

**CITY OF ARNOLD AGGREGATE PENSION TRUST FUND**

**WESTMORELAND COUNTY**

**COMPLIANCE AUDIT REPORT**

**FOR THE PERIOD**

**JANUARY 1, 2008, TO DECEMBER 31, 2009**





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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.

Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign 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 Arnold Aggregate Pension Trust 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 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 Arnold Aggregate Pension Trust Fund serves as a common administrative and investment agent for the city's police and nonuniformed employee defined benefit pension plans. The city's police pension plan is controlled by the provisions of Ordinance No. 6 of 1997, and the nonuniformed pension plan is controlled by the provisions of Ordinance No. 5 of 1997, as amended, adopted pursuant to Act 317. Members of the aggregate pension trust fund are also affected by the provisions of collective bargaining agreements between the city and its police officers and nonuniformed employees.



The Honorable Mayor and City Council  
City of Arnold  
Westmoreland County  
Arnold, PA 15068

We have conducted a compliance audit of the City of Arnold Aggregate Pension Trust Fund for the period January 1, 2008, to December 31, 2009. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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 finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding 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 trust 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. The City of Arnold contracted with an independent certified public accounting firm for an audit of the City of Arnold Aggregate Pension Trust Fund's financial statements for the year 2008 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 Arnold Aggregate Pension Trust 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, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the City of Arnold Aggregate Pension Trust Fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further discussed later in this report:

Finding – Partial Compliance With Prior Audit Recommendation – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

As previously noted, one of the objectives of our audit of the City of Arnold Aggregate Pension Trust Fund was to determine compliance with applicable state laws, contracts, administrative procedures, and local ordinances and policies. During the current audit period, 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 bill 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 and, accordingly, express no form of assurance on it. However, we are extremely concerned about the funded status of the city’s plans contained in the schedules of funding progress included in this report which indicate the police plan’s funded ratio is 55.6%, and the nonuniformed plan’s funded ratio is 72.5% as of January 1, 2009, which is the most recent date available. Based on this information, 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 its police and nonuniformed pension plans to ensure their long-term financial stability.

The contents of this report were discussed with officials of the City of Arnold and, where appropriate, their responses have been included in the report.

January 31, 2011

JACK WAGNER  
Auditor General

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

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

Nonuniformed Pension Plan

· Pension Benefits In Excess Of The Third Class City Code

The city adopted Ordinance No. 2 of 2010, which contains pension benefit provisions in compliance with the Third Class City Code. In addition, the collective bargaining agreement between the city and its nonuniformed employees for the period January 1, 2009, to December 31, 2013, also contains pension benefit provisions in compliance with the Third Class City Code. However, excess benefits are still being paid to existing retirees. Since the city received state aid based on unit value during the audit period, it did not receive state aid attributable to the excess benefits being provided. The department will continue to monitor the impact of the excess benefits being paid to the existing retirees on the city's future state aid allocations;

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

The city reimbursed \$3,285 to the Commonwealth for the overpayment of state aid;

· Improper Withdrawal Of Active Members' Contributions

The city obtained a letter from the affected plan member confirming his understanding that his withdrawal represents a reduction of eight months of credited pension service. In addition, the city adopted Ordinance No. 1 of 2009, which repealed Section 3.04 of Ordinance No. 4 of 2004, which had authorized the withdrawal of active members' contributions for plan members who had attained age 70; and

· Undocumented Salary Increase Used For Pension Benefit Determination

The city obtained an opinion from an independent legal counsel who reviewed the pension benefit determination in question and it was determined that the benefit granted was proper and in accordance with the Third Class City Code.

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
STATUS OF PRIOR FINDINGS

Partial Compliance With Prior Audit Recommendation

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

Police Pension Plan

· Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

The city deposited \$13,322 into the police pension plan which represents payment of the outstanding 2008 minimum municipal obligation; however, the delinquent payment did not include interest as required by Section 302(e) of Act 205, as further discussed in the Finding and Recommendation section of this report.

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
FINDING AND RECOMMENDATION

Police Pension Plan

Finding – Partial Compliance With Prior Audit Recommendation – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: As disclosed in the prior audit report, city officials did not fully pay the minimum municipal obligation (MMO) of the police pension plan for the year 2008, as required by Act 205. During the current audit period, the city deposited \$13,322 into the police pension plan; however, plan officials failed to pay the required interest due to the pension plan.

Criteria: Section 302(e) of Act 205 states:

- (e) **Interest penalty on omitted municipal contributions.** 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: City officials failed to establish adequate internal control procedures to ensure full compliance with the prior audit recommendation.

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

Recommendation: We again recommend that the city pay the interest due to the police pension plan 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 again recommend the city establish and implement adequate internal control procedures to ensure compliance with Act 205 funding requirements.

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

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

SCHEDULES 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, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2005, is as follows:

POLICE PENSION PLAN

	(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)]
01-01-05	\$ 1,971,900	\$ 3,236,107	\$ 1,264,207	60.9%	\$ 611,213	206.8%
01-01-07	2,129,779	3,683,896	1,554,117	57.8%	677,674	229.3%
01-01-09	2,251,941	4,048,485	1,796,544	55.6%	718,661	250.0%

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 subject to a corridor between 70 to 130 percent of the market value of assets. 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 ARNOLD AGGREGATE PENSION TRUST FUND  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

SCHEDULES OF FUNDING PROGRESS – (Continued)

NONUNIFORMED PENSION PLAN

	(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)]
01-01-05	\$ 1,715,800	\$ 2,097,800	\$ 382,000	81.8%	\$ 597,846	63.9%
01-01-07	1,864,613	2,135,080	270,467	87.3%	606,834	44.6%
01-01-09	1,998,032	2,755,469	757,437	72.5%	657,143	115.3%

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 subject to a corridor between 70 to 130 percent of the market value of assets. 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 ARNOLD AGGREGATE PENSION TRUST 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.

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. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

POLICE PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2004	\$ 172,609	100.0%
2005	177,116	100.0%
2006	167,046	100.0%
2007	177,321	100.0%
2008	178,477	100.0%
2009	211,323	100.0%

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

NONUNIFORMED PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2004	\$ 79,158	100.0%
2005	72,864	100.0%
2006	64,008	100.0%
2007	67,282	100.0%
2008	61,039	100.0%
2009	33,113	100.0%

CITY OF ARNOLD AGGREGATE PENSION TRUST 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:

POLICE PENSION PLAN

Actuarial valuation date	January 1, 2009
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 70-130% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%

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

NONUNIFORMED PENSION PLAN

Actuarial valuation date	January 1, 2009
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	16 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 70-130% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett  
Governor  
Commonwealth of Pennsylvania

City of Arnold Aggregate Pension Trust Fund  
Westmoreland County  
1829 Fifth Avenue  
Arnold, PA 15068

The Honorable John D. Campbell	Mayor
Mr. Oscar S. Doutt, Jr.	City Clerk Administrator
Mr. Kevin Palladino	City Controller
Mr. Joseph A. Gatto	Councilman – Accounts and Finance
Mr. Joseph Puet	City Treasurer

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