

# COMPLIANCE AUDIT

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## Emmaus Borough Non-Uniformed Pension Plan Lehigh County, Pennsylvania For the Period January 1, 2012 to December 31, 2014

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June 2015



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  
Emmaus Borough  
Lehigh County  
Emmaus, PA 18049

We have conducted a compliance audit of the Emmaus Borough Non-Uniformed Pension Plan for the period January 1, 2012 to December 31, 2014. 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 our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit report; and
2. 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 objectives identified above. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. 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 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 3 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, 2013 actuarial valuation report was prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2014, 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.

Emmaus Borough contracted with an independent certified public accounting firm for audits of its basic financial statements for the years ended December 31, 2012 and 2013, 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 Emmaus Borough 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 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 objectives, 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 objectives.

The results of our procedures indicated that, in all significant respects, the Emmaus Borough Non-Uniformed 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 – Noncompliance With Prior Audit Recommendation – Incorrect Data  
On Certification Form AG 385 Resulting In A Net Overpayment Of  
State Aid

The finding contained in this audit report repeats a condition that was cited in our previous audit report that has not been corrected by borough officials. We are concerned by the borough's failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation noted in this audit report.

As previously noted, one of the objectives of our audit of the Emmaus Borough Non-Uniformed Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

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 funded status of the plan contained in the schedule of funding progress included in this report which indicates **the plan's funded ratio is 60.5% as of January 1, 2013**, which is the most recent data available. Based on this information, **the Public Employee Retirement Commission issued a notification that the borough is currently in Level II moderate distress status**. We encourage borough officials to monitor the funding of the non-uniformed pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of Emmaus Borough and, where appropriate, their responses have been included in the report.

May 28, 2015

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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## **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 Emmaus Borough Non-Uniformed Pension Plan is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes.

The Emmaus Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 380, as amended. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established October 1, 1961. Active members are required to contribute 2.6 percent of compensation to the plan. As of December 31, 2014, the plan had 34 active members, 8 terminated members eligible for vested benefits in the future, and 17 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2014, selected plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement    Age 65 and 12 years of service

Early Retirement     Age 55 and 12 years of service

Vesting                100% after 5 years of service

### Retirement Benefit:

2% of average monthly compensation based on highest 5 consecutive years out of last 10 years multiplied by the number of years of benefit service.

### Survivor Benefit:

If eligible for retirement – 100% of benefit had he/she been retired at time of death and chose a joint and survivor option.

### Disability Benefit:

Actuarial equivalent of the accrued benefit at the date of disability.



EMMAUS BOROUGH NON-UNIFORMED PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Emmaus Borough has not complied with the prior audit recommendation concerning the following:

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

Municipal officials failed to comply with the recommendation in the prior audit report to establish adequate internal control procedures to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data, as further discussed in the Finding and Recommendation section of this report.

EMMAUS BOROUGH NON-UNIFORMED PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid**

Condition: As disclosed in the prior audit report, the borough failed to establish adequate internal control procedures to ensure compliance with the instructions that accompanied Certification Form AG 385, resulting in an underpayment of state aid in 2011. During the current period, the borough again failed to comply with the instructions that accompany Certification Form AG 385. The borough failed to certify 1 eligible non-uniformed employee (1 unit) and understated payroll by \$44,890 on the Certification Form AG 385 filed in 2012. In addition, the borough certified 1 ineligible non-uniformed employee (1 unit) and overstated payroll by \$16,407 on the Certification Form AG 385 filed in 2013. The data contained on these certification forms 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 these certification forms 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 allocations were based on unit value, the incorrect certification of pension data affected the borough’s state aid allocations, as identified below:

<u>Year</u>	<u>Units Overstated (Understated)</u>	<u>Unit Value</u>	<u>State Aid Overpayment (Underpayment)</u>
2012	(1)	\$3,576	\$ (3,576)
2013	1	\$3,884	<u>3,884</u>
Net Overpayment of State Aid			<u><u>\$ 308</u></u>

In addition, the borough used the overpayment of state aid to pay the minimum municipal obligation (MMO) due to the non-uniformed pension plan; therefore, if the reimbursement to the Commonwealth is made from the pension plan, the plan’s MMO will not be fully paid.

EMMAUS BOROUGH NON-UNIFORMED PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Recommendation: We recommend that the net overpayment of state aid, in the amount of \$308, 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, 320 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

We also again 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.

In addition, if the reimbursement to the Commonwealth is made from non-uniformed pension plan funds, we recommend that any resulting MMO deficiency be paid to the pension plan with interest, at a rate earned by the pension plan.

Management's Response: Borough officials agreed with the finding without exception.

Auditor's Conclusion: The borough's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through our next audit of the pension plan.

EMMAUS BOROUGH 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, 2009, is as follows:

	(1)	(2)	(3)	(4)	(5)	(6)
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)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-09	\$ 2,907,285	\$ 4,491,651	\$ 1,584,366	64.7%	\$ 1,737,295	91.2%
01-01-11	3,163,304	5,465,059	2,301,755	57.9%	1,920,050	119.9%
01-01-13	3,653,370	6,036,655	2,383,285	60.5%	1,929,359	123.5%

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 have been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period. This method 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.

EMMAUS BOROUGH 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.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

EMMAUS BOROUGH NON-UNIFORMED PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2009	\$ 78,633	100.0%
2010	78,846	100.0%
2011	288,148	100.0%
2012	291,724	100.0%
2013	429,647	100.0%
2014	416,684	100.0%

EMMAUS BOROUGH NON-UNIFORMED PENSION PLAN  
SUPPLEMENTARY INFORMATION  
NOTES TO SUPPLEMENTARY SCHEDULES  
(UNAUDITED)

The information presented in the required 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, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	14 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	5.0%

EMMAUS 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

Emmaus Borough Non-Uniformed Pension Plan  
Lehigh County  
28 South Fourth Street  
Emmaus, PA 18049

The Honorable Winfield Iobst	Mayor
Ms. Lee Ann Gilbert	Council President
Mr. Shane M. Pepe	Borough Manager
Ms. Christine Snyder	Treasurer

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