

COMPLIANCE AUDIT

Northampton Borough Non-Uniformed Defined Contribution Pension Plan Northampton County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

April 2017



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 Borough Council
Northampton Borough
Northampton County
Northampton, PA 18067

We have conducted a compliance audit of the Northampton Borough Non-Uniformed Defined Contribution Pension Plan for the period January 1, 2015 to December 31, 2016. 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 findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings 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. State aid allocations that were deposited into the pension plan for the years ended December 31, 2013 to December 31, 2016, are presented on the Summary of Deposited State Aid and Employer Contributions.

- 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. Employer contributions that were deposited into the pension plan for the years ended December 31, 2013 to December 31, 2016, are presented on the Summary of Deposited State Aid and Employer Contributions.
- 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 also tested individual employee contributions made during the audit period for all 6 active employees employed during the year 2015, amounting to \$7,576, and all 7 active employees employed during the year 2016, amounting to \$16,264.
- We determined that there were no benefit calculations prepared for the years covered by our audit period.
- We determined whether the January 1, 2015 actuarial valuation report was prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2016, 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Northampton Borough Non-Uniformed Defined Contribution 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 borough's internal controls as they relate to the borough'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 Northampton Borough Non-Uniformed Defined Contribution 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 – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Finding No. 2 – Allocation Of State Aid In Excess Of Entitlement

The contents of this report were discussed with officials of Northampton Borough and, where appropriate, their responses have been included in the report. We would like to thank borough officials for the cooperation extended to us during the conduct of the audit.

April 17, 2017



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 Northampton Borough Non-Uniformed Defined Contribution 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.

The Northampton Borough Non-Uniformed Defined Contribution Pension Plan is a single-employer defined contribution pension plan locally controlled by the provisions of Ordinance No. 1190. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established January 1, 2013 for full-time non-uniformed employees hired on or after January 1, 2013. Active members are required to contribute 3 percent of compensation to the plan, but may contribute up to 10 percent of compensation. The municipality is required to contribute 3 percent of compensation. As of December 31, 2016, the plan had 7 active members, no terminated members eligible for vested benefits in the future, and no retirees receiving pension benefits.

NORTHAMPTON BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION
PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Condition: The borough failed to certify 4 eligible non-uniformed employees (4 units) and understated payroll by \$165,775 on the Certification Form AG 385 filed in 2015. 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 were not aware that employees of their new defined contribution pension plan were immediately eligible for AG 385 certification.

Effect: The data submitted on this certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the borough's state aid allocation was based on unit value, the borough received an underpayment of state aid of \$15,684 as identified below:

<u>Units</u> <u>Understated</u>	<u>Unit</u> <u>Value</u>	<u>State Aid</u> <u>Underpayment</u>
4	\$ 3,921	\$ 15,684

Although the borough will be reimbursed for the underpayment of state aid due to the borough's certification error, the full amount of the 2015 state aid allocation was not available to be deposited timely and therefore resulted in the borough having to make additional municipal contributions in order to meet the plan's funding obligation.

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.

NORTHAMPTON BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION
PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Allocation Of State Aid In Excess Of Entitlement

Condition: In 2016, the borough allocated state aid to the non-uniformed defined contribution pension plan in excess of the plan's defined contribution pension costs under Act 205, as illustrated below:

State aid allocation	\$ 12,000
Less: Actual municipal pension costs	<u>(8,757)</u>
Excess state aid	<u><u>\$ 3,243</u></u>

Criteria: Section 402(f)(2) of Act 205 states:

No municipality shall be entitled to receive an allocation of general municipal pension system state aid in an amount which exceeds the aggregate actual financial requirements of any municipal pension plan for police officers, paid firefighters or employees other than police officers or paid firefighters maintained by the municipality, less the amount of any aggregate annual member or employee contributions during the next succeeding plan year, as reported in the most recent complete actuarial report filed with the commission.

Cause: Plan officials were unaware of the need to annually reconcile the amount of state aid allocated to the pension plan with the plan's actual defined contribution pension costs.

Effect: It is this department's opinion that, since the entire proceeds of the insurance premium tax on foreign casualty insurance companies are distributed annually to each eligible recipient municipality, it is inappropriate to use state aid in one year to offset pension costs in other years; however, the borough does have the option to allocate the excess state aid to its defined benefit pension plans.

Recommendation: We recommend that municipal officials allocate the \$3,243 of excess state aid to the borough's defined benefit pension plans.

In addition, we recommend that, in the future, plan officials reconcile the amount of state aid allocated to the non-uniformed defined contribution pension plan and municipal contributions made to the pension plan with the pension plan's defined contribution pension costs.

NORTHAMPTON BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION
PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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.

NORTHAMPTON BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION
PENSION PLAN
SUMMARY OF DEPOSITED STATE AID AND EMPLOYER CONTRIBUTIONS

Year Ended December 31	State Aid	Employer Contributions
2013	None	None
2014	None	\$ 3,428
2015	None	7,576
2016	\$ 12,000	None

NORTHAMPTON BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION
PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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PENSION PLAN
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