

**CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN**

**BERKS COUNTY**

**COMPLIANCE AUDIT REPORT**

**FOR THE PERIOD**

**JANUARY 1, 2009, TO DECEMBER 31, 2010**





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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 Reading Officers and Employees 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 362 - The Third Class City Code, Act of May 23, 1945 (P.L. 903, No. 362), Article XLIII-A, Optional Retirement System for Officers and Employes, as amended, 53 P.S. § 39371 et seq.

The City of Reading Officers and Employees Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article No. 181 of the Codified Ordinances of the City of Reading, adopted pursuant to Act 362. The plan is also affected by the provisions of collective bargaining agreements between the city and its officers and employees.





The Honorable Mayor and City Council  
City of Reading  
Berks County  
Reading, PA 19601

We have conducted a compliance audit of the City of Reading Officers and Employees Pension Plan for the period January 1, 2009, to December 31, 2010. 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 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 findings 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 Reading 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 Reading Officers and Employees 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 Reading Officers and Employees 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 finding further discussed later in this report:

Finding – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid

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

May 9, 2012

JACK WAGNER  
Auditor General

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

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

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

Subsequent to the current audit period, the city deposited \$14,227 into the pension plan to fully pay the outstanding 2005 minimum municipal obligation due to the plan.

Partial Compliance With Prior Audit Recommendation

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

- Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

During the current audit period, the city reimbursed \$514,597 to the Commonwealth for the overpayments of state aid received in 2006, 2007 and 2008; however, plan officials failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data in the years 2009 and 2010, as further discussed in the Finding and Recommendation section of this report.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
FINDING AND RECOMMENDATION

Finding – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid

Condition: As disclosed in the prior audit report, the city certified 29 ineligible officers and employees (29 units) and certified 2 ineligible firefighters (2 units) in 2006. The city certified 1 ineligible police officer (2 units), 32 ineligible officer and employees (32 units) and 2 ineligible firefighters (2 units) in 2007. Furthermore, the city certified 7 ineligible police officers (14 units) and 40 firefighters (40 units) in 2008 on Certification Form AG 385. During the current audit period, the municipality reimbursed \$514,597 to the Commonwealth for the overpayments of state aid received in 2006, 2007 and 2008; however, plan officials failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data in the years 2009 and 2010.

During the current audit period, the city failed to certify 1 eligible police officer in 2009 (2 units) and 4 police officers in 2010 (8 units) on Certification Form AG 385. In addition, the city certified 2 ineligible police officers (4 units) and 2 officers and employees (2 units) in 2010 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.

Effect: The data submitted on this certification forms is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
FINDING AND RECOMMENDATION

Finding – (Continued)

Because the city’s state aid allocations were based on unit value, the city received an underpayment of state aid of \$12,726 as identified below:

Year	Type of Plan	Units Overstated (Understated)	Unit Value	State Aid Overpayment (Underpayment)
2009	Police	(2)	\$ 3,128	\$ (6,256)
2010	Police	(4)	\$ 3,235	(12,940)
	Officers and Employees	2	\$ 3,235	<u>6,470</u>
Net Underpayment of State Aid				<u><u>\$ (12,726)</u></u>

Although the city will be reimbursed for the underpayment of state aid due to the city’s certification errors, the full amount of the 2009 and 2010 state aid allocations were not available to be deposited timely and therefore were not available to pay operating expenses or for investment.

Recommendation: We again recommend that 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: City officials stated that they would respond within 10 working days, however no response has been received from the city.

CITY OF READING OFFICERS AND EMPLOYEES 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, 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	\$ 39,767,213	\$ 53,054,485	\$ 13,287,272	75.0%	\$ 11,880,781	111.8%
01-01-07	57,572,084	57,081,669	(490,415)	100.9%	14,190,597	(3.5%)
01-01-09	53,650,657	60,800,584	7,149,927	88.2%	15,450,113	46.3%

Note: The actuarial value of assets at 01-01-07 includes bond proceeds deposited in 2006. In addition, the market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses which will be limited to a maximum of 130 percent and a minimum of 70 percent of the fair market value of assets. 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 READING OFFICERS AND EMPLOYEES 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. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2005	\$ 1,337,185	100.0%
2006	432,096	100.0%
2007	786,148	100.0%
2008	598,539	100.0%
2009	775,359	100.0%
2010	800,416	100.0%



CITY OF READING OFFICERS AND EMPLOYEES 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
Remaining amortization period	18 years
Asset valuation method	The actuarial value of assets will be limited to a maximum of 130% and a minimum of 70% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return *	8.0%
Projected salary increases *	5.0%
* Includes inflation at	Not disclosed
Cost-of-living adjustments	None assumed

CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
OBSERVATION

On September 10, 2009, the Department of Community and Economic Development (DCED) received a request for Determination of Municipal Financial Distress under the Municipalities Financial Recovery Act (Act of 1987 P.L. 246, No. 47) from the Mayor of the City of Reading. This Act empowers DCED to declare certain municipalities as financially distressed; provides for the restructuring of debt of financially distressed municipalities; limits the ability of financially distressed municipalities to obtain government funding; authorizes municipalities to participate in Federal debt adjustment actions under certain circumstances; and provides for consolidation or merger of contiguous municipalities to relieve financial distress.

DCED issued a report titled “Municipalities Financial Recovery Act Consultative Evaluation” on the City of Reading dated October 14, 2009, which contains the following recommendation:

Based on our analysis of the City’s fiscal condition, tax base and revenue trends, debt service obligations, current and projected 2008 financial position, expenditure and workforce trends, pension obligations, use of inter-fund transfers, socio-economic and demographic trends and administrative and financial management practices, it is our recommendation that the City of Reading be declared distressed under Act 47.

Clearly the City is and has been experiencing ongoing financial challenges over the past several years. These conditions make it difficult for the City to continue to fulfill its responsibilities to provide for the health, safety and welfare of its citizens. Our recommendation is based upon a pattern of:

- Increasing year-end deficits;
- Increasing negative fund balances;
- Decline of tax revenue in constant dollars taking inflation into account;
- Increasing annual costs particularly in public safety departments and employee benefits; and
- Use of one-time revenue strategies that are not sustainable.

Given Reading’s current fiscal position there are serious questions and uncertainty as to its ability to maintain municipal services without an adverse impact on the health, safety and welfare of residents of the City. In our opinion, Reading is exhibiting symptoms of distress that support a distress determination under Act 47.

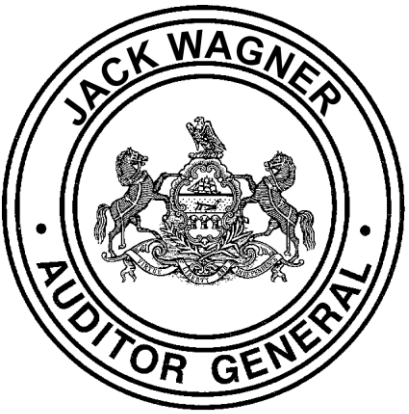
CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
OBSERVATION

On May 6, 2010, a Municipalities Financial Recovery Act Recovery Plan for the City of Reading prepared on behalf of DCED was filed with the Reading City Clerk's Office. In the Executive Summary of this report it was noted that:

The City of Reading is in a severe financial crisis and it must take immediate action to preserve its fiscal health while continuing to provide basic services to residents, businesses and visitors. Failure to act now will soon be catastrophic. The depth and immediacy of the crisis cannot be overstated.

In addition, the City of Reading Financial and Compliance Audit Report for the year ended December 31, 2010, contains the following information noted under the heading Financial Highlights for Fiscal Year 2010:

2010 proved to be yet another year of structural deficits. In December 2010, the City issued \$17,280,000 in unfunded debt. Most of these debt proceeds were used to pay off prior obligations for Sewer and Pensions. The remainder was used to cover the structural deficit for 2010. Fortunately, City Council adopted the Act 47 Plan in June 2010 and resulting financial initiatives were included in the 2011 Budget approved by City Council in December 2010. For the year ended December 31, 2010, expenditures exceeded revenues by \$10,465,719 in the General Fund. Fortunately, using Other Financing Sources totaling \$32,130,950, the City ended FY 2010 with a fund balance of \$11,155,472 in its General Fund.



CITY OF READING OFFICERS AND EMPLOYEES PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett  
Governor  
Commonwealth of Pennsylvania

City of Reading Officers and Employees Pension Plan  
Berks County  
815 Washington Street  
Reading, PA 19601

The Honorable Vaughn Spencer	Mayor
Mr. Francis Acosta	Council President
Mr. David Cituk	City Auditor

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](http://www.auditorgen.state.pa.us).