

COMPLIANCE AUDIT

Dunmore Borough Non-Uniformed Pension Plan Lackawanna County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

January 2018



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov

EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and Borough Council
Dunmore Borough
Lackawanna County
Dunmore, PA 18512

We have conducted a compliance audit of the Dunmore Borough Non-Uniformed Pension Plan for the period January 1, 2015 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 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 findings 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 findings 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 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 determined whether retirement benefits calculated for both 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 the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients.
- We determined whether the 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, 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 and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation.

Dunmore 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 Dunmore 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 Dunmore 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 – Unauthorized Pension Benefit.

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. In our prior audit report, it was noted that the Department was extremely concerned about the historical trend information contained in the schedules of funding progress included in the report which indicated a continued decline of assets available to satisfy the long-term liabilities of the plan. The plan's funded ratio went from 78.0% as of January 1, 2009, to a ratio of 44.8% as of January 1, 2013. Based on this information, and the funding status of the borough's police and firemen's pension plans, pursuant to Act 205 distress levels, the borough was in Level III severe distress status. As noted in the prior audit report, the borough deposited note proceeds in the amount of \$723,021 into the plan which was reflected in the plan's January 1, 2015 actuarial valuation report. Due in large part to the effect of this deposit, the plan's funded ratio increased to 84.6%, and based on the aggregate funding levels of its plans as of January 1, 2015, the borough received a notification from the former Public Employee Retirement Commission (PERC) that the borough has improved to Level I minimal distress status.

As noted in the Comments section of this audit report, the Borough deposited an additional \$619,897 of note proceeds into the non-uniformed pension plan in December of 2016. The effect of this deposit will be reflected in the plan's January 1, 2017, actuarial valuation report. While the Borough has dramatically improved the plan's funding status through the deposit of note proceeds in 2013 and 2016, the Borough is also obligated to pay the principal and interest on its debt service, in addition to meeting its plans' annual funding obligations in the future. We encourage borough officials in their fiduciary capacity to ensure that fiscally responsible decisions are made that will benefit Dunmore Borough and its taxpayers to ensure the Borough's pension plans have adequate resources to meet current and future benefit obligations to the Borough's hard-working police officers, firefighters and municipal employees.

The contents of this report were discussed with officials of Dunmore 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 19, 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 Dunmore 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 Dunmore Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 9 of 1972, 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 September 9, 1972. Active members are required to contribute 3 percent of compensation to the plan. As of December 31, 2016, the plan had 4 active members, 1 terminated member eligible for vested benefits in the future, and 9 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2016, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 55 and 15 years of service.
Early Retirement	None
Vesting	A member is 100% vested after 5 years of service.

Retirement Benefit:

Benefit equal to one-half of the average monthly salary of the participant during the last 12 months of employment.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	None

Service Related Disability Benefit:

None

DUNMORE BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

Dunmore Borough has complied with the prior audit recommendation concerning the following:

- Failure To Pay The Minimum Municipal Obligation Of The Plan

Borough officials paid the outstanding minimum municipal obligation (MMO) due to the non-uniformed pension plan for the year 2014.

Noncompliance With Prior Audit Recommendation

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

- Unauthorized Pension Benefit

DUNMORE BOROUGH NON-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Noncompliance With Prior Audit Recommendation – Unauthorized Pension Benefit

Condition: As disclosed in our prior audit report, a plan member terminated employment with the borough previously on December 24, 2014 and was eligible for a vested pension benefit payable beginning in August 2017. However, borough officials improperly calculated a normal retirement benefit for the member and began making payments to the member in January 2015.

Criteria: An ordinance dated November 29, 1995, at Section 6 states, in part:

A vested benefit is payable on the member's superannuation retirement date (date when both age and service requirements would have been met). The vested benefit is calculated as follows: 50% of the member's average salary over the last 12 months of employment multiplied by a fraction, the numerator of which is the number of full years from entry into the plan to the date on which the determination is made and denominator of which is the years from entry into the plan to normal retirement date.

Cause: Municipal officials were aware that this individual was 32 months short of a full retirement benefit; however, they agreed to pay an unreduced normal retirement in lieu of making continued post-retirement health care benefit payments for the member and member's spouse for the contractually obligated 36 months.

Effect: By receiving a normal retirement benefit, the pensioner began receiving a benefit of \$1,779 per month on January 1, 2015, instead of a reduced vested benefit of \$1,423 beginning on the member's superannuation retirement date of August 28, 2017.

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. In the future, the unauthorized pension benefit may result in the receipt of excess state aid and will increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

DUNMORE BOROUGH NON-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We recommend that the pension benefit of the aforementioned retiree be adjusted to the authorized vested benefit the retiree is eligible to receive.

Furthermore, to the extent that the borough continues to pay pension benefits in excess of those authorized by the plan's governing document, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, such benefits will be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the excess benefits on the borough's future state aid allocations and submit this information to the department. If it is determined the excess benefits 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.

Management's Response: Municipal officials disagreed with the recommendation indicating that the borough's intention is not to reduce the retirement incentive benefit. Moving forward the borough may consider amending the governing document to include an early retirement clause.

Auditor's Conclusion: Based on the criteria cited above, the finding remains as stated. Compliance will be evaluated during our next audit of the plan.

DUNMORE 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	\$ 1,153,695	\$ 1,748,943	\$ 595,248	66.0%
01-01-13	890,653	1,985,941	1,095,288	44.8%
01-01-15	1,854,681	2,193,132	338,451	84.6%

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 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.

DUNMORE 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.

DUNMORE 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
2011	\$ 77,912	100.0%
2012	84,579	100.0%
2013	172,364	100.0%
2014	187,870	100.0%*
2015	179,607	100.0%*
2016	173,827	100.0%*

Note* - The borough deposited a portion of the net proceeds of a general obligation note issued during 2016 into the non-uniformed pension plan in the amount of \$619,897 representing the pension plan's outstanding 2014 and 2015 required contributions as well as the 2016 minimum municipal obligation and included interest due to the late deposit of the borough's original obligations.

DUNMORE 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	1 year
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	6.0%

DUNMORE BOROUGH NON-UNIFORMED PENSION PLAN
COMMENTS

Debt Service Obligations

In 2004, the borough issued General Obligation Pension Funding Bonds - Series of 2004 in the amount of \$4,115,000 for the purpose of providing money to fund a portion of the borough's unfunded actuarial accrued pension liability for its pension plans and for the cost of issuance. The borough made payments toward the debt service (principal and interest) on these bonds in the amounts of \$363,040 and \$373,895, for the years 2015 and 2016, respectively, and an additional \$384,160 in subsequent year 2017. The annual payments for this note are due until May 2019.

In addition, during the year ended December 31, 2013, the borough obtained a General Obligation Note – Series A of 2013 in the amount of \$5,000,000 for the purpose of making contributions to its pension plans. Proceeds from the note in the amount of \$723,021 were deposited into the non-uniformed pension plan to fund the past due 2012 minimum municipal obligation (MMO) payment due and to fully pay the outstanding 2013 MMO due to the plan. The borough made monthly payments of \$35,724 towards the principal and interest totaling \$428,683 and 428,683 for the years 2015 and 2016, respectively, and an additional \$430,471 in subsequent year 2017. The monthly payments for this note are due until February 2, 2028.

Finally, during the year ended December 31, 2016, the borough obtained a General Obligation Note – Series A of 2016 in the amount of \$5,000,000 for the purpose of making a contribution to its pension plans. A portion of the proceeds from the note in the amount of \$619,897 were deposited into the non-uniformed pension plan to fund the outstanding 2014 and 2015 MMO balances due the plan and to fully pay the 2016 MMO balance due the non-uniformed pension plan. Subsequent to the current audit period, the borough began making monthly payments in the amount of \$36,012 towards the outstanding principal and interest on the note which totaled \$432,144 for the year 2017. The monthly payments for this note are due until December 16, 2031.

The following schedule summarizes the total amounts paid by the borough towards its debt service obligations for the benefit of its pension plans during and subsequent to the current audit period:

Years Paid	Series of 2004 Payments	Series of 2013 Payments	Series of 2016 Payments	Total
2015	\$ 363,040	\$ 428,683	\$ -	\$ 791,723
2016	373,895	428,683	-	802,578
2017	384,160	430,471	432,144	1,246,775
Totals	<u>\$ 1,121,095</u>	<u>\$ 1,287,837</u>	<u>\$ 432,144</u>	<u>\$ 2,841,076</u>

DUNMORE BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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