

COMPLIANCE AUDIT

Smethport Borough Police Pension Plan McKean County, Pennsylvania For the Period January 1, 2018 to December 31, 2021

May 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
Smethport Borough
McKean County
Smethport, PA 16749

We have conducted a compliance audit of the Smethport Borough Police Pension Plan for the period January 1, 2018 to December 31, 2021. 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 objective. We believe that the evidence obtained provides a reasonable basis for our finding 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.

- 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 by the plan's governing document and applicable laws and regulations for the years covered by our audit period.
- We determined whether retirement benefits calculated for the plan member who elected to vest during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined 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 payable to the recipient.
- We determined whether the January 1, 2019 and January 1, 2021 actuarial valuation reports were prepared and submitted by March 31, 2020 and 2022, 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.

Smethport Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements for the years ended 2020, 2019 and 2018, 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 Smethport 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 objective.

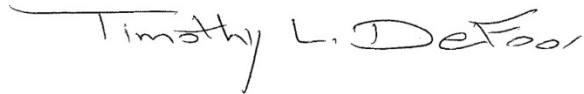
The results of our procedures indicated that, in all significant respects, the Smethport Borough Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding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

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

Finding No. 2 – Restated Plan Document Not Adopted By Ordinance

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 Smethport 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 horizontal line above the first name.

Timothy L. DeFoor
Auditor General
April 27, 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 Smethport 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 37 - The Borough Code, Act of April 18, 2014 (P.L. 432, No. 37), Chapter 11, Subchapter F Police Pension Fund in Boroughs Having a Police Force of Less Than Three Members, as amended, 8 Pa. C.S. § 1131 et seq.

The Smethport Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 354, and a separately executed plan document effective January 1, 2016. The plan was established February 2, 1970. Active members are not required to contribute to the plan. As of December 31, 2021, the plan had two active members, two terminated members eligible for vested benefits in the future, and no retirees receiving pension benefits.

SMETHPORT BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: The borough certified an ineligible police officer (2 units) and overstated payroll by \$27,053 on the Certification Form AG 385 filed in 2021. 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.

Cause: Plan officials failed to establish adequate internal control procedures, such as having another individual review the data certified, to ensure accuracy of the reported data prior to submission.

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 2021 state aid allocation was based on unit value, the incorrect certification of pension data affected the borough's state aid allocation, as identified below:

<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2	\$ 4,797	\$ 9,594

In addition, the borough used the overpayment of state aid to pay the minimum municipal obligation (MMO) due to the police 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 overpayment of state aid, in the amount of \$9,594, 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.

SMETHPORT BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

In addition, if the reimbursement to the Commonwealth is made from police 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: The borough's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through the next audit of the plan.

Finding No. 2 – Restated Plan Document Not Adopted By Ordinance

Condition: The terms, provisions and conditions of the police pension plan were restated in a separately executed plan document effective January 1, 2016. However, the restated agreement has not been formally adopted by an ordinance that would properly amend the plan's existing governing ordinance.

Criteria: Act 37, at Section 1131(a) states, in part:

If a police force of less than three full-time members is being maintained, the borough may, unless there is a private organization or association constituting and managing an existing pension fund for the members of the police force in the borough, by ordinance, establish a police pension fund...

Further, Act 205, at Section 102, defines establishment and maintenance of pension plan as:

Specification of the provisions which comprise the benefit plan of the pension plan in an ordinance or resolution of the municipality or contract to which the municipality is a party.

Cause: Due to municipal turnover, plan officials were unaware that the borough should formally adopt the provisions of the restated plan agreement through a properly executed ordinance.

Effect: The failure to properly adopt the plan agreement could result in improper or inconsistent benefit payments to plan members and their beneficiaries.

Recommendation: We recommend that municipal officials take appropriate action to formally adopt the restated plan document through a properly executed ordinance.

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.

SMETHPORT 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, 2017, 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)
01-01-17	\$ 429,008	\$ 200,515	\$ (228,493)	214.0%
01-01-19	447,906	248,174	(199,732)	180.5%
01-01-21	645,920	277,809	(368,111)	232.5%

Note: The Actuarial Accrued Liability as of 01-01-17 reflects increases in the number of active members, changes in assumptions and an experienced loss due to asset performance less than the assumed rate of return during the two-year valuation period.

SMETHPORT 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.

SMETHPORT 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>
2013	\$ -	\$ -	\$ -	\$ 75,905	0.0%
2014	-	-	-	57,815	0.0%
2015	-	-	-	96,312	0.0%
2016	-	-	-	104,845	0.0%
2017	-	-	-	108,778	0.0%
2018	5,503	5,503	-	100,561	5.5%
2019	3,698	3,698	-	113,222	3.3%
2020	10,512	10,512	-	86,762	12.1%
2021	9,145	9,145	-		

* Due to the timing of this audit, covered-employee payroll for 2021 was not provided in this schedule.

SMETHPORT 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	5.0%
Projected salary increases	4.0%
Cost-of-living adjustments	None assumed

SMETHPORT 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 Wayne Foltz
Mayor

Mr. Gregory Rounselle
Council President

Ms. Melody DeLuca
Secretary

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.