

CITY OF ERIE AGGREGATE PENSION FUND

ERIE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2005, TO DECEMBER 31, 2008



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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 Erie pension plans are 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 399 - Optional Third Class City Charter Law, Act of July 15, 1957 (P.L. 901, No. 399), as amended, 53 P.S. § 41101 et seq.

The city's pension plans are single-employer defined benefit pension plans locally controlled by Articles 145 (Officers' and Employees'), 147 (Police) and 149 (Firemen's) of the city's codified ordinances. The plans are also affected by the provisions of collective bargaining agreements between the city and its nonuniformed employees, police officers and firefighters.



The Honorable Mayor and City Council
City of Erie
Erie County
Erie, PA 16501

We have conducted a compliance audit of the City of Erie Aggregate Pension Fund for the period January 1, 2005, to December 31, 2008. 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 findings contained in our prior audit report; and
2. To determine if the aggregate pension fund was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

Our audit was limited to the areas related to the objectives identified above. The City of Erie contracted with independent certified public accounting firms for annual audits of the financial statements of each of the city's pension plans, 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 Erie Aggregate Pension Fund is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. In conducting our audit, we obtained an understanding of the city's internal controls as they relate to the city's compliance with those requirements and that we considered to be significant within the context of our audit objectives, and assessed whether those significant controls were properly designed and implemented. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to the extent necessary to satisfy the audit objectives.

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

Police and Firemen's Pension Plans

Finding No. 1 – Noncompliance With Prior Audit Recommendation –
Incorrect Data On Certification Form AG 64 Resulting In An
Overpayment Of Ad Hoc Reimbursement

Firemen's Pension Plan

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

Police Pension Plan

Finding No. 3 – Overpayment Of Pension Benefits

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 Erie and, where appropriate, their responses have been included in the report.

March 2, 2010

JACK WAGNER
Auditor General

CITY OF ERIE AGGREGATE PENSION FUND
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

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

- Failure To Collect Required Member Contributions

During the current audit period, the city collected member contributions from all plan members in accordance with the city's codified ordinances.

Rescission Of Prior Audit Recommendations

The following prior audit recommendations have been rescinded:

- Receipt Of Excess State Aid For Police Officers Electing A Partial Lump-Sum Distribution

- Receipt Of Excess State Aid For Firefighters Electing A Partial Lump-Sum Distribution

As a result of recent appellate court decisions in *City of Erie, et. al. v. Department of Auditor General*, 983A.2d 1250 (Pa. Cmwlth. 2009), the Department will be rescinding the findings set forth in the prior audit report.

It should be noted that House Bill 1828 was signed into law by the governor as Act 44 of 2009 on September 18, 2009. Before Act 44, there was no law regulating reverse Deferred Retirement Option Plans (DROPs). In response to the Court's ruling in *Erie*, Section 6 of the act prohibits the reporting of a DROP participant to the Department of the Auditor General as an active employee, which was our primary concern during this case. In addition, Section 19 prohibits new reverse DROPs and provides clear restrictions on the use and administration of standard DROPs.

Noncompliance With Prior Audit Recommendation

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

- Incorrect Data On Certification Form AG 64 Resulting In An Overpayment Of Ad Hoc Reimbursement

CITY OF ERIE AGGREGATE PENSION FUND
FINDINGS AND RECOMMENDATIONS

Police and Firemen's Pension Plans

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 64 Resulting In An Overpayment Of Ad Hoc Reimbursement

Condition: As disclosed in the prior audit report, the city overstated non-employee contributions by \$247,487 on Section II, Line B of the 2006 Certification Form AG 64, by including water authority contributions deposited to the City of Erie Officers' and Employees' Pension Plan in 2005. As a result, the non-reimbursable ratio calculated was understated and the city received an excess Act 64 ad hoc reimbursement of \$806 in 2006.

In addition, during the current audit period, the city understated the total state aid allocations on Section II, Line A of the 2007, 2008 and 2009 Certification Forms AG 64 by excluding the unit value of state aid received due to the certification of water authority employees. As a result, the non-reimbursable ratio calculated was understated.

Criteria: Regarding the amounts used in the calculation of the special ad hoc reimbursement, Section 502.1(a)(2) of Act 147 states, in part:

... the amortization contribution requirement attributable to the special ad hoc postretirement adjustment... multiplied by the ratio of the amount of general municipal pension system State aid allocated to the retirement system in the immediate prior year to the total amount of municipal contributions made to the retirement system from all sources other than employee contributions in the immediate prior year. (Emphasis added)

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

Furthermore, during the current audit period, plan officials believed that the state aid received for the certification of water authority employees was not eligible to be included on Certification Form AG 64 as part of the total state aid allocation received by the city.

Effect: The effect of the incorrect certification of non-employee contributions resulted in the city receiving an excess Act 64 ad hoc reimbursement of \$806 in 2006.

Additionally, the effects of the understatements of the state aid allocations resulted in the city receiving excess Act 64 ad hoc reimbursements of \$379, \$379 and \$355, in 2007, 2008 and 2009, respectively.

CITY OF ERIE AGGREGATE PENSION FUND
FINDINGS AND RECOMMENDATIONS

Police and Firemen's Pension Plans – (Continued)

Finding No. 1 – (Continued)

Recommendation: We recommend that the excess ad hoc reimbursements, in the total amount of \$1,919, be returned to the Commonwealth from city funds. 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.

We also recommend that, in the future, plan officials comply with the instructions that accompany Certification Form AG 64 to assist them in accurately reporting the required pension data.

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

Firemen's Pension Plan

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

Condition: The city certified 3 ineligible firefighters (6 units) in 2005 on Certification Form AG 385. In addition, the city failed to certify 4 eligible firefighters (8 units) in 2008 on Certification Form AG 385.

Criteria: Pursuant to Act 205, at Section 402(e)(2), an employee who has been employed on a full-time basis for at least six consecutive months and has been participating in a pension plan during the certification year is eligible for certification.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

CITY OF ERIE AGGREGATE PENSION FUND
FINDINGS AND RECOMMENDATIONS

Firemen’s Pension Plan – (Continued)

Finding No. 2 – (Continued)

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the city for distribution to its pension plans. Because the city’s state aid allocations were based on unit value, the city received an underpayment of state aid of \$7,926, as identified below:

<u>Year</u>	<u>Units Overstated (Understated)</u>	<u>Unit Value</u>	<u>State Aid Overpayment (Underpayment)</u>
2005	6	\$2,927	\$ 17,562
2008	(8)	\$3,186	<u>(25,488)</u>
Net Underpayment of State Aid			<u><u>\$ (7,926)</u></u>

Although the city will be reimbursed for the net underpayment of state aid due to the city’s certification errors, the full amount of the 2008 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 comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension plan data.

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

CITY OF ERIE AGGREGATE PENSION FUND
FINDINGS AND RECOMMENDATIONS

Police Pension Plan

Finding No. 3 – Overpayment Of Pension Benefits

Condition: A retiree's monthly pension benefit of \$1,979 was properly reduced to \$1,508 due to a Qualified Domestic Relations Order (QDRO), with the balance of \$471 to be paid to his ex-wife. In January of 2003, both parties began receiving annual plan cost-of-living adjustments (COLAs). However, they were not eligible to receive COLAs until January of 2006 because their combined annual pension benefit of \$23,748 (\$1,979 x 12 months) exceeded one-half of the current monthly salary paid to a patrolman of the highest pay grade, in the years 2003, 2004 and 2005.

Criteria: Article 147.05 (g) (1) of the city's codified ordinances states, in part:

Participants who were appointed police officers prior to January 1, 1981,... and who receive retirement benefits under the Plan by reason of and after the termination of the Service of any such Participant, shall have such retirement benefits increased by the percentage increase in the cost of living index ... and on the first day of January of each and every year thereafter, provided, however, that the total of any such allowance shall not at any time exceed one-half of the current monthly salary being paid a patrolman of the highest pay grade. (Emphasis added)

Cause: The plan's actuary, who calculates the COLAs, considered the two monthly benefits separately, rather than collectively, when determining eligibility for a COLA adjustment.

Effect: From January of 2003 through of February 2010, when the monthly pension benefits were properly adjusted, the pension plan overpaid pension benefits in the amount of \$11,888.

Recommendation: We recommend that the pension plan be reimbursed \$11,888 for the overpayment of pension benefits.

Management's Response: Municipal officials agree that the plan is due \$11,888, but disagree that a finding is warranted. When the error was identified, the police pension plan board immediately contacted its attorney, who then sent letters to the parties in question to make provisions to retrieve the funds through structured settlements.

Auditor's Conclusion: Based on the criteria cited above, the finding remains as stated. Compliance with the finding recommendation will be evaluated during our next audit of the fund.

CITY OF ERIE AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULES OF FUNDING PROGRESS

Historical trend information about the city's pension plans is presented herewith as supplementary information. It is intended to help users assess the plans' 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, 2003, is presented on the following pages.

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)]
01-01-03	\$78,550,628	\$80,282,806	\$ 1,732,178	97.8%	\$ 9,761,666	17.7%
01-01-05	76,055,676	89,621,649	13,565,973	84.9%	9,933,822	136.6%
01-01-07	72,616,308	94,303,724	21,687,416	77.0%	9,482,626	228.7%

Note: The market values of the plan's assets at 01-01-03, 01-01-05 and 01-01-07 have been adjusted to reflect the smoothing of gains and/or losses over a 5-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 ERIE AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULES OF FUNDING PROGRESS – (Continued)

FIREMEN’S PENSION PLAN

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-03	\$56,066,394	\$61,773,653	\$ 5,707,259	90.8%	\$ 8,495,918	67.2%
01-01-05	55,313,434	68,210,017	12,896,583	81.1%	9,044,102	142.6%
01-01-07	55,543,720	73,780,818	18,237,098	75.3%	8,703,019	209.5%

Note: The market values of the plan’s assets at 01-01-03, 01-01-05 and 01-01-07 have been adjusted to reflect the smoothing of gains and/or losses over a 5-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 ERIE AGGREGATE PENSION FUND
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULES OF FUNDING PROGRESS – (Continued)

OFFICERS' AND EMPLOYEES' PENSION PLAN

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-03	\$60,657,335	\$72,598,072	\$ 11,940,737	83.6%	\$16,541,458	72.2%
01-01-05	62,832,647	79,557,802	16,725,155	79.0%	16,994,645	98.4%
01-01-07	64,819,617	80,783,554	15,963,937	80.2%	15,375,042	103.8%

Note: The market values of the plan's assets at 01-01-03, 01-01-05 and 01-01-07 have been adjusted to reflect the smoothing of gains and/or losses over a 5-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 ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

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

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

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

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

POLICE PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2003	\$ 882,758	100.0%
2004	591,333	111.3%
2005	671,014	100.0%
2006	909,353	100.0%
2007	1,879,486	100.0%
2008	2,008,878	100.0%

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

FIREMEN'S PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2003	\$ 1,071,832	100.0%
2004	1,073,522	100.0%
2005	1,063,001	100.0%
2006	1,170,958	100.0%
2007	1,854,954	100.0%
2008	1,903,950	100.0%

CITY OF ERIE AGGREGATE PENSION FUND
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULES OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

OFFICERS' AND EMPLOYEES' PENSION PLAN

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2003	\$ 1,383,999	100.0%
2004	1,675,883	100.0%
2005	1,680,394	100.0%
2006	1,860,133	100.0%
2007	2,236,492	100.0%
2008	2,235,348	100.0%

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

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

POLICE PENSION PLAN

Actuarial valuation date	January 1, 2007
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	20 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases *	5.0%
* Includes inflation at	3.0%
Cost-of-living adjustments	4.0%

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

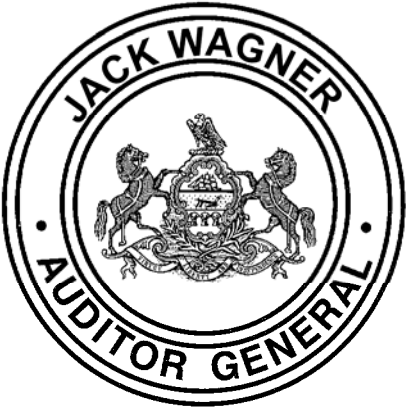
FIREMEN'S PENSION PLAN

Actuarial valuation date	January 1, 2007
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	16 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases *	5.0%
* Includes inflation at	3.0%
Cost-of-living adjustments	4.0%

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

OFFICERS' AND EMPLOYEES' PENSION PLAN

Actuarial valuation date	January 1, 2007
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	Established January 1, 1985 (18 years) Occurring after January 1, 1985 (20 years)
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases *	5.0%
* Includes inflation at	3.0%
Cost-of-living adjustments	None assumed



CITY OF ERIE AGGREGATE PENSION FUND
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

City of Erie Aggregate Pension Fund
Erie County
626 State Street
Erie, PA 16501

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