COMPLIANCE AUDIT

Pottstown Borough Non-Uniformed Pension Plan

Montgomery County, Pennsylvania

For the Period

January 1, 2011 to December 31, 2013

May 2015

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

COUNCIL 90 AFSCME UNION LABEL

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

The Honorable Mayor and Borough Council
Pottstown Borough
Montgomery County
Pottstown, PA 19464

We have conducted a compliance audit of the Pottstown Borough Non-Uniformed Pension Plan for the period January 1, 2011 to December 31, 2013. We also evaluated compliance with some requirements subsequent to the audit 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 conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our 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 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 13 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 determined whether the January 1, 2011 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, 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.

- × We determined whether the terms of the contractual agreement with the Pennsylvania Municipal Retirement System were in accordance with the plan's governing document, if separately stated, and applicable laws and regulations by comparing the terms of the contractual agreement with the plan's governing document, if separately stated, and applicable laws and regulations.

The Pottstown Borough Non-Uniformed Pension Plan participates in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's 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 Pottstown 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 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 tests indicated that, in all significant respects, the Pottstown 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 – Pension Benefits Modified Without Cost Estimate

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 Pottstown 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.

March 11, 2015

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 Pottstown 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 including, but not limited to, the following:

Act 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974 (P.L. 34, No. 15), as amended, 53 P.S. § 881.101 et seq.

The Pottstown Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1470, adopted pursuant to Act 15. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established June 1, 1963. Active members are required to contribute 5.75 percent of compensation to the plan. As of December 31, 2013, the plan had 74 active members, 5 terminated members eligible for vested benefits in the future, and 46 retirees receiving benefits funded through annuities purchased with plan assets.

BACKGROUND – (Continued)

As of December 31, 2013, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Available upon attainment of age 60 or upon attainment of age 55 and 25 years of service.
Early Retirement	A voluntary early retirement available after 24 years of service. An involuntary early retirement is available after 8 years of service.
Vesting	A member is 100% vested after 10 years of service.

Retirement Benefit:

Benefit equals 1.667% times credited service times Final Average Salary (FAS) but in no event is the basic benefit greater than 50% of FAS. FAS based upon final years salary or the final 3 years' annualized salary, whichever is the greater.

Survivor Benefit:

If eligible to retire at the time of death, beneficiary receives present value of accrued benefit. At retirement, member may select a survivor benefit.

Disability Benefit:

Service Related	A 50% disability benefit is provided to a member who is unable to perform gainful employment regardless of age or service, offset by available Workers' Compensation benefits.
Non-service Related	A 30% disability benefit is provided to a member who has at least 10 years of service and who is unable to perform gainful employment.

POTTSTOWN BOROUGH NON-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Pension Benefits Modified Without Cost Estimate

Condition: The municipality increased pension benefits for certain non-uniformed pension plan members without a cost estimate of the effect of the increase on the plan, as required by Act 205.

Effective November 1, 2012 through November 15, 2012, the borough offered a retirement incentive to certain employees under contract who had already reached superannuation (age 55 and 25 years of service), and provided these employees the opportunity to retire and receive all of the contractual obligations under the collective bargaining agreement at the time of retirement as well as an additional one month's salary for each five years of service within the borough, capped at a total of six month's salary. The borough included this incentive as normal compensation rather than a severance payment in the final determination of average compensation used in pension calculations for 2 plan members who elected to retire pursuant to this retirement incentive.

Criteria: Section 305(a) of Act 205 states:

> Prior to the adoption of any benefit plan modification by the governing body of the municipality, the chief administrative officer of each pension plan shall provide to the governing body of the municipality a cost estimate of the effect of the proposed benefit plan modification.

Furthermore, Section 305(b) of Act 205 states, in part:

> If the pension plan is a defined benefit plan which is self-insured in whole or in part, the cost estimate shall be prepared by an approved actuary. . . .

Cause: Plan officials failed to establish adequate internal control procedures to ensure a cost estimate was prepared to determine the effect of including the severance payments in the pension benefit determinations.

Effect: Due to the inclusion of 6 month severance payments in the retiree's pension calculations, the monthly pension benefits for the two retirees increased from $2,501 and $2,685 to $3,662 and $3,880, respectively. Furthermore, based upon an analysis prepared by PMRS, the inclusion of the severance payments resulted in an additional $262,041 transferred to the retiree reserve in order to sufficiently fund the pension benefits provided.

Finding – (Continued)

Recommendation: We recommend that the chief administrative officer (CAO) of the pension plan have a qualified person prepare a cost estimate of the benefit increases already granted, which includes a comparison of current and future contributions required to fund the pension plan. Furthermore, the CAO should present the cost estimate to the governing body of the municipality for its review. Finally, all future benefit modifications should be preceded by a cost estimate which has been prepared by a qualified person.

Management's Response: Municipal officials agree with the finding without exception.

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

POTTSTOWN 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	$ 14,859,503	$ 14,595,963	$ (263,540)	101.8%	$ 4,333,201	(6.1%)
01-01-11	16,224,147	16,392,119	167,972	99.0%	4,379,676	3.8%
01-01-13	17,760,277	18,032,218	271,941	98.5%	3,994,566	6.8%

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.

POTTSTOWN 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
2008	$ 243,161	100.0%
2009	195,128	100.0%
2010	172,864	100.0%
2011	173,469	100.0%
2012	181,890	100.0%
2013	208,333	100.0%

POTTSTOWN 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	10 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	5.5%, net of expenses
Projected salary increases *	Age-related scale for merit/ seniority (e.g. age 30 - 6.4%; age 40 - 5.0%; age 50 - 4.1%; age 60 - 3.7%)
Cost-of-living adjustments	3.0%, where applicable

* Includes inflation at 3.0%

POTTSTOWN 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

Pottstown Borough Non-Uniformed Pension Plan
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100 East High Street
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The Honorable Sharon Valentine-Thomas	Mayor
Mr. Stephen M. Toroney	Council President
Mr. Mark D. Flanders	Borough Manager
Ms. Janice E. Lee	Finance Director

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 231 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.