

# COMPLIANCE AUDIT

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## Towanda Borough Police Pension Plan Bradford County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

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October 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  
Towanda Borough  
Bradford County  
Towanda, PA 18848

We have conducted a compliance audit of the Towanda Borough Police 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 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 that there were no benefit calculations prepared for the years covered by our audit period.
- We determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2014 and 2016, 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.

Towanda Borough contracted with an independent certified public accounting firm for annual audits of its financial statements prepared in conformity with the accounting practices prescribed or permitted by the Department of Community and Economic Development of the Commonwealth of Pennsylvania, which are available at the borough's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Towanda Borough 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 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 Towanda Borough 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 finding further discussed later in this report:

**Finding – Failure To Properly Determine And Fully Pay The Minimum Municipal Obligation Of The Plan**

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. **However, we are extremely concerned about the historical trend information contained in the schedule of funding progress included in this report which indicates a continued decline of assets available to satisfy the long-term liabilities of the plan. The plan's funded ratio went from 74.4% as of January 1, 2011, to a ratio of 61.0% as of January 1, 2015**, which is the most recent data available. We encourage borough officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of Towanda 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.



September 28, 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 Towanda Borough Police 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 767 et seq.

The Towanda Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of an Ordinance dated July 1, 1963, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the borough and its police officers. The plan was established July 1, 1963. Active members are required to contribute 7 percent of compensation to the plan. As of December 31, 2016, the plan had 7 active members, 1 terminated member eligible for vested benefits in the future, and 6 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2016, selected plan benefit provisions are as follows:

**Eligibility Requirements:**

Normal Retirement	Age 50 and 25 years of service.
Early Retirement	Eligible with 20 years of service.
Vesting	A member is 100% vested after 12 years of service.

**Retirement Benefit:**

Benefit equals 50% of final 36 months average salary, plus a service increment of \$100 per month if years of service is at least 26 years.

**Survivor Benefit:**

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	A monthly benefit equal to 50% of the pension the member was receiving or was entitled to receive on the day of the member's death.

**Service Related Disability Benefit:**

Benefit equals 50% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

**TOWANDA BOROUGH POLICE PENSION PLAN**  
**FINDING AND RECOMMENDATION**

**Finding – Failure To Properly Determine And Fully Pay The Minimum Municipal Obligation Of The Plan**

Condition: Plan officials did not properly determine and fully pay the minimum municipal obligation (MMO) of the police pension plan for the year 2015, as required by Act 205, due to understating payroll by \$66,690. Based upon an estimate prepared by this Department, the municipality had an outstanding 2015 MMO balance due to the police pension plan in the amount of \$39,727. In addition, plan officials did not fully pay the minimum municipal obligation (MMO) that was due to the police pension plan for the year 2016, resulting in a balance due in the amount of \$27,991. Consequently, the municipality has a total outstanding MMO balance due to the police pension plan for the years 2015 and 2016 in the amount of \$67,718, plus interest.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

With regard to the payroll estimate used in the preparation of the MMO, the Pennsylvania Code, Title 16, Section 204.1(c)(1) states, in part:

The payroll used in determining the minimum municipal obligation of a pension plan under section 302(c) of the act shall be based on the payroll to be reported on the Internal Revenue Service Form W-2 and shall be calculated as the total payroll for active members of the plan as of the date of the determination, plus the payroll for the same active members of the plan projected to the year's end using the payroll rates in effect as of the date of the determination.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

**TOWANDA BOROUGH POLICE PENSION PLAN**  
**FINDING AND RECOMMENDATION**

**Finding – (Continued)**

Furthermore, Section 302(e) of Act 205 states:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the plan's MMOs were properly determined and fully paid in accordance with Act 205 requirements.

Effect: The proper determination of the plan's MMO ensures plan officials can properly allocate the necessary resources to the pension plan for the upcoming year. The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the entire 2015 and 2016 MMOs by the respective December 31, deadlines, the municipality must add the outstanding 2015 and 2016 MMOs to the current year's MMO and include interest, as required by Act 205.

Recommendation: We recommend that the municipality pay the MMO balance due to the police pension plan for the years 2015 and 2016, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

Furthermore, we recommend that in the future, plan officials properly determine the amount of payroll to be used in the MMO calculation and pay the full MMO due to the plan.

Management's Response: Municipal officials agreed with the finding without exception. Subsequent to the current audit period, the borough issued checks in the total amount of \$77,897 to fully pay the 2015 and 2016 MMOs due to the plan, plus interest.

Auditor's Conclusion: Based on the management response, it appears municipal officials have partially complied with the finding recommendation. Full compliance will be evaluated during our next audit of the plan.

**TOWANDA BOROUGH 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, 2011, is as follows:

Actuarial Valuation Date	(1) Actuarial Value of Assets (a)	(2) Actuarial Accrued Liability (AAL) - Entry Age (b)	(3) Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	(4) Funded Ratio (a)/(b)
01-01-11	\$ 1,026,123	\$ 1,378,596	\$ 352,473	74.4%
01-01-13	1,127,749	1,957,212	829,463	57.6%
01-01-15	1,162,962	1,907,854	744,892	61.0%

The market values of the plan's assets at 01-01-11, 01-01-13, and 01-01-15 have been adjusted as of the last valuation date plus non-investment increases less non-investment decreases since the last valuation date plus interest credited at the last valuation's assumed interest rate assuming non-investment increases and decreases occur at the mid-point between the last and current valuation date. The market value of the plan's assets will be limited to a maximum of 110 percent and a minimum of 90 percent of the fair market value of assets as of the current valuation date.

The actuarial accrued liability as of 01-01-13 reflects the change in the investment return assumption rate from 8.0 percent as of 01-01-11 to 5.0 percent.

**TOWANDA BOROUGH 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.

**TOWANDA BOROUGH POLICE PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)**

**SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES**

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2011	\$ 79,113	100.0%
2012	73,689	100.0%
2013	81,124	100.0%
2014	84,857	100.0%
2015	153,498	100.0%
2016	145,780	100.0%

**TOWANDA BOROUGH POLICE 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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 years
Asset valuation method	The actuarial value of assets will be limited to a maximum of 110% and a minimum of 90% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return	6.0%
Projected salary increases	4.0%
Cost-of-living adjustments	1.65% per annum; cumulative annual increases not to exceed 30% of initial pension.

TOWANDA BOROUGH POLICE PENSION PLAN  
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