

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN

BERKS COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2007, TO DECEMBER 31, 2008



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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 Reading Officers and Employees 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 362 - The Third Class City Code, Act of May 23, 1945 (P.L. 903, No. 362), Article XLIII-A, Optional Retirement System for Officers and Employes, as amended, 53 P.S. § 39371 et seq.

The City of Reading Officers and Employees Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article No. 181 of the Codified Ordinances of the City of Reading, adopted pursuant to Act 362. The plan is also affected by the provisions of collective bargaining agreements between the city and its nonuniformed employees.



The Honorable Mayor and City Council
City of Reading
Berks County
Reading, PA 19601

We have conducted a compliance audit of the City of Reading Officers and Employees Pension Plan for the period January 1, 2007, to December 31, 2008. 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 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 findings 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. The City of Reading 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 Reading Officers and Employees 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 the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the City of Reading Officers and Employees 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 – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

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.

We are extremely concerned about the city's financial condition as noted in the Observation contained in this report, which indicates a continued decline of revenues available to satisfy the long-term liabilities of the city's pension plans. We encourage city officials to make responsible decisions when monitoring the funding of its pension plans to ensure their long-term financial stability.

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

March 3, 2010

JACK WAGNER
Auditor General

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
STATUS OF PRIOR FINDINGS

The City of Reading has not complied with the prior audit recommendations concerning the following as further discussed in the Findings and Recommendations section of this report:

- Failure To Fully Pay The Minimum Municipal Obligation Of The Plan
- Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: As disclosed in the prior audit report, since the city reimbursed the Commonwealth from assets of the officers and employees pension plan for an overpayment of state aid received in 2005, the city now has not fully paid the minimum municipal obligation (MMO) that was due to the officers and employees pension plan for the year 2005, as required by Act 205. The city has an unpaid 2005 MMO balance of \$9,493.

Criteria: 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.

Cause: City officials failed to establish adequate internal control procedures to ensure compliance with the prior audit recommendation.

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.

Recommendation: We again recommend that the city pay the balance of the 2005 MMO due to the officers and employees pension plan, with interest, from the date of the reimbursement to the Commonwealth. A copy of the interest calculation must be maintained by the city for examination during our next audit of the plan.

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

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: As disclosed in the prior audit report, the city did not certify 1 eligible police officer (2 units), certified 29 ineligible officers and employees (29 units), and certified 1 ineligible firefighter (2 units) on the 2006 Certification Form AG 385. Furthermore, the city certified 1 ineligible police officer (2 units), certified 32 ineligible officers and employees (32 units), and certified 1 ineligible firefighter (2 units) on the 2007 Certification Form AG 385.

In addition, our current audit has disclosed that the city certified 7 ineligible police officers (14 units) and certified 20 ineligible firefighters (40 units) on the 2008 Certification Form AG 385.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Criteria: Pursuant to Act 205, at Section 402(e)(2), in order to be eligible for certification, an employee must have been employed on a full-time basis for at least six consecutive months and must have been participating in a pension plan during the certification year.

Cause: Plan officials have again failed to establish adequate internal control procedures to ensure that the data submitted on Certification Form AG 385 is monitored and reviewed for accuracy and compliance with Act 205 certification requirements.

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the city for distribution to its pension plans. Since the city’s state aid allocations were based on unit value, the effect of the incorrect certification of pension data on the city’s state aid allocations is identified below:

Year	Type Of Plan	Units Overstated (Understated)	Unit Value	State Aid Overpayment (Underpayment)
2006	Police	(2)	\$ 3,089	\$ (6,178)
	Officers and Employees	29	3,089	89,581
	Firemen’s	2	3,089	6,178
				\$ 89,581
2007	Police	2	\$ 3,206	\$ 6,412
	Officers and Employees	32	3,206	102,592
	Firemen’s	2	3,206	6,412
				\$ 115,416
2008	Police	14	\$ 3,186	\$ 44,604
	Firemen’s	40	3,186	127,440
				\$ 172,044
Total Overpayment of State Aid				\$ 377,041

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

In addition, since the city used the overpayments of state aid to pay the minimum municipal obligations (MMOs) due to the police, firemen's, and officers and employees pension plans, if the reimbursement to the Commonwealth is made from any of the pension plans, the plans' MMOs will not be fully paid.

Recommendation: We again recommend that the total excess state aid, in the amount of \$377,041, 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, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with the check.

We also recommend that, in the future, plan officials comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

In addition, if the reimbursement to the Commonwealth is made from police, firemen's or officers and employees pension plan funds, we recommend that any resulting MMO deficiencies be paid to the pension plan with interest, at a rate earned by the pension plan.

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

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 2 contained in this audit report cites an overpayment of state aid to the city in the amount of \$377,041. A condition of repeat finding of this nature may lead to a total withholding of state aid in the future unless that finding is corrected. A check in this amount with interest, 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, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222.

CITY OF READING OFFICERS AND EMPLOYEES 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, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2003, 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)]
01-01-03	\$ 37,920,154	\$ 49,181,881	\$ 11,261,727	77.1%	\$ 12,181,677	92.4%
01-01-05	39,767,213	53,054,485	13,287,272	75.0%	11,880,781	111.8%
01-01-07	57,572,084	57,081,669	(490,415)	100.9%	14,190,597	(3.5%)

Note - The actuarial value of assets at 01-01-07 includes bond proceeds deposited in 2006.

CITY OF READING OFFICERS AND EMPLOYEES 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. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
 AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2003	\$ 209,491	100.0%
2004	1,371,476	100.0%
2005	1,337,185	99.3%
2006	432,096	100.0%
2007	786,148	100.0%
2008	598,539	100.0%

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(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, 2007
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return *	8.0%
Projected salary increases *	5.0%
* Includes inflation at	4.0%
Cost-of-living adjustments	None assumed

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN OBSERVATION

On September 10, 2009, the Department of Community and Economic Development (DCED) received a request for Determination of Municipal Financial Distress under the Municipalities Financial Recovery Act (Act of 1987 P.L. 246, No. 47) from the Mayor of the City of Reading. This Act empowers DCED to declare certain municipalities as financially distressed; provides for the restructuring of debt of financially distressed municipalities; limits the ability of financially distressed municipalities to obtain government funding; authorizes municipalities to participate in Federal debt adjustment actions under certain circumstances; and provides for consolidation or merger of contiguous municipalities to relieve financial distress.

DCED issued a report titled “Municipalities Financial Recovery Act Consultative Evaluation” on the City of Reading dated October 14, 2009, which contains the following recommendation:

Based on our analysis of the City’s fiscal condition, tax base and revenue trends, debt service obligations, current and projected 2008 financial position, expenditure and workforce trends, pension obligations, use of inter-fund transfers, socio-economic and demographic trends and administrative and financial management practices, it is our recommendation that the City of Reading be declared distressed under Act 47.

Clearly the City is and has been experiencing ongoing financial challenges over the past several years. These conditions make it difficult for the City to continue to fulfill its responsibilities to provide for the health, safety and welfare of its citizens. Our recommendation is based upon a pattern of:

- Increasing year-end deficits;
- Increasing negative fund balances;
- Decline of tax revenue in constant dollars taking inflation into account;
- Increasing annual costs particularly in public safety departments and employee benefits; and
- Use of one-time revenue strategies that are not sustainable.

Given Reading’s current fiscal position there are serious questions and uncertainty as to its ability to maintain municipal services without an adverse impact on the health, safety and welfare of residents of the City. In our opinion, Reading is exhibiting symptoms of distress that support a distress determination under Act 47.

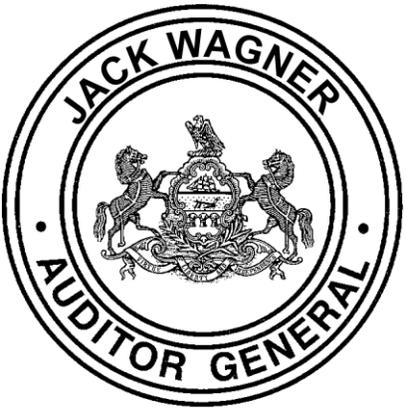
CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN OBSERVATION

On May 6, 2010, a Municipalities Financial Recovery Act Recovery Plan for the City of Reading prepared on behalf of DCED was filed with the Reading City Clerk's Office. In the Executive Summary of this report it was noted that:

The City of Reading is in a severe financial crisis and it must take immediate action to preserve its fiscal health while continuing to provide basic services to residents, businesses and visitors. Failure to act now will soon be catastrophic. The depth and immediacy of the crisis cannot be overstated.

In addition, the City of Reading Financial and Compliance Audit Report for the year ended December 31, 2008, contains the following information noted under the heading Financial Highlights for Fiscal Year 2008:

2008 was yet another year of financial difficulty. While expenditures met budget expectations, revenues fell short of expectations. The resulting deficiency of revenues over expenditures required strict cost containment and tight fiscal controls throughout 2008. Projections indicate the City is facing a cumulative structural deficit that will exceed any remedy or form of corrective action, unless substantial reform is achieved in the future. The likelihood of continued deficits in the future, in view of tight fiscal controls and reductions in personnel, suggests that financial problems faced by the City of Reading are structural and beyond the extent of improving operational efficiency. In 2008, the City of Reading, in conjunction with the cities of Easton, Bethlehem, Lancaster, and York, authorized the Pennsylvania Economy League (PEL) to undertake a comparative fiscal health analysis. The analysis concluded that total natural revenues generated in each of the five study cities are insufficient to support the cost of fundamental municipal services. The analysis further concluded that the erosion of the urban tax base, taken in combination with increasing demands for municipal services and rising personnel costs have forced cities to rely on various forms of operational supplements. This reliance cannot be sustained indefinitely. That these five cities only operate in the black from the sale of assets, debt mechanisms and fund transfers calls the very sustainability of local government in the Commonwealth of Pennsylvania into question.



CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

City of Reading Officers and Employees Pension Plan
Berks County
815 Washington Street
Reading, PA 19601

The Honorable Thomas M. McMahon	Mayor
Mr. Vaughn Spencer	Council President
Mr. Carl Geffken	Finance Director

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.