

COMPLIANCE AUDIT

McDonald Borough Police Pension Plan

Washington County, Pennsylvania
For the Period
January 1, 2017 to December 31, 2020

March 2022



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

The Honorable Mayor and Borough Council
McDonald Borough
Washington County
McDonald, PA 15057

We have conducted a compliance audit of the McDonald Borough Police Pension Plan for the period January 1, 2017 to December 31, 2020. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the 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 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 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 that there were no employee contributions required for the years covered by our audit period due to the fact that employee contributions were appropriately waived by the municipality.
- 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 benefits due to the retired individual and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient.
- We determined whether the January 1, 2017 and January 1, 2019 actuarial valuation reports were prepared and submitted by March 31, 2018 and 2020, 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 provisions of the Deferred Retirement Option Plan (DROP) were in accordance with the provisions of Act 205 by examining provisions stated in the plan's governing documents.

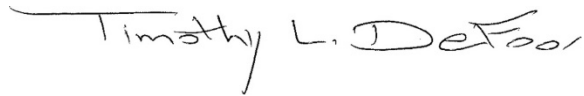
Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the McDonald Borough Police Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 McDonald Borough Police 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 Properly Determine The Minimum Municipal Obligation
Of The 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 McDonald 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.

A handwritten signature in black ink that reads "Timothy L. DeFoor". The signature is written in a cursive style with a long horizontal line extending to the left of the first letter.

Timothy L. DeFoor
Auditor General
March 1, 2022

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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.

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 McDonald Borough Police Pension Plan is also governed by implementing regulations published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

Act 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 767 et seq.

The McDonald Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution No. 524, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the borough and its police officers. The plan was established February 1, 1954. Active members are required to contribute 5 percent of compensation to the plan; however, member contributions are currently waived during the audit period. As of December 31, 2020, the plan had 5 active members and 2 retirees receiving pension benefits.

MCDONALD BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Recommendation

McDonald Borough has complied with the prior recommendation concerning the following:

- Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

During the current audit period, municipal officials complied with the instructions accompanying Certification AG 385 and accurately reported the required pension data.

MCDONALD BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Failure To Properly Determine The Minimum Municipal Obligation Of The Plan

Condition: Plan officials did not properly determine the minimum municipal obligation (MMO) of the police pension plan for the year 2020, as required by Act 205. The MMO determined by the municipality understated payroll by \$72,195. Based upon an estimate prepared by this department, the municipality had an unpaid MMO balance of \$20,781 for the year 2020.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

With regard to the payroll estimate used in the preparation of the MMO, the Pennsylvania Code, Title 16, Section 204.1(c)(1) states, in part:

The payroll used in determining the minimum municipal obligation of a pension plan under section 302(c) of the act shall be based on the payroll to be reported on the Internal Revenue Service Form W-2 and shall be calculated as the total payroll for active members of the plan as of the date of the determination, plus the payroll for the same active members of the plan projected to the year's end using the payroll rates in effect as of the date of the determination.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

MCDONALD BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Cause: Plan officials failed to include a full-time member, along with applicable payroll, when estimating the 2020 MMO's payroll.

Effect: The proper determination of the plan's MMO ensures plan officials can properly allocate the necessary resources to the pension plan for the upcoming year. The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the 2020 MMO by the December 31, deadline, the municipality must add the outstanding 2020 MMO balance to the current year's MMO and include interest, as required by Act 205.

Recommendation: We recommend that the municipality pay the MMO balance of \$20,781 due to the police pension plan for the year 2020, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

Furthermore, we recommend that, in the future, plan officials properly determine the amount of payroll to be used in the MMO calculation.

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.

MCDONALD BOROUGH POLICE 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, 2015, 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)
01-01-15	\$ 955,140	\$ 759,876	\$ (195,264)	125.7%
01-01-17	1,027,393	1,007,470	(19,923)	102.0%
01-01-19	1,063,147	1,004,880	(58,267)	105.8%

MCDONALD BOROUGH POLICE 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.

MCDONALD BOROUGH POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

<u>Year Ended December 31</u>	<u>Actuarially Determined Contribution*</u>	<u>Actual Contributions</u>	<u>Contribution Deficiency (Excess)**</u>	<u>Covered- Employee Payroll</u>	<u>Contributions as a Percentage of Covered- Employee Payroll</u>
2014	\$ -	\$ -	\$ -	\$ 154,846	N/A
2015	10,157	13,276	(3,119)	234,312	5.67%
2016	11,483	26,320	(14,837)	242,913	10.84%
2017	25,098	26,750	(1,652)	219,486	12.19%
2018	18,156	49,158	(31,002)	259,924	18.91%
2019	49,277	49,277	-	186,162	26.47%
2020	48,055	48,055	-	171,134	28.08%

* Based on calculations prepared by this department, the actuarially determined contribution for the year 2020 was actually \$68,836 as disclosed in the finding and recommendation of this report resulting in a \$20,781 underpayment of the 2020 MMO.

** The additional contributions reported in 2017 and 2018 represent deposits of the borough's annual state aid allocation in those years.

MCDONALD BOROUGH POLICE 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, 2021
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	5.75%
Projected salary increases	4.5%

MCDONALD BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable David Cooper
Mayor

Mr. Thomas Rockwell
Council President

Ms. Marie Maximovich
Manager

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.