

COMPLIANCE AUDIT

Tremont Borough Non-Uniformed Pension Plan Schuylkill County, Pennsylvania For the Period January 1, 2017 to December 31, 2018

January 2020



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
Tremont Borough
Schuylkill County
Tremont, PA 17981

We have conducted a compliance audit of the Tremont Borough Non-Uniformed Pension Plan for the period January 1, 2017 to December 31, 2018. 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 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 findings contained in our prior LPE 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 LPE 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. State aid allocations that were deposited into the pension plan for the years ended December 31, 2013 to December 31, 2018, are presented on the Summary of Deposited State Aid and Employer Contributions.

- 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 that there were no benefit calculations prepared for the years covered by our audit period.
- We determined whether the January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2016 and 2018, 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 of all of the plan's allocated insurance contracts, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contracts with the plan's provisions, investment policies, and state regulations.

The borough has elected to purchase allocated insurance contracts to fund the pension benefits for plan members. Under an allocated funding arrangement, the insurer receives and retains consideration in exchange for a legally enforceable obligation to pay future benefits. In accordance with Statement No. 25 of the Governmental Accounting Standards Board, as amended, allocated insurance contracts are excluded from the pension plan's assets. Consequently, the plan has no reportable assets.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Tremont 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 Tremont 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 – Partial Compliance With Prior Recommendation – Unauthorized Funding Mechanism
- Finding No. 2 – Partial Compliance With Prior Recommendation – Failure To File Actuarial Valuation Report
- Finding No. 3 – Partial Compliance With Prior Recommendation – Failure To Fund Members' Accounts
- Finding No. 4 – Noncompliance With Prior Recommendation – Custodial Account Records Not Maintained By The Municipality

The findings contained in this audit report repeat conditions that were cited in our previous LPE report that have not been corrected by borough officials. We are concerned by the borough's failure to correct those previously reported findings and strongly encourage timely implementation of the recommendations noted in this audit report.

The contents of this report were discussed with officials of Tremont 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.

December 12, 2019



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 Tremont 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 Tremont Borough Non-Uniformed Pension Plan is a single-employer pension plan locally controlled by the Resolution No. 2005-11. The plan was established March 14, 1994. Active members are not required to contribute to the plan. The municipality maintains a pension plan with no defined contributions and variable pension or retirement benefits provided, usually through discretionary purchases of insurance or annuity contracts. As of December 31, 2018, the plan had 3 active members, no terminated members eligible for vested benefits in the future, and no retirees receiving pension benefits.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Recommendation

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

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

During the current audit period, the borough reimbursed \$2,156 to the Commonwealth for the overpayment of state aid in 2013, with interest.

Partial Compliance With Prior Recommendations

Tremont Borough has partially complied with the prior recommendations concerning the following:

- Unauthorized Funding Mechanism

Subsequent to the current audit period, the borough purchased deferred annuity contracts in the name of the borough for the benefit of two of the members previously identified in the prior report, for the purpose of providing retirement benefits in accordance with Act 205 and appropriately deposited the state aid received by the borough during 2016 and 2017 into these eligible investment contracts. *(As of our fieldwork completion date, the borough had yet to receive its 2018 state aid allocation due to the failure to file its actuarial valuation report as noted in Finding No. 2 of this report).* However, the borough failed to take the necessary corrective action to address the prior state aid previously allocated to ineligible investment mechanisms as further discussed in Finding No. 1 of this report.

- Failure To File Actuarial Valuation Report

The borough completed the January 1, 2015 Act 205 actuarial valuation report and submitted it to the Municipal Pension Reporting Program on April 10, 2018; however, plan officials failed to complete the January 1, 2017 Act 205 actuarial valuation report and submit it to the Municipal Pension Reporting Program as further discussed in the Findings and Recommendations section of this report.

- Failure To Fund Members' Accounts

In February and July of 2019, the borough deposited the contributions due to the members' accounts for the years 2016 and 2017; however, plan officials failed to deposit the contributions due to the members' accounts for the year 2018 as further discussed in the Findings and Recommendations section of this report.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Noncompliance With Prior Recommendation

Tremont Borough has not complied with the prior recommendation concerning the following as further discussed in the Findings and Recommendations section of this report:

- Custodial Account Records Not Maintained By The Municipality

Rescission Of Prior Finding

- Improper Ownership Of Allocated Insurance Contracts

This finding has been rescinded in its prior form; however, the underlying circumstances have been incorporated into Finding No. 1 of this report.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Partial Compliance With Prior Recommendation – Unauthorized Funding Mechanism

Condition: As disclosed in the Status of Prior Findings section of this report, the borough partially complied with the prior recommendation by purchasing deferred annuity contracts for two of the members identified in the prior report, for the purpose of providing retirement benefits in accordance with Act 205. However, it was also previously recommended that municipal officials either transfer prior state aid previously allocated to these unauthorized investment vehicles amounting to \$11,857 into an eligible funding mechanism or return such state aid to the Commonwealth. Furthermore, it was recommended that plan officials take the necessary steps to change the ownership of these investments from the plan members to the pension plan or municipality or implement adequate internal control procedures to ensure that the proceeds from these investments are not surrendered to the plan members prior to eligibility to receive such retirement benefits. As of the date of this report, no such corrective action has been taken, and individual retirement accounts (IRAs) continue to exist for two members. Moreover, it was determined that one of the three members previously identified in the prior report terminated employment with the borough during the current period and the borough was unable to verify whether this individual’s account, funded entirely with prior allocations of state aid, was used for intended purposes under Act 205.

Criteria: As previously disclosed, Section 102 of Act 205 defines a pension plan 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.

Section 201.2 of Part IV of Title 16 of the Pennsylvania Code further elaborates on the definition included in Act 205, stating:

The term does not include a plan, program, or arrangement that is funded solely by municipal employee earnings or compensation reported as municipal employee earnings or compensation to the Internal Revenue Service on the Form W-2 Wage and Tax Statement or established under sections 8.1-8.3 of the act of March 30, 1811 (P.L. 145 Sm.L. 228) (72 P.S. 4521.1-4521.3) . . . / or Section 408 of the Internal Revenue Code (26 U.S.C.A. 408).

Consequently, the former Public Employee Retirement Commission (PERC) determined that Individual Retirement Accounts (IRAs) and IRS Section 457 Deferred Compensation plans are not eligible to participate in the state aid program.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Cause: Plan officials expressed concern that the employees would suffer early withdrawal tax penalties to surrender the IRA accounts and did not fully comply with the recommendation in the prior LPE report.

Effect: Since the funding mechanism does not meet the definition of a pension plan as prescribed above, it is not eligible for participation in the state aid program. In addition, since the individual employees rather than the municipality own these types of contracts, the municipality cannot ensure the integrity of these pension assets and the related benefits funded through state aid allocations from surrender by members prior to reaching retirement.

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

Recommendation: Since the borough is unable to transfer funds from the terminated former member's account to an eligible investment mechanism in accordance with Act 205, we recommend that plan officials return state aid amounting to \$5,831 to the Commonwealth. In addition, regarding the \$6,026 of state aid that was previously allocated to the unauthorized funding mechanism, we recommend it be transferred to the eligible annuities opened subsequent to the audit period or returned to the Commonwealth. A check for the reimbursement, 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. A copy of the interest calculation must be submitted along with the check.

Management's Response: Borough officials agreed with the finding without exception.

Auditor's 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 audit report and through our next audit of the plan.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Partial Compliance With Prior Recommendation – Failure To File Actuarial Valuation Report

Condition: As disclosed in the Status of Prior Findings section of this report, the borough submitted the January 1, 2015 actuarial valuation report for the police pension plan to the Municipal Pension Reporting Program (formerly the Public Employee Retirement Commission) on April 10, 2018, which had been due on March 31, 2016; however, the borough failed to submit actuarial valuation report form PC-203A for the non-uniformed pension plan with a valuation date of January 1, 2017, to the Municipal Pension Reporting Program by the March 31, 2018, deadline, as required by Act 205 and the report remained delinquent at the completion of our audit fieldwork.

Criteria: Section 201(a) of Act 205 states, in part:

Each municipality which has established or maintains a pension plan for its employees, including any municipality which participates in the Pennsylvania Municipal Retirement System, shall cause to be made actuarial valuation reports. Actuarial valuation reports shall be made biennially, unless the applicable municipality is applying or has previously applied for supplemental State assistance pursuant to Section 603, whereupon actuarial valuation reports shall be made annually.

Furthermore, Section 201(b) of Act 205 states, in part:

The biennial actuarial valuation report required pursuant to subsection (a) shall be made as of the beginning of each plan year occurring in an odd-numbered calendar year and shall be filed with the executive director of the commission no later than the last business day of March occurring in the following calendar year.

In addition, Section 204 of Act 205 provides:

If a complete actuarial valuation report or experience investigation is not filed in a timely fashion, any and all financing which is provided to the municipality by the Commonwealth and is dedicated for pension plan purposes shall be withheld until the report or investigation is filed.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Finally, Section 402(e)(7) of Act 205 states, in part:

Any municipality which has not filed with the commission on a timely basis, pursuant to the applicable municipal pension plan actuarial reporting law, an actuarial report for each of the municipal pension plans which it has established or maintains shall be entitled to receive as general municipal pension system State aid, at such time as compliance with the actuarial reporting requirement occurs, the adjusted amount of general municipal pension system State aid per unit

Cause: Plan officials failed to adopt adequate internal control procedures to ensure full compliance with the recommendation in the prior LPE report.

Effect: Due to the late filing of the January 1, 2015 Act 205 actuarial valuation reports for both the police and non-uniformed pension plans, the borough's 2016 and 2017 state aid allocations were not able to be released until the necessary reports were filed. Therefore, state aid in the amounts of \$11,620 for 2016 and \$16,462 for 2017 was not released until April 2018 whereas state aid was released in September of the respective years to those municipalities who submitted their reports by the filing deadline. As a result, the borough did not have its state aid available timely to use for operating expenses and investment opportunities. In addition, data from the January 1, 2017 Act 205 actuarial valuation reports is necessary to calculate the borough's 2018 and 2019 state aid allocations; therefore, the borough's 2018 and 2019 state aid allocations cannot be calculated and released until the necessary reports are filed for both the police and non-uniformed pension plans. Furthermore, the plan may receive less state aid than it would have received had the reports been filed in a timely manner.

Recommendation: We recommend that the municipality take immediate action to complete the January 1, 2017 Act 205 actuarial valuation report which was due by March 31, 2018 and submit it to the Municipal Pension Reporting Program, 321 Finance Building, Harrisburg, PA 17120. By submitting the report as soon as possible, the municipality can minimize the length of time the pension aid will be withheld due to the delinquent filing of the required report.

Furthermore, to insure that future actuarial filing deadlines are met and to improve pension plan administration, we recommend that plan officials develop and implement internal control procedures, such as a calendar listing the various reporting and filing deadlines required by Act 205, including the actuarial valuation report filing date.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Management’s Response: Borough officials agreed with the finding without exception. At our exit conference held on September 25, 2019, borough officials indicated that they have received the completed January 1, 2017 actuarial valuation report from their pension plan consultant and will submit it to the Municipal Pension Reporting Program as soon as possible.

Auditor’s Conclusion: The January 1, 2017 actuarial valuation report was received by the Municipal Pension Reporting Program on October 25, 2019, which will enable the calculation and release of the 2018 and 2019 state aid allocations to the borough.

Finding No. 3 – Partial Compliance With Prior Recommendation – Failure To Fund Members’ Accounts

Condition: As disclosed in the Status of Prior Findings section of this report, in February and July of 2019, the borough deposited the contributions due to the members’ account for the years 2016 and 2017; however, the borough failed to fund the accounts of the three members for 2018.

Criteria: The plan’s governing document, Resolution 2005-11, provides that pension benefits will be provided through discretionary purchases of insurance annuity contracts with the plan custodian.

Cause: Borough officials were unable to timely fund the plan for the years 2016 and 2017 because the borough’s 2016 and 2017 state aid allocations were not allocated until April 2018 due to the borough’s late filing of the January 1, 2015 Act 205 actuarial valuation report. In addition, borough officials have been unable to fund the plan for 2018 because the borough has not received its 2018 state aid allocation due to the borough’s failure to file the January 1, 2017 Act 205 actuarial valuation reports for the police and non-uniformed pension plans.

Effect: The failure to properly fund the plan could result in plan members being denied benefits to which they are entitled in accordance with the plan’s governing document.

Recommendation: We recommend that the borough deposit the contributions due to the members’ accounts for the year 2018, with interest, from the date the deposit should have been made to the date of deposit of the amount in arrears. The borough should ensure the contributions are deposited into an eligible funding mechanism (see Finding No. 1). A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

We also recommend that, in the future, borough officials properly fund the accounts of all eligible plan members.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

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

Auditor’s Conclusion: Compliance will be evaluated during our next audit of the plan.

Finding No. 4 – Noncompliance With Prior Recommendation – Custodial Account Records Not Maintained By The Municipality

Condition: The municipality did not maintain copies of allocated insurance contracts or adequate financial records or statements of the custodial account of the non-uniformed pension plan sufficient to effectively monitor the activity in this account during the years 2017 and 2018. A similar condition for the year 2016 was reported in the prior LPE report.

Criteria: Assets held in allocated insurance accounts 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: Plan officials failed to comply with the recommendation in the prior LPE report.

Effect: Although we were able to obtain copies from third-party sources in order to complete our audit procedures, the failure of plan officials to maintain adequate records prohibits municipal officials from effectively monitoring the plan’s financial operations. Inadequate monitoring of the non-uniformed 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 plan officials obtain copies of the allocated insurance contracts and again recommend that the municipality obtain annual financial statements of transactions in the custodial account of the non-uniformed pension plan and monitor the statements as to the accuracy and propriety of the transactions. The minimum steps that should be applied by a municipality to adequately monitor the custodial account are:

- Verify the mathematical accuracy of the account statements;
- Reconcile the Commonwealth and municipal contributions shown on the account statements to the municipality’s records;

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

- Review investment income for accuracy and reasonableness;
- Reconcile any large or material receipt, other than contributions, shown on the account statements to the municipality's records;
- Determine if investments are in accordance with applicable laws, regulations and policies. Reconcile investment income to the related investments;
- Reconcile pension payments shown on the account statements to the municipality's records; and
- Reconcile any large or material disbursement shown on the account statements to the municipality's records.

Management's Response: Borough officials agreed with the finding without exception.

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

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

Finding No. 1 contained in this audit report cites an overpayment of state aid to the borough in an amount to be determined based on the borough's actions. 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 the determined 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. Documentation of the borough's actions should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 314 Finance Building, Harrisburg, PA 17120.

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
SUMMARY OF DEPOSITED STATE AID AND EMPLOYER CONTRIBUTIONS

Year Ended December 31	State Aid	Employer Contributions
2013	\$ 8,666	\$ None
2014	8,827	None
2015	9,040	None
2016	6,792	None
2017	9,877	None
2018	None	None

TREMONT BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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