

# COMPLIANCE AUDIT

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## Quakertown Borough Non-Uniformed Pension Plan Bucks County, Pennsylvania For the Period January 1, 2014 to December 31, 2015

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August 2016



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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Borough Council  
Quakertown Borough  
Bucks County  
Quakertown, PA 18951

We have conducted a compliance audit of the Quakertown Borough Non-Uniformed Pension Plan for the period January 1, 2014 to December 31, 2015. 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 the plan member 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 the retired individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to the recipient. We also determined whether retirement benefits calculated for the plan member who elected to vest during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the pension benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined.
- We determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2013 and 2015, 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.

Quakertown Borough contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2014, 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 Quakertown 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 Quakertown 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 - Pension Benefit  
Not Authorized By The Plan’s Governing Document

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.

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 Quakertown Borough and, where appropriate, their responses have been included in the report.

August 10, 2016



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 Quakertown 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 Quakertown Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1006, 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 November 6, 1958. Active members are required to contribute 1 percent of salary to the plan. As of December 31, 2015, the plan had 30 active members, 18 terminated members eligible for vested benefits in the future, and 31 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2015, selected plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	Age 65
Early Retirement	Age 55
Vesting	60% after 6 years of service, plus 10% per year thereafter

### Retirement Benefit:

1.7% of average total compensation (excluding long-term illness pay) over the final 36 months of employment, multiplied by years of service up to 25 years.

### Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	50% of survivor's portion of joint and survivor annuity based on accrued pension payable to surviving spouse or eligible child of an active member who dies after retirement eligibility or vesting.

QUAKERTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Quakertown Borough has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Pension Benefit Not Authorized By The Plan's Governing Document

QUAKERTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation – Pension Benefit Not Authorized By The Plan’s Governing Document**

Condition: As disclosed in our prior audit report, municipal officials provided pension benefits in excess of those authorized by the pension plan’s governing document, Ordinance No. 1006. The borough granted a normal retirement benefit to an employee who terminated in June 2012 at age 60, while Ordinance No. 1006, which was in effect at the date of the member’s termination of employment, requires that an employee attain age 65 for a normal retirement benefit.

Criteria: Section 1.12 of Ordinance No. 1006 states, in part:

“Normal Retirement Date” shall mean the first day of the month coincident with or next following the date on which the member attains age 65.

The plan does provide a reduced early retirement benefit at age 55, which the terminated employee was eligible to receive at the time of his termination of employment with the borough.

Cause: Plan officials believed that their methodology for calculating the retirement pension benefit was authorized by Ordinance No. 1168, which provided an early retirement incentive for employees who retired in January 2010. However, the referenced employee terminated in June 2012.

In addition, the borough subsequently enacted Ordinance No. 1204 on August 6, 2014, which allows employees who retired in June of 2012 and who were within five years of retirement to retire with a pension that is not reduced for early commencement of payments.

Effect: The plan is paying pension benefits to a retiree in excess of those authorized by the plan’s governing document that was in effect at the time of the member’s termination of employment. The retiree is receiving excess benefits of \$877 per month, which have totaled approximately \$43,850 from the date of retirement through the date of this audit report.

Providing unauthorized pension benefits increases the plan’s pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Since the borough received state aid based on unit value during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, the increased costs to the pension plan as a result of the excess pension benefits could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

QUAKERTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Recommendation: We again recommend that the pension benefit of any retiree whose benefit was not determined in accordance with the provisions of the plan’s governing document be adjusted prospectively. In addition, any excess benefit payments made from the plan will be deemed ineligible for funding with state aid. Accordingly, the pension plan’s actuary may be required to determine the impact, if any, of the excess benefit payments on the borough’s future state aid allocations and submit this information to the Department. If it is determined the excess benefit payments had an impact on the borough’s future state aid allocations after the submission of this information, the plan’s actuary would then be required to contact the Department to verify the overpayment of state aid received. Plan officials would then be required to reimburse the overpayment to the Commonwealth.

We further recommend that future pension benefits be calculated and paid in accordance with the applicable provisions contained in the plan’s governing document in effect at the time of a plan member’s retirement.

Management’s Response: Municipal officials agreed with the finding without exception. However, borough officials stated they do not intend to adjust the pension benefit of the retiree.

Auditor’s Conclusion: Based on the Criteria cited above, the finding remains as stated. If municipal officials determine the plan is obligated to pay the excess pension benefit to the retiree, as noted in the Recommendation above, such excess benefit payments will be deemed ineligible for funding with state aid, and the borough’s monitoring of the effect on future state aid allocations will be evaluated during future audits of the plan.

QUAKERTOWN 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, 2011, is as follows:

	(1)	(2)	(3)	(4)
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)
01-01-11	\$ 6,078,785	\$ 7,886,686	\$ 1,807,901	77.1%
01-01-13	6,812,059	8,852,010	2,039,951	77.0%
01-01-15	8,073,578	9,060,340	986,762	89.1%

Note: The market values of the plan's assets at 01-01-11, 01-01-13, and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses over a 4-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.

QUAKERTOWN 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.

QUAKERTOWN 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
2010	\$ 269,428	100.0%
2011	307,724	100.0%
2012	294,984	100.0%
2013	287,384	100.0%
2014	290,322	100.0%
2015	401,064	100.0%

QUAKERTOWN BOROUGH NON-UNIFORMED 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	9 years
Asset valuation method	Market value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	5.0%
Cost-of-living adjustments	Annual increase equal to increase in CPI, limited to 3% per year and limited to 50% total increase.

QUAKERTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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