

COMPLIANCE AUDIT

Forest Hills Borough Non-Uniformed Pension Plan Allegheny County, Pennsylvania For the Period January 1, 2011 to December 31, 2014

June 2015



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 Borough Council
Forest Hills Borough
Allegheny County
Pittsburgh, PA 15221

We have conducted a compliance audit of the Forest Hills Borough Non-Uniformed Pension Plan for the period January 1, 2011 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 finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and 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 finding 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 finding 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 all 3 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 retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to 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.

Forest Hills Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements, for the years ended December 31, 2011, 2012 and 2013, 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 Forest Hills Borough Non-Uniformed 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 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 Forest Hills Borough Non-Uniformed 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 – Failure To Implement Act 44 Mandatory Distressed 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.

The contents of this report were discussed with officials of Forest Hills 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.

May 15, 2015



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 Forest Hills Borough Non-Uniformed 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.

The Forest Hills Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution No. 1087. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established January 1, 1960. Active members are required to contribute 4 percent of compensation to the plan. As of December 31, 2014, the plan had 9 active members, 2 terminated members eligible for vested benefits in the future and 12 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 65 and 10 years of service.
Early Retirement	Age 62 and 10 years of service.
Vesting	A member is 100% vested after 10 years of service.

Retirement Benefit:

Benefit equals 50% of final 36 months average salary.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	None

FOREST HILLS BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

Forest Hills Borough has complied with the prior audit recommendation concerning the following:

- Incorrect Pension Benefit Calculations

During the current audit period, municipal officials recalculated the 2 retirees' pension benefits and adjusted the monthly benefit payments in accordance with the provisions contained in the plan's governing document.

FOREST HILLS BOROUGH NON-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Failure To Implement Act 44 Mandatory Distressed Provisions

Condition: Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

Based on the plan’s funded ratio of 77.8% as of January 1, 2013 in aggregation with the funded ratio of the municipality’s police and non-uniformed management pension plans, the Public Employee Retirement Commission (PERC) issued a notification in 2014 that the borough was in Level II moderate distress status.

Included with the determination notice, PERC sent the municipality the Act 205 Recovery Program Election Form outlining the mandatory remedies that must be implemented and the voluntary remedies that the municipality could elect to implement. This form was required to be signed by the plan’s Chief Administrative Officer and returned to PERC.

Although the municipality submitted the election form to PERC, as of the date of this audit report, the borough has not complied with the mandatory remedies applicable to Level II.

Criteria: Act 205, amended by Act 44, at Section 605(a), states:

Recovery program level II.

- (a) Mandatory remedies. Any municipality to which level II of the recovery program applies shall utilize the following remedies:
 - (1) The aggregation of trust funds pursuant to section 607(b).
 - (2) The submission of a plan for administrative improvement pursuant to section 607(i).

Cause: Municipal officials failed to establish adequate internal control procedures to ensure that the mandatory distress remedies have been implemented.

Effect: The municipality is not in compliance with the Act 44 mandatory distress remedy provisions applicable to Level II which are designed to improve the funding status and administrative efficiency of its pension plans.

FOREST HILLS BOROUGH NON-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We recommend that municipal officials contact PERC for guidance in the implementation of the mandatory distress remedies applicable to Level II pursuant to Act 44 of 2009.

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

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

FOREST HILLS BOROUGH NON-UNIFORMED 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)	(5)	(6)
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)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-09	\$ 2,164,175	\$ 2,297,478	\$ 133,303	94.2%	\$ 686,053	19.4%
01-01-11	2,065,958	2,618,848	552,890	78.9%	656,942	84.2%
01-01-13	1,864,750	2,396,713	531,963	77.8%	549,884	96.7%

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses at 130% of market value. 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 5-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.

FOREST HILLS BOROUGH NON-UNIFORMED 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.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

FOREST HILLS BOROUGH NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2009	\$ 22,050	100.0%
2010	27,896	100.0%
2011	62,383	100.0%
2012	55,433	100.0%
2013	97,596	100.0%
2014	101,623	100.0%

FOREST HILLS BOROUGH NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the required 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	13 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases *	4.5%

* Includes inflation at 3.0%

FOREST HILLS BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Forest Hills Borough Non-Uniformed Pension Plan
Allegheny County
2071 Ardmore Boulevard
Pittsburgh, PA 15221

The Honorable Frank Porco	Mayor
Mr. Markus Erbedinger	Council President
Mr. Steven Morus	Borough Manager
Ms. Wendelin Archer	Treasurer

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, 231 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.