

**COMMONWEALTH OF PENNSYLVANIA**  
**Department of the Auditor General**

**SUBJECT:** Municipal Pension Bulletin No. 2001-01

**TO:** Municipal Officials and Attorneys

Last July the Department of the Auditor General issued Municipal Pension Bulletin No. 2001-01, "Unauthorized, or Excess, Benefits." The benefits in question are those that exceed the benefits authorized by governing pension law. The bulletin sets out the Department's position that municipalities which grant excess benefits must bear their actuarial cost.

We have received inquiries and expressions of concern from some attorneys -- both those representing employee unions and those representing municipalities. Among the former are attorneys for the Fraternal Order of Police who have specifically questioned the policy regarding inclusion of lump-sum payments for accumulated unused leave in pension computations. As set forth hereafter, we are now clarifying this policy. Among lawyers for municipalities are the authors of an article entitled "A Practical Approach to the Auditor General's Bulletin on Excess Pension Benefits," which appeared in the November edition of *Pennsylvania Borough Affairs*. These attorneys too questioned our lump-sum policy. Overall, however, the commentary provided by the authors of this article reveals a profound misunderstanding of both the content and the effect of the bulletin. We therefore thought it wise to offer the following response to this article, in addition to clarifying the policy regarding lump-sum payments.

First, the authors impute to us the "unrealistic" expectation that municipalities can bring their pension plans into compliance with law. In fact, we are well aware that factors such as collective bargaining, unappealed arbitration decisions, and the existence of vested rights may affect the ability of a municipality to discontinue providing excess benefits. Certainly, we do not seek to have municipalities disregard collective bargaining agreements or ordinances that grant such benefits. However, in accordance with the Municipal Pension Plan Funding Standard and Recovery Act (Act 205), 53 P.S. § 895.101 *et seq.*, we must address the effect excess benefits may have on state aid allocations and on the contributions municipalities must make to their pension plans.

Section 402(j) of Act 205 directs the Auditor General to administer the General Municipal Pension System State Aid Program, which is financed by taxes on foreign casualty and fire insurance companies. A municipality's yearly allocation may not exceed the actual costs of its pension plans and may be used only to defray those costs. Obviously, granting excess benefits increases the financial requirements of a pension plan. If we were to allow for these increases when distributing state aid, some municipalities would receive enhanced allocations to defray the cost of benefits not authorized by law. Since only a finite amount of

state aid is available each year, allocations to municipalities whose pension plans complied with the law would be necessarily, and unfairly, reduced.

In addition to the unfairness issue, the Department must confront the legal reality that it cannot condone, much less encourage, the provision of unauthorized benefits by subsidizing them with state aid. One approach to the problem would be to take steps to withhold aid in its entirety when our auditors discover that a recipient municipality is granting excess benefits. Under the general rule set out in the bulletin, however, a municipality will lose only the portion of its allocation that is actuarially attributable to the cost of these benefits.

Section 302 of Act 205 imposes on municipalities a minimum funding standard intended to assure that the pension benefits granted can in fact be paid. Each year municipalities must deposit into their pension plans an amount referred to as the minimum municipal obligation, or MMO. Generally speaking, the MMO is the shortfall between member contributions and the funding requirements of the pension plan. As already pointed out, granting excess benefits increases those requirements. Accordingly, the bulletin requires that municipalities which grant excess benefits must also fund them, as necessary, by way of actuarially computed increases in their MMOs.

We offer in the bulletin various “grace periods” in recognition of the time municipalities may need to conform pension benefits to governing law. We cannot, as the authors seem to suggest, offer *carte blanche*. The consequences for municipalities that do not achieve compliance will, however, be no greater than what is commensurate with the cost of the unauthorized benefits and compatible with Act 205.

Second, the authors are highly critical of our position that including lump-sum payments for accumulated unused leave in pension calculations results in excess benefits. Our position is not, however, as unyielding as the authors assert. They have overlooked the following note, which appears on page 2 of the bulletin:

When a municipality has historically made payments for accumulated unused leave on an annual or more frequent periodic basis, rather than as an end-of-career lump sum, the Department will consider the specific situation presented in determining whether such payments may be included in pension calculations.

We inserted the note to clarify the reach of our policy and to acknowledge situations that do not fall squarely within it. The authors’ comments, along with related issues raised by an attorney for the Fraternal Order of Police, caused us to revisit the note. We now realize that additional clarification is needed. Specifically, we must eliminate the potential for inconsistent treatment. For example, a municipality that paid a retiree for unused leave during each year of a three-year averaging period could, depending on how the note is applied, include those payments in the pension calculation without running afoul of the bulletin. If, however, the retiree received those three payments in an end-of-career lump sum, they could not, pursuant to the bulletin, be included in the calculation. We did not, of course, intend to create disparity of this kind, and we take this opportunity to correct it. Accordingly, please be advised that we have no objection to a

municipality's including accumulated unused leave in pension calculations as long as the leave was earned during the applicable pension computation period.

Third, the authors maintain that "a significant question remains regarding the Bulletin's reliance on the *Monroeville* decision with respect to the Home Rule Charter and Optional Plan Law (Charter Law)." In *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee*, 767 A.2d 596 (Pa. Commw. 2001), *allocatur denied*, 112 WAL 2001, July 9, 2001, the Commonwealth Court held that the Charter Law precludes home rule municipalities from granting benefits different from those prescribed in governing pension law. The Pennsylvania Supreme Court refused the police department's request to appeal the decision. In the bulletin, we applied *Monroeville* only to home rule municipalities that grant excess benefits to individuals who began full-time employment on or after January 24, 2001, the date the decision was issued.

The question the authors refer to -- whether home rule municipalities may diminish pension benefits already granted -- was not before the *Monroeville* court. Our application of *Monroeville* does not, in any event, turn on the answer to that question. If a home rule municipality concludes that it is legally bound to provide excess benefits to employees who began work on or after January 24, we have no interest in challenging that conclusion. We do, however, have an interest in the integrity of state aid allocations and MMO requirements. Therefore, like other municipalities that provide excess benefits, home rule municipalities will be expected to bear their cost.

Excess benefits take numerous forms and occur in numerous contexts. The position we have taken in Bulletin 2001-01 recognizes significant differences in form and context but applies a consistent standard. The information we have provided in this letter may not cause you to agree with our position. We hope, however, that it has fostered a greater understanding of how we arrived at that position and how we will implement it.

RDS/lad