

LIMITED PROCEDURES ENGAGEMENT

Upper Macungie Township Police Pension Plan Lehigh County, Pennsylvania For the Period January 1, 2016 to December 31, 2018

October 2019



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

Board of Township Supervisors
Upper Macungie Township
Lehigh County
Breinigsville, PA 18031

We conducted a Limited Procedures Engagement (LPE) of the Upper Macungie Township Police Pension Plan for the period January 1, 2016 to December 31, 2018 to determine its compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. We also evaluated compliance with some requirements subsequent to that period when possible. The LPE was conducted pursuant to authority derived from Section 402(j) of the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.) but was not conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. 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. We believe that the evidence obtained provides a reasonable basis to support our LPE results.

Our LPE was limited to determining the following:

- 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 engagement period.
- 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.
- Whether annual employee contributions were required during the engagement period and, if so, were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the engagement period and examining documents evidencing the deposit of these employee contributions into the pension plan.

- 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.

Based on the results of our procedures performed during our LPE, nothing came to our attention indicating that the Upper Macungie Township Police Pension Plan was not being 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 – Incorrect Data On Certification Form AG 385 Resulting In A Net Overpayment Of State Aid
- Finding No. 2 – Failure To Appoint A Chief Administrative Officer Of The Pension Plan

Our determination to perform a LPE for this engagement period does not preclude the Department from conducting an audit in accordance with *Government Auditing Standards* of the pension plan in subsequent periods. The township should continue to maintain documentation related to this 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 Upper Macungie Township and, where appropriate, their responses have been included in this report. We would like to thank township officials for the cooperation extended to us during the conduct of this LPE.

September 24, 2019



EUGENE A. DEPASQUALE
Auditor General

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UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: The township certified 2 ineligible police officers (4 units) and certified 3 ineligible non-uniformed employees (3 units) on the Certification Form AG 385 filed in 2017. In addition, the township certified an ineligible non-uniformed employee (1 unit) on the Certification Form AG 385 filed in 2018. Furthermore, subsequent to the current engagement period, the township certified 2 ineligible police officers (4 units) and failed to certify an eligible non-uniformed employee (1 unit) on the Certification Form AG 385 filed in 2019. The data contained on these certification forms 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. Moreover, the various plan documents associated with the township’s individual pension plans provide participation eligibility criteria that is more stringent than that prescribed by Act 205. For participation in the police pension plan, the collective bargaining agreement between the township and its police officer’s also requires completion of a one-year probationary period prior to participation in the plan. And, for non-uniformed plan participation, there is an additional plan entry date requirement (*January 1 nearest the date on which the individual participant satisfies both the age and service requirements*) stipulated in the governing document prior to participation in the pension plan.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the township’s state aid allocations were based on unit value, the incorrect certification of pension data affected the township’s state aid allocations for the years 2017 and 2018, as identified below:

<u>Year</u>	<u>Type Of Plan</u>	<u>Units Overstated (Understated)</u>	<u>Unit Value</u>	<u>State Aid Overpayment (Underpayment)</u>
2017	Police	4	\$ 4,588	\$ 18,352
	Non-Uniformed	3	\$ 4,588	13,764
				<u>\$ 32,116</u>
2018	Non-Uniformed	1	\$ 4,684	<u>\$ 4,684</u>
Net Overpayment of State Aid 2017-2018				<u>\$ 36,800</u>

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Subsequent to the current period, since the township’s state aid allocation was also based on unit value, the incorrect certification of pension data affected the township’s state aid allocation for 2019, as follows:

Year	Type Of Plan	Units Overstated (Understated)	Unit Value	State Aid Overpayment (Underpayment)
2019	Police	4	\$ 5,121	\$ 20,484
	Non-Uniformed	(1)	\$ 5,121	<u>(5,121)</u>
				<u>\$ 15,363</u>

In addition, the township used the overpayments of state aid to pay the minimum municipal obligations (MMOs) due to its pension plans; therefore, if the reimbursement to the Commonwealth is made from the pension plans, the plans’ MMOs will not be fully paid.

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

Recommendation: We recommend that the net overpayment of state aid, in the amount of \$52,163 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.

In addition, if the reimbursement to the Commonwealth is made from its pension plan funds, we recommend that any resulting MMO deficiencies be paid to the pension plans with interest, at a rate earned by the pension plans.

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

Auditor’s Conclusion: Due to the potential withhold of state aid, the township’s compliance with the finding recommendation will be monitored subsequent to the release of the report and through our next plan engagement.

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Failure To Appoint A Chief Administrative Officer Of The Pension Plan

Condition: As disclosed previously as a verbal observation in the prior engagement, municipal officials did not appoint a chief administrative officer (CAO) for the pension plan by ordinance, resolution or by a motion recorded in the minutes of a council meeting. Although the township enacted Ordinance No. 2014-14 establishing the position of township manager as the CAO of the township, the township failed to formally appoint a CAO for its police pension plan or include reference in the aforementioned ordinance relative to the additional responsibilities for the overall administration of the pension plan in accordance with Act 205.

Criteria: Section 102 of Act 205 defines the CAO as “The person who has primary responsibility for the execution of the administrative affairs of the municipality in the case of the municipality, or of the pension plan in the case of the pension plan, or the designee of that person.”

Municipal officials may appoint two CAOs - one for the pension plan and one for the municipality or appoint one person to fill both positions. Act 205 identifies specific duties for each position, as follows:

CAO Of The Municipality

- Supervise and direct the preparation of actuarial reports (Section 201(d));
- Certify and file actuarial valuation reports with the Public Employee Retirement Commission (Section 201(b)); and
- Make actuarial report information available to plan members (Section 201(e)).

CAO Of The Pension Plan

- Annually, determine and submit to the governing body of the municipality the financial requirements of the pension plan and minimum municipal obligation (Section 302(b), Section 302(c), Section 303(b), Section 303(c) and Section 304); and
- Provide the governing body of the municipality with a cost estimate of the effect of any proposed benefit plan modification (Section 305(a)).

Cause: Plan officials again failed to appoint a CAO for the pension plan in accordance with Act 205 provisions to ensure compliance with the prior observation as recommended.

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Effect: The failure to formally appoint a CAO could result in important filing deadlines being overlooked, state aid being adversely affected or delayed and investment opportunities being lost such as the condition noted in Finding No. 1 contained in this report.

Recommendation: Because of the significance of the CAO's responsibilities to the municipality and pension plan, we recommend that the CAO be formally appointed by ordinance, resolution or motion recorded in the minutes of a council meeting. Such ordinance, resolution or motion should detail the CAO's responsibilities and be filed with other plan documents.

Management's Response: Municipal officials agreed with the finding without exception. The township is currently working with the Pennsylvania Municipal Retirement System to implement the changes.

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

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 1 contained in this report cites overpayments of state aid to the township in the amount of \$52,163, plus interest. 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 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.

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 6 through 8 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2015

	<u>2014</u>	<u>2015</u>
Total Pension Liability		
Service cost	\$ 393,631	\$ 417,730
Interest	348,892	431,789
Difference between expected and actual experience	(588,800)	(22,879)
Changes of assumptions	-	(337,961)
Transfers	2,982,990	-
Benefit payments, including refunds of member contributions	(159,142)	(159,230)
Net Change in Total Pension Liability	<u>2,977,571</u>	<u>329,449</u>
Total Pension Liability – Beginning	4,556,835	7,534,406
Total Pension Liability – Ending (a)	<u>\$ 7,534,406</u>	<u>\$ 7,863,855</u>
Plan Fiduciary Net Position		
Contributions – employer *	\$ 1,368,386	\$ 490,899
Contributions – PMRS assessment	-	560
Contributions – member	95,575	105,289
PMRS investment income	204,451	461,134
Market value investment income	(83,955)	(522,475)
Transfers	4,471,787	-
Benefit payments, including refunds of member contributions	(159,142)	(159,230)
PMRS administrative expense	(560)	(560)
Additional administrative expense	(7,841)	(19,224)
Net Change in Plan Fiduciary Net Position	<u>5,888,701</u>	<u>356,393</u>
Plan Fiduciary Net Position – Beginning	2,320,303	8,209,004
Plan Fiduciary Net Position – Ending (b)	<u>\$ 8,209,004</u>	<u>\$ 8,565,397</u>
Net Pension Liability – Ending (a-b)	<u>\$ (674,598)</u>	<u>\$ (701,542)</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	108.95%	108.92%
Estimated Covered Employee Payroll	\$ 1,880,292	\$ 2,105,760
Net Pension Liability as a Percentage of Covered Employee Payroll	(35.88%)	(33.32%)

* 2014 employer contributions include payment from regional plan towards unfunded liability.

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2017

	<u>2016</u>	<u>2017</u>
Total Pension Liability		
Service cost	\$ 373,469	\$ 438,224
Interest	448,045	486,959
Difference between expected and actual experience	98,811	-
Changes of assumptions	347,207	-
Benefit payments, including refunds of member contributions	(184,555)	(222,149)
Net Change in Total Pension Liability	<u>1,082,977</u>	<u>703,034</u>
Total Pension Liability – Beginning	<u>7,863,855</u>	<u>8,946,832</u>
Total Pension Liability – Ending (a)	<u>\$ 8,946,832</u>	<u>\$ 9,649,866</u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 528,905	\$ 290,644
Contributions – PMRS assessment	780	40
Contributions – member	75,895	70,994
PMRS investment income	511,655	528,268
Market value investment income	124,390	1,168,406
Benefit payments, including refunds of member contributions	(184,555)	(222,149)
PMRS administrative expense	(760)	(780)
Additional administrative expense	(25,067)	(24,295)
Net Change in Plan Fiduciary Net Position	<u>1,031,243</u>	<u>1,811,128</u>
Plan Fiduciary Net Position – Beginning	<u>8,565,397</u>	<u>9,596,640</u>
Plan Fiduciary Net Position – Ending (b)	<u>\$ 9,596,640</u>	<u>\$ 11,407,768</u>
Net Pension Liability – Ending (a-b)	<u>\$ (649,808)</u>	<u>\$ (1,757,902)</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	107.26%	118.22%
Estimated Covered Employee Payroll	\$ 2,148,165	\$ 2,367,092
Net Pension Liability as a Percentage of Covered Employee Payroll	(30.25%)	(74.26%)

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

Sensitivity Of The Net Pension Liability To Changes In The Discount Rate

The following presents the net pension liability of the township as of December 31, 2014 and 2015, calculated using the discount rate of 5.50%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	<u>1% Decrease (4.50%)</u>	<u>Current Discount Rate (5.50%)</u>	<u>1% Increase (6.50%)</u>
Net Pension Liability – 12/31/14	\$ 636,401	\$ (674,598)	\$ (1,737,727)
Net Pension Liability – 12/31/15	\$ 666,882	\$ (701,542)	\$ (1,810,575)

In addition, the following presents the net pension liability of the township as of December 31, 2016 and 2017, calculated using the discount rate of 5.25%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	<u>1% Decrease (4.25%)</u>	<u>Current Discount Rate (5.25%)</u>	<u>1% Increase (6.25%)</u>
Net Pension Liability – 12/31/16	\$ 937,882	\$ (649,808)	\$ (1,937,053)
Net Pension Liability – 12/31/17	\$ (45,453)	\$ (1,757,902)	\$ (3,146,298)

UPPER MACUNGIE TOWNSHIP 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, 2013, 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)
01-01-13	\$ 1,789,758	\$ 3,941,510	\$ 2,151,752	45.4%
01-01-15	8,372,715	7,534,406	(838,309)	111.1%
01-01-17	10,250,477	8,946,832	(1,303,645)	114.6%

The Actuarial Value of Assets and Actuarial Accrued Liability at January 1, 2015 reflect the additional transfers of funds and related liabilities assumed from the former Berks-Lehigh Regional Police Pension Plan disbanded in 2012.

UPPER MACUNGIE TOWNSHIP 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.

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2013	\$ 373,174	100.0%
2014	403,119	100.0%
2015	491,459	100.0%
2016	529,665	100.0%
2017	290,644	100.0%
2018	315,533	100.0%

UPPER MACUNGIE TOWNSHIP 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, 2017
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	The Actuarial Value of Assets equals the plan's member, municipal, DROP (if applicable) reserve accounts plus the retiree actuarial liability. This asset smoothing 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, all of which are subject to comply with the Actuarial Standards of Practice No. 44, Selection and Use of Asset Valuation Methods when defining the actuarial Value of Assets.
Actuarial assumptions:	
Investment rate of return	5.25%, compounded annually, net of investment and administration expenses
Salary scale	Total rate (including inflation) (e.g. age 25 – 7.05%; age 35 – 4.55%; age 45 – 3.97%; age 55 – 3.44%; age 65 – 2.80%)
Cost-of-living adjustments	2.8% per year, subject to plan limitations

UPPER MACUNGIE TOWNSHIP POLICE PENSION PLAN
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