

LIMITED PROCEDURES ENGAGEMENT

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

February 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
Kittanning Borough
Armstrong County
Kittanning, PA 16201

We conducted a Limited Procedures Engagement (LPE) of the Kittanning Borough Non-Uniformed Pension Plan for the period January 1, 2015 to December 31, 2016 to determine its compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. We also evaluated compliance with some requirements subsequent to that period when possible. The LPE was conducted pursuant to authority derived from Section 402(j) of the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.) but was not conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. 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. We believe that the evidence obtained provides a reasonable basis to support our LPE results.

Our LPE was limited to determining the following:

- 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 engagement period.
- 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.
- Whether annual employee contributions were required during the engagement period and, if so, 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 engagement period and examining documents evidencing the deposit of these employee contributions into the pension plan.

- Whether retirement benefits calculated for plan members who retired during the engagement 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.
- 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.

Based on the results of our procedures performed during our LPE, nothing came to our attention indicating that the Kittanning Borough Non-Uniformed Pension Plan was not being 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 – Ineligible Employees Participating In The Pension Plan

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Our determination to perform an LPE for this engagement period does not preclude the Department from conducting an audit in accordance with *Government Auditing Standards* of the pension plan in subsequent periods. The borough should continue to maintain documentation related to this pension plan.

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 Kittanning Borough and, where appropriate, their responses have been included in this report. We would like to thank borough officials for the cooperation extended to us during the conduct of this LPE.

February 9, 2018



EUGENE A. DEPASQUALE
Auditor General

CONTENTS

	<u>Page</u>
Findings and Recommendations:	
Finding No. 1 – Ineligible Employees Participating In The Pension Plan.....	1
Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid.....	2
Potential Withhold of State Aid.....	4
Supplementary Information	5
Report Distribution List	11

KITTANNING BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Ineligible Employees Participating In The Pension Plan

Condition: During the current audit period, it was determined that the borough included two employees of the municipal sewer authority in the borough’s non-uniformed pension plan, which is not authorized by Act 205.

Criteria: Municipal authorities are created pursuant to the “Municipal Authorities Act of 1945,” May 2, P.L. 382, 53 P.S. §301 et seq. A municipal authority is an independent political and corporate body, not an agent or representative of its creating municipality.

Act 205 defines a Municipality as follows:

Any city, borough, incorporated town, township, home rule municipality, association of municipalities cooperating pursuant to the act of July 12, 1972 (P.L. 762, No. 180), referred to as the Intergovernmental Cooperation Law, or authority established by the actions of any county, city, borough, town or township or jointly by any such political subdivisions.

Act 205 also defines a Municipal Employee as follows:

Any person who provides regular services for a municipality in return for compensation from the municipality.

In addition, Act 205 defines a Pension Plan or System as follows:

The various aspects of the relationship between a municipality and its employees with respect to the retirement coverage provided by a municipality to the employees.

Furthermore, the pension plan agreement with PMRS, effective April 1, 2011, at Section 3.1 states, “Membership for full time officers and employees of the municipality is mandatory. [Emphasis added.]

Consequently, since the plan members are employed by the sewer authority and not the municipality, the plan members are not eligible to participate in the borough’s non-uniformed pension plan.

Cause: Borough officials were aware that the two sewer authority employees were participating in the pension plan, but relied on sewer authority officials to establish its own pension plan for the two employees before contacting PMRS to withdraw them from the borough’s non-uniformed pension plan.

KITTANNING BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Effect: The sewer authority employees' membership in the pension plan resulted in the receipt of excess state aid by the borough. (See Finding No. 2.)

Furthermore, the authority employees' participation in the plan could result in unauthorized pension benefits being paid from plan assets.

Recommendation: We recommend that municipal officials consult with their solicitor, PMRS, and the municipal authority board to establish and implement procedures that will terminate the municipal authority employees' participation in the non-uniformed pension plan at their earliest opportunity to do so.

Management's Response: Municipal officials agreed with the finding without exception. Borough officials intend to classify the two members as authority employees and indicated they have had recent discussions with the municipal authority officials regarding the issue. Borough officials also indicated that sewer authority and borough officials have both contacted PMRS and have requested the two employees be transferred to a separate retirement plan.

Auditor's Conclusion: Based on the management response, it appears municipal officials intend to comply with the finding recommendation. Compliance will be evaluated during our next engagement of the plan.

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The borough certified 1 ineligible employee (1 unit) and overstated payroll by \$57,908 and \$57,919 on the Certification Forms AG 385 filed in 2015 and 2016, respectively, and certified 2 ineligible employees (2 units) and overstated payroll by \$88,979 on the Certification Form AG 385 filed in 2017. The data contained on these certification forms is based on prior calendar year information. The ineligible members are employees of the municipal sewer authority and are not eligible to participate in the non-uniformed pension plan. (See Finding No. 1).

Criteria: Pursuant to Act 205, at Section 402(e)(2), in order to be eligible for certification, an employee must have been employed on a full-time basis by the municipality for at least six consecutive months. [Emphasis added.]

KITTANNING BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Cause: At the time the certification forms were filed, plan officials were uncertain as to the sewer authority employees’ eligibility for inclusion on the certification forms.

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the borough’s state aid allocations were based on unit value, the incorrect certification of pension data affected the borough’s state aid allocations, as identified below:

<u>Year</u>	<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2015	1	\$ 3,921	\$ 3,921
2016	1	\$ 4,375	4,375
2017	2	\$ 4,588	<u>9,176</u>
Total Overpayment of State Aid			<u><u>\$ 17,472</u></u>

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

Recommendation: We recommend that the total excess state aid, in the amount of \$17,472, plus interest, be returned 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 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. A copy of the interest calculation must be submitted along with the check.

We also recommend that in the future, plan officials establish adequate internal control procedures, such as having at least two 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’s Response: Municipal officials agreed with the finding without exception.

Auditor 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 engagement of the pension plan.

KITTANNING BOROUGH NON-UNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 2 contained in this report cites an overpayment of state aid to the borough in the amount of \$17,472, plus interest. A condition of this nature may lead to a total withholding of state aid in the future unless that finding is 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.

KITTANNING 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 AND 2015

	<u>2014</u>	<u>2015</u>
Total Pension Liability		
Service cost	\$ 89,026	\$ 87,566
Interest (includes interest on service cost)	226,073	229,388
Difference between expected and actual experience	(69,078)	-
Changes of assumptions	-	53,839
Benefit payments, including refunds of member contributions	(141,753)	(227,993)
Net Change in Total Pension Liability	<u>104,268</u>	<u>142,800</u>
Total Pension Liability - Beginning	4,091,322	4,195,590
Total Pension Liability - Ending (a)	<u>\$ 4,195,590</u>	<u>\$ 4,338,390</u>
Plan Fiduciary Net Position		
Contributions – employer*	\$ 902	\$ 59,559
Contributions – employee	23,749	24,031
PMRS investment income	216,738	223,401
Market value investment income	(28,096)	(218,794)
Benefit payments, including refunds of member contributions	(141,753)	(227,993)
PMRS administrative expense	(560)	(580)
Additional administrative expense	(8,312)	(9,313)
Net Change in Plan Fiduciary Net Position	<u>62,668</u>	<u>(149,689)</u>
Plan Fiduciary Net Position - Beginning	3,971,115	4,033,783
Plan Fiduciary Net Position - Ending (b)	<u>\$ 4,033,783</u>	<u>\$ 3,884,094</u>
Net Pension Liability - Ending (a-b)	<u>\$ 161,807</u>	<u>\$ 454,296</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	96.14%	89.53%
Estimated Covered Employee Payroll	\$ 689,497	\$ 686,609
Net Pension Liability as a Percentage of Covered Employee Payroll	23.47%	66.17%

* 2014 employer contributions consist of administrative expenses paid from actuarial surplus.

KITTANNING 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, 2014 and 2015, calculated using the discount rate of 5.5%, 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 (4.5%)	Current Discount Rate (5.5%)	1% Increase (6.5%)
	<hr/>	<hr/>	<hr/>
Net Pension Liability - 12/31/14	\$ 617,069	\$ 161,807	\$ (235,019)
Net Pension Liability - 12/31/15	\$ 933,861	\$ 454,296	\$ 37,925

KITTANNING 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	\$ 3,613,099	\$ 3,020,677	\$ (592,422)	119.6%
01-01-13	3,944,015	3,912,010	(32,005)	100.8%
01-01-15	4,122,977	4,195,590	72,613	98.3%

KITTANNING 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.

KITTANNING 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	None	N/A
2012	None	N/A
2013	None	N/A
2014	None	N/A
2015	\$ 59,559	100.0%
2016	60,828	100.0%

KITTANNING 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	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%

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