

# COMPLIANCE AUDIT

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## City of Arnold Aggregate Pension Trust Fund Westmoreland County, Pennsylvania For the Period January 1, 2012 to December 31, 2013

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September 2014



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General





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**EUGENE A. DePASQUALE  
AUDITOR GENERAL**

The Honorable Mayor and City Council  
City of Arnold  
Westmoreland County  
Westmoreland, PA 15068

We have conducted a compliance audit of the City of Arnold Aggregate Pension Trust Fund for the period January 1, 2012 to December 31, 2013. 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 finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding 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 finding contained in our prior audit report; and
2. To determine if the pension trust 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 transfers were properly authorized, accurate, timely, and properly recorded.

City officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the City of Arnold Aggregate Pension Trust 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 Arnold Aggregate Pension Trust Fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further discussed later in this report:

Finding    –    Data In Actuarial Valuation Report Inconsistent With The  
Plan's Governing Document

As previously noted, one of the objectives of our audit of the City of Arnold Aggregate Pension Trust Fund was to determine compliance with applicable state laws, regulations, contracts,



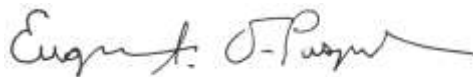
administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

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 concerned about the funded status of the city's plans contained in the schedules of funding progress included in this report which indicates **the Police Pension Plan's Funded Ratio is 62.2% as of January 1, 2013, and the Civilian Employees Pension Plan's Funded Ratio is 77.4% as of January 1, 2013, which is the most recent date available.** Based on the aggregate funded status of the city plans, 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 its pension plans to ensure their long-term financial stability.

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

August 29, 2014



EUGENE A. DEPASQUALE  
Auditor General



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## **BACKGROUND**

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

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 Arnold Aggregate Pension Trust Fund 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.

The City of Arnold Aggregate Pension Trust Fund serves as a common administrative and investment agent for the city's police and civilian employees defined benefit pension plans. The city's police pension plan is controlled by the provisions of Ordinance No. 6 of 1997, and the civilian employees' pension plan is controlled by the provisions of Ordinance No. 5 of 1997, as amended, adopted pursuant to Act 317. Members of the aggregate pension trust fund are also affected by the provisions of collective bargaining agreements between the city and its police officers and civilian employees.



## **BACKGROUND – (Continued)**

The police pension plan was established December 1, 1948. Active members of the police pension plan are required to contribute 5 percent of compensation, plus a 1 dollar per month service increment contribution to the plan. As of December 31, 2013, the police pension plan had 9 active members, 1 terminated member eligible for vested benefits in the future, and 13 retirees receiving pension benefits from the plan.

As of December 31, 2013, selected police pension plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	If hired on or before January 1, 1988, age 50 with 20 years of service. If hired after January 1, 1988, age 55 with 20 years of service.
Early Retirement	None
Vesting	A member is vested after 12 years of service.

### Retirement Benefit:

Monthly benefit equal to 50% of compensation, plus a service increment of 2.5% of the benefit for each whole year of service in excess of 20, up to a maximum of \$100 per month.

### Survivor Benefit:

Before Retirement Eligibility	25% of final average salary.
After Retirement Eligibility	100% of the benefit the participant was receiving or would have been receiving had he been retired at death.

### Service Related Disability Benefit:

Monthly benefit equal to 50% of compensation.

### Non-Service Related Disability Benefit:

If less than 10 years of service, 25% of compensation the participant was receiving; otherwise, 50% of compensation.



## **BACKGROUND – (Continued)**

The civilian employees' pension plan was established January 1, 1949. Active members of the civilian employees' pension plan are required to contribute 5 percent of compensation to the plan. As of December 31, 2013, the civilian employees' pension plan had 11 active members, 2 terminated members eligible for vested benefits in the future, and 13 retirees receiving pension benefits from the plan.

As of December 31, 2013, selected civilian employees' pension plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	Age 60 and 20 years of service.
Early Retirement	20 years of service, if participant makes monthly contributions.
Vesting	A member is vested after 12 years of service.

### Retirement Benefit:

Monthly benefit equal to 50% of compensation.

### Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions.
After Retirement Eligibility	50% of the benefit the participant was receiving or would have been receiving had he been retired at death.

### Service Related Disability Benefit:

For participants with 10 or more years of service, 50% of compensation at date of disability.

### Non-Service Related Disability Benefit:

For participants with 10 or more years of service, 50% of compensation at date of disability.



CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

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

Civilian Employees Pension Plan

· Improper Pension Benefit Calculations

The city has recalculated the improper pension benefit calculations and is currently paying pension benefits in accordance with the Third Class City Code.



CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
FINDING AND RECOMMENDATION

Police Pension Plan

**Finding – Data In Actuarial Valuation Report Inconsistent With The Plan’s Governing Document**

Condition: City of Arnold Ordinance No. 6 of 1997, Article VI, DEATH BENEFITS, Section 6.01(b), provides, in part:

If the Participant dies, while an Employee of the Employer but not as the direct result of the performance of duties as an Employee of the Employer, a Death Benefit shall be paid . . . and in the case of a Participant who has completed ten (10) Years of Service or more, equal to fifty percent (50%) of the amount which is equal to fifty percent (50%) of the average Monthly Compensation of the Participant as of the Date of Death.

Prior to the current audit period, for members who have completed 10 years of service, the city has interpreted this provision to provide a survivor benefit in the amount of 50 percent of the average monthly compensation of the participant as of the date of death. The city is now interpreting this provision to indicate that a survivor benefit granted under these circumstances should only be 25 percent of the average monthly compensation of the participant as of the date of death.

The city’s previous interpretation of the survivor benefit provision is included in the police pension plan’s January 1, 2013, Act 205 actuarial valuation report (AVR) which provides the following, in part, regarding survivor benefits:

. . . Non-service related pre-retirement death benefits – if less than 10 years of service, 25% of compensation, payable to the widow until death or remarriage or to children under age 18, otherwise, 50% of compensation payable in the same manner.

Criteria: Section 201(d) of Act 205 states:

Responsibility for preparation and filing of reports and investigations. The actuarial valuation report or experience investigation required pursuant to subsection (a) shall be prepared under the supervision and at the discretion of the chief administrative officer of the municipality, who shall be responsible for the filing of the document. The actuarial valuation report or experience investigation shall be signed by the chief administrative officer, indicating that to the extent of the understanding and knowledge of the officer, the report or investigation represents a true and accurate portrayal of the actuarial, financial and demographic condition of the pension plan of the municipality.



CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
FINDING AND RECOMMENDATION

Police Pension Plan – (Continued)

**Finding – (Continued)**

Additionally, a governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. The plan's governing document and the actuarial valuation report should contain consistent benefit provisions to ensure the sound administration of retirement benefits.

Cause: The aforementioned survivor benefit provision is being interpreted differently by the current city administration.

Effect: Since 2002, the city was paying a 50 percent benefit to the surviving spouse of a police officer who died after 11.77 years of service, until February 2014, when city officials held a special meeting and resolved to reduce the surviving spouse's monthly benefit, effective March 1, 2014, to 25 percent of final average salary. City officials also resolved to collect the overpayment (calculated by the city as \$138,386 received over 12 years) by taking \$10 per month from her monthly benefit starting June 14, 2014, until the debt is paid off or her death, whichever occurs first, and sent a letter to the surviving spouse informing her of such. The decision has been grieved by the Arnold Police Department and the Wage Policy Committee on behalf of the surviving spouse and is pending arbitration.

Since the AVR contains the survivor benefit originally awarded to the surviving spouse, if it is determined that the benefit that was paid is incorrect, the AVR contains incorrect data. Because the municipality's state aid allocation is determined, in part, by the information contained in the actuarial valuation report, the submission of incorrect data to the actuary may have resulted in the municipality receiving an incorrect allocation of state aid.

In addition, the information contained in the actuarial valuation report is used to determine the municipality's minimum municipal obligation (MMO); therefore, the incorrect data may have resulted in an erroneous MMO calculation.



CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
FINDING AND RECOMMENDATION

Police Pension Plan – (Continued)

**Finding – (Continued)**

Recommendation: If the city's current position is upheld in the arbitration process, we recommend that city officials take appropriate action to eliminate the inconsistencies between the plan's governing document and the January 1, 2013 Act 205 actuarial valuation report. Plan officials contact PERC to determine if a revised actuarial valuation report should be filed. If a revised report is prepared and accepted by PERC, a copy should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & VFRA Audits, 316-D Finance Building, Harrisburg, PA 17120.

We also recommend that if a revised actuarial valuation report is prepared and accepted by PERC, the chief administrative officer of the pension plan recalculate the MMO and make any necessary deposit to the plan, with interest in accordance with Section 302(e) of Act 205.

Management's Response: Municipal officials acknowledge the inconsistency of data between the collective bargaining agreement (CBA) and the plan's Actuarial Valuation Report (AVR), and your recommendation that we take the necessary action to eliminate the discrepancy. The very section and data you cite is the subject of a current union/labor grievance. It is in the later stage of the process and will be resolved through arbitration or legal proceedings. At the conclusion, we will have direction on the correct interpretation and implement new language in the CBA or AVR that reflects the change and eliminates the conflict.

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



CITY OF ARNOLD AGGREGATE PENSION TRUST 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, 2009, 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)]
01-01-09	\$ 2,251,941	\$ 4,048,485	\$ 1,796,544	55.6%	\$ 718,661	250.0%
01-01-11	2,437,534	4,274,586	1,837,052	57.0%	639,079	287.5%
01-01-13	2,679,990	4,310,718	1,630,728	62.2%	761,923	214.0%

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 70 percent and 130 percent of the market value of assets. The market values of the plan's assets at 01-01-11 and 01-01-13 have been adjusted to reflect the smoothing method described in Section 210 of Act 205, as amended, subject to a ceiling of 120 percent of the market value of assets. These methods 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 ARNOLD AGGREGATE PENSION TRUST FUND  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULES OF FUNDING PROGRESS – (Continued)

CIVILIAN 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)]
01-01-09	\$ 1,998,032	\$ 2,755,469	\$ 757,437	72.5%	\$ 657,143	115.3%
01-01-11	2,175,186	2,920,205	745,019	74.5%	706,048	105.5%
01-01-13	2,423,625	3,131,716	708,091	77.4%	475,197	149.0%

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 70 percent and 130 percent of the market value of assets. The market values of the plan's assets at 01-01-11 and 01-01-13 have been adjusted to reflect the smoothing method described in Section 210 of Act 205, as amended, subject to a ceiling of 120 percent of the market value of assets. These methods 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 ARNOLD AGGREGATE PENSION TRUST 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 ARNOLD AGGREGATE PENSION TRUST 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
2008	\$ 178,477	100.0%
2009	211,323	100.0%
2010	177,647	100.0%
2011	216,392	100.0%
2012	230,221	100.0%
2013	247,693	100.0%



CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

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

CIVILIAN EMPLOYEES PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2008	\$ 61,039	100.0%
2009	33,113	100.0%
2010	21,123	100.0%
2011	104,266	100.0%
2012	117,729	100.0%
2013	92,543	100.0%



CITY OF ARNOLD AGGREGATE PENSION TRUST 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, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	9 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%



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

CIVILIAN EMPLOYEES PENSION PLAN

Actuarial valuation date	January 1, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	21 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%



CITY OF ARNOLD AGGREGATE PENSION TRUST FUND  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett  
Governor  
Commonwealth of Pennsylvania

City of Arnold Aggregate Pension Trust Fund  
Westmoreland County  
1829 Fifth Avenue  
Arnold, PA 15068

The Honorable Larry M. Milito	Mayor
Mr. Floyd H. Newingham	City Clerk
Mr. Kevin Palladino	City Controller
Mr. David G. Horvat	Councilman – Accounts and Finance
Mr. Joseph Puet	City Treasurer

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