

COMPLIANCE AUDIT

City of Pittston Police Pension Plan Luzerne County, Pennsylvania For the Period January 1, 2016 to December 31, 2017

December 2018



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and City Council
City of Pittston
Luzerne County
Pittston, PA 18640

We have conducted a compliance audit of the City of Pittston Police Pension Plan for the period January 1, 2016 to December 31, 2017. 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 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 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. To determine if municipal officials took appropriate corrective action to address the finding 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 total 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 whether retirement benefits calculated for the plan member who elected to vest during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the pension benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined.
- We determined whether the January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2016 and 2018, respectively, in accordance with Act 205 and whether 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 by comparing selected information to supporting source documentation.
- We determined whether the terms of the contractual agreement with the Pennsylvania State Association of Boroughs were in accordance with the plan's governing document, if separately stated, and applicable laws and regulations by comparing the terms of the contractual agreement with the plan's governing document, if separately stated, and applicable laws and regulations.
- We determined whether the terms and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation for pension obligation bonds issued through the completion of our fieldwork procedures.

The City of Pittston 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 Pittston 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 Pittston 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 – Partial Compliance With Prior Audit Recommendation – Failure To Fully Pay The Minimum Municipal Obligation To The Plan

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. It is noted that although the city is not considered to be distressed under the distress recovery program provided by Act 205 when the police pension plan's funded status is aggregated with the more favorable funded statuses of the city's other pension plans, **we are extremely concerned about the funded status of the police pension plan contained in the schedule of funding progress included in this report which indicates the plan's funded ratio is 60.9% as of January 1, 2017, which is the most recent data available.** While this represents a substantial increase in the plan's funded status since the plan's lowest funded ratio of 47.0% as of January 1, 2013, and we acknowledge the remedial actions the city has taken to address the plan's funded status and the city's increased annual required contributions to the plan which rose 73.5% from \$245,511 in 2012 to \$426,027 in 2017, we encourage city officials to continue their efforts in the development of a long-term strategic plan to address the plan's funding level to ensure its long-term financial stability.

The contents of this report were discussed with officials of the City of Pittston 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.

November 2, 2018



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 Pittston 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 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 Pittston Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of File of Council No. 1 of 1974, adopted pursuant to Act 67 (formerly Act 317). The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established January 1, 1960. Active members are required to contribute 4 percent of compensation to the plan. As of December 31, 2017, the plan had 8 active members, 1 terminated member eligible for vested benefits in the future, and 11 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2017, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Eligible with 20 years of service.
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit equals 50% of average monthly compensation based on higher of final rate of pay or the 5 highest year average, plus an incremental pension (maximum \$100) of 1/40th of the basic pension benefit times years of service over 20 earned prior to age 65.

Survivor Benefit:

For death not in the line of duty and before completing 10 years of service, death benefit is 25% of pay. For death in line of duty or after completing 10 years of service, death benefit is 50% of pay. If retired, benefit is 100% of monthly pension.

Service Related Disability Benefit:

Benefit equals 50% of compensation.

CITY OF PITTSTON POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

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

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

In 2016 and 2017, the city deposited a total of \$264,831 into the plan, including interest of \$34,825, to fully pay the balance of the remaining 2015 minimum municipal obligation (MMO); however, a similar condition occurred during the current audit period. Plan officials did not pay the 2016 MMO until 2018, with interest, and failed to fully pay the 2017 MMO, as further discussed in the Finding and Recommendation section of this report.

CITY OF PITTSTON POLICE PENSION PLAN
FINDING AND RECOMMENDATION

**Finding – Partial Compliance With Prior Audit Recommendation – Failure To Fully Pay
The Minimum Municipal Obligation Of The Plan**

Condition: As disclosed in the prior audit report, plan officials did not fully pay the minimum municipal obligation (MMO) of the police pension plan for the year 2015, as required by Act 205. During the current audit period, the city paid the outstanding 2015 MMO due to the plan; however, the city did not timely pay the 2016 MMO and has not fully paid the 2017 MMO that was due to the plan by December 31, 2017 in accordance with Act 205. Subsequent to the audit period, during 2018, the city made its final payments for the 2016 MMO totaling \$352,395 plus applicable interest of \$45,116; however, the city has an unpaid 2017 MMO balance remaining of \$347,182, plus applicable interest.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

Cause: The city's inability to meet its full MMO obligation in a timely manner is a result of the increasing demand of the pension obligations relative to the city's overall budget.

CITY OF PITTSTON POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Effect: The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members. In addition, the failure to timely pay the MMOs results in required interest charges and an additional strain on city resources that would not be necessary had the MMOs been paid timely in accordance with Act 205 requirements.

Due to the municipality's failure to fully pay the 2017 MMO by the December 31, 2017, deadline, the municipality must add the 2017 MMO balance to the current year's MMO and include interest, as required by Act 205.

Furthermore, the city's future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that the municipality pay the MMO due to the police pension plan for the year 2017, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the city for examination during our next audit of the plan.

Furthermore, we recommend that, in the future, plan officials pay the full MMO due the plan.

Management's Response: Municipal officials agreed with the finding without exception and provided the following response:

The City has been aggressive in pursuing corrective actions to deal with the City's distressed Police Pension fund. As of this writing the City remains delinquent for the 2017 MMO for which a total of \$395,792.00 is outstanding. *[Auditor's note: \$395,792.00 includes interest.]* The 2016 MMO and all previous year delinquencies other than 2017 MMO have been satisfied and paid in full.

The City in September 2018 closed on a taxable \$2.1 million bond that will be deposited (10/11/2018) into the Police Pension to pay the unfunded liability in that plan. However, as you are also aware, none of the bond funds can be used to pay the delinquent 2017 MMO. Therefore, the City is planning on pursuing revenue enhancements specifically to pay off the delinquent 2017 MMO. The City Administration is recommending to Mayor and city Council that additional revenue be included in the FY2019 City operating budget. The Administration is recommending an increase in Real Estate Tax millage that is to be dedicated to pension recovery. The FY2018 City budget contains a real estate tax levy of 1.5 mills dedicated to pension system recovery and the recommendation for the

CITY OF PITTSTON POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

FY2019 budget will be to increase the dedicated millage an additional one mill to 2.5 mills or a projected additional appropriation of \$225,000 for pension system recovery.

The additional millage suggested in the FY2019 budget is expected to provide sufficient funds to pay the 2019 MMO with the anticipation that over the following three years there will be sufficient funds to totally pay off the delinquent 2017 MMO (\$395,792.00) while remaining current on future MMO payments.

Auditor's Conclusion: Due to the potential withhold of state aid, the city's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through our next audit of the plan.

CITY OF PITTSTON POLICE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

A condition such as that reported by the finding contained in this audit report may lead to a total withholding of state aid in the future unless the finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this Department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 314 Finance Building, Harrisburg, PA 17120.

CITY OF PITTSTON POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 8 and 9 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2015, 2016, AND 2017

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Total Pension Liability			
Service cost	\$ 106,640	\$ 111,439	\$ 118,499
Interest	359,430	373,019	405,616
Difference between expected and actual experience	-	-	229,896
Changes of assumptions	-	-	5,187
Benefit payments, including refunds of member contributions	(289,687)	(289,687)	(294,263)
Net Change in Total Pension Liability	<u>176,383</u>	<u>194,771</u>	<u>464,935</u>
Total Pension Liability – Beginning	<u>4,830,604</u>	<u>5,006,987</u>	<u>5,201,758</u>
Total Pension Liability – Ending (a)	<u><u>\$ 5,006,987</u></u>	<u><u>\$ 5,201,758</u></u>	<u><u>\$ 5,666,693</u></u>
Plan Fiduciary Net Position			
Contributions – employer	\$ 322,511	\$ 272,913	\$ 347,322
Contributions – State Aid	24,910	79,482	78,705
Contributions – Member	10,289	23,286	23,259
Net investment income	26,833	156,835	411,553
Benefit payments, including refunds of member contributions	(289,687)	(289,687)	(294,263)
Administrative expense	(22,086)	(23,081)	(27,897)
Net Change in Plan Fiduciary Net Position	<u>72,770</u>	<u>219,748</u>	<u>538,679</u>
Plan Fiduciary Net Position – Beginning	<u>2,848,211</u>	<u>2,920,981</u>	<u>3,140,729</u>
Plan Fiduciary Net Position – Ending (b)	<u><u>\$ 2,920,981</u></u>	<u><u>\$ 3,140,729</u></u>	<u><u>\$ 3,679,408</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 2,086,006</u></u>	<u><u>\$ 2,061,029</u></u>	<u><u>\$ 1,987,285</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	58.3%	60.4%	64.9%
Estimated Covered Employee Payroll	\$ 441,583	\$ 524,612	\$ 556,848
Net Pension Liability as a Percentage of Covered Employee Payroll	472.4%	392.9%	356.9%

* 2017 employer contributions include employer contributions receivable.

CITY OF PITTSTON POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the city as of December 31, 2016 and 2017, calculated using the discount rate of 7.50%, as well as what the city's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Net Pension Liability - 12/31/16	\$ 2,705,981	\$ 2,061,029	\$ 1,527,816
Net Pension Liability - 12/31/17	\$ 2,691,821	\$ 1,987,285	\$ 1,404,531

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2017	12.70%
2016	5.37%
2015	(.16%)
2014	3.71%

CITY OF PITTSTON 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, 2013, is as follows:

	(1)	(2)	(3)	(4)
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)
01-01-13	\$ 2,330,256	\$ 4,955,153	\$ 2,624,897	47.0%
01-01-15	2,848,211	4,830,604	1,982,393	59.0%
01-01-17	3,310,541	5,436,841	2,126,300	60.9%

Note: The market value of the plan’s assets at 01-01-17 has been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period. These methods 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 PITTSTON 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 PITTSTON POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
 AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2012	\$ 245,511	100.0%
2013	313,765	100.0%
2014	334,650	100.0%
2015	347,421	100.0%
2016	352,395	100.0%
2017	426,027	*18.5%

* See Finding.

CITY OF PITTSTON 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, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	7 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%

CITY OF PITTSTON POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Michael Lombardo
Mayor

Mr. Michael Lombardo, Esq.
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Mr. Samuel Argo
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Mr. Kenneth Bangs
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Mr. Joseph McLean
Councilman

Mr. Joseph Moskovitz
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