

COMPLIANCE AUDIT

City of Hermitage Non-Uniformed Pension Plan Mercer County, Pennsylvania For the Period January 1, 2017 to December 31, 2018

January 2020



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



**Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov**

**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, 2017 to December 31, 2018. 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 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 six 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 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.
- 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.

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. We would like to thank city officials for the cooperation extended to us during the conduct of the audit.

December 10, 2019



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 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 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. 06-2015, adopted pursuant to Act 15, effective July 1, 2015. The plan is also affected by the provisions of collective bargaining agreements between the city and its municipal 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, 2018, the plan had 69 active members, 2 terminated members eligible for vested benefits in the future, and 44 retirees receiving benefits funded through annuities purchased with plan assets.

BACKGROUND – (Continued)

As of December 31, 2018, 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 is 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 final 3 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 average 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
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 3 through 6 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 AND 2015

	<u>2014</u>	<u>2015</u>
Total Pension Liability		
Service cost	\$ 367,369	\$ 383,905
Interest	888,007	926,593
Difference between expected and actual experience	(25,504)	-
Changes of assumptions	-	176,757
Benefit payments, including refunds of member contributions	(498,730)	(592,228)
Net Change in Total Pension Liability	<u>731,142</u>	<u>895,027</u>
Total Pension Liability – Beginning	16,024,246	16,755,388
Total Pension Liability – Ending (a)	<u>\$ 16,755,388</u>	<u>\$ 17,650,415</u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 227,632	\$ 325,010
Contributions – PMRS assessment	-	2,120
Contributions – member	123,895	134,933
PMRS investment income	817,563	846,045
Market value investment income	87,712	(945,687)
Benefit payments, including refunds of member contributions	(498,730)	(592,228)
PMRS administrative expense	(2,060)	(2,120)
Additional administrative expense	(31,354)	(35,270)
Net Change in Plan Fiduciary Net Position	<u>724,658</u>	<u>(267,197)</u>
Plan Fiduciary Net Position – Beginning	14,980,556	15,705,214
Plan Fiduciary Net Position – Ending (b)	<u>\$ 15,705,214</u>	<u>\$ 15,438,017</u>
Net Pension Liability – Ending (a-b)	<u>\$ 1,050,174</u>	<u>\$ 2,212,398</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	93.73%	87.47%
Estimated Covered Employee Payroll	\$ 3,445,770	\$ 3,590,322
Net Pension Liability as a Percentage of Covered Employee Payroll	30.48%	61.62%

CITY OF HERMITAGE NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2017

	<u>2016</u>	<u>2017</u>
Total Pension Liability		
Service cost	\$ 320,411	\$ 355,441
Interest	970,820	989,082
Difference between expected and actual experience	93,959	-
Changes of assumptions	464,641	-
Transfers	6,105	-
Benefit payments, including refunds of member contributions	(653,879)	(746,056)
Net Change in Total Pension Liability	<u>1,202,057</u>	<u>598,467</u>
Total Pension Liability – Beginning	<u>17,650,415</u>	<u>18,852,472</u>
Total Pension Liability – Ending (a)	<u><u>\$ 18,852,472</u></u>	<u><u>\$ 19,450,939</u></u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 337,125	\$ 341,302
Contributions – PMRS assessment	2,160	2,240
Contributions – member	130,421	136,000
PMRS investment income	909,558	911,531
Market value investment income	539,678	1,963,683
Transfers	6,105	-
Benefit payments, including refunds of member contributions	(653,879)	(746,056)
PMRS administrative expense	(2,100)	(2,160)
Additional administrative expense	(44,560)	(41,920)
Net Change in Plan Fiduciary Net Position	<u>1,224,508</u>	<u>2,564,620</u>
Plan Fiduciary Net Position – Beginning	<u>15,438,017</u>	<u>16,662,525</u>
Plan Fiduciary Net Position – Ending (b)	<u><u>\$ 16,662,525</u></u>	<u><u>\$ 19,227,145</u></u>
Net Pension Liability – Ending (a-b)	<u><u>\$ 2,189,947</u></u>	<u><u>\$ 223,794</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	88.38%	98.85%
Estimated Covered Employee Payroll	\$ 3,445,068	\$ 3,487,094
Net Pension Liability as a Percentage of Covered Employee Payrolls	63.57%	6.42 %

CITY OF HERMITAGE NON-UNIFORMED 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 as of December 31, 2014 and 2015, calculated using the discount rate of 5.50%, 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:

	<u>1% Decrease (4.50%)</u>	<u>Current Discount Rate (5.50%)</u>	<u>1% Increase (6.50%)</u>
Net Pension Liability – 12/31/14	\$ 2,862,667	\$ 1,050,174	\$ (515,449)
Net Pension Liability – 12/31/15	\$ 4,124,904	\$ 2,212,398	\$ 570,820

In addition, the following presents the net pension liability of the city as of December 31, 2016 and 2017, calculated using the discount rate of 5.25%, 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:

	<u>1% Decrease (4.25%)</u>	<u>Current Discount Rate (5.25%)</u>	<u>1% Increase (6.50%)</u>
Net Pension Liability – 12/31/16	\$ 4,232,884	\$ 2,189,947	\$ 430,515
Net Pension Liability – 12/31/17	\$ 2,331,584	\$ 223,974	\$ (1,591,491)

CITY OF HERMITAGE NON-UNIFORMED PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (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
2014	\$ 227,512	\$ 227,632	\$ (120)	\$3,445,770	6.61%
2015	327,030	327,130	(100)	3,590,322	9.11%
2016	339,222	339,285	(63)	3,445,068	9.85%
2017	343,465	343,542	(77)	3,487,094	9.85%
2018	343,612	343,732	(120)	*	

* Due to the timing of this audit, covered-employee payroll for 2018 was not provided in this schedule.

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, 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	\$ 14,601,041	\$ 15,300,060	\$ 699,019	95.4%
01-01-15	16,025,160	16,755,388	730,228	95.6%
01-01-17	17,865,094	18,852,472	987,378	94.8%

CITY OF HERMITAGE 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.

CITY OF HERMITAGE NON-UNIFORMED 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, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	7 years
Asset valuation method	The Actuarial Value of Assets equals the plan's member, municipal, DROP (if applicable) reserve accounts plus the retiree actuarial liability. This asset smoothing is based on the unique legislative structure of PMRS and the administrative rules adopted by the PMRS Board in conjunction with Pennsylvania Municipal Retirement Law, all of which are subject to comply with the Actuarial Standards of Practice No. 44, Selection and Use of Asset Valuation Methods when defining the actuarial Value of Assets.
Actuarial assumptions:	
Investment rate of return	5.25%, compounded annually, net of investment and administration expenses.
Salary scale	Total rate (including inflation) (e.g. age 25 – 7.05%; age 35 – 4.55%; age 45 – 3.97%; age 55 – 3.44%; age 65 – 2.80%).
Cost-of-living adjustments	2.8% per year, subject to plan limitations.

CITY OF HERMITAGE NON-UNIFORMED PENSION PLAN
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