

COMPLIANCE AUDIT

Chester Hill Borough Non-Uniformed Pension Plan Clearfield County, Pennsylvania For the Period January 1, 2013 to December 31, 2016

January 2018



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
Chester Hill Borough
Clearfield County
Philipsburg, PA 16866

We have conducted a compliance audit of the Chester Hill Borough Non-Uniformed Pension Plan for the period January 1, 2013 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 findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings 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. State aid allocations that were deposited into the pension plan for the years ended December 31, 2013 to December 31, 2016, are presented on the Summary of Deposited State Aid and Employer Contributions.

- 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. Employer contributions that were deposited into the pension plan for the years ended December 31, 2013 to December 31, 2016, are presented on the Summary of Deposited State Aid and Employer Contributions.
- We determined that there were no employee contributions required by the plan's governing document and applicable laws and regulations for the years covered by our audit period.
- We determined that there were no benefit calculations prepared for the years covered by our audit period.
- 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 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.

The borough has elected to purchase allocated insurance contracts to fund the pension benefits for plan members. Under an allocated funding arrangement, the insurer receives and retains consideration in exchange for a legally enforceable obligation to pay future benefits. In accordance with Statement No. 67 of the Governmental Accounting Standards Board, as amended, allocated insurance contracts are excluded from the pension plan's assets. Consequently, the plan has no reportable assets.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Chester Hill 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 Chester Hill 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 findings further discussed later in this report:

- Finding No. 1 – Pension Plan Not Formally Adopted By Ordinance Or Resolution
- Finding No. 2 – Improper Receipt Of State Aid
- Finding No. 3 – Receipt Of State Aid In Excess Of Entitlement
- Finding No. 4 – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

The contents of this report were discussed with officials of Chester Hill 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.

January 4, 2018


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 Chester Hill 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 Chester Hill Borough Non-Uniformed Pension Plan is a single-employer defined contribution pension. The plan was established January 1, 2008. Active members are not required to contribute to the plan. The municipality is required to contribute \$1,800 per member. As of December 31, 2016, the plan had 2 active members and no terminated members eligible for vested benefits in the future.

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Pension Plan Not Formally Adopted By Ordinance Or Resolution

Condition: The establishment, terms, provisions and conditions of the non-uniformed defined contribution pension plan were executed in a document effective December 12, 2000. However, the document has not been formally adopted by a properly executed ordinance or resolution.

Criteria: Proper internal control procedures dictate that the provisions of the pension plan be formally adopted by a municipal ordinance or resolution.

Cause: Plan officials were unaware that the borough should formally adopt the provisions of the proposed plan agreement through a properly executed ordinance or resolution.

Effect: The failure to properly establish a pension plan or adopt plan provisions could result in receipt of state aid to which the borough is not entitled, and/or improper or inconsistent benefit payments to plan members and their beneficiaries.

Recommendation: We recommend that officials take appropriate action to formally establish the pension plan and adopt the plan provisions through a properly executed ordinance or resolution.

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.

Finding No. 2 – Improper Receipt Of State Aid

Condition: In 2010, the borough improperly received an allocation of state aid totaling \$2,400 for its non-uniformed pension plan.

Criteria: Section 402(d) of Act 205 states that pension plans established subsequent to December 18, 1984, must be maintained for at least three plan years before becoming eligible for state aid. Further, Section 102 of Act 205 defines plan year as “a calendar year commencing on January 1 and ending on December 31”.

Cause: Plan officials failed to fund the plan for three years before becoming eligible for state aid.

Effect: The borough improperly received state aid of \$2,400 in 2010 before they had become eligible for the receipt of state aid. In 2010, municipal officials returned \$1,200 of the state allocation received, leaving a balance of \$1,200 due the Commonwealth.

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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

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

Recommendation: We recommend the borough return the excess 2010 state aid allocation in the amount of \$1,200 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 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 evidence of payment.

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 plan.

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

Auditor’s Conclusion: 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 report and through our next audit of the plan.

Finding No. 3 – Receipt Of State Aid In Excess Of Entitlement

Condition: The borough received state aid in excess of the non-uniformed pension plan’s defined contribution pension costs for full-time plan members in the years 2014 and 2015, as illustrated below:

	<u>2014</u>	<u>2015</u>
State aid allocation	\$ 3,970	\$ 4,029
Municipal pension costs for full-time plan members	<u>(3,600)</u>	<u>(3,600)</u>
Excess state aid	<u>\$ 370</u>	<u>\$ 429</u>

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Criteria: Section 402(f)(2) of Act 205 states:

No municipality shall be entitled to receive an allocation of general municipal pension system State aid in an amount which exceeds the aggregate actual financial requirements of any municipal pension plans for police officers, paid firefighters or employees other than police officers or paid firefighters maintained by the municipality, less the amount of any aggregate annual member or employee contributions during the next succeeding plan year, as reported in the most recent complete actuarial report filed with the commission.

In addition, Section 402(d) of Act 205 states, in part:

Eligible recipients of general municipal pension system State aid. Any county of the second class which, prior to the effective date of this chapter, received allocations for its police pension fund pursuant to the act of May 12, 1943 (P.L. 259, No. 120), or any city, borough, incorporated town or township or any home rule municipality formerly classified as a city, borough, incorporated town or township which employs one or more full-time municipal employees. . . .

Furthermore, Section 402(e)(2) of Act 205 states, in part:

The applicable number of units shall be attributable to each active employee who was employed on a full-time basis for a minimum of six consecutive months. . . .

Therefore, Act 205 state aid funding may only be used to fund the pension costs attributable to full-time employees.

Cause: Plan officials failed to reconcile the borough's allocations of state aid to the plan's annual defined contribution pension costs attributable to full-time plan members.

Effect: It is this department's opinion that since the entire proceeds of the insurance premium tax on foreign casualty insurance companies are distributed annually to each eligible recipient municipality, it is inappropriate to use state aid in one year to offset pension costs in other years. Consequently, the overpayments of state aid in the years 2014 and 2015 must be returned to the Commonwealth for redistribution.

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

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Recommendation: We recommend that the municipality return the \$799 overpayment of state aid received in the years 2014 and 2015 to the Commonwealth from the borough’s general fund. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the 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 evidence of payment.

Furthermore, we recommend that, in the future, plan officials reconcile the amount of state aid allocated to the borough with the plan’s annual defined contribution pension costs attributable to full-time members and reimburse any excess state aid received to the Commonwealth.

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

Auditor Response: 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 report and through our next audit of the plan.

Finding No. 4 – Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Condition: The borough failed to certify one eligible non-uniformed employee and understated payroll by \$13,382 on the Certification Form AG 385 filed in 2017. The data contained on this certification form is based on prior calendar year information.

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

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

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

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 plan. Because the borough’s state aid allocation was based on pension costs, the borough received an underpayment of state aid of \$332 as identified below:

<u>Year</u>	<u>Normal Cost</u>	<u>Payroll Understated</u>	<u>State Aid Underpayment</u>
2017	2.4821%	\$ 13,382	\$ 332

Although the borough will be reimbursed for the underpayment of state aid due to the borough’s certification error, the full amount of the 2017 state aid allocation was not available to be deposited timely and therefore resulted in the borough having to make additional municipal contributions in order to meet the plan’s funding obligation.

Recommendation: We 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

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

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

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Findings Nos. 2 and 3 contained in this audit report cite overpayments of state aid to the borough in the amounts of \$1,200 and \$799, respectively. Conditions of this nature may lead to a total withholding of state aid in the future unless those findings are 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.

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

Year Ended December 31	State Aid	Employer Contributions
2011	\$ 1,285	None
2012	1,778	\$ 1,200
2013	3,404	1,200
2014	3,970	600
2015	4,029	1,200
2016	1,187	600

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
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This report was initially distributed to the following:

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