

# COMPLIANCE AUDIT

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## Shippensburg Borough Non-Uniformed Pension Plan Cumberland County, Pennsylvania For the Period January 1, 2014 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  
Shippensburg Borough  
Cumberland County  
Shippensburg, PA 17257

We have conducted a compliance audit of the Shippensburg Borough Non-Uniformed Pension Plan for the period January 1, 2014 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 also tested individual employee contributions for all 10 defined contribution plan employees hired on or after January 1, 2012 amounting to \$1,680, \$3,087, and \$5,265, for the years 2014, 2015, and 2016, respectively, made during the audit period.
- We determined whether retirement benefits calculated for all 5 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 also determined whether retirement benefits calculated for all 3 of the plan members 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 retired individuals and comparing these amounts to supporting documentation evidencing amounts determined.
- We determined 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.
- We determined whether the terms of the plan's unallocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contract with the plan's provisions, investment policies, and state regulations.

Shippensburg Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements 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 Shippensburg 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.

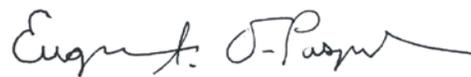
The results of our procedures indicated that, in all significant respects, the Shippensburg Borough Non-Uniformed Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further discussed later in this report:

Finding – Failure To Fund Members' Accounts

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 Shippensburg 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

October 6, 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 Shippensburg Borough Non-Uniformed 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.

The Shippensburg Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan for employees hired on or before December 31, 2011, and a single-employer defined contribution pension plan for employees hired on or after January 1, 2012, locally controlled by the provisions of Ordinance 07-813, 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 January 1, 1973. Active members were required to contribute 2 percent of total earnings to the plan for the year 2014 through February 28, 2015, and 2.5 percent from March 1, 2015 through the year 2016. The municipality is required to contribute \$3,000 per year for each member of the defined contribution plan. As of December 31, 2016, the plan had 28 active members, 12 terminated members eligible for vested benefits in the future, 20 retirees receiving pension benefits from the plan, and 3 retirees receiving benefits funded through annuities purchased with plan assets.

## **BACKGROUND – (Continued)**

As of December 31, 2016, selected plan benefit provisions for members of the defined benefit plan are as follows:

### Eligibility Requirements:

Normal Retirement	Age 65
Early Retirement	Age 55, actuarially reduced to reflect early commencement of benefits.
Vesting	None for the first 5 years of service; thereafter 100%

### Retirement Benefit:

The monthly pension shall be 1.75% of the employee's average compensation for the highest three compensation years, multiplied by the employee's benefit service which is one year for each service period during which the employee has 1,000 or more hours of service (maximum 25 years).

### Survivor Benefit:

If a participant dies prior to the date on which benefits commence and after the participant is vested in the plan, his or her spouse shall be entitled to the actuarial equivalent of the preretirement annuity that would have been payable on the earliest date on which the participant could have elected to retire.

### Disability Benefit:

None

SHIPPENSBURG BOROUGH NON-UNIFORMED PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Failure To Fund Members’ Accounts**

Condition: In 2014, the borough did not fund the account of one member who subsequently terminated and was not vested in the plan. In 2015, the borough did not fund the accounts of four members, two who subsequently terminated and were not vested in the plan. In 2016, the borough did not fund the accounts of four members, one who subsequently terminated and was not vested in the plan. Additionally, in 2016, the borough funded the account of one member who subsequently terminated and was not vested in the plan. Therefore, the amount funded will be forfeited.

Criteria: Section 4.01 of Ordinance No. 13-894 states, in part:

For an Active Participant whose date of hire occurred on or after January 1, 2012, there shall be established by the Employer, a cash balance retirement account for each Participant. ...the Employer shall contribute to such cash balance retirement account on an annual basis, an amount equal to Three Thousand Dollars (\$3,000).

Also, Section 5.02 of Ordinance No. 13-894 states, in part:

The value of the cash balance retirement account attributable to Employer Contributions set aside for any Participant who did not complete the minimum of five (5) years of service set forth above shall be considered forfeited and used to defray any current or future required Employer Contributions to this Plan.

Cause: Borough officials were unaware of their obligation to make a contribution for new full-time employees.

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.

Due to the borough’s failure to fund the accounts of the five remaining plan members, the borough must now pay interest on the delinquent contributions.

Recommendation: We recommend that the borough deposit \$12,000 of contributions plus interest due and reallocate the \$3,000 of forfeitures to the members’ accounts for the years 2015 and 2016. The interest should be calculated from the date of deposit of the municipal contributions which were made in that year to the date of deposit of the amount in arrears. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

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

SHIPPENSBURG BOROUGH NON-UNIFORMED PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

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

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

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

The supplementary information contained on Pages 5 and 6 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION  
LIABILITY AND RELATED RATIOS  
FOR THE YEARS ENDED DECEMBER 31, 2014, 2015, AND 2016

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Total Pension Liability			
Service cost	\$ 104,786	\$ 75,772	\$ 79,182
Interest	348,886	349,206	367,195
Difference between expected and actual experience	-	(252,281)	-
Benefit payments, including refunds of member contributions	(158,499)	(177,712)	(199,361)
Net Change in Total Pension Liability	<u>295,173</u>	<u>(5,015)</u>	<u>247,016</u>
Total Pension Liability - Beginning	4,626,273	4,921,446	4,916,431
Total Pension Liability - Ending (a)	<u>\$ 4,921,446</u>	<u>\$ 4,916,431</u>	<u>\$ 5,163,447</u>
Plan Fiduciary Net Position			
Contributions – state aid	\$ 116,181	\$ 117,625	\$ 135,614
Contributions – employer	81,324	80,388	67,279
Contribution – member	26,334	36,960	32,307
Net investment income	238,553	(43,415)	271,320
Benefit payments, including refunds of member contributions	(158,499)	(177,712)	(199,361)
Other	-	(4,209)	-
Net Change in Plan Fiduciary Net Position	<u>303,893</u>	<u>9,637</u>	<u>307,159</u>
Plan Fiduciary Net Position - Beginning	3,817,742	4,121,635	4,131,272
Plan Fiduciary Net Position - Ending (b)	<u>\$ 4,121,635</u>	<u>\$ 4,131,272</u>	<u>\$ 4,438,431</u>
Net Pension Liability - Ending (a-b)	<u>\$ 799,811</u>	<u>\$ 785,159</u>	<u>\$ 725,016</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	83.75%	84.03%	85.96%
Estimated Covered Employee Payroll	\$ 1,379,612	\$ 1,333,442	\$ 1,248,207
Net Pension Liability as a Percentage of Covered Employee Payroll	57.97%	58.88%	58.08%

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

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the borough as of December 31, 2015 and 2016, calculated using the discount rate of 7.5%, as well as what the borough's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Net Pension Liability - 12/31/2015	\$ 1,343,529	\$ 785,159	\$ 307,810
Net Pension Liability - 12/31/2016	\$ 1,292,622	\$ 725,016	\$ 238,889

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2014	6.64%
2015	(0.77%)
2016	6.66%

SHIPPENSBURG 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	\$ 3,166,385	\$ 4,222,979	\$ 1,056,594	75.0%
01-01-13	3,186,919	4,347,613	1,160,694	73.3%
01-01-15	4,121,635	4,669,165	547,530	88.3%

Note: The market value of the plan's assets at 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.

SHIPPENSBURG 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.

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

DEFINED BENEFIT PLAN

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2011	\$ 230,363	100.2%
2012	233,763	100.2%
2013	198,578	100.0%
2014	197,504	100.0%
2015	198,013	100.0%
2016	193,893	100.0%

SHIPPENSBURG 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
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	4.5%
Cost-of-living adjustments	None assumed

\* Includes inflation at 3.0%

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

DEFINED CONTRIBUTION PLAN

Year Ended December 31	State Aid	Employer Contributions
2014	None	None
2015	None	None
2016	None	\$ 9,000

SHIPPENSBURG BOROUGH NON-UNIFORMED PENSION PLAN  
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