

COMPLIANCE AUDIT

City of Hermitage Police Pension Plan Mercer County, Pennsylvania For the Period January 1, 2013 to December 31, 2014

September 2015



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

Board of Commissioners
City of Hermitage
Mercer County
Hermitage, PA 16148

We have conducted a compliance audit of the City of Hermitage Police 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 conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our 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 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.

The City of Hermitage 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 Hermitage 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 Hermitage Police 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 Hermitage and, where appropriate, their responses have been included in the report.

August 28, 2015

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale". The signature is fluid and cursive, with a long horizontal stroke at the end.

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 Hermitage Police 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 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1158, No. 177), as amended, 53 Pa.C.S. § 101 et seq.

Act 317 - 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 Hermitage Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2-2009, as amended. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established January 1, 1958. Active members hired prior to January 1, 2001, are required to contribute 3.5 percent of compensation to the plan. Active members hired on or after January 1, 2001, but before December 1, 2001, are required to contribute 3.5 percent of salary plus \$1 per month to the plan. All other active members hired on or after December 1, 2001, are required to contribute 5 percent of salary plus \$1 per month to the plan. As of December 31, 2014, the plan had 27 active members, 2 terminated members eligible for vested benefits in the future and 23 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions for members hired prior to January 1, 2001, are as follows:

Eligibility Requirements:

Normal Retirement	Age 55 and 25 years of service
Early Retirement	A voluntary early retirement is available after 24 years of service. An involuntary early retirement is available after 8 years of service.
Vesting	Member is vested 100% after 10 years of service.

Retirement Benefit:

Benefit equals 65% of final 36 months average compensation, plus a service increment equal to 1/40th of the retirement allowance for each year of service in excess of 25, up to a maximum of \$100 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.

Disability Benefit:

Service Related	Benefit equals 50% of final 36 months average compensation at the time the disability was incurred, offset by any benefits payable under the provisions of the Pennsylvania Workmen's Compensation Act or the Pennsylvania Occupational Disease Act, received for the same injury.
Non-Service Related	Available after 10 years of service, a benefit equal to 30% of final 36 months average compensation at the time the disability was incurred, offset by any benefits payable under the provisions of the Pennsylvania Workmen's Compensation Act or the Pennsylvania Occupational Disease Act, received for the same injury.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions for members hired on or after January 1, 2001, are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 20 years of service
Early Retirement	None
Vesting	None

Retirement Benefit:

Benefit equals 50% of greater of final 60 months average salary or monthly salary at retirement, plus a service increment equal to 1/40th of the retirement allowance for each year of service in excess of 20, 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 50% of greater of final 60 months average salary or monthly salary at retirement.

CITY OF HERMITAGE POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

The supplementary information contained on Pages 4 through 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
 DECEMBER 31, 2014

Total Pension Liability	
Service cost	\$ 366,676
Interest	906,217
Benefit payments, including refunds of member contributions	(778,326)
Net Change in Total Pension Liability	<u>494,567</u>
Total Pension Liability – Beginning	13,480,360
Total Pension Liability - Ending (a)	<u><u>\$ 13,974,927</u></u>
Plan Fiduciary Net Position	
Contributions – employer	\$ 308,849
Contributions – member	78,818
Net investment income	752,780
Benefit payments, including refunds of member contributions	(778,326)
Administrative expense	(7,117)
Net Change in Plan Fiduciary Net Position	<u>355,004</u>
Plan Fiduciary Net Position - Beginning	15,064,163
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 15,419,167</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ (1,444,240)</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	110%
Estimated Covered Employee Payroll	\$ 1,888,731
Net Pension Liability as a Percentage of Covered Employee Payroll	(76%)

CITY OF HERMITAGE 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's police pension plan, calculated using the discount rate of 6.75%, as well as what the plan'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 (5.75%)	Current Discount Rate (6.75%)	1% Increase (7.75%)
Net Pension Liability	\$ (254,510)	\$ (1,444,240)	\$ (2,865,778)

SCHEDULE OF CONTRIBUTIONS
 DECEMBER 31, 2014

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered- Employee Payroll	Contributions as a Percentage of Covered- Employee Payroll
2005	\$ 227,472	\$ 227,472	\$ -	\$ 1,577,936	14.42%
2006	235,252	235,252	-	1,616,864	14.55%
2007	205,483	205,483	-	1,611,599	12.75%
2008	237,048	237,048	-	1,664,498	14.24%
2009	233,407	233,407	-	1,908,227	12.23%
2010	246,344	246,344	-	1,968,877	12.51%
2011	352,115	352,115	-	1,907,368	18.46%
2012	334,973	334,973	-	1,977,759	16.94%
2013	333,128	333,128	-	1,913,814	17.41%
2014	308,849	308,849	-	1,898,008	16.27%

The City met its Act 205 funding requirements (MMO) for the years covered by the current audit period.

CITY OF HERMITAGE POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF ESTIMATED RATES OF RETURN ON PENSION PLAN INVESTMENTS
DECEMBER 31, 2014

<u>Year</u>	<u>Estimated Annual Return, Net of Investment Expenses</u>
2005	6.8%
2006	13.5%
2007	3.0%
2008	(25.8%)
2009	30.7%
2010	17.0%
2011	(2.6%)
2012	14.4%
2013	22.8%
2014	5.1%

CITY OF HERMITAGE 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, 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	\$ 10,698,115	\$ 11,015,000	\$ 316,885	97.1%
01-01-11	11,467,437	11,665,318	197,881	98.3%
01-01-13	11,903,577	12,040,108	136,531	98.9%

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 percent 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 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 HERMITAGE 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 HERMITAGE 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, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	8 years
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return *	7.5%
Projected salary increases	4.33%
Cost-of-living adjustments	None assumed

* Includes inflation at 2.5%

CITY OF HERMITAGE POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

City of Hermitage Police Pension Plan
Mercer County
800 North Hermitage Road
Hermitage, PA 16148

Mr. Timothy J. Ruffo	President, Board of Commissioners
Mr. Gary Hinkson	City Manager
Ms. Rachael Manuel	Finance and Technology Administrator

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