

COMPLIANCE AUDIT

City of Lock Haven Police Pension Plan Clinton County, Pennsylvania For the Period January 1, 2014 to December 31, 2015

November 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 Lock Haven
Clinton County
Lock Haven, PA 17745

We have conducted a compliance audit of the City of Lock Haven Police Pension Plan for the period January 1, 2014 to December 31, 2015. 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 our 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 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 2 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.
- Whether the January 1, 2011, January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2012, 2014 and 2016, 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.

The City of Lock Haven contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2014, which is 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 Lock Haven 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 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 Lock Haven 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 – Inconsistent Member Contribution Provision

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 Lock Haven 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.

November 7, 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 Lock Haven 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 399 - Optional Third Class City Charter Law, Act of July 15, 1957 (P.L. 901, No. 399), as amended, 53 P.S. § 41101 et seq.

The City of Lock Haven Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Chapter 1, Part 8A of the city's codified ordinances. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established November 15, 1943. Active members are required to contribute 0.5 percent of base pay, plus 1.0 percent of total W-2 wages, plus \$1 per month to the plan. As of December 31, 2015, the plan had 12 active members, no terminated members eligible for vested benefits in the future, and 18 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2015, selected plan benefit provisions are as follows:

Eligibility Requirements:

- | | |
|-------------------|--|
| Normal Retirement | Age 50 and 20 years of service. |
| Early Retirement | A one-time early retirement window was offered to plan participants who terminate employment between December 1, 2013 and January 1, 2016, and whose sum of age and years of service equal or exceed 60 and who have accumulated at least 12 years of service. |
| Vesting | A member is 100% vested after 12 years of service. |

Retirement Benefit:

Benefit equals 50% of the highest one year's W-2 earnings during the last three years of service preceding retirement, plus a monthly service increment equal to 1/40th of the retirement allowance for each year of service, in excess of 20 years, up to a maximum of \$100 per month.

Survivor Benefit:

- | | |
|-------------------------------|---|
| Before Retirement Eligibility | Refund of member contributions without 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:

Benefit equals 2.5% of final monthly salary times years of service, not to exceed 50% of the member's final monthly salary.

CITY OF LOCK HAVEN POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Inconsistent Member Contribution Provision

Condition: The pension plan’s governing document, Chapter 1, Part 8A, 6B of the city’s codified ordinances, contains a member contribution provision that conflicts with the 2014-2017 collective bargaining agreement between the police officers and the city, as illustrated below:

Benefit Provision	Governing Document	Collective Bargaining Agreement
Member contributions	Each contributor, from and after the effective date of this amendment, shall pay into the retirement fund a monthly sum for the service increment contribution which shall be equal to ½% of his or her salary.	Beginning on January 1, 2012, each employee covered by this contract will contribute towards the police pension fund in the amount of one percent (1%) of his total W-2 salary. This contribution is in addition to any contribution for any other benefits paid under the pension fund, including widow and spouse benefits and longevity benefits.

In addition, the plan’s actuarial valuation report dated January 1, 2015, reported the benefit provisions included in the collective bargaining agreement.

Criteria: A governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. The plan’s governing document and the collective bargaining agreement should contain consistent benefit provisions to ensure the sound administration of retirement benefits.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure the member contribution provision contained in the plan’s governing document was consistent with the collective bargaining agreement.

Effect: Inconsistent member contribution provisions could result in an improper amount of contributions being deducted.

CITY OF LOCK HAVEN POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We recommend that municipal officials take appropriate action to ensure the member contribution provision contained in the plan's governing document and the collective bargaining agreement are consistent at their earliest opportunity to do so.

Management's Response: Municipal officials agreed with the finding without exception.

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

CITY OF LOCK HAVEN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 5 and 6 reflect 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 YEAR ENDED DECEMBER 31, 2014

Total Pension Liability	
Service cost	\$ 118,381
Interest	345,026
Benefit payments, including refunds of member contributions	(357,183)
Net Change in Total Pension Liability	<u>106,224</u>
Total Pension Liability - Beginning	5,383,182
Total Pension Liability - Ending (a)	<u><u>\$ 5,489,406</u></u>
Plan Fiduciary Net Position	
Contributions - employer	\$ 152,210
Contribution – member	10,323
Net investment income	350,170
Benefit payments, including refunds of member contributions	(357,183)
Administrative expense	(19,552)
Net Change in Plan Fiduciary Net Position	<u>135,968</u>
Plan Fiduciary Net Position - Beginning	5,425,919
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 5,561,887</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ (72,481)</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	101.3%
Estimated Covered Employee Payroll	\$ 660,022
Net Pension Liability as a Percentage of Covered Employee Payroll	(10.98%)

CITY OF LOCK HAVEN 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 city as of December 31, 2014, calculated using the discount rate of 6.5%, as well as what the city'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:

	1% Decrease (5.5%)	Current Discount Rate (6.5%)*	1% Increase (7.5%)
Net Pension Liability	\$ 573,578	\$ (72,481)	\$ (610,558)

* This rate differs from the 7.0% used in the plan's January 1, 2015, actuarial valuation report.

SCHEDULE OF INVESTMENT RETURNS

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

2014	6.5%
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CITY OF LOCK HAVEN 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, 2011, 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)
01-01-11	\$ 4,549,639	\$ 4,417,256	\$ (132,383)	103.0%
01-01-13	4,526,703	4,762,090	235,387	95.1%
01-01-15	5,162,314	5,219,864	57,550	98.9%

The market values of the plan's assets at 01-01-11, 01-01-13 and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. 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 LOCK HAVEN 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 LOCK HAVEN POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2010	\$ 50,572	166.3%
2011	140,351	105.0%
2012	156,821	100.0%
2013	155,503	100.0%
2014	145,654	104.5%
2015	191,163	100.0%

CITY OF LOCK HAVEN 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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	4 years
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases *	4.0%
Cost-of-living adjustments	None assumed

* Includes inflation at 2.75%

CITY OF LOCK HAVEN 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 William Baney III
Mayor

Mr. Stephen L. Stevenson
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Mr. Jonathan Bravard
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Mr. Richard W. Marcinkevage
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