

COMPLIANCE AUDIT

City of Sharon Police Pension Plan Mercer County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

June 2017



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

City Council
City of Sharon
Mercer County
Sharon, PA 16146

We have conducted a compliance audit of the City of Sharon Police Pension Plan for the period January 1, 2015 to December 31, 2016. We also evaluated compliance with some requirements subsequent to that period when possible. 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 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. To determine if municipal officials took appropriate corrective action to address the findings contained in our prior audit report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. To determine whether the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, our methodology included the following:

- We determined whether state aid was properly determined and deposited in accordance with Act 205 requirements by verifying the annual deposit date of state aid and determining whether deposits were made within 30 days of receipt for all years within the period under audit.

- We determined whether annual employer contributions were calculated and deposited in accordance with the plan's governing document and applicable laws and regulations by examining the municipality's calculation of the plan's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plan as evidenced by supporting documentation.
- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- We determined that there were no benefit calculations prepared for the years covered by our audit period.
- We determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2014 and 2016, respectively, in accordance with Act 205 and whether selected information provided on these reports are accurate, complete, and in accordance with plan provisions to ensure compliance for participation in the state aid program by comparing selected information to supporting source documentation.
- We determined whether all annual special ad hoc postretirement reimbursements received by the municipality were authorized and appropriately deposited in accordance with Act 147 by tracing information to supporting documentation maintained by plan officials.
- We determined whether transfers were properly authorized, timely, and appropriately recorded by plan officials by examining supporting documentation for all of the transfers made during the audit period and through the completion of our fieldwork procedures.

The City of Sharon contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2015, which is 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 Sharon Police 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 and as

previously described, 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 procedures indicated that, in all significant respects, the City of Sharon Police 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 – Noncompliance With Prior Audit Recommendation – Unauthorized Pension
Benefit Provision

The finding contained in this audit report repeats a condition that was cited in our previous audit report that has not been corrected by city officials. We are concerned by the city's failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation noted in this audit report.

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 Sharon and, where appropriate, their responses have been included in the report. We would like to thank city officials for the cooperation extended to us during the conduct of the audit.

May 17, 2017



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 Sharon Police Pension Plan is also governed by implementing regulations adopted by the former 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 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1158, No. 177), as amended, 53 Pa.C.S. § 101 et seq.
- Act 67 - The Third Class City Code, Act of November 24, 2015 (P.L. 242, No. 67), as amended, 11 Pa. C.S. § 10101 et seq.

The City of Sharon Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Chapters 286 and 287 of the city's codified ordinances. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established April 12, 1967. Active members are required to contribute 4 percent of base and longevity pay, plus 1 percent for survivor benefits, plus \$3 per month to the plan. As of December 31, 2016, the plan had 28 active members, no terminated members eligible for vested benefits in the future, and 32 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2016, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 20 years of service.
Early Retirement	None
Vesting	Member is 100% vested after 10 years of service. If hired on or after January 1, 2008, member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit equals 50% of Final Monthly Average Salary plus a service increment equal to $1/40^{\text{th}}$ of the retirement allowance times years of completed service over 20 years (service beyond age 65 is not counted) to a maximum increment of \$300 per month. Final Monthly Average Salary is defined as the greater of (a) the rate of the participant's monthly salary at retirement, death or termination of employment or (b) the sum of salary received during the five highest years prior to retirement, death or termination of employment, divided by 60.

Survivor Benefit:

Before Retirement Eligibility	Any police officer who has less than 10 years of service and who dies not in the line of duty, shall be entitled to 25% of the Final Monthly Average Salary computed as of the time of death. For death after 10 years of service, benefit equals 50% of Final Monthly Average Salary as of the time of death.
After Retirement Eligibility	100% to the surviving spouse during their lifetime. If the surviving spouse dies or already has died, then 50% (100% for disability pensioners) to a child or children of the officer under the age of 18.

BACKGROUND – (Continued)

Disability Benefit:

Service Related

Normal Retirement Benefit including Service Increment. If hired on or after January 1, 2008, the benefit is offset by Workers Compensation payments or Enforcement Officers Disability Benefit Law payments.

Non-Service Related

Benefit equals 25% of Salary at the time of disability for any police officer with less than 10 years of service who is disabled due to injury or illness not in the line of duty. After 10 years of service, an officer shall be entitled to 50% of Salary at the time of disability.

CITY OF SHARON POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

City officials have complied with the prior audit recommendation concerning the following:

Incorrect Data On Certification Form AG 490 Resulting In An Excess Reimbursement For Special 1989 Ad Hoc Postretirement Adjustment

Municipal officials reimbursed \$3,000 to the Commonwealth for the overpayment of ad hoc postretirement adjustments received in 2014 and 2015.

Noncompliance With Prior Audit Recommendation

Municipal officials have not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

Unauthorized Pension Benefit Provision

CITY OF SHARON POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Noncompliance With Prior Audit Recommendation – Unauthorized Pension Benefit Provision

Condition: As disclosed in the prior audit report, the plan’s governing document and the collective bargaining agreement between the city and its police officers continue to provide for a non-service related disability survivor benefit that is not in compliance with the Third Class City Code, as noted below:

<u>Benefit Provision</u>	<u>Ordinance No. 07-09 Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Third Class City Code</u>
Nonservice Related Disability Survivor Benefit	...paid to the surviving spouse until the date of death of the surviving spouse...if the Participant died without a surviving spouse,...50% of pension shall be paid monthly in equal shares to the surviving children of the deceased Participant until the death or attainment of age 18 of each child...	Same as Ordinance No. 07-09.	For families, a continuation of the disability benefit payment to the spouse until death or remarriage, then to the child or children under age 18.

Criteria: Section 14303(g) of the Third Class City Code states, in part:

Disability pension.--The disability pension may be payable to the police officer during the police officer’s lifetime, and, if the police officer dies, the pension payment that the police officer was receiving may be continued to be paid to:

- (1) the police officer’s spouse if the spouse survives; or
- (2) if the spouse subsequently dies or remarries, the child or children under 18 years of age of the police officer.

Cause: The city was unable to effect compliance with the prior audit recommendation through the collective bargaining process.

Effect: Unauthorized benefit provisions could result in incorrect benefit payment to beneficiaries.

CITY OF SHARON POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We again recommend that municipal officials take appropriate action to ensure that the plan's governing document and the collective bargaining agreement contain benefit provisions in accordance with the Third Class City Code, at their earliest opportunity to do so.

Management's Response: City officials agreed with the finding without exception and have indicated they will make every effort to attempt to comply with the recommendation upon the expiration of the collective bargaining agreement in December 2017.

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

CITY OF SHARON POLICE 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, 2011, is as follows:

	(1)	(2)	(3)	(4)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Liability (b) - (a)	Funded Ratio (a)/(b)
01-01-11	\$ 8,493,783	\$ 10,495,978	\$ 2,002,195	80.9%
01-01-13	7,618,125	11,330,094	3,711,969	67.2%
01-01-15	9,001,269	12,845,796	3,844,527	70.1%

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 70 to 130 percent of the market value of assets. The market values of assets at 01-01-13 and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. These methods will lower contributions in years of less 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 SHARON POLICE 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.

CITY OF SHARON POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2011	\$ 340,929	100.0%
2012	348,588	100.0%
2013	447,617	100.0%
2014	449,131	100.0%
2015	709,590	100.0%
2016	687,357	100.0%

CITY OF SHARON POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the 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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	10 years
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	7.25%
Projected salary increases *	3.83%
Cost-of-living adjustments	None assumed

* Includes inflation at 2.75%

CITY OF SHARON POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Mr. Frank Connelly
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Mr. Robert Lucas
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Ms. Molly Bundrant
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