CITY OF ALIQUIPPA CITY EMPLOYEES PENSION PLAN

BEAVER COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2011 TO DECEMBER 31, 2012

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL

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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and City Council
City of Aliquippa
Beaver County
Aliquippa, PA 15001

We have conducted a compliance audit of the City of Aliquippa City Employees Pension Plan for the period January 1, 2011 to December 31, 2012. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the 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. Our methodology addressed determinations about the following:

- Whether state aid was properly determined and deposited in accordance with Act 205 requirements.

- Whether employer contributions are determined and deposited in accordance with the plan's governing document and applicable laws and regulations.

- Whether employee contributions are required and, if so, are determined, deducted and deposited into the pension plan and are in accordance with the plan provisions and applicable laws and regulations.

- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.

- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and selected information provided on these reports is accurate, complete and in accordance with plan provisions to ensure compliance for participation in the state aid program.

- Whether refunds are made to eligible members in accordance with the plan provisions and applicable laws and regulations.

- Whether the pension plan is in compliance with state regulations for distressed municipalities.

The City of Aliquippa contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2011, 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 Aliquippa City 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 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 tests indicated that, in all significant respects, the City of Aliquippa City 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 – Improper Disability Pension Benefit
Finding No. 2	–	Noncompliance With Prior Audit Recommendation – Pension Benefits In Excess Of The Third Class City Code
Finding No. 3	–	Failure To Implement Act 44 Mandatory Distressed Provisions
Finding No. 4	–	Custodial Account Transactions Not Adequately Monitored By The Municipality

As previously noted, one of the objectives of our audit of the City of Aliquippa City Employees Pension Plan was to determine compliance with applicable state laws, contracts, administrative procedures, and local ordinance and policies. 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 act provides for the implementation of a distress recovery program. Three levels of distress have been established:

Level	Indication	Funding Criteria
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 plan contained in the schedule of funding progress included in this report which indicates **the plan's funded ratio is 54.0% as of January 1, 2011**, 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 the city employees pension plan to ensure its long-term financial stability.

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

Eugene A. DePasquale

December 10, 2013

EUGENE A. DEPASQUALE
Auditor General

CONTENTS

BACKGROUND

On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.). The act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to Pennsylvania's public pension plans. Section 402(j) of Act 205 specifically requires the Auditor General, as deemed necessary, to make an audit of every municipality which receives general municipal pension system state aid and of every municipal pension plan and fund in which general municipal pension system state aid is deposited.

Annual state aid allocations are provided from a 2 percent foreign (out-of-state) casualty insurance premium tax, a portion of the foreign (out-of-state) fire insurance tax designated for paid firefighters and any investment income earned on the collection of these taxes. Generally, municipal pension plans established prior to December 18, 1984, are eligible for state aid. For municipal pension plans established after that date, the sponsoring municipality must fund the plan for three plan years before it becomes eligible for state aid. In accordance with Act 205, a municipality's annual state aid allocation cannot exceed its actual pension costs.

In addition to Act 205, the City of Aliquippa City 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 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 Aliquippa City Employees Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 3 of 2008, as amended, effective January 1, 2007, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. As of December 31, 2012, the plan had 9 active members, no terminated members eligible for vested benefits in the future and 12 retirees receiving pension benefits.

CITY OF ALIQUIPPA CITY EMPLOYEES PENSION PLAN
STATUS OF PRIOR FINDINGS

Status Of Prior Audit Recommendation

- Pension Benefit Not Authorized By The Third Class City Code

  As disclosed in the prior audit report, the city is providing pension benefits to a retiree in excess of those authorized by the Third Class City Code and the plan's governing document pursuant to an "Enhanced Retirement Benefit Package Agreement" between the city and the retiree. The retiree is receiving excess benefits of $52 per month. During the current audit period, there were no additional agreements or retirements. In addition, during the current and prior audit periods, the city received no state aid allocations attributable to the excess benefits provided. The Department of the Auditor General will continue to monitor the effect of the excess benefits on the city's state aid allocations during future audits of the plan, which may require the city to reimburse any excess state aid received attributable to the excess benefit to the Commonwealth.

Noncompliance With Prior Audit Recommendations

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

- Improper Disability Pension Benefit

- Pension Benefits In Excess Of The Third Class City Code

Finding No. 1 - Noncompliance With Prior Audit Recommendation - Improper Disability Pension Benefit

Condition: As disclosed in our prior audit report, on December 31, 2009, the city granted an improper disability pension benefit to a plan member who was only employed by the city for 6 years.

Criteria: Section 4343 of the Third Class City Code states, in part:

> Should any employee, however, become totally and permanently disabled, after ten years of service and before attaining the age of sixty years, he or she shall be entitled to the said pension. . . .

Furthermore, Ordinance No. 3 of 2008 at Section 5.01 states, as follows:

> A Participant who has completed at least ten (10) Years of Credited Service and who incurs a Total and Permanent Disability before attaining Normal Retirement Age shall be entitled to a Disability Retirement Benefit determined as of the Disability Retirement Date.

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

Effect: The plan is paying pension benefits that are not authorized by the Third Class City Code or the plan's governing document. The retiree is receiving unauthorized pension benefits of $1,194 per month, which totaled approximately $57,312 from the date of retirement through the date of this audit report.

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

Finding No. 1 – (Continued)

Recommendation: We again recommend that city officials consult with their solicitor to determine if the improper disability pension benefit should continue to be paid. We further recommend that future pension benefits be determined in accordance with the Third Class City Code and the applicable provisions contained in the plan's governing document in effect at the time of the plan member's retirement.

Management's Response: City officials agreed with the finding without exception. City officials indicated they will take corrective actions to address the condition that was cited in the audit report.

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

Finding No. 2 - Noncompliance With Prior Audit Recommendation – Pension Benefits In Excess Of The Third Class City Code

Condition: As disclosed in our prior audit report, the pension plan's governing document and collective bargaining agreement between the non-uniformed employees and the city provide for a survivor benefit for minor children of retirees. Section 6.03 of Ordinance No. 3 of 2008 states, in part:

> If there is no surviving spouse or if the surviving spouse becomes ineligible . . . such benefit shall be paid to the surviving children of the deceased participant who are under the age of eighteen (18).

Criteria: The Third Class City Code does not authorize a survivor benefit for minor children of retired non-uniformed employees.

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

Finding No. 2 – (Continued)

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

Recommendation: We again recommend that the city comply with the Third Class City Code upon the renewal, extension, or renegotiation of the collective bargaining agreement. To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to pay benefits to existing survivors in excess of those authorized by the Third Class City Code, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, the excess benefits will be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the improper survivor benefits on the plan's future state aid allocations and submit this information to the Department.

Management's Response: City officials agreed with the finding without exception. City officials indicated they will take corrective action to address the condition cited in the audit report.

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

Finding No. 3 – Failure To Implement Act 44 Mandatory Distressed Provisions

Condition: 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 act provides for the implementation of a distress recovery program. Three levels of distress have been established:

Level	Indication	Funding Criteria
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

Based in part on the plan's funded ratio of 57.9% as of January 1, 2009, the Public Employee Retirement Commission (PERC) issued a notification in 2010 that the city was in Level II moderate distress status. Based again in part on the plan's funded ratio of 54.0% as of January 1, 2011, PERC issued another notification in 2012 that the city is currently in Level II moderate distress status.

Included with the determination notices, PERC sent the municipality the Act 205 Recovery Program Election Form outlining the mandatory remedies that must be implemented and the voluntary remedies that the municipality could elect to implement. This form was required to be signed by the plan's chief administrative officer and returned to PERC; however, the city never returned the 2012 election form to PERC.

Criteria: Act 205, amended by Act 44, at Section 605(a), states:

> Recovery program level II.
>
> (a) Mandatory remedies. Any municipality to which level II of the recovery program applies shall utilize the following remedies:
>
> (1) The aggregation of trust funds pursuant to section 607(b).
>
> (2) The submission of a plan for administrative improvement pursuant to section 607(i).

Cause: Municipal officials failed to establish adequate internal control procedures to ensure the mandatory distress remedies have been implemented.

Finding No. 3 – (Continued)

Effect: The municipality is not in compliance with Act 44 mandatory distress remedy provisions applicable to Level II which are designed to improve the funding status and administrative efficiency of its pension plans.

Recommendation: We recommend that municipal officials contact PERC for guidance in the implementation of the mandatory distress remedies applicable to Level II pursuant to Act 44 of 2009.

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

Finding No. 4 - Custodial Account Transactions Not Adequately Monitored By The Municipality

Condition: Plan officials did not provide evidence that the plan's custodial account is adequately monitored to ensure the propriety of the account transactions.

Criteria: Assets held in a pension account for the purpose of plan management are to be governed by the terms and provisions of the agreement provided that they are within the parameters of all prevailing pension legislation. Although a municipality may contract with a trustee to administer the financial management of the plan, the fiduciary responsibility for the plan remains with the municipality.

Cause: Plan officials were not aware of their fiduciary responsibility to monitor the pension account. Furthermore, plan officials have not prepared management guidelines which describe the duties and responsibilities of municipal and plan officials to ensure an effective transition of duties.

Effect: Inadequate monitoring of the custodial account could lead to undetected errors or improprieties in account transactions as well as deficiencies in authorizing and implementing pension plan policies and procedures.

Finding No. 4 – (Continued)

Recommendation: We recommend that the municipality examine the financial transactions of the custodial account to ensure the accuracy and propriety of the transactions. The minimum steps that should be applied by a municipality to adequately monitor the custodial account are:

- Verify the mathematical accuracy of the account statements;
- Reconcile the Commonwealth, municipal and members' contributions shown on the account statements to the municipality's records;
- Review investment income for accuracy and reasonableness;
- Reconcile any large or material receipt, other than contributions, shown on the account statements to the municipality's records;
- Determine if investments are in accordance with applicable laws, regulations and policies. Reconcile investment income to the related investments;
- Review custodial statements at pension board meetings;
- Reconcile pension payments shown on the account statements to the municipality's records; and
- Reconcile any large or material disbursement, shown on the account statements to the municipality's records.

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

CITY OF ALIQUIPPA CITY 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, 2007, 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)]
01-01-07	$ 712,204	$ 960,453	$ 248,249	74.2%	$ 325,344	76.3%
01-01-09	601,930	1,038,921	436,991	57.9%	304,021	143.7%
01-01-11	740,898	1,371,013	630,115	54.0%	315,238	199.9%

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 have been adjusted to reflect a 4-year smoothing of gains and/or losses subject to a corridor between 90 to 110 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 ALIQUIPPA CITY 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. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF ALIQUIPPA CITY EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2007	$ 83,397	111.3%
2008	53,794	173.3%
2009	56,101	155.8%
2010	66,944	139.4%
2011	80,436	175.8%
2012	98,066	128.2%

CITY OF ALIQUIPPA CITY EMPLOYEES PENSION PLAN
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:

Actuarial valuation date	January 1, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	27 years
Asset valuation method	Fair value, 4-year smoothing subject to a corridor between 90-110% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%

CITY OF ALIQUIPPA CITY EMPLOYEES PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of Aliquippa City Employees Pension Plan
Beaver County
581 Franklin Avenue
Aliquippa, PA 15001

The Honorable Dwan B. Walker	Mayor
Mr. Samuel L. Gill	City Administrator
Ms. Cheryl McFarland	Finance Officer

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