

# COMPLIANCE AUDIT

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## Pottstown Borough Non-Uniformed Pension Plan Montgomery County, Pennsylvania For the Period January 1, 2016 to December 31, 2018

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March 2020



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  
Pottstown Borough  
Montgomery County  
Pottstown, PA 19464

We have conducted a compliance audit of the Pottstown Borough Non-Uniformed Pension Plan for the period January 1, 2016 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 the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings 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 whether annual employee contributions 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 period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- We determined whether retirement benefits calculated for six of nine plan members<sup>1</sup> who retired during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined and disbursed 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 individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients. We also determined whether retirement benefits calculated for both plan members 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 pension benefits due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined.
- We determined whether retirement benefits calculated for both of the plan members who terminated employment and/or retired and elected a lump-sum form of pension benefit during the current audit period, represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws and regulations by comparing the distributed amounts to supporting documentation evidencing amounts determined and actually paid to recipients.
- 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.

Pottstown Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements 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.

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<sup>1</sup> We selected plan members randomly from the population of plan members who retired during the current audit period in order to obtain a representative selection for the purpose of our testing to achieve the audit objective. While representative selection is a required factor of audit sampling methodologies, audit sampling methodology was not applied to achieve this test objective; accordingly, the results of this audit procedure are not, and should not be, projected to the population.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Pottstown 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 objective, 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 objective.

The results of our procedures indicated that, in all significant respects, the Pottstown 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 finding further discussed later in this report:

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

Finding No. 2 - Incorrect Pension Benefit Calculation

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 Pottstown 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.

March 6, 2020



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 Pottstown 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 Pottstown Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2118, as amended. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established June 6, 1963. Active members are required to contribute 5.75 percent of compensation to the plan. As of December 31, 2018, the plan had 80 active members, 7 terminated members eligible for vested benefits in the future, and 50 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2018, selected plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	Age 60 or Age 55 with 25 years of service.
Early Retirement	Voluntary - 24 years of service. Involuntary - 8 years of service.
Vesting	100% vesting available after 10 years of service.

### Retirement Benefit:

Benefit equals 1.667% of average monthly compensation multiplied by years of service. The maximum benefit is 50% of average monthly compensation. Average monthly compensation is based on the final 36 consecutive months of employment; or the final one (1) year of employment, whichever is greater.

### Survivor Benefit:

If a member is eligible for voluntary early retirement, a death benefit is equal to the present value of the accrued benefit. If not eligible for voluntary retirement, the benefit is a refund of the contributions and excess interest.

### Service Related Disability Benefit:

Benefit equals 50% of final salary, reduced by any Worker's Compensation.

### Non-Service Related Disability Benefit:

After 10 years of service, 30% of final salary, reduced by any Worker's Compensation.

POTTSTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 1 - Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid**

Condition: The borough failed to certify an eligible non-uniformed employee (1 unit) and understated payroll by \$40,213 on the Certification Form AG 385 filed in 2017. The data contained on this 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 indicated that an error was made when certifying the number of eligible participants during 2017 because the non-uniformed pension pay code, utilized by the borough when an individual is hired and becomes an eligible, contributing participant of the pension plan, was not properly input into the aforementioned member’s profile in the payroll system. As such, contributions were not properly deducted from the member’s pay and forwarded to the pension plan for approximately two months after initial eligibility; and, the member was inadvertently omitted from the report utilized by the borough when determining AG-385 certification eligibility. In addition, the borough’s internal control procedures were not adequate to timely detect the omission on the AG 385 prior to submission during 2017.

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 state aid allocation was based on unit value, the borough received an underpayment of state aid of \$4,588 as identified below:

<u>Year</u>	<u>Units (Understated)</u>	<u>Unit Value</u>	<u>State Aid (Underpayment)</u>
2017	(1)	\$ 4,588	\$ (4,588)

Recommendation: We recommend that in the future, plan officials implement adequate and consistent internal control procedures, such as having at least 2 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.

POTTSTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
FINDINGS AND RECOMMENDATIONS

**Finding No. 2 - Incorrect Pension Benefit Calculation**

Condition: A member of the pension plan who retired on June 19, 2017 had her pension benefit incorrectly determined because municipal officials failed to accurately calculate the member's final monthly average salary in accordance with the plan's governing document.

Criteria: The governing document adopted by Ordinance No. 2131, at Section 4.02, states, in part:

Normal Retirement Benefit - Each participant who retires upon attainment of Normal Retirement Age shall be entitled to receive a monthly retirement benefit . . . in an amount equal to one and six hundred sixty-seven thousandths percent (1.667%) of the Participant's Final Monthly Average Compensation multiplied by the Participant's years of Aggregate Service, not to exceed fifty percent (50%) of the Participant's Final Monthly Average Compensation.

Also, the governing document adopted by Ordinance No. 2131, at Section 1.28, states, in part:

"Final Monthly Average Compensation" shall mean the average of the Participant's Compensation paid during the final thirty-six (36) consecutive months of Employment within the last five (5) years preceding termination of active Employment or the final one (1) year of Employment, whichever is greater.

Cause: Municipal officials provided incorrect payroll information to ensure the pension benefit was properly determined in accordance with the plan's governing document.

Effect: The plan is paying a monthly pension benefit to a retiree in an amount less than authorized by the plan's governing document. Based on estimates prepared by this department from the files and records maintained by the borough, the retiree is receiving \$195 per month less than entitled under the plan's governing document. As of the date of this report, the total amount of underpayments to the retiree totaled approximately \$6,074.

Recommendation: We recommend that municipal officials adjust the retiree's pension benefit in accordance with the provisions contained in the plan's governing document and reimburse the retiree for the total underpayments of retirement benefits, \$6,074 since date of commencement.

Management's Response: Municipal officials agreed with the finding without exception and have obtained a revised benefit calculation from their actuary and are also in the process of issuing back payments to the retiree.

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

POTTSTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

The supplementary information contained on Pages 5 through 7 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, 2016, 2017, AND 2018

	<u>2016</u>	<u>2017</u>	<u>2018</u>
Total Pension Liability			
Service cost	\$ 415,040	\$ 481,105	\$ 500,349
Interest	1,224,267	1,335,503	1,384,335
Difference between expected and actual experience	-	288,649	-
Changes of assumptions	-	823,062	-
Benefit payments, including refunds of member contributions	(1,254,043)	(957,464)	(1,211,709)
Net Change in Total Pension Liability	385,264	1,970,855	672,975
Total Pension Liability - Beginning	19,046,854	19,432,118	21,402,973
Total Pension Liability - Ending (a)	<u>\$19,432,118</u>	<u>\$21,402,973</u>	<u>\$22,075,948</u>
Plan Fiduciary Net Position			
Contributions - employer	\$ 295,227	\$ 343,074	\$ 326,988
Contributions - member	315,396	298,909	275,632
Net investment income	922,590	923,562	(1,085,041)
Benefit payments, including refunds of member contributions	(1,254,043)	(957,464)	(1,211,709)
Administrative expense	(3,848)	(16,970)	(10,760)
Net Change in Plan Fiduciary Net Position	275,322	591,111	(1,704,890)
Plan Fiduciary Net Position - Beginning	15,887,573	16,162,895	16,754,006
Plan Fiduciary Net Position - Ending (b)	<u>\$16,162,895</u>	<u>\$16,754,006</u>	<u>\$15,049,116</u>
Net Pension Liability - Ending (a-b)	<u>\$ 3,269,223</u>	<u>\$ 4,648,967</u>	<u>\$ 7,026,832</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	83.18%	78.28%	68.17%
Estimated Covered Employee Payroll	\$ 4,612,354	\$ 4,914,197	\$ 4,633,088
Net Pension Liability as a Percentage of Covered Employee Payroll	70.88%	94.60%	151.67%

POTTSTOWN BOROUGH NON-UNIFORMED 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 borough as of December 31, 2016, 2017 and 2018, calculated using the discount rate of 6.5%, as well as what the borough'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:

	1% Decrease (5.5%)	Current Discount Rate (6.5%)	1% Increase (7.5%)
Net Pension Liability - 12/31/16	\$ 5,149,827	\$ 3,269,223	\$ 1,711,217
Net Pension Liability - 12/31/17	\$ 6,770,725	\$ 4,648,967	\$ 2,846,897
Net Pension Liability - 12/31/18	\$ 9,170,395	\$ 7,026,832	\$ 5,207,999

SCHEDULE OF CONTRIBUTIONS

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered- Employee Payroll*	Contributions as a Percentage of Covered- Employee Payroll
2013	\$ 208,333	\$ 208,333	\$ -		
2014	186,577	186,577	-		
2015	268,813	268,813	-	\$ 4,379,671	6.14%
2016	295,227	295,227	-	4,612,354	6.40%
2017	343,074	343,074	-	4,914,197	6.98%
2018	326,952	326,988	(36)	4,633,088	7.06%

\* Due to GASB Statement No. 67, *Financial Reporting for Pension Plans*, being implemented only recently, the amount of Covered-Employee Payroll was not provided for years prior to 2015.

POTTSTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2018	(6.90%)
2017	5.57%
2016	5.92%

POTTSTOWN BOROUGH NON-UNIFORMED 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	\$ 17,760,277	\$ 18,032,218	\$ 271,941	98.5%
01-01-15	17,300,293	18,338,522	1,038,229	94.3%
01-01-17	16,162,895	20,543,829	4,380,934	78.7%

Note: The Actuarial Accrued Liability as of 01-01-17 reflects increases due to a change in mortality assumption of approximately \$825,000, along with an investment loss of \$2.5 million due to negative investment returns during 2015.

POTTSTOWN BOROUGH NON-UNIFORMED 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.

POTTSTOWN BOROUGH NON-UNIFORMED 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	Level dollar
Remaining amortization period	10 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	6.5%
Projected salary increases	4.0%
Cost-of-living adjustments	None assumed

POTTSTOWN BOROUGH NON-UNIFORMED PENSION PLAN  
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