

COMPLIANCE AUDIT

City of Allentown Officers' and Employees' - PMRS Pension Plan Lehigh County, Pennsylvania For the Period January 1, 2021 to December 31, 2022

February 2024



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

The Honorable Mayor and City Council
City of Allentown
Lehigh County
Allentown, PA 18101

We have conducted a compliance audit of the City of Allentown Officers' and Employees' - PMRS Pension Plan for the period January 1, 2021 to December 31, 2022. 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 14 of the 49 plan members¹ who retired or elected to vest during the current audit period, and through the completion of our fieldwork procedures, 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 or payable to the recipients.
- We determined whether the January 1, 2019 and January 1, 2021 actuarial valuation reports were prepared and submitted by March 31, 2020, and 2022, 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 pension plan is in compliance with Act 205 for distressed municipalities through inquiry of plan officials and evaluation of the recovery remedies implemented during the audit period.

¹ We selected plan members randomly from the population of plan members who retired or elected to vest during the current audit period, and through the completion of our fieldwork procedures, in order to obtain a representative selection for the purpose of our testing to achieve the audit objective. While representative selection is a required factor of audit sampling methodologies, audit sampling methodology was not applied to achieve this test objective; accordingly, the results of this audit procedure are not, and should not be, projected to the population.

The City of Allentown 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.

The City of Allentown 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 Annual Comprehensive 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 Allentown 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 Allentown 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:

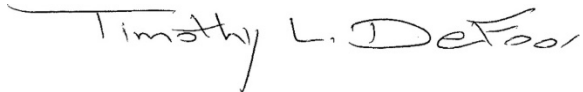
Finding No. 1 – Noncompliance With Prior Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid

Finding No. 2 – Failure To Fund The City's Pension Plans In Accordance With Special Tax Provisions Of Act 205

Finding No. 1 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 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 Allentown 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.

A handwritten signature in black ink that reads "Timothy L. DeFoor". The signature is written in a cursive style with a long horizontal line extending to the left of the first letter.

Timothy L. DeFoor
Auditor General
January 3, 2024

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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 two 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 Allentown 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 Allentown Officers' and Employees' - PMRS Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 142 of the city's codified ordinances, as amended by Ordinance No. 15856, effective December 7, 2022, and a separately executed plan agreement with PMRS, adopted pursuant to Act 15. Prior to December 7, 2022, the plan was locally controlled by the provisions of Ordinance No. 13640, and a 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 August 5, 1981. Active members are required to contribute 7.5 percent of compensation to the plan. As of December 31, 2022, the plan had 423 active members, 14 terminated members eligible for vested benefits in the future, and 504 retirees receiving pension benefits funded through annuities purchased with plan assets.

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

Compliance With Prior Audit Recommendation

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

- Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan

During the current audit period, the city provided annual financial statements of the pension plan's activity for all years.

Noncompliance With Prior Audit Recommendation

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

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

Although the city received reimbursement for the prior state aid underpayment, the city again failed to comply with the instructions that accompany Certification Form AG 385 in accurately reporting the required pension data, as further discussed in Finding No. 1 of this report.

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

Finding No. 1 – Noncompliance With Prior Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid

Condition: As disclosed in the Status of Prior Findings section of this report, the city again failed to comply with the instructions that accompanied Certification Form AG 385. The city certified three ineligible non-uniformed employees (3 units) on the Certification Form AG 385 filed in 2022. In addition, the city failed to certify an eligible police officer (2 units) and certified seven ineligible non-uniformed employees (7 units) on the Certification Form AG 385 filed in 2023. The data contained on these certification forms 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: Although the city has implemented adequate internal control procedures by having two individuals review the data certified prior to submission, they have acknowledged shortcomings with the software system that extracts the data, which contributed to the certification errors.

Effect: The data submitted on these certification forms 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 allocations were based on unit value, the incorrect certification of pension data affected the city's state aid allocations, as identified below:

<u>Year</u>	<u>Type of Plan</u>	<u>Units Overstated (Understated)</u>	<u>Unit Value</u>	<u>State Aid Overpayment (Underpayment)</u>
2022	O&E - PMRS	3	\$ 5,180	<u>\$ 15,540</u>
2023	Police	(2)	5,828	(11,656)
	O&E - PMRS	7	5,828	<u>40,796</u>
				<u>2023 Net Overpayment of State Aid</u> \$ 29,140
				<u>Net Overpayment of State Aid</u> \$ <u>44,680</u>

In addition, the city used the overpayments of state aid to pay the minimum municipal obligations (MMOs) due to the pension plans; therefore, if the reimbursement to the Commonwealth is made from the pension plans, the plans' MMOs will not be fully paid.

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

Finding No. 1 – (Continued)

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

Recommendation: We recommend that the total excess state aid, in the amount of \$44,680, 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.

We also recommend that in the future, plan officials establish adequate internal control procedures to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

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

Management's Response: Management agreed with the finding and will remit payment to the Commonwealth.

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 ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Failure To Fund The City’s Pension Plans In Accordance With Special Tax Provisions Of Act 205

Condition: Under the discretionary remedies available through the distress provisions of Act 205 to provide short-term fiscal relief to local governments operating public pension plans, the city adopted Ordinance No. 14839, effective January 1, 2011, as amended, increasing its Earned Income Tax rate for both residents and non-residents of the city for the sole purpose of defraying the additional costs required to be paid pursuant to Act 205 directly related to the city’s pension plans. Additionally, the city prepared the calculation necessary to determine the appropriate funding level mandated under the distress provisions of Act 205. However, during the current audit period, the city did not reconcile and maintain its level of funding from sources prior to implementation of the special tax as required by the distress provisions of Act 205.

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, relative to the funding of certain distress pension plans, Section 607(f) of Act 205 states:

(f) Special municipal taxing authority.

- (1) If the tax rates set by the municipality on earned income or on real property are at the maximum provided by applicable law, the municipality may increase its tax on either earned income or real property above those maximum rates. The proceeds of this special municipal tax increase shall be used solely to defray the additional costs required to be paid pursuant to this act which are directly related to the pension plans of the municipality. The municipality utilizing this special municipal taxing authority shall not reduce the level of municipal contributions to the pension plans prior to the implementation of the special municipal taxing authority. (Emphasis added.)

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

Finding No. 2 – (Continued)

- (2) The average level of municipal contributions to the pension plans from all revenue sources for the three years immediately prior to the implementation of the special municipal taxing authority shall be expressed as a percentage of the average covered payroll for that same three-year period: Provided, however, That any supplemental contributions made to the plans pursuant to any pension recovery legislation enacted by the municipalities shall be excluded for purposes of determining the level of municipal contribution to the pension plans prior to the implementation of the special municipal taxing authority. In each year subsequent to the implementation of the special municipal taxing authority, the municipal contributions to the pension plan from all revenue sources existing prior to the implementation of the special existing municipal taxing authority, reduced by any supplemental pension recovery contributions, shall equal, or exceed this average percentage of the current covered payroll. A municipality utilizing the provisions of section 404 may levy or continue to levy the special municipal tax increase under this subsection provided that the municipality does not reduce the level of municipal contributions to the pension plans prior to the implementation of the special municipal taxing authority. In executing the procedure prescribed in this subsection to determine the level of municipal contributions, the debt service payments for bonds or notes issued under section 404 shall be considered municipal contributions. (Emphasis added.)

Cause: There was turnover of officials responsible for the administration of the city's pension plans during the current audit period, and current officials were unaware of the required funding level previously determined and the necessity for a reconciliation. Additionally, the city retained the special tax collected in the general fund as reimbursement for contributions made to its pension plans each year; however, the city lacked adequate internal control procedures to ensure that it did not reduce its level of contributions to its pension plans prior to the implementation of the special municipal taxing authority before application of funding available under the special tax provisions of Act 205.

Effect: The failure to properly apply the provisions of Section 607(f) of Act 205 and fund the pension plans, accordingly, resulted in reduced annual funding towards the city's distressed pension plans than afforded under the provisions of Act 205 during the audit period and could result in the plans not having sufficient resources to meet current and future benefit obligations to its members.

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

Finding No. 2 – (Continued)

Recommendation: We recommend the city reconcile the total contributions made to the pension plans during 2021 and 2022 from sources other than special tax funding with its required level of funding from sources prior to the implementation of the special municipal taxing authority (*i.e., the baseline percentages as previously determined by the city*) in accordance with Act 205 and deposit the additional funds necessary to meet the city's required funding level for the respective years.

In addition, we recommend that the city implement adequate internal control procedures, such as maintaining appropriate supporting documentation identifying the sources of its annual contributions to its pension plans and performing annual reconciliations evidencing funding requirements made, to ensure that in the future, the city does not reduce its level of contributions to its pension plans from funding sources in existence prior to the implementation of the special municipal taxing authority in accordance with Act 205.

Management's Response: Management understands this finding and as a result will revise the process on how the City receives Act 205 revenue and closely monitor City calculations to ensure we meet the baseline percentage.

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

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 1 contained in this audit report cites an overpayment of state aid to the city in the amount of \$44,680, 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 ALLENTOWN 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, 2017, 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)
01-01-17	\$153,749,151	\$ 169,326,609	\$ 15,577,458	90.8%
01-01-19	162,496,303	176,284,810	13,788,507	92.2%
01-01-21	174,451,547	187,937,343	13,485,796	92.8%

CITY OF ALLENTOWN 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 ALLENTOWN 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>
2013	\$ 1,612,483	\$ 1,612,483	\$ -	\$22,740,178	7.09%
2014	1,557,908	1,558,888	(980)	28,432,224	5.48%
2015	2,229,106	2,230,827	(1,721)	23,067,602	9.67%
2016	2,239,534	2,240,743	(1,209)	23,169,719	9.67%
2017	2,629,868	2,630,992	(1,124)	23,651,715	11.12%
2018	2,647,644	2,648,140	(496)	24,535,775	10.79%
2019	3,252,315	3,252,975	(660)	24,532,647	13.26%
2020	3,257,977	3,258,437	(460)	27,531,948	11.84%
2021	3,376,666	3,377,766	(1,100)	27,746,390	12.17%
2022	3,667,714	3,667,714	-	*	

* Due to the timing of this audit, covered-employee payroll for 2022 was not provided in this schedule.

CITY OF ALLENTOWN 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, 2021
Actuarial cost method	Entry age normal
Amortization method	Not available
Remaining amortization period	8 years
Asset valuation method	Not available
Actuarial assumptions:	
Investment rate of return *	5.25%, compounded annually, net of investment and administration expenses.
Projected salary increases *	4.1%
* Includes inflation at	2.2%
Cost-of-living adjustments	2.2% per year, subject to plan limitations.

The information reported above was extracted from the Pennsylvania Municipal Retirement System Experience Study Results Report dated September 2020, which is the basis for the 01-01-2021 actuarial valuation. The report did not specify the actuarial or market value methodologies often contained in the Notes to Supplementary Schedules and will be added going forward when readily available.

CITY OF ALLENTOWN OFFICERS' AND EMPLOYEES' - PMRS PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Joshua D. Shapiro
Governor
Commonwealth of Pennsylvania

The Honorable Matt Tuerk
Mayor

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Ms. Bina Patel
Director of Finance

Ms. Erika Strohler
Treasury and Accounting Manager

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Mr. Michael Hanlon
City Clerk

Mr. Richard Cardamone, CPA, CGMA
Pennsylvania Municipal Retirement System

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