erie County
Erie, PA 16501

We have conducted a compliance audit of the City of Erie Aggregate Pension Fund for the period January 1, 2013 to December 31, 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 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 aggregate 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 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 aggregate 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 plans' governing documents and applicable laws and regulations by examining the municipality's calculation of the plans' annual financial requirements and minimum municipal obligations (MMOs) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plans as evidenced by supporting documentation.

- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plans in accordance with the plans' governing documents and applicable laws and regulations by testing members' contributions on an annual basis using the rates obtained from the plans' 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 plans.

- We determined whether retirement benefits calculated for 48 of the 71 individuals who retired during the current audit period, and through completion of our fieldwork procedures, represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plans' governing documents, 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 also determined whether retirement benefits calculated for all 4 of the individuals who elected to vest during the current audit period, represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plans' governing documents, applicable laws and regulations by recalculating the amount of the pension benefit due and comparing these amounts to supporting documentation evidencing amounts determined.

- 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 all annual special ad hoc postretirement reimbursements received by the municipality were authorized and appropriately deposited in accordance with Act 147 by tracing information to supporting documentation maintained by plan officials.

- We determined whether the pension plan is in compliance with Act 205 for distressed municipalities through inquiry of plan officials and evaluation of the recovery remedies implemented during the audit period.

- We determined whether the terms and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions, were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation for pension obligation bonds previously issued by the city.

- We determined whether provisions of the Deferred Retirement Option Plan (DROP) were in accordance with the provisions of Act 205 by examining provisions stated in the plans' governing documents.

The City of Erie contracted with independent certified public accounting firms for audits of the financial statements of each of the city's pension plans for the year ended December 31, 2013, 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 Erie Aggregate 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 Erie Aggregate Pension Fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

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 schedules of funding progress which indicates the police pension plan's funded ratio is 70.5% and the firemen's pension plan's funded ratio is 68.9% as of January 1, 2013**, which is the most recent data available. We encourage city officials to monitor the funding of the police and firemen's pension plans to ensure their long-term financial stability.

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

October 9, 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 Erie Aggregate 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 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 399 - Optional Third Class City Charter Law, Act of July 15, 1957 (P.L. 901, No. 399), as amended, 53 P.S. § 41101 et seq.

The city's pension plans are single-employer defined benefit pension plans locally controlled by Article 145 (Officers' and Employees'), Article 147 (Police) and Article 149 (Firemen's) of the city's codified ordinances. The plans are also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees, police officers and firefighters.

The officers' and employees' pension plan was established May 23, 1944. Active members are required to contribute 6.5 percent of compensation to the plan. As of December 31, 2014, the plan had 320 active members, 25 terminated members eligible for vested benefits in the future, and 383 retirees receiving pension benefits from the plan.

## BACKGROUND – (Continued)

The police pension plan was established June 20, 1950. Active members hired prior to January 1, 1981 are required to contribute 5 percent of base and longevity pays, plus $1 per month, to the plan. Members hired on or after January 1, 1981 are required to contribute 6 percent of base and longevity pays, plus $1 per month, to the plan. As of December 31, 2014, the plan had 172 active members, 3 terminated members eligible for vested benefits in the future and 253 retirees receiving pension benefits from the plan.

The firemen's pension plan was established December 22, 1965. Active members are required to contribute 6 percent of base and longevity pays, plus $1 per month, to the plan. As of December 31, 2014, the plan had 134 active members, no terminated members eligible for vested benefits in the future and 192 retirees receiving pension benefits from the plan.

## BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions are as follows:

Officers' and Employees' Pension Plan

Eligibility Requirements:

| | |
|---|---|
| Normal Retirement | Age 55 and 20 years of service. |
| Early Retirement | None |
| Vesting | With 12 years of service, deferred to age 60; and with 20 years of service, deferred to age 55. |

Retirement Benefit:

Benefit equals 50% of the greater of the member's current hourly pay rate expressed as monthly earnings or the highest 5 year average monthly earnings, plus a service increment equal to $1/40^{th}$ of the retirement allowance times years of service in excess of 20 years.

Survivor Benefit:

| | |
|---|---|
| Before Retirement Eligibility | Refund of member contributions, without interest. |
| After Retirement Eligibility | A monthly benefit equal to 50% of the pension the member was receiving or was entitled to receive on the day of the member's death. |

Service Related Disability Benefit:

The normal retirement benefit after 15 years of service.

## Police Pension Plan

Eligibility Requirements:

| | |
|---|---|
| Normal Retirement | Age 50 and 20 years of service. |
| Early Retirement | None |
| Vesting | A member is 100% vested after 12 years of service. |

Retirement Benefit:

Benefit equals 50% of the final pay at retirement plus a service increment equal to 1/40th of the retirement allowance times years of service in excess of 20 years, to a maximum of $500 per month.

Survivor Benefit:

| | |
|---|---|
| Before Retirement Eligibility | Refund of member contributions, without interest. |
| After Retirement Eligibility | A monthly benefit equal to 100% of the pension the member was receiving or was entitled to receive on the day of the member's death. |

Service Related Disability Benefit:

| | |
|---|---|
| Standard Service-Connected | Benefit equals 50% of the member's final pay at the time the disability was incurred, plus service increments. |
| Enhanced Service-Connected | Benefit equals 75% of the member's final pay at the time the disability was incurred. |

## Firemen's Pension Plan

Eligibility Requirements:

| | |
|---|---|
| Normal Retirement | Age 50 and 20 years of service. |
| Early Retirement | None |
| Vesting | A member is 100% vested after 12 years of service. |

Retirement Benefit:

Benefit equals 50% of the final pay at retirement plus a service increment equal to 1/40$^{th}$ of the retirement allowance times years of service in excess of 20 years, to a maximum of $500 per month.

Survivor Benefit:

| | |
|---|---|
| Before Retirement Eligibility | With less than 12 years of service, a monthly benefit equal to 25% of the member's final pay. With the completion of 12 years of service, a monthly benefit equal to 50% of the member's final pay. |
| After Retirement Eligibility | A monthly benefit equal to 100% of the pension the member was receiving or was entitled to receive on the day of the member's death. |

Service Related Disability Benefit:

Benefit equals 75% of the member's final pay at the time the disability was incurred.

CITY OF ERIE AGGREGATE PENSION FUND
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

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

- Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

  The city reimbursed $36,992 to the Commonwealth for excess state aid received in 2012 and 2013.

CITY OF ERIE AGGREGATE PENSION FUND
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:

### OFFICERS' AND EMPLOYEES' PENSION PLAN

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a) | Funded Ratio (a)/(b) |
| 01-01-09 | $ 70,560,169 | $ 88,757,151 | $ 18,196,982 | 79.5% |
| 01-01-11 | 76,533,767 | 93,663,027 | 17,129,260 | 81.7% |
| 01-01-13 | 82,347,721 | 100,763,350 | 18,415,629 | 81.7% |

Note: 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 subject to a corridor between 70 to 130 percent of the market value of assets. The market value of the plan's assets at 01-01-13 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 80 to 120 percent of the market value 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.

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF FUNDING PROGRESS – (Continued)

POLICE PENSION PLAN

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a) | Funded Ratio (a)/(b) |
| 01-01-09 | $ 74,279,908 | $ 99,787,719 | $ 25,507,811 | 74.4% |
| 01-01-11 | 78,366,780 | 107,811,043 | 29,444,263 | 72.7% |
| 01-01-13 | 82,049,259 | 116,397,494 | 34,348,235 | 70.5% |

Note: 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 subject to a corridor between 70 to 130 percent of the market value of assets. The market value of plan's assets at 01-01-13 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 80 to 120 percent of the market value 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.

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF FUNDING PROGRESS – (Continued)

FIREMEN'S PENSION PLAN

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a) | Funded Ratio (a)/(b) |
| 01-01-09 | $ 56,028,150 | $ 78,717,825 | $ 22,689,675 | 71.2% |
| 01-01-11 | 59,916,715 | 84,758,266 | 24,841,551 | 70.7% |
| 01-01-13 | 63,498,793 | 92,112,660 | 28,613,867 | 68.9% |

Note: 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 subject to a corridor between 70 to 130 percent of the market value of assets. The market value of the plan's assets at 01-01-13 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 80 to 120 percent of the market value 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.

CITY OF ERIE AGGREGATE 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 plan's funding status on a going-concern basis. Analysis of this percentage, over time, indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the plan.

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

OFFICERS' AND EMPLOYEES' PENSION PLAN

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2009 | $ 2,180,475 | 100.0% |
| 2010 | 2,184,070 | 100.0% |
| 2011 | 2,060,284 | 100.0% |
| 2012 | 2,073,598 | 100.0% |
| 2013 | 2,458,545 | 100.0% |
| 2014 | 2,456,199 | 100.0% |

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES – (Continued)

POLICE PENSION PLAN

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2009 | $ 2,870,932 | 100.0% |
| 2010 | 2,885,521 | 100.0% |
| 2011 | 2,658,837 | 100.0% |
| 2012 | 2,698,115 | 100.0% |
| 2013 | 3,988,557 | 100.0% |
| 2014 | 4,004,714 | 100.0% |

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES – (Continued)

FIREMEN’S PENSION PLAN

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2009 | $ 2,595,678 | 100.0% |
| 2010 | 2,669,197 | 100.0% |
| 2011 | 2,583,586 | 100.0% |
| 2012 | 2,618,602 | 100.0% |
| 2013 | 3,642,281 | 100.0% |
| 2014 | 3,703,438 | 100.0% |

CITY OF ERIE AGGREGATE PENSION FUND
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:

OFFICERS' AND EMPLOYEES' PENSION PLAN

| | |
|---|---|
| Actuarial valuation date | January 1, 2013 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar, closed |
| Remaining amortization period | |
| Established January 1, 1985 | 12 years |
| After January 1, 1985 | 11 years |
| Asset valuation method | Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 80-120% of the market value of assets. |
| Actuarial assumptions: | |
| Investment rate of return | 8.0% |
| Projected salary increases * | 5.0% |
| Cost-of-living adjustments | None assumed |

* Includes inflation at 3.0%

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

POLICE PENSION PLAN

| | |
|---|---|
| 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 | Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 80-120% of the market value of assets. |
| Actuarial assumptions: | |
| Investment rate of return | 8.0% |
| Projected salary increases * | 5.0% |
| Cost-of-living adjustments | 4.0% |

* Includes inflation at 3.0%

## FIREMEN’S PENSION PLAN

| | |
|---|---|
| Actuarial valuation date | January 1, 2013 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar, closed |
| Remaining amortization period | 12 years |
| Asset valuation method | Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 80-120% of the market value of assets. |
| Actuarial assumptions: | |
| Investment rate of return | 8.0% |
| Projected salary increases * | 5.0% |
| Cost-of-living adjustments | 4.0% |

* Includes inflation at 3.0%

CITY OF ERIE AGGREGATE PENSION FUND
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

City of Erie Aggregate Pension Fund
Erie County
626 State Street
Erie, PA 16501

| | |
|---|---|
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