

LIMITED PROCEDURES ENGAGEMENT

Tremont Borough Non-Uniformed Pension Plan Schuylkill County, Pennsylvania For the Period January 1, 2013 to December 31, 2016

August 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
Tremont Borough
Schuylkill County
Tremont, PA 17981

We conducted a Limited Procedures Engagement (LPE) of the Tremont Borough Non-Uniformed Pension Plan for the period January 1, 2013 to December 31, 2016 to determine its compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. We also evaluated compliance with some requirements subsequent to that period when possible. The LPE was conducted pursuant to authority derived from Section 402(j) of the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.) but was not conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. 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. We believe that the evidence obtained provides a reasonable basis to support our LPE results.

Our LPE was limited to determining the following:

- 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 engagement period. State aid allocations that were deposited into the pension plan for the years ended December 31, 2011 to December 31, 2016, are presented on the Summary of Deposited State Aid and Employer Contributions.
- 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, 2011 to December 31, 2016, are presented on the Summary of Deposited State Aid and Employer Contributions.

- Whether the January 1, 2011, 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, 2012, 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.
- Whether the terms of the plan's allocated insurance contracts, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contracts with the plan's provisions, investment policies, and state regulations.

Based on the results of our procedures performed during our LPE, nothing came to our attention indicating that the Tremont Borough Non-Uniformed Pension Plan was not being 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 Overpayment Of State Aid
- Finding No. 2 – Unauthorized Funding Mechanism
- Finding No. 3 – Failure To File Actuarial Valuation Report
- Finding No. 4 – Failure To Fund Members' Accounts
- Finding No. 5 – Improper Ownership Of Allocated Insurance Contracts
- Finding No. 6 – Custodial Account Records Not Maintained By The Municipality

We are concerned that this report contains six findings and encourage compliance with the recommendations contained in this report at the earliest opportunity to do so.

Our determination to perform a LPE for this engagement period does not preclude the Department from conducting an audit in accordance with *Government Auditing Standards* of the pension plan in subsequent periods. The borough should continue to maintain documentation related to this pension plan.

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

August 2, 2017

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

EUGENE A. DEPASQUALE
Auditor General

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TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: The borough certified 1 ineligible non-uniformed employee and overstated payroll by \$23,073 on the Certification Form AG 385 filed in 2013. The data contained on this certification form is based on prior calendar year information.

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

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

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 pension costs, the incorrect certification of pension data affected the borough’s state aid allocation, as identified below:

<u>Normal Cost</u>	<u>Payroll Overstated</u>	<u>State Aid Overpayment</u>
8.737%	\$ 23,073	\$ 2,016

Furthermore, the borough’s future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that the total excess state aid, in the amount of \$2,016, plus interest, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

We also recommend that in the future, plan officials establish adequate internal control procedures, such as having at least 2 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.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Management’s Response: Council will Motion to appoint an Administration Agent for Pension Purposes at their August 8, 2017 meeting. Together with our Finance Committee, Financial Advisor and Solicitor we will determine the interest rate and calculate the interest from 2012 (date of receipt) until 2017 (date of repayment). The overpayment amount of \$2,016.00, plus interest will be returned to the Commonwealth of Pennsylvania, with the calculation sheet attached.

Auditor’s Conclusion: It appears plan officials are striving to comply with the finding recommendation. We note however, that the overpayment of state aid is for the year 2013, and would have been allocated to the borough on or about October 1, 2013. That is the starting date from which interest should be calculated, not 2012. Due to the potential withhold of state aid, the borough’s compliance with the finding recommendation will be monitored subsequent to the release of the LPE report and through our next engagement.

Finding No. 2 – Unauthorized Funding Mechanism

Condition: During the engagement period, the municipality improperly purchased three individual retirement accounts (IRAs) to provide benefits to three members of the non-uniformed pension plan at retirement. State aid was deposited into one IRA in the amount of \$2,889 in 2013 and \$2,942 in 2014. In 2015, \$3,013 was deposited into a second IRA and \$3,013 was deposited into a third IRA.

Criteria: Section 102 of Act 205 defines a pension plan as follows:

The various aspects of the relationship between a municipality and its employees with respect to the retirement coverage provided by a municipality to the employees.

Section 201.2 of Part IV of Title 16 of the Pennsylvania Code further elaborates on the definition included in Act 205, stating:

The term does not include a plan, program, or arrangement that is funded solely by municipal employee earnings or compensation reported as municipal employee earnings or compensation to the Internal Revenue Service on the Form W-2 Wage and Tax Statement or established under sections 8.1-8.3 of the act of March 30, 1811 (P.L. 145 Sm.L. 228) (72 P.S. 4521.1-4521.3) . . . / or Section 408 of the Internal Revenue Code (26 U.S.C.A. 408).

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Consequently, the former Public Employee Retirement Commission (PERC) determined that Individual Retirement Accounts (IRAs) and IRS Section 457 Deferred Compensation plans are not eligible to participate in the state aid program.

Cause: Municipal officials were not aware that IRAs were not eligible funding vehicles for pension plans participating in the state aid program.

Effect: Since the funding mechanism does not meet the definition of a pension plan as prescribed above, it is not eligible for participation in the state aid program. In addition, since the individual employees rather than the municipality own these types of contracts, the municipality cannot ensure the integrity of these pension assets and the related benefits funded through state aid allocations from surrender by members prior to reaching retirement. Furthermore, the borough's future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that municipal officials either transfer plan assets to an eligible funding mechanism or return all state aid allocated to the unauthorized funding mechanism for the engagement period, in the amount of \$11,857, to the Commonwealth. In the latter case, a check in this amount, with interest at a rate earned by the pension plan, should be made payable to Commonwealth of Pennsylvania, and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check. Further, municipal officials should exclude members belonging to the ineligible plan from future Certification Forms AG 385 submitted to the department.

Management's Response: We will discuss our options with our Finance Committee, Financial Advisor, probably a Tax Advisor and our Solicitor and follow their recommendations of either transferring the funds from IRA's to eligible funding mechanisms or return the allocated amount of \$11,857.00 plus interest, with the interest calculation sheet, to the Commonwealth of Pennsylvania. With the employee owned IRA's, we have to technically get the employees to consent to this first. We will also entrust our Advisers and Solicitor to take the necessary steps to establish Employer Owned Pension Plans for the employees who currently have Individual Retirement Accounts. From this point on, all employees with IRA's will be excluded from the Form AG 385 Report.

Auditor's Conclusion: It appears plan officials are striving to comply with the finding recommendation. Due to the potential withhold of state aid, the borough's compliance with the finding recommendation will be monitored subsequent to the release of the LPE report and through our next engagement.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – Failure To File Actuarial Valuation Report

Condition: Actuarial valuation report form PC-203A for the non-uniformed pension plan with a valuation date of January 1, 2015, was not submitted to the former Public Employee Retirement Commission by the March 31, 2016, deadline, as required by Act 205 and remained delinquent at the completion of our engagement fieldwork.

Criteria: Section 201(a) of Act 205 states, in part:

Each municipality which has established or maintains a pension plan for its employees, including any municipality which participates in the Pennsylvania Municipal Retirement System, shall cause to be made actuarial valuation reports. Actuarial valuation reports shall be made biennially, unless the applicable municipality is applying or has previously applied for supplemental State assistance pursuant to Section 603, whereupon actuarial valuation reports shall be made annually.

Furthermore, Section 201(b) of Act 205 states, in part:

The biennial actuarial valuation report required pursuant to subsection (a) shall be made as of the beginning of each plan year occurring in an odd-numbered calendar year and shall be filed with the executive director of the commission no later than the last business day of March occurring in the following calendar year.

Section 204 of Act 205 provides:

If a complete actuarial valuation report or experience investigation is not filed in a timely fashion, any and all financing which is provided to the municipality by the Commonwealth and is dedicated for pension plan purposes shall be withheld until the report or investigation is filed.

Cause: The failure to file the necessary actuarial valuation report occurred because plan officials were not familiar with the applicable Act 205 filing guidelines.

Effect: Data from the January 1, 2015 Act 205 actuarial valuation report is necessary to calculate the borough's 2016 state aid allocation; therefore, the borough's 2016 state aid allocation cannot be calculated and released the necessary report is filed. In addition, future state aid, if any, will be withheld until the necessary report is filed. Furthermore, the plan may receive less state aid than it would have received had the report been filed in a timely manner.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Recommendation: We recommend that the municipality take immediate action to complete the January 1, 2015 Act 205 actuarial valuation report which was due by March 31, 2016 and submit it to the Municipal Pension Reporting Program (formerly the Public Employee Retirement Commission), 321 Finance Building, Harrisburg, PA 17120. By submitting the report as soon as possible, the municipality can minimize the length of time the pension aid will be withheld due to the delinquent filing of the required report.

Furthermore, to insure that future actuarial filing deadlines are met and to improve pension plan administration, we recommend that plan officials develop and implement internal control procedures, such as a calendar listing the various reporting and filing deadlines required by Act 205, including the actuarial valuation report filing date.

Management's Response: We will continue our efforts to obtain the necessary data from MetLife in order to complete and file [the] Actuarial Valuation Report. Important dates along with the reporting and filings deadlines will be added to our scheduling calendar.

Auditor's Conclusion: Compliance will be evaluated during our next engagement of the plan.

Finding No. 4 – Failure To Fund Members' Accounts

Condition: In 2016, the borough did not fund the accounts of three members who were full-time employees.

Criteria: The plan's governing document, Resolution 2005-11, provides that pension benefits will be provided through discretionary purchases of insurance annuity contracts with the plan custodian.

Cause: Borough officials were unable to fund the plan for the year 2016 because the borough's 2016 state aid allocation was withheld due to the borough's failure to file the January 1, 2015 Act 205 actuarial valuation report. The borough was not able to allocate funding for each full-time employee.

Effect: The failure to properly fund the plan could result in plan members being denied benefits to which they are entitled in accordance with the plan's governing document.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

Recommendation: We recommend that the borough deposit the contributions due to the members' accounts for the year 2016, with interest, from the date the deposit should have been made to the date of deposit of the amount in arrears. The borough should ensure the contributions are deposited into an eligible funding mechanism (see Finding No. 2.) A copy of the interest calculation must be maintained by the borough for examination during our next engagement of the plan.

We also recommend that, in the future, borough officials properly fund the accounts of all eligible plan members.

Management's Response: Together with our Finance Committee, Financial Advisor, Tax Advisor and Solicitor, we have to determine the necessary steps to correct all discrepancies found. With the employee owned IRA's, we have [to] get the consent of each employee who has an IRA, then request that they "cash out" their IRA and return the money to Tremont Borough. One hurdle we may be faced with is if the employee does not consent. There are many various hurdles the Borough will have to overcome in order to correct these wrongdoings. Once we have corrected the errors we will complete the reports as recommended, in order to receive our 2016 State Aid Allocation. Once we have corrected the errors we will complete the reports as recommended, in order to receive our 2016 State Aid Allocation. Once State Aid is received the monies will be divided among the eligible full-time employees and deposited into each of their Pension Funds. Interest will be calculated from 2016 until the time the allocation is deposited.

Auditor's Conclusion: It appears plan officials are striving to comply with the finding recommendation. Compliance will be evaluated during our next engagement.

Finding No. 5 – Improper Ownership Of Allocated Insurance Contracts

Condition: The borough is funding allocated insurance contracts that improperly designate individual plan members as the owners of the contracts.

Criteria: Since premiums on these policies have been paid with state aid and municipal funds, the borough should maintain ownership of the allocated insurance contracts to ensure the proceeds of the contracts will be distributed in accordance with the plan's governing document.

Cause: Plan officials were unaware of the risks of the improper ownership of the contracts.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 5 – (Continued)

Effect: Continued improper ownership of these annuity contracts could result in premature withdrawals or other improper dispositions of the funds. Improper distribution from the insurance contracts could result in the borough having to reimburse the Commonwealth for any improper distribution to the plan members.

Recommendation: We recommend that pension plan officials take the necessary steps to change the ownership of these allocated insurance contracts from the plan members to the pension plan or municipality. If this cannot be accomplished, we recommend that the municipality implement adequate internal control procedures to ensure that the proceeds from the allocated insurance contracts are not surrendered to the plan members prior to their eligibility to receive benefits from the pension plan.

Management's Response: We will discuss our options with our Financial Advisor, probably a Tax Advisor and our Solicitor and follow their recommendation of the proper way to change the ownership of the pension contracts that were improperly established. Again, with the employee owned IRA's, we have to technically get the employees to consent to this.

Auditor's Conclusion: It appears plan officials are striving to comply with the finding recommendation. Compliance will be evaluated during our next engagement.

Finding No. 6 – Custodial Account Records Not Maintained By The Municipality

Condition: The municipality did not maintain adequate financial records or statements of the custodial account of the non-uniformed pension plan sufficient to effectively monitor the activity in this account during the year 2016.

Criteria: Assets held in allocated insurance accounts for the purpose of plan management are to be governed by the terms and provisions of the account contract, provided that the terms and provisions of the contract are within the parameters of all prevailing pension legislation. Although the municipality may contract with a trustee to administer the financial management of the plan, the fiduciary responsibility for the plan remains with the municipality.

Cause: Plan officials were not aware of their fiduciary responsibility to monitor the allocated insurance accounts. Furthermore, during our engagement period there was a turnover of municipal officials. Additionally, plan officials have failed to adopt adequate internal control procedures over their pension plan.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 6 – (Continued)

Effect: Inadequate monitoring of the non-uniformed pension plan account could lead to undetected errors or improprieties in account transactions as well as deficiencies in authorizing and implementing pension plan policies and procedures.

Recommendation: We recommend that the municipality obtain annual financial statements of transactions in the custodial account of the non-uniformed pension plan and monitor the statements as to the accuracy and propriety of the transactions. The minimum steps that should be applied by a municipality to adequately monitor the custodial account are:

- Verify the mathematical accuracy of the account statements;
- Reconcile the Commonwealth and municipal contributions shown on the account statements to the municipality's records;
- Review investment income for accuracy and reasonableness;
- Reconcile any large or material receipt, other than contributions, shown on the account statements to the municipality's records;
- Determine if investments are in accordance with applicable laws, regulations and policies. Reconcile investment income to the related investments;
- Reconcile pension payments shown on the account statements to the municipality's records; and
- Reconcile any large or material disbursement shown on the account statements to the municipality's records.

Management's Response: Council will Motion to appoint an Administration Agent for Pension Purposes at their August 8, 2017 meeting. This appointed official will properly monitor the activity of the Non-Uniformed Pension Plan.

Auditor's Conclusion: It appears plan officials are striving to comply with the finding recommendation. Compliance will be evaluated during our next engagement.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 1 contained in this report cites an overpayment of state aid to the borough in the amount of \$2,016, plus interest. A condition of this nature may lead to a total withholding of state aid in the future unless that finding is corrected. A check in this amount with interest, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania, and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120.

In addition, a condition such as that reported by Finding No. 2 contained in this report may lead to a total withholding of state aid in the future unless that finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 314 Finance Building, Harrisburg, PA 17120.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
SUMMARY OF DEPOSITED STATE AID AND EMPLOYER CONTRIBUTIONS

Year Ended December 31	State Aid	Employer Contributions
2011	\$ 9,398	None
2012	6,292	None
2013	8,666	None
2014	8,827	None
2015	9,040	None
2016	None	None

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Roger D. Adams
Mayor

Mr. James G. Scheibley
Council President

Ms. Shea Lucas
Secretary/Treasurer

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