

COMPLIANCE AUDIT

Castle Shannon Borough Police Pension Plan Allegheny County, Pennsylvania For the Period January 1, 2014 to December 31, 2017

March 2018



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 Borough Council
Castle Shannon Borough
Allegheny County
Castle Shannon, PA 15234

We have conducted a compliance audit of the Castle Shannon Borough Police Pension Plan for the period January 1, 2014 to December 31, 2017. 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 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 the plan member 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 retired individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to recipient.
- We determined whether the January 1, 2013, January 1, 2015, and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2014, 2016, and 2018, 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 of the plan's unallocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contract with the plan's provisions, investment policies, and state regulations.
- 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.

Castle Shannon Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements for the years ended December 31, 2014, 2015, and 2016, which are available at the borough's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Castle Shannon Borough Police 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 borough's internal controls as they relate to the borough'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 Castle Shannon Borough 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 - Pension Benefit Not In Compliance With Act 600 Provisions.

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. However, we are extremely concerned about the funded status of the plan contained in the schedule of funding progress included in this report which indicates **the plan's funded ratio is 69.1% as of January 1, 2017**, which is the most recent data available. We encourage borough officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of Castle Shannon Borough and, where appropriate, their responses have been included in the report. We would like to thank borough officials for the cooperation extended to us during the conduct of the audit.

March 12, 2018



EUGENE A. DEPASQUALE
Auditor General

CONTENTS

	<u>Page</u>
Background.....	1
Finding and Recommendation:	
Finding – Pension Benefit Not In Compliance With Act 600 Provisions.....	3
Supplementary Information	5
Report Distribution List	11

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 Castle Shannon Borough Police Pension Plan is also governed by implementing regulations adopted by the former 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 767 et seq.

The Castle Shannon Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 788-A, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the borough and its police officers. The plan was established September 15, 1958. Active members are required to contribute 6 percent of compensation to the plan. As of December 31, 2017, the plan had 13 active members, no terminated members eligible for vested benefits in the future, and 11 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2017, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement Age 55 and 25 years of service

Early Retirement None

Vesting 100% after 12 years of service

Retirement Benefit:

50% of final 36 months average salary, plus a service increment of \$100 per month for each year of service in excess of 25 years, up to a maximum of \$138 per month.

Survivor Benefit:

Before Retirement Eligibility Refund of member contributions plus interest.

After Retirement Eligibility A monthly benefit equal to 50% of the pension the member was receiving or was entitled to receive on the day of the member's death.

Service Related Disability Benefit:

50% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

CASTLE SHANNON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Pension Benefit Not In Compliance With Act 600 Provisions

Condition: The pension plan’s governing document, Ordinance No. 788-A, as amended, contains a benefit provision that conflicts with the collective bargaining agreement between the police officers and the borough. Also, the benefit provision contained in the collective bargaining agreement is not in compliance with Act 600. The specific inconsistency is as follows:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Service-related disability benefit	A Participant who retires due to a Total and Permanent Disability shall be eligible for a disability retirement benefit equal to fifty percent (50%) of the Member’s Salary at the Time the Disability was Incurred determined as of the Disability Date, provided that any member who receives benefits for the same injuries under social security disability shall have the Participant’s disability benefits offset or reduced by the amount of such benefits.	Each member of the unit who becomes permanent disabled from an in-service disability should receive a disability pension from the Borough in accordance with the following scale of payment: 1 year of service completed - 25% of average monthly pay, 2 years of service completed - 32% of average monthly pay, 3 years of service completed - 35% of average monthly pay, 4 years of service completed – 40% of average monthly pay, 5 years of service completed – 45% of average monthly pay, and 6 or more years of service completed – 50% of average monthly pay.	The benefit must be in conformity with a uniform scale and fixed by the plan’s governing document at no less than 50% of the member’s salary at the time the disability was incurred, reduced by the amount of Social Security disability benefits received for the same injury.

CASTLE SHANNON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Continued

Criteria: A governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. In addition, the police pension plan's benefit structure should be in compliance with Act 600, as amended, unless continuance of a contradictory benefit is justified by the provisions of the collective bargaining agreement in effect.

Cause: Plan officials failed to establish adequate internal control procedures to ensure that the pension plan's governing document and the collective bargaining agreement are consistent and in accordance with Act 600.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan. In addition, maintaining a benefit structure which is not in compliance with Act 600 could result in plan members or their beneficiaries receiving incorrect benefit amounts or being denied benefits to which they are statutorily entitled.

Recommendation: We recommend that municipal officials, after consulting with their solicitor, take whatever action is necessary to bring the police pension plan's benefit structure into compliance with Act 600, as amended, at their earliest opportunity to do so. If continuation of benefits contrary to Act 600, as amended, is justified by the provisions of the current collective bargaining agreement, we recommend that the benefits be adopted as soon as deemed appropriate, but not later than the expiration of the current collective bargaining agreement on December 31, 2020.

Management's Response: Municipal officials agreed with the finding without exception and have discussed the finding with the borough's labor attorney who is preparing documents to address this finding as early as possible.

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

CASTLE SHANNON BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 5 through 7 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2014, 2015, AND 2016

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Total Pension Liability			
Service cost	\$ 102,810	\$ 97,852	\$ 103,534
Interest	445,190	461,424	481,603
Change of benefit terms	-	165,956	-
Difference between expected and actual experience	-	63,654	-
Benefit payments, including refunds of member contributions	(464,381)	(303,954)	(304,219)
Net Change in Total Pension Liability	<u>83,619</u>	<u>484,932</u>	<u>280,918</u>
Total Pension Liability - Beginning	<u>5,694,251</u>	<u>5,777,870</u>	<u>6,262,802</u>
Total Pension Liability - Ending (a)	<u><u>\$ 5,777,870</u></u>	<u><u>\$ 6,262,802</u></u>	<u><u>\$ 6,543,720</u></u>
Plan Fiduciary Net Position			
Contributions - employer	\$ 36,871	\$ 43,435	\$ 22,677
Contributions - State Aid	120,397	133,308	153,113
Contributions - member	61,929	67,345	73,292
Net investment income	175,827	(58,012)	263,858
Benefit payments, including refunds of member contributions	(464,381)	(303,954)	(304,219)
Net Change in Plan Fiduciary Net Position	<u>(69,357)</u>	<u>(117,878)</u>	<u>208,721</u>
Plan Fiduciary Net Position - Beginning	<u>4,528,241</u>	<u>4,458,884</u>	<u>4,341,006</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 4,458,884</u></u>	<u><u>\$ 4,341,006</u></u>	<u><u>\$ 4,549,727</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 1,318,986</u></u>	<u><u>\$ 1,921,796</u></u>	<u><u>\$ 1,993,993</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	77.17%	69.31%	69.53%
Estimated Covered Employee Payroll	\$ 954,032	\$ 1,056,022	\$ 1,036,345
Net Pension Liability as a Percentage of Covered Employee Payroll	138.25%	181.98%	192.41%

CASTLE SHANNON BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the borough as of December 31, 2015 and 2016, calculated using the discount rate of 7.75%, as well as what the borough's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	<u>1% Decrease (6.75%)</u>	<u>Current Discount Rate (7.75%)</u>	<u>1% Increase (8.75%)</u>
Net Pension Liability - 12/31/15	\$ 2,660,701	\$ 1,921,796	\$ 1,303,225
Net Pension Liability - 12/31/16	\$ 2,754,413	\$ 1,993,993	\$ 1,357,591

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>
2008	\$ 55,000	\$ 55,000	\$ -		
2009	59,530	67,044	(7,514)	1,053,035	6.37%
2010	62,532	77,637	(15,105)		
2011	90,424	111,929	(21,505)	1,003,347	11.16%
2012	98,131	98,131	-		
2013	154,715	154,715	-	906,417	17.07%
2014	157,268	157,268	-	954,032	16.48%
2015	176,743	176,743	-	1,056,022	16.74%
2016	175,790	175,790	-	1,036,345	16.96%
2017	234,926	234,926	-		

* Due to GASB Statement No. 67, *Financial Reporting for Pension Plans*, being implemented only recently, the amount of Covered-Employee Payroll was not provided for even years prior to 2013. In addition, due to the timing of this audit, covered-employee payroll for 2017 was not provided in this schedule.

CASTLE SHANNON BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2016	6.22%
2015	(1.32%)
2014	4.76%

CASTLE SHANNON BOROUGH 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, 2013, 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)
01-01-13	\$ 3,976,552	\$ 5,411,762	\$ 1,435,210	73.5%
01-01-15	4,458,884	6,007,480	1,548,596	74.2%
01-01-17	4,549,727	6,580,891	2,031,164	69.1%

CASTLE SHANNON BOROUGH 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.

CASTLE SHANNON BOROUGH 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, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	12 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%
Cost-of-living adjustments	3.0%

CASTLE SHANNON BOROUGH 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 Donald J. Baumgarten
Mayor

Mr. Mark J. Heckman
Council President

Ms. Marian Randazzo
Councilwoman

Mr. William Oak
Councilman

Ms. Nancy J. Kovach
Councilwoman

Mr. Michael K. Warhold
Councilman

Mr. Daniel Swisher
Councilman

Mr. Timothy Kirsch
Councilman

Mr. Thomas C. Hartswick
Borough Manager

Ms. Loretta J. Miller
Assistant Borough Manager

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.