

CITY OF MCKEESPORT POLICE PENSION PLAN

ALLEGHENY COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2009, TO DECEMBER 31, 2010



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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.

Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign 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 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 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 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 McKeesport Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 06-11, as amended, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers.



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 Police Pension Plan for the period January 1, 2009, to December 31, 2010. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings 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. 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 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 objectives, and assessed whether those significant controls were properly designed and implemented. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the City of McKeesport Police 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 findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation –
Incorrect Data On Certification Form AG 64 Resulting In An
Underpayment Of Reimbursement For The Special 2002 Ad
Hoc Postretirement Adjustment

Finding No. 2 – Pension Benefits Modified Without Prior Cost Estimate

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information 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.

November 29, 2011

JACK WAGNER
Auditor General

CITY OF MCKEESPORT POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

The City of McKeesport has not complied with the prior audit recommendation concerning the following as further discussed in the Findings and Recommendations section of this report:

- Incorrect Data On Certification Form AG 64 Resulting In An Underpayment Of Reimbursement For The Special 2002 Ad Hoc Postretirement Adjustment

CITY OF MCKEESPORT POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 64 Resulting In An Underpayment Of Reimbursement For The Special 2002 Ad Hoc Postretirement Adjustment

Condition: As disclosed in the prior audit report, the city submitted incorrect data on the 2008 and 2009 Certification Forms AG 64 which resulted in an underpayment of reimbursement for the special 2002 ad hoc postretirement adjustment. In 2010 and 2011, the city again submitted incorrect data on the Certification Forms AG 64 which resulted in an underpayment of reimbursement for the special 2002 ad hoc postretirement adjustment. The city understated the total non-employee contributions made to all pension plans because the amounts certified did not include the bond debt payments made during the immediate prior year.

Criteria: Section 502.1(a)(2) of Act 147 states, in part:

The determination of the reimbursable amount of the amortization contribution requirement attributable to the special ad hoc postretirement adjustment under Chapter 4 in any year shall be calculated as the amortization contribution requirement attributable to the special ad hoc postretirement adjustments under Chapter 4 and reflected in the determination of the financial requirements of the pension plan under Chapter 3 of the Municipal Pension Plan Funding Standard and Recovery Act for the immediate prior year less the product of that amortization contribution requirement multiplied by the ratio of the amount of general municipal pension system State aid allocated to the retirement system in the immediate prior year to the total amount of municipal contributions made to the retirement system from all sources other than employee contributions in the immediate prior year.

In addition, Section 502.1(b) of Act 147 states:

Limitation of eligibility –

(1) The Commonwealth shall not reimburse any municipality for a special ad hoc adjustment paid under Chapter 4 if the information required under section 901(a)(2) either was not certified to the Auditor General or was certified after April 1 of the year the certification was due.

(2) The Commonwealth shall not reimburse a municipality for the reimbursable amount of the amortization contribution requirement attributable to the special ad hoc postretirement adjustment under Chapter 4 if the municipality fails to submit a complete certification of the reimbursable amount of the amortization contribution requirement determined under subsection (a) to the Auditor General before April 1 of the year in which the reimbursement is payable.

CITY OF MCKEESPORT POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Consequently, the city is not eligible to receive an additional reimbursement due to their certification errors since all data must be certified accurately prior to April 1 of the year in which the reimbursement is payable.

Cause: City officials failed to adopt adequate internal control procedures to ensure compliance with the prior audit recommendation.

Effect: The data submitted on these certification forms is used to calculate the reimbursement due the city for ad hoc postretirement adjustments granted pursuant to Chapter 4 of Act 147. The effect of the incorrect certification of pension data on the city’s reimbursements is identified below:

<u>Year</u>	<u>Reimbursement Received</u>	<u>Reimbursement Due</u>	<u>Reimbursement Underpayment</u>
2010	\$ 13,101	\$ 20,282	\$ 7,181
2011	\$ 13,980	\$ 20,683	<u>\$ 6,703</u>
		Total	<u><u>\$ 13,884</u></u>

Therefore, the total amount of the eligible reimbursements were not available to pay operating expenses or for investment.

Recommendation: We again recommend that, in the future, city officials comply with the instructions that accompany Certification Form AG 64 to assist them in accurately reporting the required pension data.

Management’s Response: City officials agreed with the finding without exception.

Finding No. 2 – Pension Benefits Modified Without Prior Cost Estimate

Condition: The city increased pension benefits for its police pension plan members without a cost estimate of the effect of the increase on the plan, as required by Act 205. On October 2, 2009, the city adopted Ordinance No. 09-19, which increased the service increment to \$500 per month for members who retired by January 1, 2010. In addition, the most recent collective bargaining agreement between the city and its police officers provides for a survivor benefit to be paid to the surviving spouse in the amount of 100% of the participant’s accrued benefit.

CITY OF MCKEESPORT POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Criteria: Section 305(a) of Act 205 states:

Prior to the adoption of any benefit plan modification by the governing body of the municipality, the chief administrative officer of each pension plan shall provide to the governing body of the municipality a cost estimate of the effect of the proposed benefit plan modification.

Furthermore, Section 305(b) of Act 205 states, in part:

If the pension plan is a defined benefit plan which is self-insured in whole or in part, the cost estimate shall be prepared by an approved actuary. . . .

Cause: Plan officials failed to establish adequate internal control procedures to ensure that the cost of the benefit modifications was determined in accordance with Act 205 requirements.

Effect: The city has obligated itself to pay for benefit increases without having adequate documentation to support the cost of the amended benefit provisions.

Recommendation: We recommend that the chief administrative officer of the pension plan ensure that the increased pension benefits already granted are included in the plan's next actuarial valuation report. We also recommend that all future benefit modifications be preceded by a cost estimate prepared in accordance with Act 205 provisions.

Management's Response: City officials agreed with the finding without exception.

CITY OF MCKEESPORT 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, 2005, 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)]
01-01-05	\$ 7,791,293	\$ 11,588,270	\$ 3,796,977	67.2%	\$ 2,332,527	162.8%
01-01-07	10,082,775	13,191,683	3,108,908	76.4%	2,604,781	119.4%
01-01-09	9,658,509	13,330,478	3,671,969	72.5%	2,654,475	138.3%

Note: The market values of the plan's assets at 01-01-05 and 01-01-07 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 70 to 130 percent of the market value of 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 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.

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. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF MCKEESPORT POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2005	\$ 190,714	100.0%
2006	173,568	100.0%
2007	346,346	100.0%
2008	357,626	100.0%
2009	600,569	100.0%
2010	607,030	100.0%

CITY OF MCKEESPORT POLICE 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, 2009
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	12 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 70-130% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	4.0%

CITY OF MCKEESPORT POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of McKeesport Police Pension Plan
Allegheny County
500 5th Avenue
McKeesport, PA 15132

The Honorable Regis T. McLaughlin	Mayor
Mr. Dennis K. E. Pittman	City Administrator
Ms. Samantha Coddington	Deputy Finance Director

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.