

COMPLIANCE AUDIT

City of Hazleton Non-Uniformed Pension Plan Luzerne County, Pennsylvania For the Period January 1, 2021 to December 31, 2022

October 2023



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

The Honorable Mayor and City Council
City of Hazleton
Luzerne County
Hazleton, PA 18201

We have conducted a compliance audit of the City of Hazleton Non-Uniformed Pension Plan for the period January 1, 2021 to December 31, 2022. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the 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 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 findings contained in our prior 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 total 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 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 benefits 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, 2021 actuarial valuation report was prepared and submitted by March 31, 2022, in accordance with Act 205 and whether selected information provided on this report 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.

City officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the City of Hazleton Non-Uniformed Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 Hazleton Non-Uniformed 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:

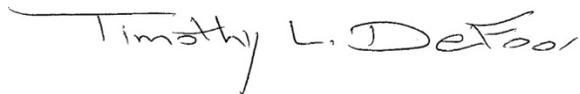
Finding No. 1 – Noncompliance With Prior Recommendation – Failure To Establish Procedures To Ensure Required Annual Funding Of The City’s Pension Plans In Accordance With Special Taxing Provisions Of Act 205

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

The findings contained in this audit report repeat conditions that were cited in our previous report that have not been corrected by city officials. We are concerned by the city’s failure to correct those previously reported findings and strongly encourage timely implementation of the recommendations 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 funded status of the plan contained in the schedule of funding progress included in this report which indicates a decline of assets available to satisfy the long-term liabilities of the plan. **The plan’s funded ratio went from 81.0% as of January 1, 2019, to a ratio of 61.4% as of January 1, 2021**, which is the most recent data available. We encourage city officials to monitor the funding of the non-uniformed pension plan to ensure its long-term financial stability.

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



Timothy L. DeFoor
Auditor General
September 22, 2023

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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.

Annual state aid allocations are provided from a two 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 Hazleton Non-Uniformed Pension Plan is also governed by implementing regulations 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 67 - The Third Class City Code, Act of November 24, 2015 (P.L. 242, No. 67),
as amended, 11 Pa. C.S. § 10101 et seq.

The City of Hazleton Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2001-26, as amended, adopted pursuant to Act 67. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established April 1, 1975. Active members hired before January 1, 2004 are required to contribute four percent of compensation to the plan. Active members hired on or after January 1, 2004 are required to contribute three and one-half percent of compensation below the Social Security taxable wage base and five percent of compensation above the wage base to the plan. As of December 31, 2022, the plan had 54 active members, no terminated members eligible for vested benefits in the future, and 25 retirees receiving pension benefits from the plan.

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Status Of Prior Recommendations

· Failure To Maintain Required Documentation And Evidence Of Required Annual Funding Of The City's Pension Plans In Accordance With Special Taxing Provisions Of Act 205

As disclosed in the prior audit report, it was recommended that the city, with assistance from its actuary, determine or locate the prior determination of the city's required level of annual contributions under Section 607(f) of Act 205. During the current audit period, after much effort by current officials, the city was again unable to locate such documentation, but city officials have agreed with the analysis prepared by the department (*as disclosed in the prior audit report*) and indicated that they will utilize the 21.4 percent required level of contributions rate beginning with the payment of their 2023 MMO which was not due as of the date of this report. The department will monitor the city's compliance with the agreed-upon level of funding (*21.4 percent*) on the city's subsequent MMO payments beginning with the MMO due December 31, 2023.

In addition, it was recommended that the city utilize the proceeds of its annual special municipal tax collected pursuant to the distress provisions of Act 205. The city liquidated \$6.3 million from its special municipal tax account into its police, paid firemen, and non-uniformed pension plan accounts pursuant to the act on February 2, 2023.

Moreover, it was recommended that the city establish and implement adequate internal control procedures to ensure that the city does not reduce its required level of contributions to its pension plans from funding sources prior to the implementation of the special municipal tax along with maintaining documentation evidencing that funding requirements were appropriately met in accordance with Section 607(f) of Act 205. However, the city again failed to provide such formal written procedures as further discussed in Finding No. 1 in the Findings and Recommendations section of this report; and

· Failure To Implement Act 44 Mandatory Distressed Provisions

As previously disclosed in prior audit reports, prior to 2015 the City of Hazleton Aggregate Pension Fund served as a common investment and administrative agent for the city's police and paid firemen's pension plans. During 2015, however, the city entered into three separate investment agreements with the plans' current custodian for the administration of its police, paid firemen's, and non-uniformed pension funds even though the city was in Level II moderate distress status, which required the aggregation of pension trust funds as a mandatory remedy under Section 605 of Act 205, and as such, it was previously recommended that the city aggregate its pension funds accordingly, to comply with the act. During the current audit period, the city received notification from the Municipal Pension Reporting Program that based

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Status Of Prior Recommendations – (Continued)

on the aggregate funding level of the city's pension plans as of the most recent valuation, January 1, 2021, the city was classified Level I minimal distress status; therefore, the mandatory Level II moderate distress remedies are no longer required. Although the city is no longer mandated to aggregate its pension trust fund under its current Level I distress status and the trust fund's assets are no longer aggregated, the city's codification of ordinances continues to provide for an Aggregated Pension Trust Fund for its police and paid firemen's pension funds, and we encourage city officials to review the city's ordinances with its solicitor and make the appropriate amendments deemed necessary for the proper restatement of its individual pension plans, accordingly.

Noncompliance With Prior Recommendation

The City of Hazleton has not complied with the prior recommendation concerning the following:

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

The city again failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data, as further discussed in Finding No. 2 in the Findings and Recommendations section of this report.

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Recommendation – Failure To Establish Procedures To Ensure Required Annual Funding Of The City’s Pension Plans In Accordance With Special Taxing Provisions Of Act 205

Condition: As disclosed in the Status of Prior Findings section of this report, the city again failed to establish adequate formal written procedures to ensure that the city meets its annual funding requirements in accordance with the distress provisions of Act 205.

Criteria: As disclosed in the prior audit report, relative to the additional remedies available to distressed municipalities to assist with the funding of their pension plans, Section 607(f) of Act 205 states:

(f) Special municipal taxing authority.

- (1) If the tax rates set by the municipality on earned income or on real property are at the maximum provided by applicable law, the municipality may increase its tax on either earned income or real property above those maximum rates. The proceeds of this special municipal tax increase shall be used solely to defray the additional costs required to be paid pursuant to this act, which are directly related to the pension plans of the municipality. The municipality utilizing this special municipal taxing authority shall not reduce the level of municipal contributions to the pension plans prior to the implementation of the special municipal taxing authority. (Emphasis added.)
- (2) The average level of municipal contributions to the pension plans from all revenue sources for the three years immediately prior to the implementation of the special municipal taxing authority shall be expressed as a percentage of the average covered payroll for that same three-year period: Provided, however, that any supplemental contributions made to the plans pursuant to any pension recovery legislation enacted by the municipalities shall be excluded for purposes of determining the level of municipal contribution to the pension plans prior to the implementation of the special municipal taxing authority. In each year subsequent to the implementation of the special municipal taxing authority, the municipal contributions to the pension plan from all revenue sources existing prior to the implementation of the special existing municipal taxing authority, reduced by any supplemental pension recovery contributions, shall equal or exceed this average percentage of the current covered payroll. A municipality utilizing the provisions of section 404 may levy or continue to levy the special municipal tax increase under this subsection provided that the municipality does not reduce the level of municipal contributions to the pension plans prior to the implementation of the special municipal taxing authority. In executing

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

the procedure prescribed in this subsection to determine the level of municipal contributions, the debt service payments for bonds or notes issued under section 404 shall be considered municipal contributions. (Emphasis added.)

Cause: The city again failed to establish and implement procedures to assist them in documenting compliance with the special tax provisions of Act 205 evidencing whether annual funding levels mandated by Act 205 since implementation of the special tax were met and ensure compliance with the prior recommendation.

Effect: The continued failure to establish and/or implement adequate internal control procedures to apply the distress provisions of Section 607(f) of Act 205 and fund the city's pension plans accordingly, results in less annual funding towards the city's distressed pension plans than afforded under the provisions of Act 205 and could result in the plans not having the necessary resources to meet current and future benefit obligations to its members.

Recommendation: We again recommend that the city establish and implement adequate internal control procedures to ensure that the city does not reduce its level of contributions to its pension plans from funding sources prior to the implementation of the special municipal tax in accordance with Act 205. Such procedures should include maintaining appropriate supporting documentation identifying the sources of its annual contributions to its pension plans as well as an annual reconciliation evidencing that funding requirements are appropriately met in accordance with Section 607(f) of Act 205.

Management's Response: Municipal officials provided the following response:

As mentioned in the previous audit response, the city at the time was having difficulty with the Actuary receiving guidance in order to properly respond to the finding. In the interim time until this recent audit, the city has completed the RFP process and selected a new actuary, [name omitted]. The city's current actuary has taken all of the feedback received regarding the special tax provisions provided by the Auditor General's office and is currently reviewing and assisting the city in order to meet the requirements outlined in the special taxing provision.

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

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: As disclosed in the Status of Prior Findings section of this report, the city again failed to comply with the instructions that accompanied Certification Form AG 385 during the current audit period. The city certified three ineligible non-uniformed employees, incorrectly certified a non-uniformed employee as a police officer, and overstated payroll by \$69,890 on the Certification Form AG 385 filed in 2022. The data contained on this certification form is based on prior calendar year information.

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. Additionally, pursuant to the instructions that accompany Certification Form AG 385, the total payroll eligible to be certified should be Internal Revenue Service Form W-2 earnings pertaining to full-time positions.

Cause: Current plan officials did not have a thorough understanding of the Certification Form AG 385 instructions or the limitations on earnings eligible for certification purposes. In addition, the city lacked adequate oversight procedures to ensure the accuracy of the data certified.

Effect: The data submitted on this certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the city’s state aid allocation was based on unit value, the incorrect certification of pension data affected the city’s state aid allocation, as identified below:

| <u>Year</u> | <u>Type of Plan</u> | <u>Units Overstated</u> | <u>Unit Value</u> | <u>State Aid Overpayment</u> |
|--------------------------------|---------------------|-------------------------|-------------------|------------------------------|
| 2022 | Non-Uniformed | 2 | \$ 5,180 | \$ 10,360 |
| | Police | 2 | 5,180 | <u>10,360</u> |
| Total Overpayment of State Aid | | | | <u><u>\$ 20,720</u></u> |

In addition, the city used the overpayment of state aid to pay the minimum municipal obligations (MMOs) due to the police and non-uniformed pension plans; therefore, if the reimbursement to the Commonwealth is made from either pension plan, the plan’s MMO will not be fully paid.

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Recommendation: We recommend that the overpayment of state aid, in the amount of \$20,720, plus interest, 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, 321 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 two people review the data certified, to ensure compliance 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 or non-uniformed pension plan funds, we recommend that any resulting MMO deficiency be paid to the pension plan with interest, at a rate earned by the pension plan.

Management’s Response: Municipal officials provided the following response:

This finding stems from a misunderstanding of city personnel completing form AG385. Calendar year was misunderstood to mean the calendar year of the due date between the form, thus believing that the six months of consecutive employment could “wrap” into two different years. The city understands now that this is not the case. Additionally, we believe that this finding will be corrected with the city’s new actuary, [name omitted], who is much more helpful and participatory in the preparation of these forms, assisting in review for verification purposes. We do not expect a repeat of this finding and believe we are now and will continue to be compliant with this provision.

Subsequent to the audit exit conference, the city returned \$22,484.99 to the Commonwealth for the overpayment of state aid.

Auditor’s Conclusion: Compliance will be evaluated during our next audit of the plan.

CITY OF HAZLETON NON-UNIFORMED 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, 2017, 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) |
| 01-01-17 | \$ 5,527,291 | \$ 7,375,124 | \$ 1,847,833 | 74.9% |
| 01-01-19 | 6,065,577 | 7,489,621 | 1,424,044 | 81.0% |
| 01-01-21 | 6,771,468 | 11,020,547 | 4,249,079 | 61.4% |

Note: The market values of the plan’s assets at 01-01-17, 01-01-19, and 01-01-21 have been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period, which will be limited to a maximum of 120 percent and a minimum of 80 percent of the fair 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 HAZLETON NON-UNIFORMED 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 HAZLETON NON-UNIFORMED PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

| Year Ended December 31 | Actuarially Determined Contribution | Actual Contributions | Contribution Deficiency (Excess) | Covered- Employee Payroll* | Contributions as a Percentage of Covered- Employee Payroll |
|---------------------------|---|-------------------------|--|----------------------------------|--|
| 2013 | \$ 193,307 | \$ 193,307 | \$ - | | |
| 2014 | 197,724 | 197,724 | - | \$ 1,743,703 | 11.3% |
| 2015 | 256,261 | 256,261 | - | 1,795,231 | 14.3% |
| 2016 | 383,317 | 484,532 | (101,215) | 1,995,637 | 24.3% |
| 2017 | 382,990 | 388,790 | (5,800) | 1,991,035 | 19.5% |
| 2018 | 433,183 | 433,183 | - | 1,959,163 | 22.1% |
| 2019 | 401,912 | 401,912 | - | | |
| 2020 | 394,491 | 394,491 | - | | |
| 2021 | 354,622 | 354,622 | - | | |
| 2022 | 342,659 | 813,269 | **(470,610) | | |

* This schedule is presented pursuant to the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans* by reporting entities responsible for administering the pension plan to improve financial reporting by state and local governmental pension plans. Due to the statement being implemented only recently, the amount of Covered-Employee Payroll was not provided for years prior to 2014. In addition, due to the timing of this audit and availability of municipal records, covered-employee payroll for 2019, 2020, 2021, and 2022 were not provided in this schedule.

** Represents deposit of the 2022 Special Municipal Tax Account proceeds (*refer to Status of Prior Findings section of this report*).

CITY OF HAZLETON NON-UNIFORMED 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, 2021 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar |
| Remaining amortization period | 12 years |
| Asset valuation method | 5-year smoothing – the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair market value of assets. |
| Actuarial assumptions: | |
| Investment rate of return | 7.5% |
| Projected salary increases | 4.5% |

CITY OF HAZLETON NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Joshua D. Shapiro
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Commonwealth of Pennsylvania

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