

LIMITED PROCEDURES ENGAGEMENT

Freeport Borough Non-Uniformed Pension Plan Armstrong County, Pennsylvania For the Period January 1, 2014 to December 31, 2017

December 2018



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
Freeport Borough
Armstrong County
Freeport, PA 16229

We conducted a Limited Procedures Engagement (LPE) of the Freeport Borough Non-Uniformed Pension Plan for the period January 1, 2014 to December 31, 2017 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 municipal officials took appropriate corrective action to address the finding contained in our prior audit report, by inquiring of plan officials and evaluating supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken.
- 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. State aid allocations that were deposited into the pension plan for the years ended December 31, 2012 to December 31, 2017, are presented on the Summary of Deposited State Aid and Employer Contributions.

- 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, 2012 to December 31, 2017, are presented on the Summary of Deposited State Aid and Employer Contributions.
- 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.
- We determined whether retirement benefits calculated for the plan member who elected to vest during the current engagement 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 benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined.
- Whether the January 1, 2013, January 1, 2015, and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2014, 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 Freeport Borough Non-Uniformed 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 – Noncompliance With Prior Audit Recommendation – Failure To Deposit The Full Amount Of State Aid Into An Eligible Pension Plan
- Finding No. 2 – Receipt Of State Aid In Excess Of Entitlement
- Finding No. 3 – Failure To Implement Professional Services Contract Provisions Of Act 205

Finding No. 1 contained in this report repeats a condition that was cited in our previous audit report that has not been corrected by borough officials. We are concerned by the borough's failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendations noted in this report.

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 borough 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 Freeport Borough and, where appropriate, their responses have been included in this report. We would like to thank borough officials for the cooperation extended to us during the conduct of this LPE.

December 3, 2018



EUGENE A. DEPASQUALE
Auditor General

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FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Report Recommendation

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

- Failure To Deposit The Full Amount Of State Aid Into An Eligible Pension Plan

FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - Noncompliance With Prior Audit Recommendation – Failure To Deposit The Full Amount Of State Aid Into An Eligible Pension Plan

Condition: During the audit of the plan for the period January 1, 2008 to December 31, 2010, the municipality was given a verbal observation that it did not deposit the full amount of its 2008 state aid allocation in the amount of \$170 into the non-uniformed pension plan. Since the plan's administrative expenses were paid from the individual members' accounts, and the borough's police pension plan did not have any reimbursable costs in 2008, the state aid could have been allocated to the non-uniformed members' account. This was disclosed in the prior audit report for the period January 1, 2011 to December 31, 2013, and that report also disclosed that the municipality failed to deposit \$331 of its 2011 state aid allocation into an eligible pension plan. Since the borough's police and non-uniformed pension plans both had pension costs in 2011, the balance of the 2011 state aid allocation can be deposited into either plan. As of the date of this report, municipal officials have not deposited the balance of the 2008 or 2011 state aid allocations into an eligible pension plan.

Criteria: Section 402(g) of Act 205 states, in part:

. . . the total amount of the general municipal pension system State aid received by the municipality shall, within 30 days of receipt by the treasurer of the municipality, be deposited in the pension fund or the alternate funding mechanism applicable to the respective pension plan.

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

Effect: When state aid is not deposited into a pension plan account, the funds are not available to pay operating expenses or for investment and the risk of misapplication is increased.

Recommendation: We again recommend that the municipality consult with PMRS to determine how the balance of the 2008 state aid allocation should be allocated to the current members' accounts.

We also again recommend that the municipality deposit the remaining 2011 state aid allocation of \$331, plus interest earned during the period beyond the 30 day grace period allowed by Act 205, compounded annually, into their police or non-uniformed pension plan. A copy of the interest calculation must be maintained by the borough for examination during our next engagement.

FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Furthermore, we again recommend that plan officials develop and implement adequate internal control procedures to ensure that future state aid allocations are deposited into an eligible pension plan within 30 days of receipt by the municipal treasurer.

Management’s Response: Municipal officials agreed with the finding without exception. Officials provided a copy of a check dated October 14, 2018 in the amount of \$276.96, including interest, which is to be deposited into the non-uniformed pension plan for the 2008 state aid, and a copy of a check dated October 14, 2018 in the amount of \$465.77, including interest, which is to be deposited into the police pension plan for the 2011 state aid; however, as of the date of this report the checks had not yet been deposited into the pension plans.

Auditor’s Conclusion: Based on the management response, it appears municipal officials intend to comply with the finding recommendation. Compliance will be evaluated during our next engagement.

Finding No. 2 – Receipt Of State Aid In Excess Of Entitlement

Condition: The borough received state aid in excess of the non-uniformed pension plan’s annual pension costs in the years 2015 and 2017, as illustrated below:

	<u>2015</u>	<u>2017</u>
State aid allocation	\$ 9,230	\$ 7,838
Forfeitures available	-	7,087
Actual municipal pension costs	<u>(8,090)</u>	<u>(7,599)</u>
Excess state aid	<u>\$ 1,140</u>	<u>\$ 7,326</u>

Criteria: Section 402(f)(2) of Act 205 states:

No municipality shall be entitled to receive an allocation of general municipal pension system State aid in an amount which exceeds the aggregate actual financial requirements of any municipal pension plans for police officers, paid firefighters or employees other than police officers or paid firefighters maintained by the municipality, less the amount of any aggregate annual member or employee contributions during the next succeeding plan year, as reported in the most recent complete actuarial report filed with the commission.

FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Cause: Plan officials failed to establish adequate internal control procedures to reconcile the borough's state aid allocation and employee forfeitures available to reduce municipal contributions with the plan's actual pension costs.

Effect: It is this department's opinion that because the entire proceeds of the insurance premium tax on foreign casualty insurance companies are distributed annually to each eligible recipient municipality, it is inappropriate to use state aid in one year to offset pension costs in other years. Consequently, the overpayments of state aid in the years 2015 and 2017 must be returned to the Commonwealth for redistribution.

Recommendation: We recommend that the municipality return the \$8,466 of excess state aid received in the years 2015 and 2017 to the Commonwealth from the borough's general fund. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the 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 evidence of payment.

Furthermore, we recommend that, in the future, plan officials reconcile the borough's annual state aid allocation and municipal contributions made to the pension plan and any available employee forfeitures with the plan's annual pension costs and reimburse any excess state aid received to the Commonwealth.

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

Auditor's Conclusion: The borough's compliance with the finding recommendation will be monitored subsequent to the release of the report and through our next engagement of the plan.

Finding No. 3 – Failure To Implement Professional Services Contract Provisions Of Act 205

Condition: Municipal officials have not adopted the mandatory provisions regarding professional services contracts under Act 205. During the prior audit, a verbal observation was issued to plan officials notifying them of the passage of Act 44 of 2009 which amended Act 205, and recommending that the borough adopt the mandatory Act 44 provisions. However, as of the date of this report, the borough has not adopted these mandatory provisions.

FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Criteria: Section 701-A of Act 205, as amended by Act 44 of 2009, defines a “Professional Services Contract” as follows:

“Professional services contract.” A contract to which the municipal pension system is a party that is:

- (1) for the purchase or provision of professional services, including investment services, legal services, real estate services and other consulting services; and
- (2) not subject to a requirement that the lowest bid be accepted.

In addition, Section 702-A (a) of Act 205 states in part:

Each municipal pension system ... shall develop procedures to select the most qualified person to enter into a professional services contract. The procedures shall ensure that the availability of a professional services contract is advertised to potential participants in a timely and efficient manner. Procedures shall include applications and disclosure forms to be used to submit a proposal for review and to receive the award of a professional services contract.

Additionally, Section 702-A (c), (e), (f) and (h) state, in part:

Review. Procedures to select the most qualified person shall include a review of the person’s qualifications, experience and expertise and the compensation to be charged.

Conflict of interest – The municipal pension system shall adopt policies relating to potential conflicts of interest in the review of a proposal or the negotiation of a contract.

Public information. Following the award of a professional services contract, all applications and disclosure forms shall be public except for proprietary information or other information protected by law.

Notice and summary. The relevant factors that resulted in the award of the professional services contract must be summarized in a written statement to be included in or attached to the documents awarding the contract. Within ten days of the award of the professional services contract, the original application, a summary of the basis for the award and all required disclosure forms must be transmitted to all unsuccessful applications and posted on the municipal pension system’s Internet website, if an Internet website is maintained, at least seven days prior to the execution of the professional services contract.

FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Cause: Plan officials failed to establish adequate internal controls procedures to ensure compliance with provisions of Act 205 and our prior recommendation.

Effect: The failure to implement and follow the provisions stipulated in Act 205 regarding the procurement of professional investment and advisory services for the borough's pension plans could result in a general lack of overall transparency of the actions taken by plan officials relative to the awarding of contracts for investment and advisory services for the borough's pension plans.

Recommendation: We recommend that municipal officials obtain a comprehensive understanding of Act 205 and develop and implement procedures for the procurement of professional services for the borough's pension plans to ensure compliance with provisions stipulated in Act 205.

Management Response: Municipal officials agreed with the finding without exception and indicated that they would implement a resolution that adopts the Act 44 procedures at their earliest opportunity.

Auditor Conclusion: Based on the management response, it appears municipal officials intend to comply with the finding recommendation. Compliance will be evaluated during our next engagement.

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

The supplementary information contained on Pages 7 and 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, 2015, AND 2016

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Total Pension Liability			
Service cost	\$ 18,901	\$ 17,348	\$ 17,196
Interest	18,838	20,887	22,202
Difference between expected and actual experience	1	-	(7,304)
Net Change in Total Pension Liability	<u>37,740</u>	<u>38,235</u>	<u>32,094</u>
Total Pension Liability – Beginning	335,603	373,343	411,578
Total Pension Liability – Ending (a)	<u>\$ 373,343</u>	<u>\$ 411,578</u>	<u>\$ 443,672</u>
Plan Fiduciary Net Position			
Contributions – employer*	\$ 9,019	\$ 7,998	\$ 7,581
Contributions – PMRS Assessment	-	-	100
Contributions – employee	9,982	9,357	9,615
PMRS investment income	18,748	20,794	22,504
Market value investment income	(1,271)	(23,297)	7,969
PMRS administrative expense	(100)	(100)	(100)
Additional administrative expense	(719)	(867)	(1,103)
Net Change in Plan Fiduciary Net Position	<u>35,659</u>	<u>13,885</u>	<u>46,566</u>
Plan Fiduciary Net Position – Beginning	332,287	367,946	381,831
Plan Fiduciary Net Position – Ending (b)	<u>\$ 367,946</u>	<u>\$ 381,831</u>	<u>\$ 428,397</u>
Net Pension Liability – Ending (a-b)	<u>\$ 5,397</u>	<u>\$ 29,747</u>	<u>\$ 15,275</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	98.55%	92.77%	96.56%
Estimated Covered Employee Payroll	\$ 178,378	\$ 159,808	\$ 151,627
Net Pension Liability as a Percentage of Covered Employee Payroll	3.03%	18.61%	10.07%

* 2015 employer contributions exclude \$92 transfer from municipal reserve.

FREEPORT 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, 2014 and 2015, calculated using the discount rate of 5.5%, 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:

	<u>1% Decrease (4.5%)</u>	<u>Current Discount Rate (5.5%)</u>	<u>1% Increase (6.5%)</u>
Net Pension Liability – 12/31/14	\$ 80,065	\$ 5,397	\$ (69,272)
Net Pension Liability – 12/31/15	\$ 112,062	\$ 29,747	\$ (52,569)

The following presents the net pension liability of the borough as of December 31, 2016, calculated using the discount rate of 5.25%, 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:

	<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	\$ 104,009	\$ 15,275	\$ (73,460)

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

Year Ended December 31	State Aid	Employer Contributions
2012	\$ 8,209	None
2013	8,363	\$ 24
2014	8,678	341
2015	8,090	None
2016	7,657	24
2017	512	None

Note: In 2017, the borough met the plan's \$7,599 funding requirement through the deposit of \$512 in state aid and \$7,087 in terminated employee forfeitures.

FREEPORT BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable James E. Swartz, Jr.
Mayor

Mr. John Mazurowski
Council President

Mr. Rich Hill
Treasurer/Chief Administrative Officer

Ms. Charity Rosenberry, CPA
Pennsylvania Municipal Retirement System

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.