

COMPLIANCE AUDIT

Chester Hill Borough Non-Uniformed Pension Plan Clearfield County, Pennsylvania For the Period January 1, 2017 to December 31, 2018

November 2019



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
Chester Hill Borough
Clearfield County
Philipsburg, PA 16866

We have conducted a compliance audit of the Chester Hill 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 audit 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 audit 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. Employer contributions 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 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, 2017 actuarial valuation report was prepared and submitted by March 31, 2018, in accordance with Act 205 and whether selected information provided on this report 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 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. 67 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 Chester Hill 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 Chester Hill 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 – Failure To Properly Fund Member’s Account

Finding No. 2 – Questionable Funding Mechanism Under Act 205

The contents of this report were discussed with officials of Chester Hill 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.

October 15, 2019

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale", with a long horizontal flourish extending to the right.

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 Chester Hill 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 Chester Hill Borough Non-Uniformed Pension Plan is a single-employer defined contribution pension plan locally controlled by the provisions of Ordinance No. 02-27-2018/1. The plan was established January 1, 2008. Active members are not required to contribute to the plan. The municipality is required to contribute 7 percent of employee's salary. As of December 31, 2018, the plan had 2 active members, no terminated members eligible for vested benefits in the future, and no retirees receiving pension benefits.

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Chester Hill Borough has complied with the prior audit recommendations concerning the following:

- Pension Plan Not Formally Adopted By Ordinance Or Resolution

During the audit period, municipal officials adopted Ordinance No. 02-27-2018/1 effectively governing the pension plan;

- Improper Receipt Of State Aid;

- Receipt Of State Aid In Excess Of Entitlement

During the current audit period, the borough reimbursed \$1,999 to the Commonwealth for the overpayment of state aid received in 2010 and the additional excess state aid received in 2014 and 2015; and

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

During the current audit period, municipal officials accurately reported the required pension data on the Certification Forms AG 385.

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Failure To Properly Fund Member’s Account

Condition: The borough did not fully fund the account of one plan member in 2017 in the amount of \$1,265, as illustrated below:

Required Contribution	Actual Contribution	Contributions Due
\$ 1,861	\$ 596	\$ 1,265

Criteria: Article IX of the borough’s recently adopted pension plan document, Ordinance No. 02-27-2018/1, formally establishes the plan’s employer contribution rate as 7% of the employee’s salary.

In addition, the most recently filed actuarial valuation report valued January 1, 2017 also discloses a municipal contribution rate of 7 percent of payroll.

Cause: There was a recent change in the plan’s municipal contribution rate during the current period with the adoption of the newly enacted plan ordinance as discussed earlier in the Status of Prior Finding section of this report. The borough failed to establish adequate internal control procedures to ensure the accuracy of the contributions made to individual members’ accounts in accordance with this plan document.

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

Furthermore, due to the borough’s failure to properly fund the account of one member, the borough must now pay interest on the delinquent contributions.

Recommendation: We recommend that the borough deposit the outstanding contribution due to the individual member’s account for the year 2017, with interest. A copy of the interest calculations should be maintained by the borough for examination during our next audit of the plan.

We also recommend that, in the future, the borough establish adequate internal control procedures to ensure the accuracy of the contributions made to fund the accounts of all eligible plan members in accordance with the plan document.

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

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

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Questionable Funding Mechanism Under Act 205

Condition: The municipality deposited state aid into an investment contract during 2018 for the purpose of providing benefits to a member of the pension plan at retirement. However, based on documentation provided by plan officials, we were unable to determine whether the investment vehicle represents an authorized funding mechanism in accordance with Act 205 as noted by the following:

- The owner of the investment contract is the borough and not the pension plan even though contract premiums were paid with general municipal pension system state aid during 2018.
- The investment certificate makes reference to a flexible premium deferred annuity contract; however, this document also indicates that the investment is an individual retirement account (IRA)/Keogh type arrangement which is not an authorized investment under the Act.
- The investment provides for a life income to the annuitant beginning on the maturity date; however, it also permits withdrawals by the annuitant prior to retirement.

Criteria: 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) has determined that Individual Retirement Accounts (IRAs) and IRS Section 457 Deferred Compensation plans are not eligible to participate in the state aid program. Moreover, Act 205 funding (state aid) is intended to provide retirement benefit payments and not to be used for distributions to active members of a pension plan prior to their retirement benefit eligibility.

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued):

Cause: Municipal officials were not aware that this type of investment may not be an eligible funding vehicle for pension plans participating in the state aid program.

Effect: Since we were unable to clearly determine whether the funding mechanism meets the definition of a pension plan as prescribed above based on the documentation provided, this investment may not qualify as an eligible depository for funding from the state aid program.

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

Recommendation: We recommend that municipal officials provide additional documentation to this department evidencing that the investment is an authorized investment under Act 205 and not an IRA. If the municipality is able to provide such substantiation, we recommend that pension plan officials consider taking the necessary steps to change the ownership of this investment contract from the borough to the pension plan and implement adequate internal control procedures to ensure that early distributions are not taken by plan members prior to actual retirement.

Conversely, if such documentation is not available, we recommend that plan officials either transfer plan assets to an eligible funding mechanism or return the state aid allocated to the unauthorized funding mechanism for the year 2018, in the amount of \$1,505, to the Commonwealth. In the latter case, 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. A copy of the interest calculation must be submitted along with the check. Further, municipal officials should exclude members belonging to the ineligible plan from future Certification Forms AG 385 submitted to the department.

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

Auditors 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.

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

A condition such as that reported by Finding No. 2 contained in this audit report may lead to a total withholding of state aid in the future unless that finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 314 Finance Building, Harrisburg, PA 17120.

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

Year Ended December 31	State Aid	Employer Contributions
2013	\$ 3,404	\$ 1,200
2014	3,970	600
2015	4,029	1,200
2016	1,187	600
2017	596	1,510
2018	3,365	None

CHESTER HILL BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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