

COMPLIANCE AUDIT

City of McKeesport Officers and Employees Pension Plan Allegheny County, Pennsylvania For the Period January 1, 2013 to December 31, 2014

April 2016



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 McKeesport
Allegheny County
McKeesport, PA 15132

We have conducted a compliance audit of the City of McKeesport Officers and Employees Pension Plan for the period January 1, 2013 to December 31, 2014. 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 the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings 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 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 all 5 of the 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 benefit 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, 2011 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, 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 and through the completion of our fieldwork procedures.
- × 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.
- × We determined whether provisions of the Deferred Retirement Option Plan (DROP) were in accordance with the provisions of Act 205 by examining provisions stated in the plan's governing documents.

The City of McKeesport 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 McKeesport Officers and Employees 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 objective, 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 objective.

The results of our procedures indicated that, in all significant respects, the City of McKeesport Officers and Employees 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:

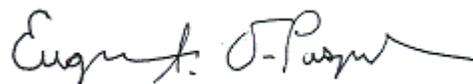
Finding No. 1 – Failure To Deposit State Aid Into An Eligible Pension Plan

Finding No. 2 – Failure To Pay The Minimum Municipal Obligation Of 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.

The contents of this report were discussed with officials of the City of McKeesport and, where appropriate, their responses have been included in the report.

March 16, 2016



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 McKeesport Officers and Employees Pension Plan is also governed by implementing regulations adopted by the 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 317 - 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 McKeesport Officers and Employees Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 02-6, as amended, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees hired prior to January 1, 1993. The plan was established January 18, 1949. Active members are required to contribute 4.5 percent of compensation to the plan. As of December 31, 2014, the plan had 6 active members, 2 terminated members eligible for vested benefits in the future and 47 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 55 and 20 years of service.
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit equals 50% of final average earnings plus a service increment equal to 1/40th of the retirement benefit for each completed year of service in excess of 20 years. Compensation is basic earnings (i.e. excludes overtime and any extra form of compensation). Average compensation equal to the greater of (a) final 5 years of service; and (b) average of basic compensation during the last 12 months of employment.

Survivor Benefit:

Before Retirement Eligibility	Refund of contributions if not vested.
After Retirement Eligibility	50% of the pension the member was receiving or was entitled to receive on the day of the member's death.

Service Related Disability:

Accrued benefit at date of disability with 15 years of credited service.

Non-Service Related Disability:

None

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - Failure To Deposit State Aid Into An Eligible Pension Plan

Condition: The city did not deposit its 2015 state aid allocation into an eligible pension plan. The city received its 2015 state aid allocation in the amount of \$729,275 on September 24, 2015; however, through the date of this audit report, none of the state aid allocation has been deposited into an eligible pension plan.

Criteria: Section 402(g) of Act 205 states, in part:

. . . the total amount of the general municipal pension system State aid received by the municipality shall, within 30 days of receipt by the treasurer of the municipality, be deposited in the pension funds or the alternate funding mechanisms applicable to the respective pension plans.

Cause: City officials failed to establish adequate internal control procedures to ensure the timely deposit of state aid in accordance with Act 205 requirements.

Effect: When state aid is not deposited into a pension plan account, the funds are not available to pay operating expenses or for investment and the risk of misapplication is increased.

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

Recommendation: We recommend that the municipality deposit the city's state aid allocation of \$729,275, plus interest earned during the period beyond the 30 day grace period allowed by Act 205, compounded annually, into an eligible pension plan. A copy of the interest calculation must be maintained by the city for examination during our next audit of the plan.

We also recommend that plan officials develop and implement adequate internal control procedures to ensure that future state aid is deposited into an eligible pension plan within 30 days of receipt by the municipal treasurer.

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Management’s Response: We at the City of McKeesport acknowledge preliminary draft findings contained in the recently completed audits of our City’s pension plans for the period January 1, 2013 through December 31, 2014. Upon receipt of the 2015 General Municipal Pension System State Aid allocation in the amount of \$729,275, the funds were deposited into the City’s General Fund with intent to forward a check in the same amount to the Hefren-Tillotson for disbursement into our eligible pension plans. However, due to a ledger error, the funds inadvertently were spent while that check was in transit to the financial brokers at Hefren-Tillotson, who were unable to cancel their scheduled deposit. Once the financial status of our City is improved, with the sale of an asset in the near future, this \$729,275 will be forwarded to the eligible pension plans with an interest that should have been gained on these funds.

Auditor’s Conclusion: Due to the Potential Withhold of State Aid, compliance will be evaluated subsequent to the release of the audit report.

Finding No. 2 - Failure To Pay The Minimum Municipal Obligation Of The Plan

Condition: The municipality did not pay the \$347,697 minimum municipal obligation (MMO) that was due to the pension plan for the year 2015, as required by 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.

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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: Plan officials failed to establish adequate internal control procedures to ensure the 2015 MMO was paid in accordance with Act 205 requirements.

Effect: The failure to pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to pay the 2015 MMO by the December 31, 2015, deadline, the municipality must add the 2015 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 pension plan for the year 2015, 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.

Management's Response: We at the City of McKeesport acknowledge preliminary draft findings contained in the recently completed audits of our City's pension plans for the period January 1, 2013 through December 31, 2014. Due to severe financial distress, the City of McKeesport did not have funds available to pay the \$1,531,716 required to meet its [total] minimum municipal obligation of \$2,260,991. Once the financial status of our City is improved, with the sale of an asset in the near future, the City's MMO will be met, including interest.

Auditor's Conclusion: Due to the Potential Withhold of State Aid, compliance will be evaluated subsequent to the release of the audit report.

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Conditions such as those reported by Finding Nos. 1 and 2 contained in this audit report may lead to a total withholding of state aid in the future unless those findings are 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 MCKEESPORT OFFICERS AND EMPLOYEES 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, 2009, 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)
01-01-09	\$ 5,591,147	\$ 6,959,412	\$ 1,368,265	80.3%
1-01-110	5,733,107	7,160,766	1,427,659	80.1%
01-01-13	5,852,672	7,074,546	1,221,874	82.7%

Note: The market values of the plan's assets at 01-01-11 and 01-01-13 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/ or losses subject to a corridor between 70 to 130 percent of the market value of assets. 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 MCKEESPORT OFFICERS AND EMPLOYEES 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 MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2009	\$ 208,496	100.0%
2010	199,449	100.0%
2011	227,440	100.0%
2012	225,162	100.0%
2013	325,477	100.0%
2014	312,837	100.0%

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES 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, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	5 years
Asset valuation method	Fair value, 4-year smoothing.
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	4.0%

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
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Commonwealth of Pennsylvania

The Honorable Michael E, Cherepko
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