

# COMPLIANCE AUDIT

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## City of Bethlehem Officers' and Employees' - PMRS Pension Plan Northampton County, Pennsylvania For the Period January 1, 2018 to December 31, 2019

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January 2021



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



**Commonwealth of Pennsylvania  
Department of the Auditor General  
Harrisburg, PA 17120-0018  
Facebook: Pennsylvania Auditor General  
Twitter: @PAAuditorGen  
www.PaAuditor.gov**

**EUGENE A. DePASQUALE  
AUDITOR GENERAL**

The Honorable Mayor and City Council  
City of Bethlehem  
Northampton County  
Bethlehem, PA 18018

We have conducted a compliance audit of the City of Bethlehem Officers' and Employees' - PMRS Pension Plan for the period January 1, 2018 to December 31, 2019. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the 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 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 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 plan members who retired and elected to vest during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws, and regulations by recalculating the amount of the pension benefits due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients.
- We determined whether the January 1, 2017 and January 1, 2019 actuarial valuation reports were prepared and submitted by March 31, 2018 and 2020, 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 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 during the current audit period and through the completion of our fieldwork procedures.

The City of Bethlehem Officers' and Employees' - PMRS Pension Plan participates 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 Bethlehem Officers' and Employees' - PMRS Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 Bethlehem Officers' and Employees' - PMRS 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 – Partial Compliance With Prior Recommendation – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid
- Finding No. 2 – Noncompliance With Prior Recommendation – Failure To Implement Professional Services Contract Provisions Of Act 205
- Finding No. 3 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan

Finding No. 2 contained in this audit report repeats a condition that was cited in our previous report that has not been corrected by city officials. We are concerned by the city's failure to correct this previously reported finding and strongly encourage timely implementation of the recommendations 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 Bethlehem 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.

January 8, 2021



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.

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 Bethlehem Officers' and Employees' - PMRS Pension Plan is also governed by implementing regulations 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.

The City of Bethlehem Officers' and Employees' - PMRS Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2019-22, and a separately executed plan agreement with PMRS, adopted pursuant to Act 15. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established January 1, 1964. Active members are required to contribute 7.5 percent of compensation to the plan. As of December 31, 2019, the plan had 307 active members, 9 terminated members eligible for vested benefits in the future, and 371 retirees receiving benefits.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
STATUS OF PRIOR FINDINGS

Partial Compliance With Prior Recommendation

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

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

During the current audit period, the city reimbursed \$9,642 to the Commonwealth for the net overpayment of state aid received in 2017 and 2018, including interest; 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 year 2019, as further discussed in the Findings and Recommendations section of this report.

Noncompliance With Prior Recommendation

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

- Failure To Implement Professional Services Contract Provisions Of Act 205

CITY OF BETHLEHEM OFFICERS’ AND EMPLOYEES’ - PMRS PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – Partial Compliance With Prior Recommendation - Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid**

Condition: As disclosed in the Status of Prior Findings section of this report, the city partially complied with the prior finding by reimbursing the Commonwealth for the net overpayment of state aid received in 2017 and 2018; 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 year 2019. Plan officials failed to certify 1 eligible non-uniformed employee (1 unit) and understated payroll by \$46,136 on the Certification Form AG 385 filed in 2019. The data contained on this certification form is based on prior calendar year information.

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: The employee in question retired in August 2018 and met the eligibility criteria in 2018 to be certified on the Certification Form AG 385 filed in 2019. In addition, the city lacked adequate internal control procedures, such as having another individual review the data certified to ensure compliance with the instructions that accompanied Certification Form AG 385 prior to submission and to ensure full compliance with the prior recommendation.

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 unit value, the city received an underpayment of state aid of \$5,121 as identified below:

Year	Units Understated	Unit Value	State Aid Underpayment
2019	1	\$5,121	\$ 5,121

Although the additional state aid will be allocated to the city, the full amount of the 2019 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, such as having at least two people review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.



CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – (Continued)**

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

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

**Finding No. 2 – Noncompliance With Prior Audit Recommendation – Failure To Implement Professional Services Contract Provisions Of Act 205**

Condition: As disclosed in the prior audit report, city officials failed to adopt the mandatory provisions regarding professional services contracts under Act 205. As of the date of our fieldwork completion, the city still had not adopted such mandatory provisions.

Criteria: Section 701-A of Act 205, as amended by Act 44, defines a “Professional Services Contract”, as follows:

“Professional services contract.” A contract to which the municipal pension system is a party that is:

- (1) for the purchase or provision of professional services, including investment services, legal services, real estate services and other consulting services; and
- (2) not subject to a requirement that the lowest bid be accepted.

In addition, Section 702-A (a) of Act 205 states, in part:

Each municipal pension system ... shall develop procedures to select the most qualified person to enter into a professional services contract. The procedures shall ensure that the availability of a professional services contract is advertised to potential participants in a timely and efficient manner. Procedures shall include applications and disclosure forms to be used to submit a proposal for review and to receive the award of a professional services contract.

Additionally, Section 702-A (c), (e), (f) and (h) state, in part:

**Review.** Procedures to select the most qualified person shall include a review of the person's qualifications, experience and expertise and the compensation to be charged.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – (Continued)**

**Conflict of interest.** The municipal pension system shall adopt policies relating to potential conflicts of interest in the review of a proposal or the negotiation of a contract.

**Public information.** Following the award of a professional services contract, all applications and disclosure forms shall be public except for proprietary information or other information protected by law.

**Notice and summary.** The relevant factors that resulted in the award of the professional services contract must be summarized in a written statement to be included in or attached to the documents awarding the contract. Within ten days of the award of the professional services contract, the original application, a summary of the basis for the award and all required disclosure forms must be transmitted to all unsuccessful applications and posted on the municipal pension system's Internet website, if an Internet website is maintained, at least seven days prior to the execution of the professional services contract.

Section 703-A (c) states, in part:

Upon advertisement for a professional services contract by the municipal pension system, the contractor may not cause or agree to allow a third party to communicate with officials or employees of the municipal pension system except for requests for technical clarification.

Cause: Plan officials were under the impression that monitoring Act 44 disclosures was sufficient to be in compliance with the prior audit finding.

Effect: The city's failure to implement and follow the provisions stipulated in Act 205 regarding the procurement of professional investment and advisory services for the pension plan could result in a general lack of overall transparency of the proposed actions to be taken by plan officials relative to the awarding of future investment and advisory service contracts for the plan.

Recommendation: We again recommend that municipal officials obtain a comprehensive understanding of Act 205 provisions for the procurement of professional services and develop and implement formal written procedures to ensure compliance with these provisions which should include the maintaining of appropriate and sufficient supporting documentation evidencing every phase of the process to ensure the transparency of the actions taken by plan officials relative to the awarding of any future professional services contracts for its pension plan.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – (Continued)**

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

Auditor's Conclusion: We are concerned that the municipality has not complied with the prior audit recommendation and encourage compliance at the earliest opportunity to do so.

**Finding No. 3 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan**

Condition: The city's record-keeping system did not provide effective control over the transactional activity of the officers' and employees' - PMRS pension plan during 2019. Municipal officials were unable to furnish annual financial statements or custodial account transaction statements for the officers' and employees' - PMRS pension plan. These annual financial and account statements have historically been provided by the plan's custodian, PMRS. However, as of the date of this report, annual financial and accounting statements summarizing the pension account activity have not been provided for the year 2019.

Criteria: An adequate system of accounting and record keeping is a prerequisite for sound administration of pension plans. In addition, assets held in a custodial account for the purpose of plan management are to be governed by the terms and provisions of the account contract, provided that the terms and provisions of the contract are within the parameters of all prevailing pension legislation. Although the municipality may contract with a trustee to administer the financial management of the plan, the fiduciary responsibility for the plan remains with the municipality.

Cause: Municipal officials indicated that the plan's custodian, PMRS, failed to provide copies of the custodial account transaction statements summarizing activity of the pension plan account for the year 2019. In addition, municipal officials did not maintain a separate detailed accounting of pension plan transactions which, among other things, helps assure the production of proper financial statements to effectively monitor the annual activity of the pension plan.

Effect: Although we were able to obtain alternate documentation from the municipality to evidence the propriety of the individual transactions tested during performance of the audit for the year 2019, the failure to maintain annual financial and/or account transaction statements prohibits municipal officials from effectively monitoring the plan's financial operations. Additionally, inadequate monitoring of the pension plan account could lead to undetected errors or improprieties in account transactions as well as deficiencies in authorizing and implementing pension plan policies and procedures.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 3 – (Continued)**

Recommendation: We recommend that municipal officials contact the plan custodian and obtain annual financial statements of the custodial account of the officers' and employees' - PMRS pension plan for the year 2019 to ensure the accuracy and propriety of the transaction activity. In addition, we recommend that municipal officials establish and maintain a financial record-keeping system that allows the municipality to effectively monitor the plan's financial operations, even in the absence of statements from the plan custodian. Municipal officials should refer to the Auditor General's Bulletin No. 2-88 entitled "Preparation, Maintenance and Auditability of Financial Records," for further guidance in establishing adequate accounting and record-keeping procedures.

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

Auditor's Conclusion: PMRS has indicated that they are in the process of preparing 2019 Year-End Financial Activity Reports and Annual Member Statements for all municipalities. PMRS has also indicated that they recently went through a substantial upgrade to the plan administration software and implemented a new accounting system. This transition in addition to disruptions in normal government operation due to COVID-19 has resulted in a three to four month delay in the 2019 year-end reporting process. Compliance with the finding recommendation will be evaluated during our next audit of the plan.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS 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, 2015, 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)
01-01-15	\$ 130,321,063	\$ 130,977,234	\$ 656,171	99.5%
01-01-17	137,900,792	144,046,339	6,145,547	95.7%
01-01-19	144,106,306	149,884,989	5,778,683	96.1%

Note: The 01-01-15 actuarial value of assets reflects the deposit of bond proceeds in the net amount of \$27,410,549 on November 25, 2014. The Actuarial Accrued Liability as of 01-01-17 reflects increases in the plan's liabilities due to the reduction in the interest rate assumption as well as demographic losses and other plan changes made in 2017.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS 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 BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

<u>Year Ended December 31</u>	<u>Actuarially Determined Contribution</u>	<u>Actual Contributions</u>	<u>Contribution Deficiency (Excess)</u>	<u>Covered- Employee Payroll</u>	<u>Contributions as a Percentage of Covered- Employee Payroll</u>
2014	\$ 820,449	\$ 28,582,658	\$(27,762,209)	\$21,678,896	131.85%
2015	1,117,586	1,118,126	(540)	20,428,871	5.47%
2016	1,177,599	1,177,999	(400)	22,036,333	5.35%
2017	1,181,049	1,181,609	(560)	21,347,566	5.54%
2018	1,195,583	2,311,003	**(1,115,420)	22,100,890	10.46%
2019	1,837,873	1,838,333	(460)	*	

\* Due to the timing of this audit, covered-employee payroll for 2019 was not provided in this schedule.

\*\* Excess Contribution in 2018 was due to the transfer of assets from the (non-PMRS) Officers' and Employees' Pension Plan.

CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS 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, 2019
Actuarial cost method	Entry age normal
Amortization method	Level dollar for plan bases and an average for Aggregate Gain/Loss, 10% of surplus is credited against aggregate cost where applicable.
Remaining amortization period	8 years
Asset valuation method	The Actuarial Value of Assets equal the sum of all audited reserve funds as of the valuation date, including Member, Municipal, Retired, Disability, and DROP Reserves, when applicable, and a one year administration expense reserve, plus the portion of any additional investment income to be distributed as excess interest, based on PMRS Policy Statement 05-2. This asset valuation is based on the unique legislative structure of PMRS and the administrative rules adopted by the PMRS Board in conjunction with Pennsylvania Municipal Retirement Law. <sup>1</sup>

Actuarial assumptions:

Investment rate of return *	5.25%, compounded annually, net of investment and administration expenses.
Projected salary increases *	2.8%-7.05%
* Includes inflation at	2.8%
Cost-of-living adjustments	2.8% per year, subject to plan limitations.

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<sup>1</sup> The administrative rules adopted by the PMRS Board, which are not subject to comply with Actuarial Standards of Practice (ASOP), when defining the Actuarial Value of Assets (AVA), does not necessarily meet the requirement of ASOP 44 Selection and Use of Asset Valuation Methods for Pension Valuations. The AVA provided within this report follow the Pennsylvania Municipal Retirement Law and the PMRS policy statement.



CITY OF BETHLEHEM OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN  
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