



**CITY OF ARNOLD AGGREGATE PENSION
TRUST FUND**

WESTMORELAND COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2010, TO DECEMBER 31, 2011

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE 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.

Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign 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.





Commonwealth of Pennsylvania
Department of the Auditor General
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EUGENE A. DePASQUALE
AUDITOR GENERAL

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

We have conducted a compliance audit of the City of Arnold Aggregate Pension Trust Fund for the period January 1, 2010, to December 31, 2011. 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 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 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 refunds are made to eligible members in accordance with the plan provisions and applicable laws and regulations.

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 – Improper Pension Benefit Calculations

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

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
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 funded status of the city's plans contained in the schedule of funding progress included in this report which indicates the **Police Pension Plan's Funded Ratio is 57.0% as of January 1, 2011, and the Civilian Employees Pension Plan's Funded Ratio is 74.5% 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 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.



March 28, 2013

EUGENE A. DEPASQUALE
Auditor General



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:

Police Pension Plan

· Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

The city paid the interest due to the police pension plan in accordance with Act 205 requirements.

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND
FINDING AND RECOMMENDATION

Civilian Employees Pension Plan

Finding – Improper Pension Benefit Calculations

Condition: The city calculated a normal retirement benefit and a vested benefit for two civilian employees who terminated employment on January 3, 2012, using their 2012 base salaries instead of using their 2011 actual wages received during their last year of employment. Using the higher rates of pay (which were not actually received by the employees due to their dates of termination) resulted in monthly benefit amounts in excess of the amounts authorized by the Third Class City Code.

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

During the lifetime of any person in the employment of any city creating such pension fund and pension board as hereinbefore provided, he or she shall be entitled to receive as a pension annually, from the fund set aside for the purpose, fifty per centum of the amount which would constitute the average annual salary or wages which he or she received during the last or any five years of his or her employment by the said city, whichever is the higher, . . . (emphasis added)

In addition, Section 4343.2, of the Third Class City Code states, in part:

. . . should a member of the pension fund terminate employment before reaching the date which would have been the member's earliest retirement date had the member continued employment by meeting the minimum age and minimum period of continuous service requirements but after having completed twelve years of full-time service, the member shall be entitled to vest his or her retirement benefits

Furthermore, Section 4343.2(b)(2), of the Third Class City Code, states:

. . . the portion of the base retirement benefits due the member shall be determined by applying to the base amount the percentage that his or her years of service actually rendered bears to the years of service which would have been rendered had the member continued to be employed by the city until his or her earliest retirement date.

Cause: Plan officials indicated that there has been a recent turnover in plan officials and that they followed the past practice of using the following year's annual salary in pension calculations, as long as the employee worked one working day in that year.

CITY OF ARNOLD AGGREGATE PENSION TRUST FUND
FINDING AND RECOMMENDATION

Civilian Employees Pension Plan – (Continued)

Finding – (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. 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 recommend the city determine and pay all pension benefits in accordance with the Third Class City Code. 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. If it is determined the excess benefits had an impact on the city’s future state aid allocations after the submission of this information, the plan’s actuary would then be required to contact the department to verify the overpayment of state aid received. Plan officials would then be required to reimburse the overpayment to the Commonwealth.

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

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, 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	\$ 2,129,779	\$ 3,683,896	\$ 1,554,117	57.8%	\$ 677,674	229.3%
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%

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets. 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% and 130% 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)]
01-01-07	\$ 1,864,613	\$ 2,135,080	\$ 270,467	87.3%	\$ 606,834	44.6%
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%

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets. 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% and 130% 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. However, 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
2006	\$ 167,046	100.0%
2007	177,321	100.0%
2008	178,477	100.0%
2009	211,323	100.0%
2010	177,647	100.0%
2011	216,392	100.0%

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

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

CIVILIAN EMPLOYEES PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2006	\$ 64,008	100.0%
2007	67,282	100.0%
2008	61,039	100.0%
2009	33,113	100.0%
2010	21,123	100.0%
2011	104,266	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, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
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 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, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
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 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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