COMPLIANCE AUDIT

City of McKeesport Combined Pension Plan

Allegheny County, Pennsylvania

For the Period

January 1, 2017 to December 31, 2018

July 2019

EUGENE A. DEPASQUALE • AUDITOR GENERAL •

Commonwealth of Pennsylvania
Department of the Auditor General

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

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 Combined 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 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 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 both 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 also determined whether the retirement benefit calculated for the lone 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 benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined.

- We determined whether the January 1, 2017 actuarial valuation report was prepared and submitted by March 31, 2018 in accordance with Act 205 and whether selected information provided on this report 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 pension plan is in compliance with Act 205 for distressed municipalities through inquiry of plan officials and evaluation of the recovery remedies implemented during the audit period and through the completion of our fieldwork procedures.

- We determined whether the terms and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation.

- We determined whether provisions of the Deferred Retirement Option Plan (DROP) were in accordance with the provisions of Act 205 by examining provisions stated in the plan's governing documents.

The City of McKeesport contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year 2017, which is available at the city's offices. These 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 Combined 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 McKeesport Combined 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 Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

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 McKeesport 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.

July 23, 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 McKeesport Combined 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

Act 67 - The Third Class City Code, Act of November 24, 2015 (P.L. 242, No. 67), as amended, 11 Pa. C.S. § 10101 et seq.

The City of McKeesport Combined Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 06-9, as amended, adopted pursuant to Act 67. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees hired after January 1, 1994. The plan was established September 24, 1987. Active members are required to contribute 5 percent of base pay to the plan. As of December 31, 2018, the plan had 30 active members, 4 terminated members eligible for vested benefits in the future, and 15 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

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As of December 31, 2018, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 60 and 20 years of service.
Early Retirement	Age 60 and 12 years of service.
Vesting	100% vesting available after 12 years of service; payment of benefit is deferred to age 60.

Retirement Benefit:

Benefit equals 50% of the average compensation of the participant during the five (5) last continuous years of credited service prior to termination of employment, or the average monthly compensation for the best twelve (12) consecutive months of credited service in the last (60) months of service prior to retirement.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions if not vested.
After Retirement Eligibility	a monthly benefit equal to 50% of the monthly benefit participant was eligible to receive as of date of death.

Service Related Disability Benefit:

After 15 years of service, a monthly benefit equal to the normal retirement benefit as of date of disablement pro-rated for service less than 20 years.

Non-Service Related:

None

Finding – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Condition: The city failed to certify an eligible employee participating in the city's combined pension plan (1 unit) and understated payroll by $35,910 on the Certification Form AG 385 filed in 2018. The data contained on this certification form is based on prior calendar year information.

Criteria: Pursuant to Act 205, at Section 402(e)(2), an employee who has been employed on a full-time basis for at least six consecutive months and has been participating in a pension plan during the certification year is eligible for certification.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified during 2018.

Effect: The data submitted on the certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the city's state aid allocation for 2018 was based on unit value, the incorrect certification of pension data affected the city's 2018 state aid allocation, as identified below:

Units Understated	Unit Value	State Aid Underpayment
1	$ 4,684	$ 4,684

Although the city will be reimbursed for the underpayment of state aid due to the city's certification error, the full amount of the 2018 state aid allocation was not available for timely deposit and therefore was not available to pay operating expenses or for investment purposes.

Recommendation: We recommend that in the future, plan officials establish adequate internal control procedures, such as having at least two people review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

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 MCKEESPORT COMBINED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 4 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, 2015, 2016 AND 2017

	2014	2015	2016	2017
Total Pension Liability				
Service cost	$ 198,578	$ 212,502	$ 218,481	$ 207,190
Interest	344,441	474,933	492,826	564,042
Change of benefit terms	641,713	-	-	-
Difference between expected and actual experience	(98,000)	-	-	(120,798)
Changes of assumptions	273,827	-	-	229,785
Benefit payments, including refunds of member contributions	(77,599)	(99,769)	(100,257)	(147,268)
Net Change in Total Pension Liability	1,282,960	587,666	611,050	732,951
Total Pension Liability – Beginning	4,784,120	6,067,080	6,654,746	7,265,796
Total Pension Liability – Ending (a)	$ 6,067,080	$ 6,654,746	$ 7,265,796	$ 7,998,747
Plan Fiduciary Net Position				
Contributions – employer *	$ 111,348	$ -	$ 283,309	$ 316,487
Contributions – member	86,132	91,253	92,462	92,746
Net investment income	123,862	(167,517)	377,839	861,591
Benefit payments, including refunds of member contributions	(77,599)	(99,769)	(100,257)	(147,268)
Administrative expense	(12,201)	(20,254)	(11,552)	(11,683)
Other	317	-	-	-
Net Change in Plan Fiduciary Net Position	231,859	(196,287)	641,801	1,111,873
Plan Fiduciary Net Position – Beginning	4,869,713	5,101,572	4,905,285	5,547,086
Plan Fiduciary Net Position – Ending (b)	$ 5,101,572	$ 4,905,285	$ 5,547,086	$ 6,658,959
Net Pension Liability – Ending (a-b)	$ 965,508	$ 1,749,461	$ 1,718,710	$ 1,339,788
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	84.09%	73.71%	76.35%	83.25%
Estimated Covered Employee Payroll	$ 1,776,624	$ 1,796,282	$ 1,850,285	$ 1,744,178
Net Pension Liability as a Percentage of Covered Employee Payroll	54.35%	97.39%	92.89%	76.81%

* Employer contributions for 2016 include 2015 contributions with interest.

CITY OF MCKEESPORT COMBINED 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, 2015 and 2016, calculated using the discount rate of 7.90%, 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 (6.90%)	Current Discount Rate (7.90%)	1% Increase (8.90%)
Net Pension Liability – 12/31/14	$ 1,707,905	$ 965,508	$ 333,014
Net Pension Liability – 12/31/15	$ 2,563,768	$ 1,749,461	$ 1,055,703
Net Pension Liability – 12/31/16	$ 2,607,788	$ 1,718,710	$ 961,250

In addition, the following presents the net pension liability of the city as of December 31, 2017, calculated using the discount rate of 7.75%, 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 (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
Net Pension Liability – 12/31/17	$ 2,264,027	$ 1,339,788	$ 554,981

CITY OF MCKEESPORT COMBINED 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
2009	$ 162,307	$ 162,307	$ -	$1,675,381	9.69%
2010	144,034	144,034	-	1,764,696	8.16%
2011	94,642	94,642	-	1,746,694	5.42%
2012	93,573	93,573	-	1,861,692	5.03%
2013	119,509	119,509	-	1,715,348	6.97%
2014	111,348	111,348	-	1,776,624	6.27%
2015**	131,062	-	131,062	1,796,282	0.00%
2016**	283,309	283,309	-	1,850,285	15.31%
2017	316,487	316,487	-	1,744,178	18.15%
2018	297,420	297,420	-		

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

** Due to severe financial distress, the city did not have funds available to pay its required obligation for 2015. However, the outstanding obligation, along with applicable interest, was added to the 2016 required obligation and deposited during 2016.

SCHEDULE OF INVESTMENT RETURNS

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

2017	16.08%
2016	8.20%
2015	(2.82)%
2014	3.04%
2013	13.32%
2012	13.08%
2011	0.36%
2010	13.41%
2009	19.62%
2008	(20.07)%

CITY OF MCKEESPORT COMBINED 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	$ 4,197,043	$ 4,275,387	$ 78,344	98.2%
01-01-15	5,101,572	6,067,080	965,508	84.1%
01-01-17	6,010,722	7,374,783	1,364,061	81.5%

Note: The market values of the plan's assets at 01-01-13, 01-01-15 and 01-01-17 are valued using the smoothing method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of the 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.

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 MCKEESPORT COMBINED 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	8 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	4.0%

CITY OF MCKEESPORT COMBINED PENSION PLAN
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Commonwealth of Pennsylvania

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