

COMPLIANCE AUDIT

City of McKeesport Officers and Employees Pension Plan Allegheny County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

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 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, 2015 to December 31, 2016. 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 conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our 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 audit 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 audit 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 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 the retired individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to the recipient.
- We determined whether the 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, 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.
- 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 objectives, 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 objectives.

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.

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. We would like to thank city officials for the cooperation extended to us during the conduct of the audit.

February 7, 2018



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 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 67 - The Third Class City Code, Act of June 23, 1931 (P.L. 932, No. 317), as amended, 53 P.S. § 35101 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. 2-06, as amended, adopted pursuant to Act 67. 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, 2016, the plan had 5 active members, 1 terminated member eligible for vested benefits in the future, and 49 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2016, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement Age 55 and 20 years of service

Early Retirement None

Vesting 100% after 12 years of service

Retirement Benefit:

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
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

The City of McKeesport has complied with the prior audit recommendations concerning the following:

- Failure To Deposit State Aid Into An Eligible Pension Plan

The city deposited its 2015 state aid allocation, plus interest, into the police pension plan.

- Failure To Pay The Minimum Municipal Obligation Of The Plan

The city paid the 2015 MMO due to the officers and employees pension plan, with interest, in accordance with Act 205 provisions.

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 4 and 5 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	\$ 39,129	\$ 21,304	\$ 21,857
Interest	510,413	519,520	647,180
Change of benefit terms	46,847	-	-
Difference between expected and actual experience	300,933	-	-
Changes of assumptions	321,903	-	-
Benefit payments, including refunds of member contributions	<u>(625,815)</u>	<u>(662,821)</u>	<u>(804,153)</u>
Net Change in Total Pension Liability	593,410	(121,997)	(135,116)
Total Pension Liability - Beginning	<u>7,065,842</u>	<u>7,659,252</u>	<u>7,537,255</u>
Total Pension Liability - Ending (a)	<u>\$ 7,659,252</u>	<u>\$ 7,537,255</u>	<u>\$ 7,402,139</u>
Plan Fiduciary Net Position			
Contributions - employer *	\$ 312,837	\$ -	\$ 736,214
Contributions - member	18,691	18,398	12,615
Net investment income	116,539	(169,729)	297,275
Benefit payments, including refunds of member contributions	<u>(625,815)</u>	<u>(662,821)</u>	<u>(804,153)</u>
Administrative expense	(15,775)	(14,211)	(9,941)
Other	<u>2,459</u>	<u>-</u>	<u>-</u>
Net Change in Plan Fiduciary Net Position	(191,064)	(828,363)	232,010
Plan Fiduciary Net Position - Beginning	<u>5,433,831</u>	<u>5,242,767</u>	<u>4,414,404</u>
Plan Fiduciary Net Position - Ending (b)	<u>\$ 5,242,767</u>	<u>\$ 4,414,404</u>	<u>\$ 4,646,414</u>
Net Pension Liability - Ending (a-b)	<u>\$ 2,416,485</u>	<u>\$ 3,122,851</u>	<u>\$ 2,755,725</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	68.45%	58.57%	62.77%
Estimated Covered Employee Payroll	\$ 433,936	\$ 289,067	\$ 294,869
Net Pension Liability as a Percentage of Covered Employee Payroll	556.88%	1080.32%	934.56%

* Employer contributions for 2016 include 2015 contributions with interest.

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES 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, 2015, and 2016, calculated using the discount rate of 7.90%, 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 (6.90%)	Current Discount Rate (7.90%)	1% Increase (8.90%)
Net Pension Liability - 12/31/14	\$ 2,999,880	\$ 2,416,485	\$ 1,872,405
Net Pension Liability - 12/31/15	\$ 3,696,954	\$ 3,122,851	\$ 2,587,437
Net Pension Liability - 12/31/16	\$ 3,319,536	\$ 2,755,725	\$ 2,229,909

SCHEDULE OF INVESTMENT RETURNS

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

2016	7.82%
2015	-2.98%
2014	2.80%
2013	13.57%
2012	13.40%
2011	0.22%
2010	13.35%
2009	20.03%
2008	-24.96%

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, 2011, is as follows:

	(1)	(2)	(3)	(4)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Liability (b) - (a)	Funded Ratio (a)/(b)
01-01-11	\$ 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%
01-01-15	5,998,352	7,659,252	1,660,900	78.3%

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. The market values of the plan's assets at 01-01-13 and 01-01-15 are valued using the smoothing method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of the 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
2011	\$ 227,440	100.0%
2012	225,162	100.0%
2013	325,477	100.0%
2014	312,837	100.0%
2015	347,697	100.0%
2016	333,343	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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	5 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.9%
Projected salary increases	4.0%

CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
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This report was initially distributed to the following:

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CITY OF MCKEESPORT OFFICERS AND EMPLOYEES PENSION PLAN
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