

# COMPLIANCE AUDIT

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## Nesquehoning Borough Non-Uniformed Pension Plan Carbon County, Pennsylvania For the Period January 1, 2017 to December 31, 2020

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December 2021



Commonwealth of Pennsylvania  
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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

**TIMOTHY L. DEFOOR  
AUDITOR GENERAL**

The Honorable Mayor and Borough Council  
Nesquehoning Borough  
Carbon County  
Nesquehoning, PA 18240

We have conducted a compliance audit of the Nesquehoning Borough Non-Uniformed 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings 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 that there were no benefit calculations prepared for the years covered by our audit period.
- 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.

Nesquehoning Borough contracted with an independent certified public accounting firm for annual audits of its 2017 and 2018 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.

The Nesquehoning Borough Non-Uniformed Pension Plan participates in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's 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 Nesquehoning Borough Non-Uniformed 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.

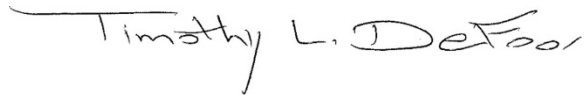
The results of our procedures indicated that, in all significant respects, the Nesquehoning Borough Non-Uniformed Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following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

Finding No. 1 – Noncompliance With Prior Recommendation – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Finding No. 2 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The 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 Nesquehoning 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, flowing style.

Timothy L. DeFoor  
Auditor General  
November 16, 2021

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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 Nesquehoning Borough Non-Uniformed 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 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974  
(P.L. 34, No. 15), as amended, 53 P.S. § 881.101 et seq.

The Nesquehoning Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2020-2, effective April 1, 2020, and a separately executed plan agreement with the Pennsylvania Municipal Retirement System (PMRS), as amended, adopted pursuant to Act 15. Prior to April 1, 2020, the plan was subject to the provisions of Ordinance No. 02-2015, as amended, and a plan agreement with the PMRS pursuant to Act 15. 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, 1992. Active members are required to contribute 3 percent of compensation to the plan; however, member contributions were eliminated during the audit period. As of December 31, 2020, the plan had 7 active members, 1 terminated member eligible for vested benefits in the future, and 6 retirees receiving pension benefits.

NESQUEHONING BOROUGH NON-UNIFORMED PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Recommendation

Nesquehoning Borough has not complied with the prior audit recommendation concerning the following:

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

Municipal officials again failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data, as further discussed in the Findings and Recommendations section of this report.

NESQUEHONING BOROUGH NON-UNIFORMED PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – Noncompliance With Prior Recommendation – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid**

Condition: As disclosed in the Status of Prior Finding section of this report, the borough again failed to comply with the instructions accompanying Certification Form AG 385 to assist them in accurately reporting required data. The borough certified an ineligible non-uniformed employee (1 unit) and overstated payroll by \$15,574 on the Certification Form AG 385 filed in 2021. The individual was on short-term disability from March 2020 through February 2021 and the borough did not provide adequate substantive documentation evidencing that the individual satisfied the requirements for certification pursuant to Act 205. The data contained on this certification form is based on prior calendar year information.

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 for at least six consecutive months and must have been participating in a pension plan during the certification year. In addition, pursuant to the instructions that accompany Certification Form AG 385, the total payroll eligible to be certified should be Internal Revenue Service Form W-2 earnings pertaining to full-time positions.

It has been the position of this department that the status of an employee in relation to his or her pension plan during a temporary disability is defined by the plan document. Various procedures are available to municipalities regarding such disabilities and there may well be multiple options available in each case due to such factors as the availability or applicability of Heart and Lung Act coverage, Workers Compensation, disability insurance and other compensation and/or leave benefits. Due to the nature of the Tax Code, and other factors, all, some, or none of these payments may appear on an employee's W-2. Additionally, the source of such disability entitlement may impact whether or not there is creditable service time for the period of disability under the terms of the municipal pension plan. As it is the element of service time for the period of disability that determines whether or not an employee's temporary disability has any impact on a plan's normal cost or defined contribution, the definition of service in the pension plan will be critical to how disability-related periods of absence are accounted for and thus whether or not any impact occurs on the calculation of normal cost. Generally, disability-related absences, other than work related, will not be included in service time and thus will not impact on normal costs.

Cause: Plan officials believed that a member on short term disability could be certified, even if the employee did not work six months based on prior experience with the department.

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 plans. Because the borough's state aid allocation was based on unit value, the incorrect certification of pension data affected the borough's state aid allocation, as identified below:



NESQUEHONING BOROUGH NON-UNIFORMED PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – (Continued)**

| <u>Year</u> | <u>Units<br/>Overstated</u> | <u>Unit<br/>Value</u> | <u>State Aid<br/>Overpayment</u> |
|-------------|-----------------------------|-----------------------|----------------------------------|
| 2021        | 1                           | \$ 4,797              | \$ 4,797                         |

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

**Recommendation:** We recommend that the total excess state aid, in the amount of \$4,797, 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.

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 pension plan.

**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 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan**

**Condition:** The borough's record-keeping system did not provide effective control over the transactional activity of the non-uniformed pension plan during 2020. Municipal officials were unable to furnish annual financial statements or custodial account transaction statements for the non-uniformed pension plan. These annual financial and account statements have historically been provided by the plan's custodian, PMRS. However, as of the date of this report, annual financial and accounting statements summarizing the pension account activity have not been provided for the year 2020.

NESQUEHONING BOROUGH NON-UNIFORMED PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – (Continued)**

Criteria: An adequate system of accounting and record keeping is a prerequisite for sound administration of pension plans. In addition, assets held in a custodial account for the purpose of plan management are to be governed by the terms and provisions of the account contract, provided that the terms and provisions of the contract are within the parameters of all prevailing pension legislation. Although the municipality may contract with a trustee to administer the financial management of the plan, the fiduciary responsibility for the plan remains with the municipality.

Cause: Municipal officials indicated that the plan’s custodian, PMRS, failed to provide copies of the custodial account transaction statements summarizing activity of the pension plan account for the year 2020. In addition, municipal officials did not maintain a separate detailed accounting of pension plan transactions which, among other things, helps assure the production of proper financial statements to effectively monitor the annual activity of the pension plan.

Effect: Although we were able to obtain alternate documentation from the municipality to evidence the propriety of the individual transactions tested during performance of the audit for the year 2020, the failure to maintain annual financial and/or account transaction statements prohibits municipal officials from effectively monitoring the plan’s financial operations. Additionally, inadequate monitoring of the pension plan account could lead to undetected errors or improprieties in account transactions as well as deficiencies in authorizing and implementing pension plan policies and procedures.

Recommendation: We recommend that municipal officials contact the plan custodian and obtain annual financial statements of the custodial account of the non-uniformed pension plan for the year 2020 to ensure the accuracy and propriety of the transaction activity. In addition, we recommend that municipal officials establish and maintain a financial record-keeping system that allows the municipality to effectively monitor the plan’s financial operations, even in the absence of statements from the plan custodian. Municipal officials should refer to the Auditor General’s Bulletin No. 2-88 entitled “Preparation, Maintenance and Auditability of Financial Records,” for further guidance in establishing adequate accounting and record-keeping procedures.

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

Auditor’s Conclusion: It was noted that PMRS recently went through a substantial upgrade to the plan administration software and implemented a new accounting system. The modernization process, along with the COVID-19 pandemic, resulted in unforeseen delays in the year-end reporting process for financial statements and GASB 68 reports. PMRS officials have taken active measures to resolve these issues and began providing 2020 Year-End Financial Activity Reports and Annual Member Statements for their plans in the fall of 2021. Compliance with the finding recommendation will be evaluated during our next audit of the plan.

NESQUEHONING 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, 2015, is as follows:

|                                | (1)                                    | (2)  | (3)  | (4)                        |
|--------------------------------|--|--|--|----------------------------|
| Actuarial<br>Valuation<br>Date | Actuarial<br>Value of<br>Assets<br>(a) | Actuarial<br>Accrued<br>Liability<br>(AAL) -<br>Entry Age<br>(b) | Unfunded<br>(Assets in<br>Excess of)<br>Actuarial<br>Accrued<br>Liability<br>(b) - (a) | Funded<br>Ratio<br>(a)/(b) |
| 01-01-15                       | \$ 643,038                             | \$ 623,450   | \$ (19,588)  | 103.1%                     |
| 01-01-17                       | 697,887                                | 666,342  | (31,545)   | 104.7%                     |
| 01-01-19                       | 751,782                                | 760,831  | 9,049  | 98.8%                      |

NESQUEHONING 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.

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

SCHEDULE OF CONTRIBUTIONS

| <u>Year Ended<br/>December 31</u> | <u>Actuarially<br/>Determined<br/>Contribution</u> | <u>Actual<br/>Contributions</u> | <u>Contribution<br/>Deficiency<br/>(Excess)</u> | <u>Covered-<br/>Employee<br/>Payroll</u> | <u>Contributions as<br/>a Percentage of<br/>Covered-<br/>Employee<br/>Payroll</u> |
|-----------------------------------|--|---------------------------------|---|--|---|
| 2014                              | \$ 25,950  | \$ 25,950                       | \$ -  | \$ 398,698                               | 6.51%   |
| 2015                              | 18,363   | 18,403                          | (40)  | 274,786                                  | 6.70%   |
| 2016                              | 17,217   | 17,237                          | (20)  | 292,988                                  | 5.88%   |
| 2017                              | 15,874   | 15,874                          | -   | 361,641                                  | 4.39%   |
| 2018                              | 22,666   | 22,666                          | -   | 329,180                                  | 6.89%   |
| 2019                              | 20,701   | 20,701                          | -   | 367,271                                  | 5.64%   |
| 2020                              | 21,341   | 21,341                          | -   | *  | *   |

\* Due to the timing of this audit, covered-employee payroll for 2020 was not provided in this schedule.

NESQUEHONING 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, 2019  |
| Actuarial cost method         | Entry age normal   |
| Amortization method           | Level dollar for plan bases and an average for Aggregate Gain/Loss, 10% of surplus is credited against aggregate cost where applicable.  |
| Remaining amortization period | 14 years   |
| Asset valuation method        | The Actuarial Value of Assets equal the sum of all audited reserve funds as of the valuation date, including Member, Municipal, Retired, Disability, and DROP Reserves, when applicable, and a one year administration expense reserve, plus the portion of any additional investment income to be distributed as excess interest, based on PMRS Policy Statement 05-2. This asset valuation is based on the unique legislative structure of PMRS and the administrative rules adopted by the PMRS Board in conjunction with Pennsylvania Municipal Retirement Law. <sup>1</sup> |

Actuarial assumptions:

|                              |  |
|------------------------------|--|
| Investment rate of return *  | 5.25%, compounded annually, net of investment and administration expenses. |
| Projected salary increases * | 2.8%-7.05%   |
| * Includes inflation at      | 2.8%   |
| Cost-of-living adjustments   | 2.8% per year, subject to plan limitations.                                |

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<sup>1</sup> The administrative rules adopted by the PMRS Board, which are not subject to comply with Actuarial Standards of Practice (ASOP), when defining the Actuarial Value of Assets (AVA), does not necessarily meet the requirement of ASOP 44 Selection and Use of Asset Valuation Methods for Pension Valuations. The AVA provided within this report follow the Pennsylvania Municipal Retirement Law and the PMRS policy statement.

NESQUEHONING BOROUGH NON-UNIFORMED PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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Commonwealth of Pennsylvania

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