

CITY OF BUTLER FIREMEN'S PENSION PLAN

BUTLER COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2008, TO DECEMBER 31, 2009



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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 Butler Firemen's Pension Plan is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

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

The City of Butler Firemen's Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1517, as amended. The plan is also affected by the provisions of collective bargaining agreements between the city and its firefighters.



The Honorable Mayor and City Council
City of Butler
Butler County
Butler, PA 16001

We have conducted a compliance audit of the City of Butler Firemen's Pension Plan for the period January 1, 2008, to December 31, 2009. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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 finding contained in our prior audit report; and
2. To determine if the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

Our audit was limited to the areas related to the objectives identified above. The City of Butler 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 Butler Firemen's Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. In conducting our audit, we obtained an understanding of the city's internal controls as they relate to the city's compliance with those requirements and that we considered to be significant within the context of our audit objectives, and assessed whether those significant controls were properly designed and implemented. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the City of Butler Firemen's Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following findings further discussed later in this report:

Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Pension Benefits In Excess Of The Third Class City Code

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Finding No. 3 – Inconsistent Member Contributions Provision

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information and, accordingly, express no form of assurance on it.

The contents of this report were discussed with officials of the City of Butler and, where appropriate, their responses have been included in the report.

December 20, 2010

JACK WAGNER
Auditor General

CITY OF BUTLER FIREMEN'S PENSION PLAN
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

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

- Pension Benefits In Excess Of The Third Class City Code

The plan's actuary determined the impact of the excess benefits on the city's state aid allocations received during the audit period; however, city officials failed to amend the plan's governing document and the collective bargaining agreement between the city and its firefighters to comply with the Third Class City Code as further discussed in the Findings and Recommendations section of this report.

CITY OF BUTLER FIREMEN'S PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Pension Benefits In Excess Of The Third Class City Code

Condition: As disclosed in the prior audit report, the pension plan's governing document and the collective bargaining agreement between the city and its firefighters grant a benefit that is not authorized by the Third Class City Code. Ordinance No. 1534 states, in part:

Each participant retiring on or after January 1, 2000, and receiving a pension benefit shall receive a four-percent cost of living adjustment on each anniversary of retirement.

Furthermore, the collective bargaining agreements between the International Association of Firefighters Local 1749 and the City of Butler, effective January 1, 2003, through December 31, 2005, at Article XXII, effective January 1, 2006, through December 31, 2008, at Article XXIII, and effective January 1, 2009 through December 31, 2011, at Article XXIII Sections 3.c and 4.b state, in part:

(3.c) A cost-of-living adjustment (COLA) of four percent (4%) per year capped at fifty percent (50%) of the base wage paid in the highest rank in the bargaining unit (Captain) shall be added for all firefighters who retire on or after January 1, 2000.

(4.b) The COLA cap mentioned in paragraph 3c of Article XXIII, is eliminated in accordance with the provisions of Act 65 of 2002.

Therefore, the city removed any limitations on cost-of-living adjustments that can be paid from the pension plan.

Criteria: Section 4322.1 of the Third Class City Code states:

Any city may, at any time, at its discretion, upon the recommendation of the persons having custody and management of the firemen's pension fund, increase the allowances of persons receiving allowances of any kind from the fund by reason of and after the termination of the services of any member of the fund. Such increases shall be in conformity with a uniform scale, which may be based on the cost of living, but the total of any such allowances shall not at any time exceed one-half of the current salary being paid firemen of the highest pay grade. (Emphasis added)

CITY OF BUTLER FIREMEN'S PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

In addition, Act 65 of 2002 pertained to cities governed by home rule and optional plan government, which does not apply to the City of Butler.

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

Effect: The plan is paying pension benefits to retirees in excess of those authorized by the Third Class City Code. Retirees received excess benefits since the removal of the cost-of-living-adjustment limits as follows (COLAs are awarded on retirement anniversary date):

<u>Year</u>	<u>COLA Overpayments</u>
2010	\$ 1,250
2009	17,385
2008	9,982
2007	6,449
2006	3,262
2005	1,506
2004	560
Total	<u>\$ 40,394</u>

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 provision of unauthorized pension benefits resulted in the receipt of excess state aid in the amounts of \$17,055 and \$17,055 in 2008 and 2009, respectively, and increased municipal contributions necessary to fund the plan in accordance with Act 205 standards.

Recommendation: We again recommend that the city comply with the Third Class City Code upon the renewal, extension, or renegotiation of the collective bargaining agreement. To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to pay benefits to existing 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 must determine the impact, if any, of the excess benefits on the plan's state aid allocations received and submit this information to the department.

CITY OF BUTLER FIREMEN’S PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

We also recommend that the total excess state aid, in the amount of \$34,110, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with the check.

Management’s Response: City officials agreed with the finding without exception. Subsequent to the audit period, city officials reduced the monthly benefit payments of the seven retired firefighters to compliance with the Third Class City Code. City officials and the firefighters are negotiating the removal of the noncompliant provision from the plan’s governing document and the collective bargaining agreement.

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

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Condition: The city failed to certify the total eligible wages for one firefighter and understated payroll by \$5,141 in 2009 on Certification Form AG 385.

Criteria: Pursuant to the instructions that accompany Certification Form AG 385, the total payroll eligible to be certified should be Internal Revenue Service Form W-2 earnings pertaining to full-time positions which includes Heart and Lung benefits.

Cause: Plan officials failed to certify all of the eligible Heart and Lung benefits earned by the firefighter.

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 pension costs, the city received an underpayment of state aid of \$1,051 as identified below:

<u>Normal Cost</u>	<u>Payroll Understated</u>	<u>State Aid Underpayment</u>
20.44%	\$ 5,141	\$ 1,051

CITY OF BUTLER FIREMEN’S PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Although the city will be reimbursed for the underpayment of state aid due to the city’s certification error, the full amount of the 2009 state aid allocation was not available to be deposited timely and therefore was not available to pay operating expenses or for investment.

Recommendation: We recommend that, in the future, plan officials establish adequate internal control procedures 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.

Finding No. 3 – Inconsistent Member Contributions Provision

Condition: The pension plan’s governing document, Ordinance No. 1517, as amended, contains a benefit provision that conflicts with the collective bargaining agreement between the firefighters and the city as follows:

<u>Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>
Member contributions	3% of regular monthly wages (base salary, plus longevity pay, plus shift differential pay)	3% of regular wage (base salary, plus longevity pay, plus shift differential pay, plus overtime)

Criteria: The plan’s governing document and the collective bargaining agreement should contain consistent provisions to ensure the sound administration of retirement benefits.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure the plan’s governing document and the collective bargaining agreement contained consistent member contribution provisions.

Effect: Inconsistent plan documents could result in incorrect member contributions made to the pension plan.

Recommendation: We recommend that the city take appropriate action to ensure the plan’s governing document and the collective bargaining agreement contain consistent member contribution provisions at their earliest opportunity to do so.

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

CITY OF BUTLER FIREMEN'S PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 1 contained in this audit report cites an overpayment of state aid to the city in the amount of \$34,110. 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 plan, should be made payable to: Commonwealth of Pennsylvania, and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222.

CITY OF BUTLER FIREMEN'S PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

SCHEDULE OF FUNDING PROGRESS

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

The actuarial information is required by Act 205 biennially, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2005, is as follows:

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-05	\$ 10,755,319	\$ 12,829,984	\$ 2,074,665	83.8%	\$ 1,164,076	178.2%
01-01-07	14,528,905	13,574,710	(954,195)	107.0%	1,110,826	(85.9%)
01-01-09	13,957,768	14,284,139	326,371	97.7%	1,114,447	29.3%

Note: The market values of the plan's assets at 01-01-05 and 01-01-09 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. 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 BUTLER FIREMEN'S PENSION PLAN
POTENTIAL WITTHOLD OF STATE AID

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 BUTLER FIREMEN'S PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2004	\$ 335,276	144.6%
2005	352,740	138.1%
2006	476,714	120.2%
2007	475,513	120.5%
2008	106,108	333.3%
2009	103,652	329.9%

CITY OF BUTLER FIREMEN'S PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

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

Actuarial valuation date	January 1, 2009
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	20 years
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases *	4.5%
* Includes inflation at	3.0%

CITY OF BUTLER FIREMEN'S PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of Butler Firemen's Pension Plan
Butler County
140 West North Street
Butler, PA 16001

The Honorable Margaret D. Stock	Mayor
Ms. Melinda F. Gall	City Clerk
Mr. Jon W. Campbell	Treasurer

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.