CITY OF ALLENTOWN AGGREGATE PENSION FUND

LEHIGH 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 Allentown
Lehigh County
Allentown, PA 18101

We have conducted a compliance audit of the City of Allentown Aggregate Pension Fund 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 fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

Our audit was limited to the areas related to the objectives identified above. 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 plans' governing documents and applicable laws and regulations.

- Whether employee contributions are required and, if so, are determined, deducted and deposited into the pension plans 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 the special ad hoc postretirement adjustment granted to eligible pensioners is in accordance with applicable laws and regulations and whether the ad hoc reimbursement received by the municipality was treated in accordance with applicable laws and regulations.

- Whether benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.

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

- Whether the terms and methodologies of the issuance of bonds by the municipality, and any restrictions are in compliance with plan provisions and state regulations.

- Whether Deferred Retirement Option Plan (DROP) participants' benefit payments are properly determined in accordance with the provisions of the DROP and any other applicable laws and regulations.

The City of Allentown 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 Allentown Aggregate Pension Fund is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. In conducting our audit, we obtained an understanding of the city's internal controls as they relate to the city's compliance with those requirements and that we considered to be significant within the context of our audit objectives, and assessed whether those significant controls were properly designed and implemented. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to 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 Allentown Aggregate Pension Fund 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:

Police Pension Plan

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Plan Provisions Not In Compliance With The Third Class City Code

Firemen's Pension Plan

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Plan Provisions Not In Compliance With The Third Class City Code

Aggregate Pension Fund

Finding No. 3 – Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid

Finding Nos. 1 and 2 contained in this audit report repeat conditions that were cited in our previous audit report that have not been corrected by city officials. We are concerned by the city's failure to correct those previously reported audit findings and strongly encourage timely implementation of the recommendations noted in this audit report.

As previously noted, one of the objectives of our audit of the City of Allentown Aggregate Pension Fund was to determine compliance with applicable state laws, contracts, administrative procedures, and local ordinances 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 or conclude on it and, accordingly, express no form of assurance on it. However, we are extremely concerned about the historical trend information contained in the respective schedules of funding progress included in this report which indicate a continued decline of assets available to satisfy the long-term liabilities of the fund. This condition is due, in part, to the effect of arbitration awards and memoranda of understanding granting excess pension benefits to the city's police officers and firefighters. For example, **the Police Pension Plan's funded ratio went from 103.2% as of January 1, 2000, to a ratio of 43.7% as of January 1, 2011. Similarly, the Firemen's Pension Plan's funded ratio went from 117.4% as of January 1, 2000, to 47.4% as of January 1, 2011. Based on this information, and the funded ratios of the Officers' and Employees' Pension Plan and the Officers' and Employees' - PMRS Pension Plan, the Public Employee Retirement Commission issued a notification that the city is in Level II moderate distress status.** In addition, the city's annual required contribution to the Police Pension Plan has gone from $791,507 in 2000, to $7,324,133 in 2012. Similarly, the city's annual required contribution to the Firemen's Pension Plan has gone from $30,181 in 2000, to $4,069,771 in 2012. As noted in the Comments section of this audit report, the City of Allentown has made substantial deposits to their plans subsequent to the current audit period. We encourage city officials to continue to monitor 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 Allentown 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.

January 31, 2014

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 Allentown Aggregate 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 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.

Act 317 - The Third Class City Code, Act of June 23, 1931 (P.L. 932, No. 317), as amended, 53 P.S. § 35101 et seq.

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. § 39371 et seq.

The City of Allentown Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 143 of the city's codified ordinances, adopted pursuant to the Third Class City Code. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers, as well as Act 111 interest arbitration awards. The plan was established March 9, 1926. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2012, the plan had 194 active members, 1 terminated member eligible for vested benefits in the future and 283 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2012, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	20 years of service. If hired after January 1, 2009, age 50 and 20 years of service.
Early Retirement	None
Vesting	100% after 12 years of service.

Retirement Benefit:

50.5% of pension wages the member was receiving at the date of retirement, or, if higher, 50.5% of average salary of any 5 years of service, plus a service increment of 7.5% for the first full year of service over 20 years, plus 3.0% for each of the next 4 full years of service over 21 years to a maximum of 70% of pension wages for 25 or more years of service. If hired after January 1, 2009, 50% of pension wages or, if higher, 50% of average wages of any 5 years of service, plus a service increment of $100 per month for each year of service in excess of 20 years of service to a maximum of $500 per month.

Survivor Benefit:

100% of pension benefits applicable to the member for members retired on or after December 17, 1969, active members dying in the line of duty, and active members dying not in the line of duty with 10 or more years of service.

50% of pension benefits applicable to the member for active members not dying in the line of duty with less than 10 years of service.

Killed In Service - 62.5% of the officer's wages or 50.5% plus a service increment which the officer would be entitled to receive at the time of death, whichever is higher.

Service Related Disability Benefit:

50.5% of the member's salary at the time the disability was incurred

The City of Allentown Firemen's Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 145 of the city's codified ordinances, adopted pursuant to the Third Class City Code. The plan is also affected by the provisions of collective bargaining agreements between the city and its firefighters, as well as Act 111 interest arbitration awards. The plan was established December 8, 1927. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2012, the plan had 122 active members, no terminated members eligible for vested benefits in the future and 220 retirees receiving pension benefits from the plan.

As of December 31, 2012, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	20 years of service.
Early Retirement	None
Vesting	None

Retirement Benefit:

50.5% of salary at time of retirement, or, if higher, 50.5% of average annual salary during any 5 years of service. A service increment of 3.5% of salary for the first full year of service and 4.0% of salary for each full year of service in excess of 20 years, with a maximum benefit of 70% after 25 years of service. The increment benefit shall not exceed 5 years of service. Minimum pension is $10,400 per year.

Survivor Benefit:

100% of the member's retirement benefits.

Service Related Disability Benefit:

10% of salary for less than 2 years of service, but more than 1 day of service, 20% of salary for 2 to 5 years of service, 30% of salary for 5 to 10 years of service, 40% of salary for 10 to 15 years of service and 50% for 15 or more years of service.

BACKGROUND – (Continued)

The City of Allentown Officers' and Employees' Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 141 of the city's codified ordinances, adopted pursuant to the Third Class City Code. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. Non-uniformed employees hired prior to August 5, 1981, are members of the officers' and employees' pension plan. The plan was established May 1, 1946. Active members are required to contribute 5.5 percent of compensation to the plan. As of December 31, 2012, the plan had 4 active members, no terminated members eligible for vested benefits in the future and 173 retirees receiving pension benefits from the plan.

As of December 31, 2012, selected plan benefit provisions are as follows:

<u>Eligibility Requirements</u>:

Normal Retirement	Age 55 and 20 years of service or age 60 and 12 years of service.
Early Retirement	None
Vesting	100% after 12 years of service.

<u>Retirement Benefit</u>:

50% of compensation, or, if higher, 50% of average compensation during any 5 years of service. Benefit is reduced for service less than 20 years at retirement. Service increment of $1/40^{th}$ of basic benefit for each year in excess of 20 years if elected by member.

<u>Survivor Benefit</u>:

If elected by a member, a survivor benefit is payable in the amount of 50% of the pension benefit the member was receiving or would have received had he/she been retired at time of death.

<u>Service Related Disability Benefit</u>:

50% of compensation, or, if higher, 50% of average compensation during any 5 years of service. Benefit is reduced for service less than 20 years at retirement. Service increment of $1/40^{th}$ of basic benefit for each year in excess of 20 years if elected by member.

Status Of Prior Audit Recommendation

Firemen's Pension Plan

- Arbitration Award And Memorandum Of Understanding Grant Benefits Not Authorized By The Third Class City Code

  A finding in the prior audit report for the period January 1, 2005 to December 31, 2006, noted an arbitration award dated December 22, 2004, covering the period January 1, 2005 through December 31, 2011, and subsequent Memorandums of Understanding (MOUs) dated June 22, 2005 and September 9, 2005, between the city and Allentown Local 302 of the International Association of Firefighters, contain benefit provisions which are not authorized by the Third Class City Code.

  The arbitration award includes an early retirement option under which firefighters with a minimum of 16 years of service credit are permitted to purchase up to 4 years of additional service credit. The award also included an "Early Retirement Incentive" provision under which firefighters who retired between January 1, 2005 and February 28, 2005, could apply for up to 5 years of service credit with the city assuming the liability for the cost of providing the additional service credit.

  Allentown City Council initially appealed the arbitration award to the Lehigh County Court of Common Pleas. However, the Court of Common Pleas ruled that City Council lacked appropriate standing to appeal the award because the Allentown City Charter provides that the mayor is appointed to act as the city's exclusive representative for collective bargaining. City Council then appealed the award to the Pennsylvania Commonwealth Court. However, that appeal was formally terminated by vote of council on July 20, 2005.

  Pursuant to the MOUs executed on June 22, 2005 and September 9, 2005, the city agreed to provide the benefits offered under the "Early Retirement Incentive" provision included in the arbitration award to firefighters who retired during the period from August 1, 2005 through September 16, 2005.

  During the current audit period, the unauthorized 4 year service credit was granted to 36 firefighters which permitted some of them to qualify for an immediate retirement benefit to which they would otherwise not have been entitled and/or increased the amount of their monthly benefit. In addition, because the definition of pay used to calculate pension benefits contained in the plan document includes overtime, permitting firemen to select any consecutive 26 pay periods in the preceding 3 years of service to serve as the basis for their pension benefit artificially inflated the amount of those benefits which, in the majority of cases, exceeded the amount of the firefighter's base salary.

Status Of Prior Audit Recommendation – (Continued)

Firemen's Pension Plan – (Continued)

The Department of the Auditor General respectfully recognizes the city's attempt to rectify the impact of the Memorandum of Understanding. Since the city received its state aid allocations based on unit value during the current audit period, it did not receive excess state aid allocations attributable to the excess benefits provided; however we will continue to monitor the effect of the pension plan's excess benefits prospectively. 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 retirees 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, such 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 excess benefits on the city's future state aid allocations and submit this information to the Department. We further recommend that the city comply with the Third Class City Code upon the expiration or renegotiation of the arbitration award.

Compliance With Prior Audit Recommendation

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

Aggregate Pension Fund

- Untimely Deposit Of State Aid

  During the current audit period, city officials deposited their state aid allocations into the fund within 30 days of receipt in accordance with Act 205.

Status Of Prior Audit Recommendations – (Continued)

Noncompliance With Prior Audit Recommendations

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

Police Pension Plan

- Plan Provisions Not In Compliance With The Third Class City Code

Firemen's Pension Plan

- Plan Provisions Not In Compliance With The Third Class City Code

Police Pension Plan

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Plan Provisions Not In Compliance With The Third Class City Code

Condition: As disclosed in the prior audit report, the city adopted a home rule charter pursuant to the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2901 et seq. (previously 53 P.S. § 1-101 et seq.). Furthermore, it was noted that the plan's governing document contained provisions that were not in compliance with the Third Class City Code, as noted below:

Provision	Plan Governing Document	Third Class City Code
Survivor's death benefit (not killed in service) after 10 years of service	Effective January 1, 2009 such pension shall be equivalent of 62.5% of the officer's salary at the time of death or 50.5% of salary and any service increment in effect on the date which the officer may be entitled to at the time of retirement.	The spouse of a member of the police force or a member who retires on pension who dies or if no spouse survives or if such person survives and subsequently dies or remarries, then the child or children under the age of eighteen years, of a member of the police force or a member who retires on pension who dies on or after the effective date of this amendment, shall, during the lifetime of the surviving spouse, even if the surviving spouse remarries, or until reaching the age of eighteen years in the case of a child or children, be entitled to receive a pension calculated at the rate of fifty per centum of the pension the member was receiving or would have been receiving had he been retired at the time of his death and may receive the pension the member was receiving or would have been receiving had he been retired at the time of his death.

Finding No. 1 – (Continued)

Police Pension Plan – (Continued)

Provision	Plan Governing Document	Third Class City Code
Refund of service increment contributions	Not provided	Service increment contributions may be withdrawn in full, without interest, by persons who retire before becoming entitled to any service increment.
Survivor benefits for a surviving spouse of a retiree	Upon remarriage, benefits revert to dependent children under age 18, when the last child reaches 18, they revert back to the original surviving spouse.	Pension benefit is payable during the lifetime of the surviving spouse, even if they remarry.
Nonservice-related disability benefit with more than 10 years of service	50.5% of salary and any service increment in effect on the date which the officer may be entitled to at the time of retirement.	Benefit may be 50% of annual compensation.
Minimum pension	Effective 1/1/00, each retiree or surviving spouse shall receive a minimum amount of $10,400, annually.	Not provided

Criteria: On January 24, 2001, the Commonwealth Court of Pennsylvania issued its opinion in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee.* Therein, the court held that Section 2962(c)(5) of the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2962(c)(5), "clearly precludes home rule municipalities from providing pension benefits different from those prescribed in general law." The court's holding was in accordance with the position taken by this Department since at least January 1995.

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

Finding No. 1 – (Continued)

Police Pension Plan – (Continued)

Effect: The provision of benefits that are not in compliance with the Third Class City Code could increase the plan's pension costs and reduce the amount of funds available for investment purposes or the payment of authorized benefits or administrative expenses. Since the city received its state aid allocations based on unit value during the current audit period, it did not receive excess state aid allocations attributable to the benefits not in compliance with the Third Class City Code. However, providing benefits not in compliance with the Third Class City Code could result in the receipt of excess state aid in the future, and could also increase required municipal contributions to the plan.

In addition, the failure to provide benefits mandated by the Third Class City Code could result in plan members or their beneficiaries being denied benefits to which they are statutorily entitled.

Recommendation: As noted in the prior audit report, until *Monroeville*, there was no definitive decision as to whether home rule municipalities were obliged to comply with applicable pension law. The Department seeks, therefore, to implement the decision in as equitable a fashion as possible, while paying necessary deference to the court's ruling. Accordingly, the Department will not penalize a home rule municipality for granting benefits not authorized by the Third Class City Code to existing retirees or to individuals who began full-time employment before January 24, 2001 (the date *Monroeville* was issued). However, to the extent that the city is providing pension benefits in excess of those authorized by the Third Class City Code to employees who began full-time employment on or after that date, the unauthorized 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 unauthorized benefits on the city's future state aid allocations and submit this information to the Department.

Furthermore, we again caution city officials that the Department's application of *Monroeville* only to employees hired on or after January 24, 2001, does not sanction (1) a municipality's granting excess benefits to existing or future employees when none had been granted as of January 24, 2001, or (2) a municipality's increasing excess benefits for existing or future employees beyond those that had been granted as of that date.

Finally, to the extent that the city is not providing benefits mandated by the Third Class City Code, we recommend that those benefits be adopted at the city's earliest opportunity to do so.

Finding No. 1 – (Continued)

Police Pension Plan – (Continued)

Management's Response: Municipal officials indicated that the latest collective bargaining agreement between the city and the police officers contained the following language: "Officers hired after January 1, 2009 shall be entitled to a pension calculated in conformity with the provisions of the Pennsylvania Third Class City Code. Specifically, new officers hired after January 1, 2009 shall be eligible only for service increments calculated in accordance with the formula provided under Section 4303(b) of the Third Class City Code."

Auditor's Conclusion: Although city officials have collectively bargained the pension benefits to be in accordance with the Third City Code for police officers hired after January 1, 2009, the pension plan's governing document has not been properly amended to reflect such changes. Based on the criteria cited above, the finding remains as stated.

Firemen's Pension Plan

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Plan Provisions Not In Compliance With The Third Class City Code

Condition: The city adopted a home rule charter pursuant to the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2901 et seq. (previously 53 P.S. § 1-101 et seq.). As disclosed in the prior audit report, certain plan provisions are not in compliance with the Third Class City Code, as noted below:

Provision	Plan Governing Document	Third Class City Code
Service increment	21 years of service – 3%; 22-25 years of service – 3.5%; at least 22 ½ years of service but less than 23 years of service - receive credit of 2.5 service increments.	1/40th (2.5%) of pension benefit multiplied by the number of whole years in excess of 20 years, not to exceed $100 per month. No credit for service after the employee is 65 years old. Effective June 19, 2002, the maximum payment was increased to $500 per month.

Finding No. 2 – (Continued)

Firemen's Pension Plan – (Continued)

Provision	Plan Governing Document	Third Class City Code
Survivor benefits for minor children of members not killed in service	Upon the death of the surviving spouse, pension benefits shall be paid to the guardian of the deceased officer's dependent children, if any, without abatement until the youngest child reaches the age of 18 or up to 23 if enrolled in and attending a post-secondary certified education institution on a full time basis.	Not provided
Refund of service increment contributions	Not provided	Service increment contributions may be withdrawn in full, without interest, by persons who leave the employment of such city, subject to the same conditions by which retirement contributions may be withdrawn, or by persons who retire before becoming entitled to any service increment.
Minimum pension	Effective 1/1/00, each retiree or surviving spouse shall receive a minimum amount of $10,400, annually.	Not provided

Criteria: On January 24, 2001, the Commonwealth Court of Pennsylvania issued its opinion in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee.* Therein, the court held that Section 2962(c)(5) of the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2962(c)(5), "clearly precludes home rule municipalities from providing pension benefits different from those prescribed in general law." The court's holding was in accordance with the position taken by this Department since at least January 1995.

Cause: Municipal officials did not have the opportunity to revise the collective bargaining agreement that expired on December 31, 2011. The most recent agreement is currently pending appeal in Common Pleas Court.

Finding No. 2 – (Continued)

Firemen's Pension Plan – (Continued)

Effect: The provision of benefits that are not in compliance with the Third Class City Code could increase the plan's pension costs and reduce the amount of funds available for investment purposes or the payment of authorized benefits or administrative expenses. Since the city received its state aid allocations based on unit value during the current audit period, it did not receive excess state aid allocations attributable to the benefits not in compliance with the Third Class City Code. However, providing benefits not in compliance with the Third Class City Code could result in the receipt of excess state aid in the future, and could also increase required municipal contributions to the plan.

In addition, the failure to provide benefits mandated by the Third Class City Code could result in plan members or their beneficiaries being denied benefits to which they are statutorily entitled.

Recommendation: As noted in the prior audit report, until *Monroeville*, there was no definitive decision as to whether home rule municipalities were obliged to comply with applicable pension law. The Department seeks, therefore, to implement the decision in as equitable a fashion as possible, while paying necessary deference to the court's ruling. Accordingly, the Department will not penalize a home rule municipality for granting benefits not authorized by Third Class City Code to existing retirees or to individuals who began full-time employment before January 24, 2001 (the date *Monroeville* was issued). However, to the extent that the city is providing pension benefits in excess of those authorized by the Third Class City Code to employees who began full-time employment on or after that date, the unauthorized 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 unauthorized benefits on the city's future state aid allocations and submit this information to the Department.

Furthermore, we again caution city officials that the Department's application of *Monroeville* only to employees hired on or after January 24, 2001, does not sanction (1) a municipality's granting excess benefits to existing or future employees when none had been granted as of January 24, 2001, or (2) a municipality's increasing excess benefits for existing or future employees beyond those that had been granted as of that date.

Finally, to the extent that the city is not providing benefits mandated by the Third Class City Code, we recommend that those benefits be adopted at the city's earliest opportunity to do so.

Management's Response: City officials stated that the most recent arbitration award is pending appeal in the Court of Common Pleas.

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

Aggregate Pension Fund

Finding No. 3 – Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid

Condition: The city failed to certify 3 eligible non-uniformed employees (3 units) on the Certification Form AG 385 filed in 2012. In addition, the city certified 2 ineligible police officers (4 units) and 3 ineligible firefighters (6 units) on the Certification Form AG 385 filed in 2012. 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.

Cause: Plan officials failed to establish adequate internal control 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:

Type of Plan	Units Overstated (Understated)	Unit Value	State Aid Overpayment (Underpayment)
Police	4	$ 3,576	$ 14,304
Officers' and Employees - PMRS	(3)	$ 3,576	(10,728)
Firemen's	6	$ 3,576	21,456
Net Overpayment of State Aid			$ 25,032

Furthermore, the city's future state aid allocations may be withheld until the finding recommendation is complied with.

Finding No. 3 – (Continued)

Aggregate Pension Fund – (Continued)

Recommendation: We recommend that the net overpayment of state aid, in the amount of $25,032, be returned to the Commonwealth from the city's general fund. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plans, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 320 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

We also again recommend that in the future, plan officials establish adequate internal control procedures, such as having at least 2 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: Due to the potential withhold of state aid, the city's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through our next audit of the pension fund.

CITY OF ALLENTOWN AGGREGATE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 3 contained in this audit report cites a net overpayment of state aid to the city in the amount of $25,032. A condition 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 plans, should be made payable to: Commonwealth of Pennsylvania, and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 320 Finance Building, Harrisburg, PA 17120.

CITY OF ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF FUNDING PROGRESS

Historical trend information about the plan is presented herewith as supplementary information. It is intended to help users assess the plan's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other state and local government retirement systems.

The actuarial information is required by Act 205 biennially. The historical information, beginning as of January 1, 2007, is as follows:

POLICE PENSION PLAN

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-07	$ 64,733,840	$ 114,801,290	$ 50,067,450	56.4%	$ 10,126,336	494.4%
01-01-09	62,262,176	132,568,344	70,306,168	47.0%	11,384,012	617.6%
01-01-11	62,355,723	142,839,885	80,484,162	43.7%	13,821,650	582.3%

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 have been adjusted to reflect the smoothing of gains and/or losses which will be limited to a maximum of 130 percent and a minimum of 70 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 ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF FUNDING PROGRESS – (Continued)

FIREMEN'S PENSION PLAN

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-07	$ 43,525,113	$ 64,764,292	$ 21,239,179	67.2%	$ 7,350,267	289.0%
01-01-09	42,706,507	77,233,681	34,527,174	55.3%	9,386,995	367.8%
01-01-11	43,052,580	90,866,138	47,813,558	47.4%	10,475,590	456.4%

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 have been adjusted to reflect the smoothing of gains and/or losses which will be limited to a maximum of 130 percent and a minimum of 70 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 ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF FUNDING PROGRESS – (Continued)

OFFICERS' AND EMPLOYEES' PENSION PLAN

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-07	$ 21,982,132	$ 25,711,360	$ 3,729,228	85.5%	$ 327,197	1,139.8%
01-01-09	17,238,602	23,095,953	5,857,351	74.6%	370,644	1,580.3%
01-01-11	16,902,051	20,896,120	3,994,069	80.9%	314,909	1,268.3%

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 have been adjusted to reflect the smoothing of gains and/or losses which will be limited to a maximum of 130 percent and a minimum of 70 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 ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the actuarial accrued liability as a factor.

Analysis of the dollar amount of the actuarial value of assets, actuarial accrued liability, and unfunded (assets in excess of) actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability (Column 4) provides one indication of the plan's funding status on a going-concern basis. Analysis of this percentage, over time, indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the plan.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

POLICE PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2007	$ 5,841,327	100.0%
2008	6,022,935	100.0%
2009	7,115,495	100.0%
2010	5,726,720	100.0%
2011	7,338,716	100.0%
2012	7,324,133	100.0%

CITY OF ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES – (Continued)

FIREMEN’S PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2007	$ 3,049,326	100.0%
2008	3,106,329	100.0%
2009	3,565,384	100.0%
2010	3,133,439	100.0%
2011	4,146,949	100.0%
2012	4,069,771	100.0%

CITY OF ALLENTOWN AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES – (Continued)

OFFICERS' AND EMPLOYEES' PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2007	$ 528,875	100.0%
2008	355,279	100.0%
2009	451,053	100.0%
2010	343,531	100.0%
2011	514,014	100.0%
2012	512,669	100.0%

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

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation date follows:

POLICE PENSION PLAN

Actuarial valuation date	January 1, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	15 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 70-130% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.0%
Cost-of-living adjustments	2.4% after 19 years of retirement

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

FIREMEN'S PENSION PLAN

Actuarial valuation date	January 1, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	16 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 70-130% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0% after 19 years of retirement

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

OFFICERS' AND EMPLOYEES' PENSION PLAN

Actuarial valuation date	January 1, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	11 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 70-130% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.0%

SUBSEQUENT EVENT

On August 7, 2013, the City of Allentown leased its water/sewer operations to the Lehigh County Authority. On December 4, 2013, city council passed Ordinance 15106 which issued a Series AA note payable to the Restricted Pension Obligation Account in the amount of $150,000,000 bearing interest at 3.5% per year for a term not to exceed 15 years, with no penalty for early payment. Furthermore, on December 4, 2013, city council authorized and directed the Series AA note of 2013 be forgiven and deemed paid in full. Consequently, $84,500,000 was deposited to the police pension plan, $4,300,000 was deposited to the officer's and employee's pension plan and $61,200,000 was deposited to the firemen's pension plan.

CITY OF ALLENTOWN AGGREGATE PENSION FUND
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of Allentown Aggregate Pension Fund
Lehigh County
435 Hamilton Street
Allentown, PA 18101

The Honorable Edward Pawlowski	Mayor
Mr. Julio Guridy	Council President
Mr. Garret H. Strathearn	Director of Finance
Mr. Michael P. Hanlon	City Clerk

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