

# COMPLIANCE AUDIT

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## City of Lock Haven Employees' Retirement Fund Clinton County, Pennsylvania For the Period January 1, 2016 to December 31, 2017

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October 2018



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 Employees' Retirement Fund for the period January 1, 2016 to December 31, 2017. 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 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 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 total 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 5 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 the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients. We also determined whether retirement benefits calculated for the plan member 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 benefits due to the retired individual and comparing these amounts to supporting documentation evidencing amounts determined.
- We determined whether the January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2016 and 2018, 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 annual audit of its basic financial statements for the year ended December 31, 2016, 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 Lock Haven Employees' Retirement Fund 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 Lock Haven Employees' Retirement Fund 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 – Awarding of Professional Services Contract Inconsistent With Provisions of Act 205

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 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.

September 24, 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 Lock Haven Employees' Retirement Fund 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 Employees' Retirement Fund is a single-employer defined benefit pension plan locally controlled by the provisions of Chapter 1, Part 8B of the city's codified ordinances. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established February 1, 1966. Active members are required to contribute 6 percent of salary to the plan. As of December 31, 2017, the plan had 36 active members, 2 terminated members eligible for vested benefits in the future, and 33 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2017, selected plan benefit provisions are as follows:

### Eligibility Requirements:

- |                   |  |
|-------------------|--|
| Normal Retirement | Age 65 and 10 years of continuous service.         |
| Early Retirement  | Age 50 and 10 years of continuous service.         |
| Vesting           | A member is 100% vested after 10 years of service. |

### Retirement Benefit:

Benefit equals 1.8% of average monthly earnings times years of service. Average monthly earnings are based on the highest 5 consecutive years of earnings out of the 10 years prior to retirement.

### Survivor Benefit:

- |                               |   |
|-------------------------------|---|
| Before Retirement Eligibility | Return of member contributions plus interest.   |
| After Retirement Eligibility  | The normal form of benefit is a life annuity. A survivor benefit may be selected at the time of retirement. |

### Service Related Disability Benefit:

None

CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND  
FINDING AND RECOMMENDATION

**Finding – Awarding of Professional Services Contract Inconsistent With Provisions of Act 205**

**Condition:** In 2016, the city changed investment and advisory services contractors for the city's pension plans. However, there was no substantive evidence provided to support that the change in service providers was conducted in accordance with the provisions of Act 205 and that the change was approved by City Council.

**Criteria:** Section 701-A of Act 205, defines a "Professional Services Contract", as follows:

"Professional services contract." A contract to which the municipal pension system is a party that is:

- (1) for the purchase or provision of professional services, including investment services, legal services, real estate services and other consulting services; and
- (2) not subject to a requirement that the lowest bid be accepted.

In addition, Section 702-A (a) of Act 205 states in part:

Each municipal pension system ... shall develop procedures to select the most qualified person to enter into a professional services contract. The procedures shall ensure that the availability of a professional services contract is advertised to potential participants in a timely and efficient manner. Procedures shall include applications and disclosure forms to be used to submit a proposal for review and to receive the award of a professional services contract

Additionally, Section 702-A (c), (e), (f), and (h) state, in part:

**Review.** Procedures to select the most qualified person shall include a review of the person's qualifications, experience and expertise and the compensation to be charged.

**Conflict of interest** – The municipal pension system shall adopt policies relating to potential conflicts of interest in the review of a proposal or the negotiation of a contract.

**Public information.** Following the award of a professional services contract, all applications and disclosure forms shall be public except for proprietary information or other information protected by law.



CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

**Notice and summary.** The relevant factors that resulted in the award of the professional services contract must be summarized in a written statement to be included in or attached to the documents awarding the contract. Within ten days of the award of the professional services contract, the original application, a summary of the basis for the award and all required disclosure forms must be transmitted to all unsuccessful applications and posted on the municipal pension system's Internet website, if an Internet website is maintained, at least seven days prior to the execution of the professional services contract.

Section 703-A (c) states in part:

Upon the advertisement for a professional services contract by the municipal pension system, the contractor may not cause or agree to allow a third party to communicate with officials or employees of the municipal pension system except for requests for technical clarification.

Furthermore, Resolution No. 1192, enacted by the city March 4, 2013, established procedures for the procurement of professional services for the municipal pension system in accordance with Act 205 provisions.

Cause: Plan officials failed to establish adequate procedures to properly follow and document adherence with each requirement prescribed under the provisions of Act 205 and its own procurement procedures in the awarding of the professional services contract for the investment and advisory services for the city's pension plans.

Effect: We were unable to determine whether the city complied in all respects with the provisions stipulated in Act 205 and its own governing policies and procedures for the procuring of professional investment and advisory services for the city's pension plans. Also, by failing to maintain appropriate substantive supporting documentation evidencing adherence with each requirement prescribed under Act 205 and the city's own procedures in the awarding of the professional services contract, it denotes a general lack of overall transparency of the actions taken by plan officials relative to the awarding of the investment and advisory services contract for the city's pension plans.

CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Recommendation: We recommend the city follow procedures developed and implemented by the city in Resolution No. 1192 of 2013 for the procurement of professional services for the city's pension plans and ensure compliance with Act 205 provisions while maintaining appropriate and sufficient supporting documentation. This documentation should evidence every phase of the process in accordance with the city's policies and procedures in the awarding of future professional services contracts for the city's pension plans.

In addition, since we were unable to conclude whether the city complied in all respects with the provisions stipulated in Act 205 and its own governing policies and procedures relative to the procurement of the professional investment and advisory services for the city's pension plans awarded in 2016, we recommend that plan officials, along with current city officials, collectively review the process and familiarize themselves with the procedures enacted by the city while closely examining and identifying ways to improve the process as a whole, thus ensuring transparency for plan members as well as the citizens of the City of Lock Haven and the avoidance of any confusion pertaining to the proper administration of the city's pension plans.

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

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

CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 NOTES TO SUPPLEMENTARY SCHEDULES  
 (UNAUDITED)

The supplementary information contained on Pages 5 through 8 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	\$ 162,495	\$ 149,426	\$ 140,324
Interest	378,253	397,860	430,829
Difference between expected and actual experience	-	(62,327)	-
Changes of assumptions	-	260,629	-
Benefit payments, including refunds of member contributions	<u>(242,392)</u>	<u>(212,166)</u>	<u>(243,735)</u>
Net Change in Total Pension Liability	298,356	533,422	327,418
Total Pension Liability - Beginning	<u>5,788,070</u>	<u>6,086,426</u>	<u>6,619,848</u>
Total Pension Liability - Ending (a)	<u><u>\$ 6,086,426</u></u>	<u><u>\$ 6,619,848</u></u>	<u><u>\$ 6,947,266</u></u>
Plan Fiduciary Net Position			
Contributions – employer	\$ 103,387	\$ 138,657	\$ 110,577
Contributions – member	84,254	81,381	86,666
Net investment income	347,838	(28,143)	407,095
Benefit payments, including refunds of member contributions	<u>(242,392)</u>	<u>(212,166)</u>	<u>(243,735)</u>
Administrative expense	<u>(9,903)</u>	<u>(13,913)</u>	<u>(14,775)</u>
Net Change in Plan Fiduciary Net Position	283,184	(34,184)	345,828
Plan Fiduciary Net Position - Beginning	<u>5,802,108</u>	<u>6,085,292</u>	<u>6,051,108</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 6,085,292</u></u>	<u><u>\$ 6,051,108</u></u>	<u><u>\$ 6,396,936</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 1,134</u></u>	<u><u>\$ 568,740</u></u>	<u><u>\$ 550,330</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	99.98%	91.41%	92.08%
Estimated Covered Employee Payroll	\$ 1,520,906	\$ 1,550,266	\$ 1,644,670
Net Pension Liability as a Percentage of Covered Employee Payroll	0.07%	36.69%	33.46%

CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 NOTES TO SUPPLEMENTARY SCHEDULES  
 (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 then 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 - 12/31/14	\$ 697,020	\$ 1,134	\$ (596,700)
Net Pension Liability - 12/31/15	\$ 1,351,107	\$ 568,740	\$ (93,361)
Net Pension Liability - 12/31/16	\$ 1,348,917	\$ 550,330	\$ (129,378)

\* This rate differs from the 7.0% used in the plan's January 1, 2015 and January 1, 2017, actuarial valuation reports.

CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
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 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered- Employee Payroll	Contributions as a Percentage of Covered- Employee Payroll
2008	\$ 10,313	\$ 10,645	\$ (332)	\$1,464,870	0.73%
2009	7,926	7,926	-	1,460,194	0.54%
2010	12,320	139,098	(126,778)	1,429,000	9.73%
2011	87,184	91,485	(4,301)	1,521,800	6.01%
2012	90,931	90,931	-	1,526,250	5.96%
2013	86,957	86,957	-	1,374,000	6.33%
2014	91,331	103,387	(12,056)	1,520,906	6.80%
2015	138,657	138,657	-	1,550,266	8.94%
2016	110,388	110,577	(189)	1,644,670	6.72%
2017	118,809	118,809	-	*	*

\* Due to the timing of this audit, covered-employee payroll for 2017 was not provided in this schedule.

SCHEDULE OF INVESTMENT RETURNS

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

2016	6.8%
2015	(0.6%)
2014	6.5%

CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
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 (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, 2013, 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)
01-01-13	\$ 4,752,868	\$ 5,133,350	\$ 380,482	92.6%
01-01-15	5,745,356	5,934,083	188,727	96.8%
01-01-17	6,516,877	6,440,650	(76,227)	101.2%

Note: The market values of the plan's assets at 01-01-13, 01-01-15, and 01-01-17 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. This method 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 EMPLOYEES' RETIREMENT FUND PENSION PLAN  
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(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 EMPLOYEES' RETIREMENT FUND PENSION PLAN  
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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, 2017
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	None
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 2.5%



CITY OF LOCK HAVEN EMPLOYEES' RETIREMENT FUND PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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