# CITY OF DUBOIS NON-UNIFORMED PENSION PLAN

## CLEARFIELD 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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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and City Council
City of DuBois
Clearfield County
DuBois, PA 15801

We have conducted a compliance audit of the City of DuBois Non-Uniformed Pension Plan 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 the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

The objective of the audit was 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 objective 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 terms of the contractual agreement with the Pennsylvania Municipal Retirement System are in accordance with the plan's governing document, if separately stated, and applicable laws and regulations.

- Whether transfers were properly authorized, accurate, timely and properly recorded.

The City of DuBois 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.

Prior to January 1, 2012, the City of DuBois Non-Uniformed Pension Plan participated in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's 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 DuBois Non-Uniformed 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 objective, 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 objective.

The results of our tests indicated that, in all significant respects, the City of DuBois Non-Uniformed 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 – 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

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.

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

April 23, 2013

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 DuBois Non-Uniformed 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 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974 (P.L. 34, No. 15), as amended, 53 P.S. § 881.101 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 DuBois Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1776, effective January 1, 2012. Prior to January 1, 2012, the plan was a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1543, adopted pursuant to Act 15. The assets of the plan were transferred from PMRS to Nationwide Financial in December of 2011. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees.

CITY OF DUBOIS NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Pension Benefits In Excess Of The Third Class City Code

Condition: On February 27, 2012, city officials passed Ordinance No. 1776, with an effective date of January 1, 2012, establishing a pension plan for the city's non-uniformed employees and elected officials. The ordinance states that the plan shall be deemed a continuation of the previous non-uniformed pension plan, as maintained and administered by PMRS, for state aid purposes.

Since the non-uniformed pension plan is no longer administered by PMRS, the plan must operate under the requirements of Act 317, the Third Class City Code, not Act 15, the Pennsylvania Municipal Retirement Law. However, Ordinance No. 1776 grants benefits that are not authorized by the Third Class City Code, as illustrated below:

| Benefit Provision | Ordinance No. 1776 | Third Class City Code |
|---|---|---|
| Normal retirement | Age 60 and 12 years of service. Benefit equal to 2.5% multiplied by years of credited service with a maximum benefit of 90%, multiplied by average monthly salary over the highest 5 consecutive years of employment. (Sections 4.1 & 4.2) | Age 60 and 20 years of service. Benefit equal to 50% of highest average annual salary during any 5 years of service. (Sections 4342 & 4343) |
| Early retirement | A participant who has been involuntarily terminated after 8 years of credited service or who has separated voluntarily after 20 years of credited service may retire early. Benefits will be actuarially reduced for each year or partial year prior to age 60. (Section 4.3) | A participant who has completed at least 20 years of service, but has not attained age 60, shall be entitled to a pension at age 60 if the participant continues paying monthly employee's contributions equal to the last amount due while in active employment until the employee reaches age 60. (Section 4343) |

Finding No. 1 – (Continued)

| Benefit Provision | Ordinance No. 1776 | Third Class City Code |
|---|---|---|
| Refund of terminated employee contributions | Participant shall be entitled to a refund of contributions plus interest at a rate of 6% per annum. (Section 4.7) | Participant shall be entitled to a refund of contributions without interest. (Section 4344) |
| Disability | A member who has 10 or more years of credited service shall be sufficient to produce a retirement allowance of 30% of member's final salary. If disability is service connected there is no minimum service requirement and the benefit shall equal 50% of the member's final salary. The disability annuity shall be reduced by the amount of any payments for which the member shall be eligible under worker's compensation. (Section 4.4) | After completing at least 10 years of credited service and before attaining age 60. Eligible for a normal retirement benefit but without offset for Social Security benefits. (Section 4343) |
| Cost of living adjustments | An annual cost of living adjustment (COLA) may be provided to a retired participant effective the first January following at least one year from the initial date of retirement. Such increment shall not exceed the percentage increase in the Consumer Price Index each year. Total benefits shall not exceed 90% of retired participant's salary for computing retirement benefits and total COLAs shall not exceed 30% of retiree's original pension benefit. Effective 1/1/12, a COLA of 3.6% shall be provided to all retirees and/or survivors who are receiving benefits as of 12/31/11. (Section 4.10) | None |

Finding No. 1 – (Continued)

| Benefit Provision | Ordinance No. 1776 | Third Class City Code |
|---|---|---|
| Military service credit | Non-Intervening – Employee may purchase credit for military service for a period not to exceed 5 years provided the member has completed 5 years of service to the city subsequent to military service.<br><br>Credit for Intervening or Non-Intervening service is only eligible if member is not entitled to retirement benefits for such service under a retirement system administered or partially paid for by any other governmental agency with the exception of a member eligible to receive military retirement pay. (Sections 6.1, 6.2 & 6.3) | None |

| Benefit Provision | Ordinance No. 1776 | Third Class City Code |
|---|---|---|
| Social Security offset | Subject to limitations imposed by the Commonwealth, no offset or reduction from the normal retirement benefit shall be made for Social Security retirement benefits, workmen's compensation, or other benefits to which the member is entitled. (Section 4.2) | For employees covered by Social Security, a reduction in the pension by 40 percent of the participant's primary Social Security insurance amount attributable to city service to be made at the time of the participant's eligibility for the Social Security primary insurance benefit. Or, payment by the participant to the fund the difference of member contributions made and those that would have been made if the contribution rate was 5%. (Section 4343 & 4344) |

Finding No. 1 – (Continued)

Criteria: The pension plan must operate pursuant to the Third Class City Code, not Act 15, because the Third Class City Code, a statewide statute, preempts the city's local ordinance which created a new municipal pension plan operating under the same provisions as Act 15.

Cause: Municipal officials believed the plan would still be subject to Act 15.

Effect: As of January 28, 2013, the plan had no new retirees whose benefits were calculated in accordance with Ordinance No. 1776. However, cost of living adjustments were granted to 31 retirees on January 1, 2012, which were not authorized by the Third Class City Code. The excess benefits for these 31 cost of living adjustments amounted to $37,511 per month, which totaled approximately $450,132 for the calendar year ending December 31, 2012.

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. Furthermore, 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 that the city comply with the Third Class City Code at its earliest opportunity to do so. To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to pay benefits 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.

Finding No. 1 – (Continued)

Management's Response: The plan's consultant contends that the authority to maintain the City of DuBois Non-Uniformed Pension Plan under the previous benefit structure contained in the agreement with PMRS is found in the Pennsylvania Constitution under Article 1 Section 17, which has been applied to various pension situations in the past. Under this statute, no municipality is permitted to diminish any benefits without the consent of the members. Since such consent was not obtained, and in fact the withdrawal would not have occurred if benefits had been diminished, all of the previous plan provisions must be maintained for those employees exactly as they were inside of PMRS under the executed agreement. Act 15 itself does not contain an exact benefit structure for every plan, but rather establishes a general framework for the system and the member plans. The actual benefit structure is then detailed in the written agreement between PMRS and the governing body of each municipality. Consequently, the agreement between the City of DuBois and PMRS governing this plan was the basis for Ordinance No. 1776 that was adopted after the withdrawal and includes all of the provisions of that agreement, even where certain provisions differ from those contained in the Third Class City Code, Act 317. Further, the calculation of state aid, which had previously been based on the provisions of that agreement without challenge by the Department, should continue to be based on those same provisions without challenge. The simple transition of a pension plan from one plan administrator/custodian to another should not impair any part of state aid that was previously available and acceptable under the same benefit structure.

In support of the city's position, the plan's consultant offered an opinion letter from 1997 dealing with another municipality's police pension plan. The opinion letter refers to a situation where another unrelated municipality wished to withdraw its police pension plan from PMRS membership. The opinion letter relies on Article 1, Section 17 of Pennsylvania Constitution, which provides in part that "no ex post facto law, nor any law impairing the obligation of contracts, or making irrevocable any grant of special privileges or immunities, shall be passed" (emphasis in original). The opinion letter further states that the municipality for whom the opinion was requested should develop a two-tiered system so that subsequent hires who were not members of the plan at the time of its creation would have to be under Act 600, not under Act 15 as the members were who participated in the plan while it was in PMRS.

Finding No. 1 – (Continued)

Auditor's Conclusion: Under Act 15, a municipality may withdraw from PMRS if it meets the following requirements: (1) if it has been enrolled in the system for at least five years; (2) if it has met all of its financial obligations to the system; (3) if the legislative body of the municipality has passed an ordinance or resolution showing its intention to withdraw from PMRS; and (4) it has certified to the PMRS board that at least 75% of the municipal employees affected by the ordinance or resolution have voted affirmatively in support thereof. All of the statutory requirements for withdrawal were met by the City of DuBois.

Municipal pension plans which are administered by PMRS are subject to the benefits and requirements of Act 15. Act 15 only pertains to municipal plans under the administration of PMRS.

The City of DuBois is a City of the Third Class and subject to the Third Class City Code. Unless a City of the Third Class participating in PMRS (subject to Act 15), has adopted an optional charter pursuant to the Optional Third Class City Charter Law, or otherwise elected to provide an optional retirement system under Act 362's amendment of the Third Class City Code, its non-uniformed pension plan is subject to the mandates of the Third Class City Code. The City has neither adopted an optional charter, nor elected to provide an optional retirement system under Act 362 and it has already withdrawn from PMRS, so, as a Third Class City, it is subject to the pension requirements of the Third Class City Code and not the Act 15 structure it enjoyed while a member of PMRS.

Regarding the opinion letter from 1997 offered in support of the city's position, this position is flawed for several reasons. To begin with, a statewide municipal pension statute preempts a local inconsistent municipal ordinance (Perruso v. Township of Palmer, 141 Pa. Cmwlth. 520, 596 A.2d 292 (1991)). In this case, the Third Class City Code and its requirements dictate the administration of and what benefit structure the non-uniformed pension plan of a City of the Third Class must have. Once the membership elected to withdraw from PMRS and the benefits and administrative structure created by Act 15, the new plan that was created by Ordinance No. 1776 should have conformed to the benefit structure of the Third Class City Code. Because this was a new plan, created by a Third Class City not subject to other permissible exceptions, it should have been drafted according to the Third Class City Code. There was no constitutional impairment of contract because the membership voted to create a new plan and the plan itself was not legal.

Therefore, to the extent that the city's non-uniformed pension plan provides benefits that are unauthorized under the Third Class City Code, such benefits are improper. The city's non-uniformed pension plan must operate under the requirements of the Third Class City Code, not under Act 15, consequently the finding and recommendation remain as stated.

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

Condition: The city understated payroll for a non-uniformed employee by $6,056 on the Certification Form AG 385 filed in 2011. The data contained on this certification form is based on prior calendar year information.

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.

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 pension costs, the city received an underpayment of state aid of $363 as identified below:

| Year | Normal Cost | Payroll Understated | State Aid Underpayment |
|---|---|---|---|
| 2011 | 5.99044% | $ 6,056 | $ 363 |

Although the city will be reimbursed for the underpayment of state aid due to the city's certification error, the full amount of the 2011 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.

CITY OF DUBOIS NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

## SCHEDULE OF FUNDING PROGRESS

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

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

| | (1) | (2) | (3) | (4) | (5) | (6) |
|---|---|---|---|---|---|---|
| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a) | Funded Ratio (a)/(b) | Covered Payroll (c) | Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)] |
| 01-01-07 | $ 7,855,596 | $ 7,502,222 | $ (353,374) | 104.7% | $ 1,616,592 | (21.9%) |
| 01-01-09 | 8,561,358 | 8,233,630 | (327,728) | 104.0% | 1,683,282 | (19.5%) |
| 01-01-11 | 8,561,916 | 7,531,921 | (1,029,995) | 113.7% | 1,579,676 | (65.2%) |

CITY OF DUBOIS NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

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

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

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

CITY OF DUBOIS NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2006 | $ 46,676 | 111.7% |
| 2007 | 67,898 | 100.0% |
| 2008 | 74,669 | 100.1% |
| 2009 | 68,798 | 100.1% |
| 2010 | 58,803 | 100.0% |
| 2011 | 67,351 | 185.3% |

CITY OF DUBOIS NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

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

| | |
|---|---|
| Actuarial valuation date | January 1, 2011 |
| Actuarial cost method | Entry age normal |
| Amortization method | N/A |
| Remaining amortization period | N/A |
| Asset valuation method | Fair value |
| Actuarial assumptions: | |
| Investment rate of return | 7.25% |
| Projected salary increases * | 4.25% |
| Cost-of-living adjustments | None assumed |

* Inflation rate not disclosed

CITY OF DUBOIS NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of DuBois Non-Uniformed Pension Plan
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|---|---|
| The Honorable Gary D. Gilbert | Mayor |
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