COMPLIANCE AUDIT

City of Hermitage Non-Uniformed 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

COUNCIL 90 AFSCME UNION LABEL

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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 Non-Uniformed 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 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 all 4 of the plan members who retired during the current audit period, and through the completion of our fieldwork procedures, 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 also determined whether retirement benefits calculated for the 2 plan members who elected to vest during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the pension benefit due to retired individuals and comparing these amounts to supporting documentation evidencing amounts determined.

- × 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.

- × We determined whether the terms of the contractual agreement with the Pennsylvania Municipal Retirement System were in accordance with the plan's governing document, if separately stated, and applicable laws and regulations by comparing the terms of the contractual agreement with the plan's governing document, if separately stated, and applicable laws and regulations.

The City of Hermitage Non-Uniformed Pension Plan participates in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's 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 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 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 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 – Incorrect Pension Benefit Calculation

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

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 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 including, but not limited to, the following:

Act 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974 (P.L. 34, No. 15), as amended, 53 P.S. § 881.101 et seq.

The City of Hermitage Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 4-2009, adopted pursuant to Act 15. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established July 1, 1970. Active members hired prior to May 1, 2010, are required to contribute 3.5 percent of compensation to the plan. Active members hired on or after May 1, 2010, are required to contribute 5 percent of compensation to the plan. As of December 31, 2014, the plan had 65 active members, 4 terminated members eligible for vested benefits in the future, and 34 retirees receiving pension benefits funded through annuities purchased with plan assets.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Available upon attainment of age 60 and 10 years of credited service.
Early Retirement	A voluntary early retirement available after 24 years of service. An involuntary early retirement is available after 8 years of service.
Vesting	A member is 100% vested after 10 years of service.

Retirement Benefit:

Benefit equals 2.0% times credited service times Final Average Salary (FAS), up to a maximum of 50%. FAS based upon highest 3 consecutive years annualized salary.

If hired prior to May 1, 1994, the greater of: 2.0% times credited service, times highest 3 consecutive years annualized salary, up to a maximum of 50%; or 1.25% times credited service, times highest 5 years average salary, with no maximum.

Survivor Benefit:

If eligible to retire at the time of death, beneficiary receives present value of accrued benefit. At retirement, member may select a survivor benefit.

Disability Benefit:

Service Related	Benefit equals 50% of member's final salary, offset by available Workers' Compensation benefits.
Non-Service Related	Benefit equals 30% of member's final salary, provided that the member has at least 10 years of service.

CITY OF HERMITAGE NON-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Incorrect Pension Benefit Calculation

Condition: A member of the pension plan hired October 26, 1971 who retired on October 7, 2013, with 41.89 years of service, had her pension benefit incorrectly determined by PMRS. The benefit was calculated using Sections 3 and 4 of the plan's agreement with PMRS, instead of Section 16 of the agreement.

Criteria: Section 3 of the agreement states:

> The basic annual benefit shall be equal to two percent (2%) of the member's final salary multiplied by all years of credited service. Provided however, in no event shall the basic benefit exceed fifty percent (50%) of the member's final salary.

Section 4 of the agreement states, in part:

> The final salary shall be the average annual compensation earned and paid during the member's highest three (3) consecutive years of employment….

Section 16 of the agreement provides that for members hired prior to May 1, 1994, the benefit authorized in the PMRS agreement of October 8, 1978 shall be deemed applicable if the benefit so accrued to the member is greater in value at the time of separation.

The October 8, 1978 agreement at Section 3 states, in part:

> The basic monthly pension benefit shall be computed in accordance with the formula of one-eightieth (1/80) multiplied by the highest five (5) year average salary multiplied by the employee's years of service or fraction thereof ….

Effect: The current monthly pension benefit being received by the retiree, calculated using the incorrect provision is less than authorized under the plan document.

Cause: PMRS failed to recognize Section 16 of the agreement when calculating the pension benefit and the error was not ultimately identified prior to our audit.

Recommendation: We recommend that the pension benefit be recalculated and adjusted accordingly. We also recommend that retroactive payments of benefits due be made to the retiree.

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 HERMITAGE 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)
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	$ 11,681,103	$ 11,879,845	$ 198,742	98.3%
01-01-11	12,963,054	13,189,676	226,622	98.3%
01-01-13	14,601,041	15,300,060	699,019	95.4%

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 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	$ 248,290	100.0%
2010	252,360	100.0%
2011	247,913	100.0%
2012	246,425	100.0%
2013	233,138	100.0%
2014	227,512	100.0%

CITY OF HERMITAGE 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	10 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	5.5%, net of expenses
Projected salary increases *	Age-related scale for merit/ seniority (e.g. age 30 - 6.4%; age 40 - 5.0%; age 50 - 4.1%; age 60 - 3.7%)
Cost-of-living adjustments	3.0%, where applicable

* Includes inflation at 3.0%

CITY OF HERMITAGE NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

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Mr. Timothy J. Ruffo	President, Board of Commissioners
Mr. Gary Hinkson	City Manager
Ms. Rachael Manuel	Finance and Technology Administrator
Ms. Kristine M. Cline	Pennsylvania Municipal Retirement System

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