

# COMPLIANCE AUDIT

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## City of Butler Police Pension Plan Butler County, Pennsylvania For the Period January 1, 2018 to December 31, 2019

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September 2020



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 Butler  
Butler County  
Butler, PA 16001

We have conducted a compliance audit of the City of Butler Police 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 finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

The objective of the audit was 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 objective identified above. 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 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 monthly 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 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.

The City of Butler 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 Butler Police 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 objective.

The results of our procedures indicated that, in all significant respects, the City of Butler 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 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

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 Butler 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.

August 21, 2020



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 Butler Police 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 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.

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.

The City of Butler Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1516, as amended. 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, 1948. Active members are required to contribute 5 percent of base wages, plus longevity, plus shift differential to the plan. As of December 31, 2019, the plan had 24 active members, 1 terminated member eligible for vested benefits in the future, and 38 retirees receiving pension benefits from the plan.

CITY OF BUTLER POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid**

Condition: The city certified 1 ineligible police officer (2 units) and overstated payroll by \$144,690 on the Certification Form AG 385 filed in 2019. The police officer was under suspension during 2018 and did not work the required six consecutive months full-time required for certification purposes under Act 205. The data contained on this certification form is based on prior calendar year information.

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

Cause: Municipal officials believed that the officer was eligible for certification purposes because he was still an employee of the city and a member of the pension plan during the individual’s time on suspension.

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 incorrect certification of pension data affected the city’s state aid allocation, as identified below:

| <u>Year</u> | <u>Units Overstated</u> | <u>Unit Value</u> | <u>State Aid Overpayment</u> |
|-------------|-------------------------|-------------------|------------------------------|
| 2019        | 2                       | \$5,120           | \$ 10,240                    |

In addition, the city used the overpayment of state aid to pay the minimum municipal obligation (MMO) due to the police pension plan; therefore, if the reimbursement to the Commonwealth is made from the pension plan, the plan’s MMO will not be fully paid.

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

Recommendation: We recommend that the overpayment of state aid, in the amount of \$10,240, plus interest, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

CITY OF BUTLER POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

We also 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.

In addition, if the reimbursement to the Commonwealth is made from police pension plan funds, we recommend that any resulting MMO deficiency be paid to the pension plan with interest, at a rate earned by the pension plan.

Management’s Response: Municipal officials provided the following response:

While I understand why State Aid would have been overstated, I am not sure how else his contributions to the pension plan would have been recorded. The officer in question was suspended without pay most of 2017. In 2018, he was awarded the right to be made “whole”. In 2018, he received wages from both 2017 and 2018 where he was required to pay into the Police Pension Plan for that time period. Had he been paid in 2017 and contributed to the plan, the State Aid would have been higher in 2017. Basically, State Aid was understated for the year 2017.

Auditor’s Conclusion: Although the police officer was awarded a severance package as a result of his suspension, the officer was not employed for most of 2017 or during any time in 2018 and, as such, according to Act 205, was not eligible for certification purposes according on Certification Form AG 385 submitted in 2019. 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 BUTLER POLICE PENSION PLAN  
POTENTIAL WITHHOLD OF STATE AID

The finding contained in this audit report cites an overpayment of state aid to the city in the amount of \$10,240, plus interest. A condition of this nature may lead to a total withholding of state aid in the future unless that finding is corrected. A check in this amount with interest, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania, and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120.

CITY OF BUTLER 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, 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                 | \$ 12,360,496                 | \$ 12,029,625                                     | \$ (330,871)   | 102.8%               |
| 01-01-17                 | 12,893,472                    | 13,133,788  | 240,316  | 98.2%                |
| 01-01-19                 | 13,020,592                    | 14,056,816  | 1,036,224  | 92.6%                |

Note: The market values of the plan's assets at 01-01-15, 01-01-17, and 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses over a four-year averaging period. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

CITY OF BUTLER 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 BUTLER POLICE PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|------------------------|------------------------------|------------------------|
| 2014                   | \$ 161,788                   | 110.2%                 |
| 2015                   | 222,266                      | 100.0%                 |
| 2016                   | 186,543                      | 107.7%                 |
| 2017                   | 175,281                      | 113.6%                 |
| 2018                   | 167,806                      | 119.0%                 |
| 2019                   | 257,504                      | 100.0%                 |

CITY OF BUTLER 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, 2019              |
| Actuarial cost method         | Entry age normal             |
| Amortization method           | Level dollar                 |
| Remaining amortization period | 14 years                     |
| Asset valuation method        | Fair value, 4-year smoothing |
| Actuarial assumptions:        |                              |
| Investment rate of return     | 7.25%                        |
| Projected salary increases *  | 4.5%                         |
| Cost-of-living adjustments    | None assumed                 |

\* Includes inflation at 2.75%

CITY OF BUTLER POLICE PENSION PLAN  
COMMENT

Historically, the plan's governing document, Ordinance No. 1516, as amended, effective January 1, 2002, defines normal retirement as obtainment of age 50 and 20 years of service, which is consistent with the Third Class City Code as noted below.

The Third Class City Code states the following:

**§ 14302. Retirement and final discharge.**

**(a) Requirements for ordinance.**--With regard to continuous service and minimum retirement age requirements, the ordinance establishing the police pension fund shall prescribe as follows:

- (1) A minimum period of continuous service of not less than 20 years.
- (2) If a minimum retirement age is prescribed, a minimum age of 50 years.

However, during the current audit period, in 2018, municipal officials amended the definition of normal retirement to permit police officers who elected to retire during 2018, to retire after completion of 25 years of service, regardless of age. This impacted only one police officer, who retired in August 2018 at age 44 with 25 years of service. The city appropriately contracted an actuarial cost study, which estimated this benefit change would increase the unfunded actuarial accrued liability of the plan by approximately \$107,000, and the plan's annual minimum municipal obligation (MMO) by approximately \$12,000 per year for 10 years.

A similar situation occurred in 2014 when municipal officials amended the definition of normal retirement to permit police officers who elected to retire during 2014 to retire after 20 years of service, regardless of age. This also impacted one police officer, who retired in December 2014 at age 45 with 24 years of service. Again, an actuarial cost study was conducted and estimated this benefit change would increase the unfunded actuarial accrued liability of the plan by approximately \$131,000 and the plan's annual MMO by an estimated \$14,000 per year for 10 years.

Moreover, municipal officials had previously provided a retirement window pursuant to the provisions of a collective bargaining agreement between the city and its police officers. In 2003, municipal officials amended the definition of normal retirement to permit police officers who retired in 2003, 2004, 2005, 2006, and 2007 to retire after 20 years of service, regardless of age. This impacted at least four police officers who retired during those years prior to age 50; however, due to the timing of this engagement, the impact on the plan's liability was not readily available.

CITY OF BUTLER POLICE PENSION PLAN  
COMMENT

The benefits provided through these retirement windows were not in excess of the provisions stipulated in the Third Class City Code, and the city appropriately conducted cost estimates to determine the effect of the benefit changes as required by Act 205; however, as the funding standard for municipal pension plans, the overarching principle of Act 205 is undermined when a plan is funded based on an established plan benefit structure and that structure is repeatedly contradicted for specific populations of plan membership. The practice of recurrently opening windows to allow police officers to retire earlier than stipulated in the plan's governing document could have potential adverse ramifications on the plan and the city and, therefore, is not a common practice among municipal pension plans in the Commonwealth of Pennsylvania. As evidenced by the cost studies, the benefit changes result in increased annual MMOs which, when the city's annual state aid allocation is not sufficient to cover the annual MMO, is borne by the taxpayer in the form of increased required municipal contributions from the general fund.

We note that city officials enacted Ordinance No. 1766, effective August 23, 2018, to amend the definition of normal retirement going forward, to require 25 years of service and age 50 for police officers hired on or after October 1, 2018. There are numerous police officers who were hired prior to October 1, 2018 and who are still subject to the provisions of Ordinance No. 1516, which, as stated above, provides a normal retirement benefit at age 50 with 20 years of service. Many of these police officers will reach 20 years of service prior to reaching age 50. With its precedent of granting retirement windows, the city could face the unintended consequence of perceived inequality in the event that a police officer, in the future, attains the required years of service but not the required age and the city either does not pursue a retirement window or does pursue a retirement window and a cost study determines the granting of a window to allow the officer to retire to be unsustainable at that time.

Upon discussing the issue with city officials during the conduct of the current engagement, officials indicated the following relative to the retirement window approved during the current audit period:

This was handled properly by the City – an actuarial study was prepared prior to passage of plan amendment – and that the eligibility of 25 years of service stipulated in the amendment is authorized by the Third Class City Code. The City could have defined normal retirement age all along as the completion of 20 years of service (no age requirement, and service less than the 25 years required by the window) or could amend the plan at any time to make that the normal retirement eligibility, under section 14302 of the Third Class City Code (excerpt below). A “20 and out” retirement eligibility would have resulted in much higher plan liabilities and funding requirements. Contrary to what might be expected, [the Department] essentially reprimands the City for having a more conservative retirement eligibility all along and making an exception via window for individuals who qualified in 2018.

CITY OF BUTLER POLICE PENSION PLAN  
COMMENT

**§ 14302. Retirement and final discharge.**

**(a) Requirements for ordinance.**--With regard to continuous service and minimum retirement age requirements, the ordinance establishing the police pension fund shall prescribe as follows:

- (1) A minimum period of continuous service of not less than 20 years.
- (2) If a minimum retirement age is prescribed, a minimum age of 50 years.

As you will note, windows have been passed over the years for qualifying officers from time to time. For example, in 2014 officers who had completed 20 years of service were permitted to retire with full pension. Similarly, officers could retire from 2003-2007 upon completion of 20 years of service. Please note that all of the calculations are made, reviewed and/or approved by the Third Party Administrator. The City followed the Third Class City Code as it has with other windows and this issue has not been raised in previous audits.

It is not the intent of this Department to take exception to the benefits provided by the city, merely to point out that the practice of recurrently opening windows to allow retirements earlier than expected under the plan's governing document and funding under Act 205 could have adverse ramifications to the plan and that the city should make fiscally responsible decisions as both plan fiduciaries and city officials that will benefit the City of Butler and its taxpayers to ensure the city's pension fund has adequate resources to meet current and future benefit obligations to the city's hard-working police officers.



CITY OF BUTLER 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 Benjamin A. Smith**  
Mayor

**Ms. Melinda F. Gall**  
City Clerk

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