

# COMPLIANCE AUDIT

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## West Chester Borough Non-Uniformed Defined Contribution Pension Plan Chester County, Pennsylvania For the Period January 1, 2015 to December 31, 2018

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October 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  
West Chester Borough  
Chester County  
West Chester, PA 19380

We have conducted a compliance audit of the West Chester Borough Non-Uniformed Defined Contribution Pension Plan for the period January 1, 2015 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.

- 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, 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 the plan's unallocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contract with the plan's provisions, investment policies, and state regulations.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the West Chester Borough Non-Uniformed Defined Contribution 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 West Chester Borough Non-Uniformed Defined Contribution 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 Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Improper Loan Provision Contained In The Plan's Adoption Agreement

Findings Nos. 1 and 2 contained in this audit report repeat conditions that were cited in our previous audit report that have not been corrected by borough officials. We are concerned by the borough's failure to correct these previously reported audit findings and strongly encourage timely implementation of the recommendations noted in this audit report.

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

September 30, 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 West Chester Borough Non-Uniformed Defined Contribution 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 West Chester Borough Non-Uniformed Defined Contribution Pension Plan is a single-employer defined contribution pension plan locally controlled by the provisions of Ordinance No. 12-2013. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established October 16, 2013 for non-uniformed employees hired on or after January 1, 2013. Active members are not required to contribute to the plan. The municipality is required to contribute 5 percent of compensation. As of December 31, 2018, the plan had 33 active members and 12 terminated members eligible for vested benefits in the future.

WEST CHESTER BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION  
PENSION PLAN  
STATUS OF PRIOR FINDINGS

Partial Compliance With Prior Audit Recommendation

West Chester Borough has partially complied with the prior audit 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 returned the overpayment of state aid received in 2015 plus interest to the Commonwealth; however, plan officials again failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data in the years 2016, 2018, and 2019, as further discussed in the Findings and Recommendation section of this report.

Noncompliance With Prior Audit Recommendation

West Chester Borough has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Improper Loan Provision Contained In The Plan's Adoption Agreement

WEST CHESTER BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION  
PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment Of State Aid**

Condition: As disclosed in the Status of Prior Findings section of this report, although the borough partially complied with the prior audit recommendation by returning the overpayment of state aid received in 2015 to the Commonwealth, a similar condition occurred during the current audit period. Plan officials again failed to comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data in the years 2016, 2018, and 2019.

During the current audit period, the borough certified 1 ineligible non-uniformed employee (1 unit) and understated payroll by \$33,591 on the Certification Form AG 385 filed in 2016. In addition, the borough failed to certify 5 eligible non-uniformed employees (5 units) and understated payroll by \$171,212, and failed to certify 1 eligible police officer (2 units) and understated payroll by \$131,686 on the Certification Form AG 385 filed in 2018. Subsequent to the audit period, the borough certified 1 ineligible non-uniformed employee (1 unit) and overstated payroll by \$15,599 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), an employee who has been employed on a full-time basis for at least six consecutive months and has been participating in a pension plan during the certification year is eligible for certification.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified and to ensure full compliance with the prior audit recommendation.



WEST CHESTER BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION  
PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 – (Continued)**

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 borough’s state aid allocations were based on unit value, the borough received a net underpayment of state aid of \$23,293 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>
2016	Non-Uniformed	1	\$4,375	\$ 4,375
2018	Police	(2)	\$4,684	(9,368)
	Non-Uniformed	(5)	\$4,684	(23,420)
			Subtotal	\$ (32,788)
2019	Non-Uniformed	1	\$5,120	5,120
			Net Underpayment of State Aid	\$ (23,293)

Although the additional state aid will be allocated to the borough, the full amount of the 2018 state aid allocation was not available to be deposited timely and therefore were not available to pay operating expenses or for investment.

Recommendation: We again 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.

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.

WEST CHESTER BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION  
PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 – Noncompliance With Prior Audit Recommendation – Improper Loan Provision Contained In The Plan’s Adoption Agreement**

Condition: As disclosed in our prior audit report, Section Q of the pension plan’s adoption agreement, which was approved on June 26, 2013, improperly contains a provision that allows for loans to active plan members.

Criteria: Section 102 of Act 205 contains the following definitions:

“Pension plan or system.” 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.

“Defined contribution pension plan.” A type of pension plan which provides for a fixed contribution rate or amount and which provides for periodic benefit payments calculable at retirement dependent on the accumulated contributions, investment income, experience gains and losses credited to the member and the expected mortality of the member.

Therefore, Act 205 funding (state aid) is intended to provide retirement benefit payments, not for loans to be made to active plan members.

Cause: Plan officials have failed to adopt adequate internal control procedures to ensure compliance with this department’s prior audit recommendation.

Effect: The unauthorized loan provision violates the intent of Act 205 to only provide distributions to plan members upon their retirement or termination of employment with the municipality.

Recommendation: We again recommend that municipal officials take appropriate action to eliminate the unauthorized loan provision from the plan’s governing document and to limit future distributions to those benefits authorized under Act 205.

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

Auditor’s Conclusion: We are concerned that the municipality has not complied with the prior audit recommendation and encourage compliance at the earliest opportunity to do so.

WEST CHESTER BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION  
PENSION PLAN  
SUMMARY OF DEPOSITED STATE AID AND EMPLOYER CONTRIBUTIONS

Year Ended December 31	State Aid	Employer Contributions
2014	None	\$ 29,535
2015	None	47,422
2016	None	53,716
2017	None	74,889
2018	None	80,824

WEST CHESTER BOROUGH NON-UNIFORMED DEFINED CONTRIBUTION  
PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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