

COMPLIANCE AUDIT

City of Reading Officers and Employees Pension Plan Berks County, Pennsylvania For the Period January 1, 2018 to December 31, 2019

January 2021



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



**Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov**

**EUGENE A. DePASQUALE
AUDITOR GENERAL**

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, 2018 to December 31, 2019. 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 and elected to vest during the current audit period, and through the completion of our fieldwork procedures, represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the 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 and payable to the recipients.
- We determined whether the January 1, 2019 actuarial valuation report was prepared and submitted by March 31, 2020, 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.
- We determined whether the pension plan is in compliance with Act 205 for distressed municipalities through inquiry of plan officials and evaluation of the recovery remedies implemented during the audit period and through the completion of our fieldwork procedures.
- We determined whether the terms and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions, were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation.

City of Reading contracted with an independent certified public accounting firm for annual audits of the City of Reading Officers and Employees Pension Plan's 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. 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 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 – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid

Finding No. 2 – Failure To Implement Mandatory Provisions Of Act 205

Finding No. 1 contained in this audit report repeats a condition that was cited in our previous report that has not been corrected by city officials. We are concerned by the city's failure to correct this previously reported 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. As noted in the appendix included in this report, the City of Reading has been declared a distressed municipality pursuant to the provisions of Act 47. We encourage city officials to continue its efforts in the development of a long term strategic plan to monitor the funding of the officers and employees pension plan to ensure its long term financial stability.

The contents of this report were discussed with officials of City of Reading 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.

December 23, 2020



EUGENE A. DEPASQUALE
Auditor General

CONTENTS

	<u>Page</u>
Background	1
Status of Prior Finding	2
Findings and Recommendations:	
Finding No. 1 – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid.....	3
Finding No. 2 – Failure To Implement Mandatory Provisions Of Act 205	4
Supplementary Information	7
Appendix.....	11
Report Distribution List	12

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 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 Reading Officers and Employees Pension Plan is also governed by implementing regulations adopted by the former 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 Employees, as amended, 53 P.S. § 42001 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, as amended, adopted pursuant to Act 362. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established October 9, 1946. Active members are required to contribute 3 percent of compensation to the plan. As of December 31, 2019, the plan had 260 active members, 31 terminated members eligible for vested benefits in the future, and 303 retirees receiving pension benefits.

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

Compliance With Prior Recommendation

City of Reading has complied with the prior recommendations concerning the following:

- Failure To Fully Pay The Minimum Municipal Obligation (MMO) Of The Plan

Subsequent to the current audit period, municipal officials paid the outstanding MMO due to the officers and employees pension plan for the year 2018, with interest, in accordance with Section 302(e) of Act 205.

Noncompliance With Prior Recommendation

City of Reading has not complied with the prior recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

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

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid

Condition: As disclosed in the prior audit report, the city failed to properly certify its required pension data on the Certification Form AG 385s filed in 2014, 2015, 2016 and 2017. These errors resulted in a total underpayment of state aid to the city totaling \$12,760. Although the city was subsequently reimbursed for the total amount of the underpayment by the Commonwealth during April 2019, it was recommended that the city implement adequate internal control procedures to ensure compliance with the instructions that accompany future Certification Form AG 385 to assist in accurately reporting the required pension data. However, a similar condition occurred during the current audit period. The city failed to certify 6 eligible non-uniformed employees (6 units) and 3 eligible police officers (6 units) and understated total payroll by \$595,876, on the Certification Form AG 385 filed in 2020. The data contained on this certification form is based on prior calendar year information.

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

Cause: Plan officials again failed to implement adequate internal control procedures, such as having another individual review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 385 and the accuracy of the data certified prior to submission.

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 city received an underpayment of state aid as identified below:

<u>Year</u>	<u>Type Of Plan</u>	<u>Units Understated</u>	<u>Unit Value</u>	<u>State Aid Underpayment</u>
2020	Non-Uniformed	6	\$ 4,924	\$ 29,544
	Police	6	4,924	29,544
Total				<u>\$ 59,088</u>

Although the city will be reimbursed for the underpayment of state aid due to the city's certification errors, the full amount of the 2020 state aid allocation was not available to be deposited timely, and therefore was not available to pay operating expenses or for investment.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Recommendation: We again 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.

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

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

Finding No. 2 – Failure To Implement Mandatory Provisions Of Act 205

Condition: During the four most recent prior audits, plan officials were notified via verbal observation of the passage of Act 44 of 2009, which effectively amended Act 205 for the procurement of professional services contracts, and recommending that the municipality adopt the mandatory provisions, accordingly. However, during the current audit period, the municipality again failed to adopt such mandatory provisions.

Criteria: Section 701-A of Act 205, as amended by Act 44, defines a “Professional Services Contract”, as follows:

“Professional services contract.” A contract to which the municipal pension system is a party that is:

- (1) for the purchase or provision of professional services, including investment services, legal services, real estate services and other consulting services; and
- (2) not subject to a requirement that the lowest bid be accepted.

In addition, Section 702-A (a) of Act 205 states in part:

Each municipal pension system ... shall develop procedures to select the most qualified person to enter into a professional services contract. The procedures shall ensure that the availability of a professional services contract is advertised to potential participants in a timely and efficient manner. Procedures shall include applications and disclosure forms to be used to submit a proposal for review and to receive the award of a professional services contract.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Additionally, Section 702-A (c), (e), (f) and (h) state, in part:

Review. Procedures to select the most qualified person shall include a review of the person's qualifications, experience and expertise and the compensation to be charged.

Conflict of interest. The municipal pension system shall adopt policies relating to potential conflicts of interest in the review of a proposal or the negotiation of a contract.

Public information. Following the award of a professional services contract, all applications and disclosure forms shall be public except for proprietary information or other information protected by law.

Notice and summary. The relevant factors that resulted in the award of the professional services contract must be summarized in a written statement to be included in or attached to the documents awarding the contract. Within ten days of the award of the professional services contract, the original application, a summary of the basis for the award and all required disclosure forms must be transmitted to all unsuccessful applications and posted on the municipal pension system's Internet website, if an Internet website is maintained, at least seven days prior to the execution of the professional services contract.

Section 703-A (c) states in part:

Upon advertisement for a professional services contract by the municipal pension system, the contractor may not cause or agree to allow a third party to communicate with officials or employees of the municipal pension system except for requests for technical clarification.

Cause: Plan officials failed to establish adequate internal control procedures to ensure compliance with provisions of Act 205 as previously recommended.

Effect: The municipality's failure to comply in all respects with the provisions stipulated in Act 205 regarding the procurement of professional investment and advisory services for the municipality's pension plan could denote a general lack of overall transparency of the actions taken by plan officials relative to the contracting for custodial and investment services for the municipality's pension plan.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Recommendation: We recommend that municipal officials obtain a comprehensive understanding of Act 205 provisions for the procurement of professional services and develop and implement formal written procedures to ensure compliance with these provisions which should include the maintaining of appropriate and sufficient supporting documentation evidencing every phase of the process to ensure the transparency of the actions taken by plan officials relative to the awarding of any future professional services contracts for its pension plan.

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

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

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. The historical information, beginning as of January 1, 2015, 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)
01-01-15	\$ 53,627,779	\$ 69,698,860	\$ 16,071,081	76.9%
01-01-17	57,631,113	75,421,894	17,790,781	76.4%
01-01-19	60,608,302	76,301,546	15,693,244	79.4%

Note: The market values of the plan's assets at 01-01-15, 01-01-17, and 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period, which will be limited to a maximum of 120 percent and 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 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.

CITY OF READING OFFICERS AND EMPLOYEES 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
2010	\$ 800,416	\$ 1,670,803	\$ (870,387)	\$17,182,014	9.72%
2011	1,376,733	1,404,139	(27,406)	14,850,270	9.46%
2012	1,488,269	1,510,837	(22,568)	15,498,759	9.75%
2013	2,836,234	2,860,603	(24,369)	14,888,776	19.21%
2014	2,769,963	2,780,193	(10,230)	14,233,277	19.53%
2015	3,173,811	3,179,616	(5,805)	14,403,603	22.08%
2016	3,005,282	3,005,282	-	14,240,701	21.10%
2017	3,033,047	3,135,808	(102,761)	13,832,568	22.67%
2018	3,532,555	3,532,555	-	13,931,821	25.36%
2019	3,446,705	3,476,030	(29,325)	12,522,275	27.76%

CITY OF READING OFFICERS AND EMPLOYEES 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, 2019
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	10 years
Asset valuation method	4-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	7.25%
Projected salary increases	4.75%
Cost-of-living adjustments	None assumed

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
APPENDIX

It was noted in prior audit reports that during 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 in 2009, which contained a recommendation that the City of Reading be declared distressed under Act 47. The report also indicated that the City had been experiencing ongoing financial challenges over the past several years, and given Reading's fiscal position, there were serious questions and uncertainty as to the City's ability to maintain municipal services without an adverse impact on the health, safety, and welfare of residents of the City.

The City stated the following in its Notes to Basic Financial Statements of the City of Reading Financial and Compliance Audit Report for the year ended December 31, 2019:

In July of 2019, the City adopted a 3-year exit plan from Act 47 of 1987 with the goal of exiting the program by the end of 2022. During 2019, the City continued efforts to control costs, improve collections, and maintain solvency. The cash and investments balance available for general operations of the City as of December 31, 2019, was \$24,025,823. This was sufficient to maintain normal functions of the City until tax revenues were received. Currently, the Act 47 of 1987 coordinators will provide oversight to ensure compliance with the operating budget and the approved plan.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Eddie Moran
Mayor

Mr. Jeffrey Waltman, Sr.
Council President

Mr. Abe Amoros
Managing Director

Mr. Jamar Kelly
Director of Administrative Services

Ms. Maria Rodriguez
City Auditor

Mr. Michael Oppenheimer
City Controller

Ms. Aida Acevedo
Human Resource Director

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.