

# COMPLIANCE AUDIT

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## City of Sharon Police Pension Plan Mercer County, Pennsylvania For the Period January 1, 2013 to December 31, 2014

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October 2015



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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**EUGENE A. DePASQUALE  
AUDITOR GENERAL**

City Council  
City of Sharon  
Mercer County  
Sharon, PA 16146

We have conducted a compliance audit of the City of Sharon Police Pension Plan 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 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 to 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 all 3 of the plan members 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 the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients.
- × 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.

The City of Sharon contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2013, which is 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 Sharon 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 Sharon 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 – Partial Compliance With Prior Audit Recommendation –  
Inconsistent And Unauthorized Pension Benefit Provision

Finding No. 2 – Incorrect Data On Certification Form AG 490 Resulting In An  
Excess Reimbursement For Special 1989 Ad Hoc  
Postretirement Adjustment

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.

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information or conclude on it and, accordingly, express no form of assurance on it. However, we are extremely concerned about the historical trend information contained in the schedule of funding progress included in this report which indicates a continued decline of assets available to satisfy the long-term liabilities of the plan. **The plan's funded ratio went from 83.9% as of January 1, 2009, to a ratio of 67.2% as of January 1, 2013**, which is the most recent data available. 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 Sharon 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.

September 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 Sharon 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 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1158, No. 177), as amended, 53 Pa.C.S. § 101 et seq.
- Act 317 - The Third Class City Code, Act of June 23, 1931 (P.L. 932, No. 317), as amended, 53 P.S. § 35101 et seq.

The City of Sharon Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Chapters 286 and 287 of the city's codified ordinances. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established April 12, 1967. Active members are required to contribute 3 percent of base and longevity pay, plus \$1 per month to the plan. As of December 31, 2014, the plan had 25 active members, 1 terminated member eligible for vested benefits in the future and 34 retirees receiving pension benefits from the plan.

## BACKGROUND – (Continued)

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

### Eligibility Requirements:

Normal Retirement	Age 50 and 20 years of service.
Early Retirement	None
Vesting	Member is 100% vested after 10 years of service. If hired on or after January 1, 2008, Member is 100% vested after 12 years of service.

### Retirement Benefit:

Benefit equals 50% of Final Monthly Average Salary plus a service increment equal to 1/40<sup>th</sup> of the retirement allowance times years of completed service over 20 years (service beyond age 65 is not counted) to a maximum increment of \$300 per month. Final Monthly Average Salary is defined as the greater of (a) the rate of the participant's monthly salary at retirement, death or termination of employment or (b) the sum of salary received during the five highest years prior to retirement, death or termination of employment, divided by 60.

### Survivor Benefit:

Before Retirement Eligibility	Any police officer who has less than 10 years of service and who dies not in the line of duty, shall be entitled to 25% of the Final Monthly Average Salary computed as of the time of death. For death after 10 years of service, benefit equals 50% of the Final Monthly Average Salary as of the time of death.
After Retirement Eligibility	100% to the surviving spouse during their lifetime. If the surviving spouse dies or already has died, then 50% (100% for disability pensioners) to a child or children of the officer under the age of 18.

## **BACKGROUND – (Continued)**

### Disability Benefit:

Service Related	Normal Retirement Benefit including Service Increment. If hired on or after January 1, 2008, the benefit is offset by Workers Compensation payments or Enforcement Officers Disability Benefit Law payments.
Non-Service Related	Benefit equals 25% of Salary at the time of disability for any police officer with less than 10 years of service who is disabled due to injury or illness not in the line of duty. After 10 years of service, an officer shall be entitled to 50% of Salary at the time of disability.

CITY OF SHARON POLICE PENSION PLAN  
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

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

- Inconsistent And Unauthorized Pension Benefit Provisions

On July 17, 2014, the city entered into a collective bargaining agreement for the period January 1, 2014 through December 31, 2017, which provides a vesting provision for police officers hired as of January 1, 2008 in compliance with Ordinance No. 07-09 and the Third Class City Code. However, Ordinance No. 07-09 and the current collective bargaining agreement continue to provide a non-service related disability survivor benefit that is not in compliance with the Third Class City Code, as further discussed in Finding No. 1 contained in this report.

CITY OF SHARON POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Inconsistent And Unauthorized Pension Benefit Provision**

Condition: As disclosed in the Status of Prior Finding section of this report, the city partially complied with our prior audit recommendation by correcting an inconsistent vesting provision for police officers hired after January 1, 2008 to comply with the Third Class City Code. However, Ordinance No. 07-09 and the collective bargaining agreement between the city and its police officers still contain a non-service related disability survivor benefit that is not in compliance with the Third Class City Code, as noted below:

<u>Benefit Provision</u>	<u>Ordinance No. 07-09 Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Third Class City Code</u>
Nonservice-Related Disability Survivor Benefit	...paid to the surviving spouse until the date of death of the surviving spouse... if the Participant died without a surviving spouse, ... 50% of pension shall be paid monthly in equal shares to the surviving children of the deceased Participant until the death or attainment of age 18 of each child....	Same as Ordinance No. 07-09.	For families, a continuation of the disability benefit payment to the spouse until death or remarriage, then to the child or children under age 18.

Criteria: Section 4303(d) of the Third Class City Code states, in part:

The disability pension may be payable to the police officer during his lifetime and if he shall die, the pension payment that he was receiving may be continued to be paid to his spouse if such person survives or if such person subsequently dies or remarries, then the child or children under the age of eighteen years of the police officer.

Cause: The city was unable to resolve this remaining issue through the collective bargaining process.

Effect: Unauthorized benefit provisions could result in incorrect benefit payments to beneficiaries.

CITY OF SHARON POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – (Continued)**

Furthermore, providing an unauthorized pension benefit could increase the plan's pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Since the city received state aid based on unit value for its pension plans during the current audit period, it did not receive allocations attributable to the unauthorized pension benefit provided. However, the increased costs to the pension plan as a result of the unauthorized pension benefit could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

Recommendation: We again recommend that municipal officials take appropriate action to ensure that the plan's varying governing document and collective bargaining agreement contain benefit provisions in accordance with the Third Class City Code for police officers hired after January 1, 2008, at their earliest opportunity to do so.

Management's Response: City officials agreed with the finding and indicated the city will make every effort to attempt to comply during the next collective bargaining process.

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

**Finding No. 2 – Incorrect Data On Certification Form AG 490 Resulting In An Excess Reimbursement For Special 1989 Ad Hoc Postretirement Adjustment**

Condition: The city improperly certified \$1,500 of special ad hoc postretirement adjustment reimbursements on Certification Forms AG 490 submitted during 2014 and 2015. The city certified ad hoc benefits amounting to \$1,200 for two surviving spouses receiving benefits from the police pension plan and \$300 for one surviving spouse receiving benefits from the firemen's pension plan. The retirees related to these surviving spouses were all deceased prior to December 31, 1988; therefore, neither the retirees nor the survivors ever received these special ad hoc postretirement adjustments and the city was not entitled to these reimbursements.

Criteria: Section 301 of Act 147 states, in part:

A municipal retirement system shall pay a retired police officer or firefighter a special ad hoc municipal police and firefighter postretirement adjustment under this chapter...

CITY OF SHARON POLICE PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – (Continued)**

Section 303 of Act 147 states, in part:

The special ad hoc adjustment is effective on the date of the first payment of the retiree’s retirement annuity, retirement benefit, service pension or disability pension benefit due after December 31, 1988....

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

Effect: The data submitted on this certification form is used to calculate the reimbursement due the city for ad hoc postretirement adjustments granted pursuant to Chapter 3 of Act 147. The effect of the incorrect certification of pension data on the city’s reimbursement is identified below:

<u>Year</u>	<u>Reimbursement Claimed</u>	<u>Reimbursement Due</u>	<u>Excess Reimbursement</u>
2014	\$ 6,150	\$ 4,650	\$ 1,500
2015	5,850	4,350	<u>1,500</u>
		Total	<u><u>\$ 3,000</u></u>

Recommendation: We recommend that the total excess reimbursement, in the amount of \$3,000, be returned 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 plan, 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.

We also recommend that in the future, plan officials establish adequate internal control procedures, such as having at least 2 people review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 490 to assist them in accurately reporting the required pension data.

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

Auditor’s Conclusion: Compliance will be subject to verification through our next audit.

CITY OF SHARON 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)
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	\$ 8,573,807	\$ 10,223,026	\$ 1,649,219	83.9%
01-01-11	8,493,783	10,495,978	2,002,195	80.9%
01-01-13	7,618,125	11,330,094	3,711,969	67.2%

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 over a 4-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 SHARON 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.

CITY OF SHARON POLICE PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2009	\$ 269,443	100.0%
2010	238,845	100.0%
2011	340,929	100.0%
2012	348,588	100.0%
2013	447,617	100.0%
2014	449,131	100.0%

CITY OF SHARON POLICE PENSION PLAN  
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:

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, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	7.25%, net of investment expenses
Projected salary increases *	4.4%
Cost-of-living adjustments	None assumed

\* Includes inflation at 2.5%

CITY OF SHARON POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf  
Governor  
Commonwealth of Pennsylvania

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