

COMPLIANCE AUDIT

Independence Township Non-Uniformed Pension Plan Washington County, Pennsylvania For the Period January 1, 2016 to December 31, 2019

September 2020



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
Independence Township
Washington County
Avella, PA 15312

We have conducted a compliance audit of the Independence Township Non-Uniformed Pension Plan for the period January 1, 2016 to December 31, 2019. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed 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. State aid allocations that were deposited into the pension plan for the years ended December 31, 2014 to December 31, 2019, 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, 2014 to December 31, 2019, 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 whether retirement benefits calculated for the plan member who separated employment and received a lump-sum distribution 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 pension benefits due to the retired individual and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient.
- We determined whether the January 1, 2017, and January 1, 2019 actuarial valuation reports were prepared and submitted by March 31, 2018, and 2020, 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.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Independence Township Non-Uniformed Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 Independence Township 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 – Receipt Of State Aid In Excess Of Entitlement
- Finding No. 2 – Failure To Properly Fund Member Accounts
- Finding No. 3 – Municipal Contributions Made In Excess Of Contributions Required To Fund The Plan

The contents of this report were discussed with officials of Independence Township and, where appropriate, their responses have been included in the report. We would like to thank township officials for the cooperation extended to us during the conduct of the audit.

September 9, 2020



EUGENE A. DEPASQUALE
Auditor General

CONTENTS

	<u>Page</u>
Background.....	1
Findings And Recommendations:	
Finding No. 1 – Receipt Of State Aid In Excess Of Entitlement.....	2
Finding No. 2 – Failure To Properly Fund Member Accounts	5
Finding No. 3 – Municipal Contributions Made In Excess Of Contributions Required To Fund The Plan.....	7
Potential Withhold Of State Aid.....	10
Summary Of Deposited State Aid And Employer Contributions.....	11
Report Distribution List	12

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.

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 Independence Township Non-Uniformed Pension Plan is also governed by implementing regulations published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes.

The Independence Township Non-Uniformed Pension Plan is a single-employer defined contribution pension plan locally controlled by the provisions of Ordinance No. 92-2. The plan was established March 18, 1987. Active members are not required to contribute to the plan. The municipality is required to contribute 7 percent of compensation per year. As of December 31, 2019, the plan had two active members.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Receipt Of State Aid In Excess Of Entitlement

Condition: The township received state aid in excess of the non-uniformed pension plan’s defined contribution pension costs in the years 2016 and 2019, as illustrated below:

	<u>2016</u>	<u>2019</u>
State aid allocation	\$ 5,513	\$ 6,524
Actual municipal pension costs	(2,664)	(5,381)
Excess state aid	\$ 2,849	\$ 1,143

In 2016 and 2019, administrative expenditures totaling \$1,200 and \$1,165, respectively, attributable to the non-uniformed employees’ pension plan, were paid from the township’s general fund; however, the excess 2016 and 2019 state aid amounts, as shown above, which should have been utilized towards reimbursing the township’s general fund for these authorized plan expenditures, remained in the pension plan.

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.

In addition, the plan’s governing plan document, Ordinance No. 92-2 at Section 3.01(b), states:

The Employer may additionally contribute the amount necessary to pay expenses of administering the Plan.

Cause: Plan officials failed to establish adequate internal control procedures to reconcile the township’s state aid allocation with the plan’s annual defined contribution pension costs.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Effect: As further described in Finding No. 3 of this report, the non-uniformed pension plan had an unallocated reserve balance of \$409 at January 1, 2016, which increased to \$9,952 as of December 31, 2019 as a result of the excess state aid and municipal contributions. It was also noted that this balance included a portion of unexpended 2015 state aid, \$404, which should have been used in the prior audit period to reimburse the township's general fund towards plan administrative expenses incurred during 2015 or returned to the Commonwealth. However, the township previously failed to reimburse the township's general fund for these authorized plan expenditures and eventually used a portion of the 2015 excess state aid towards the plan's 2017 minimum municipal obligation (MMO). Additionally, the township also used a portion of its 2016 excess state aid allocation to fund its MMO due in 2018 (*refer to Finding No. 2*).

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 overpayment of state aid, net of previously unreimbursed pension plan administrative expenditures paid from the township's general fund during 2015, 2016 and 2019, must be returned to the Commonwealth for redistribution. Furthermore, the township's future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that municipal officials transfer \$2,747 from its pension plan to the township's general fund for reimbursement towards eligible pension plan administrative expenses previously paid from the general fund during 2015, 2016 and 2019.

We also recommend that the municipality return the remaining \$1,649 of excess state aid received in 2016 to the Commonwealth from the non-uniformed pension plan. 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 amount of state aid allocated to the non-uniformed pension plan with the pension plan's annual defined contribution pension costs and determine whether any excess state may be utilized to pay plan administrative expenses or must be returned to the Commonwealth.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Management's Response: Township officials agreed with the finding without exception and indicated that they will return the excess state aid this year.

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 audit report and through our next audit of the plan.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Failure To Properly Fund Member Accounts

Condition: During 2017 and 2018, the township did not properly fund members’ accounts in accordance with the plan document and Act 205. In 2017, the township used a portion of the excess state aid received in 2015 amounting to \$311 to fund a member’s account during 2017. Similarly, during 2018, the township utilized a portion of the 2016 excess state aid in the amount of \$2,744 to fund two members’ accounts during 2018 (*see Effect in Finding No. 1*). Additionally, the township did not properly fund these two members’ accounts during 2018 in accordance with the plan document, as illustrated below:

<u>2018 Employees</u>	<u>Required Contributions</u>	<u>Actual Contributions</u>	<u>Contributions Due</u>
1	\$ 2,464	\$ 1,781	\$ 683
2	2,755	2,632	123
		Total	<u><u>\$ 806</u></u>

Criteria: The plan’s governing document, Ordinance No. 92-2, states in part:

Section 1.15 *Entry Date*: means the date on which an Employee completes 2-Years Of Full Time Service.

Section 2.01 *Eligibility Requirements*: Any Eligible Employee who was a Participant as of the Effective Date of this Amendment and Restatement shall continue to participate in the Plan. Thereafter, any Eligible Employee who has completed 2-years of full-time service shall be eligible to participate.

Section 3.01(a) The Employer shall, for each plan year, pay to the Chief Administrative officer for allocation to the Employer Contribution Accounts of Participants who completed a Year of Service during the Plan Year...an amount which will be sufficient to credit each Employer Contribution Account with:

- (1) An amount equal to 7 percent of the Participant’s Compensation for the plan year.

Section 303(e) of Act 205 states, in part:

Any amount of the minimum municipal obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is made....

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Moreover, as aforementioned in Finding No. 1, 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.

Cause: Two full-time employees became eligible to join the pension plan during 2018 after meeting the provisions of Sections 1.15 and 2.01; however, the township was unaware when to commence funding the accounts for these new members and lacked formal procedures to annually reconcile the accounts of all eligible plan members based on the plan document.

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

Furthermore, due to township's failure to properly fund the referenced member accounts, the township must now pay interest on the delinquent contributions.

Recommendation: We recommend that plan officials, with the assistance of the pension plan consultant, determine whether the township must deposit additional contributions into the plan, with interest, based on the plan document. A copy of the interest calculation must be maintained by the township for examination during our next audit of the plan.

We also recommend that, in the future, township officials properly fund and annually reconcile the accounts of all eligible plan members.

Management's Response: Going forward the township will consult with the plan custodian to ensure the correct contributions are being made.

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

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – Municipal Contributions Made In Excess Of Contributions Required To Fund The Plan

Condition: The township made contributions to the non-uniformed pension plan during 2019 in excess of contributions required to fund the pension plan, as illustrated below:

	<u>2019</u>
Actual municipal pension costs	\$ 5,381
State aid allocated	<u>(6,524)</u>
Municipal contributions required to fund plan	<u>\$ -</u>
Actual municipal contributions made	\$ 7,576
Municipal contributions required to fund plan	<u>-</u>
Excess municipal contributions	<u>\$ 7,576</u>

Criteria: Section 3.01 of Ordinance No. 92-2 states, in part:

The Employer shall, for each Plan Year, pay to the Chief Administrative Officer for allocation to the Employer Contribution Accounts of Participants who completed a Year of Service during the Plan Year, an amount which will be sufficient to credit each such Employer Contribution Account with an amount equal to 7% of the Participant’s Compensation for the plan year.

Since state aid allocated to a pension plan must be expended on pension costs, it is the opinion of this department that where municipal contributions and state aid are both deposited into a pension plan, the state aid is expended first to fund pension costs.

Cause: Municipal officials indicated that they errantly deposited the amount figured on the Minimum Municipal Obligation (MMO) for the plan for 2019 even though it was only an estimate and the township lacked adequate procedures to reconcile the amount of state aid and municipal contributions made to the pension plan with the pension plan’s annual defined contribution pension costs to timely identify the excess contributions.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Effect: As a result of the township making contributions to the non-uniformed pension plan in excess of contributions required to fund the pension plan, the unallocated reserve fund in the amount of \$409 at January 1, 2016, (*refer to Finding No. 1*), increased to a reserve fund in the amount of \$9,952 at December 31, 2019, as illustrated by the following:

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Unallocated reserve fund at January 1*	\$ 409	\$ 3,258	\$ 2,947	\$ 1,233
Excess state aid (<i>see Finding No. 1</i>)	2,849	-	-	1,143
Excess state aid allocated to members in subsequent year (<i>see Finding No. 2</i>)	-	(311)	(2,744)	-
Excess municipal Contributions (<i>above</i>)	-	-	-	7,576
Interest earned on reserve funds	-	-	1,030	-
Unallocated reserve fund at December 31	<u>\$ 3,258</u>	<u>\$ 2,947</u>	<u>\$ 1,233</u>	<u>\$ 9,952</u>

* Reserve fund at January 1, 2016 included \$404 in excess 2015 state aid not previously reimbursed to the township for plan administrative expenditures originally paid from the general fund in the prior period (*see Finding No. 1*).

The unallocated reserve fund maintained by the non-uniformed pension plan resulted because no reduction of municipal contributions occurred to reconcile the amount of state aid with the plan's defined contribution pension costs. It is appropriate to use state aid to reimburse a municipality for contributions made to the pension plan to fund the pension costs in that same fiscal year, as long as annual pension costs for that pension plan are equal to or greater than the state aid allocated to that pension plan.

It is the opinion of this department that the township's failure to withdraw excess municipal contributions made in prior years does not preclude the township from withdrawing the municipal contributions maintained in the unallocated reserve fund at this time.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Recommendation: We recommend that plan officials, with the assistance of the pension plan consultant, and in conjunction with the recommendations disclosed in Finding Nos. 1 and 2, respectively, liquidate any remaining unallocated reserve funds maintained by the non-uniformed pension plan by transferring the assets which represent non state aid funds, to the township's general fund along with any residual interest earned on amounts held in the reserve fund through the date of transfer to the general fund.

We also recommend that, in the future, plan officials reconcile the amount of state aid allocated to the non-uniformed pension plan and municipal contributions made to the pension plan with the pension plan's annual defined contribution pension costs.

Management's Response: Going forward the township will consultant with the plan custodian to make the correct contributions are being made.

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

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 1 contained in this audit report cites an overpayment of state aid to the township in the amount of \$1,649, 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.

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
SUMMARY OF DEPOSITED STATE AID AND EMPLOYER CONTRIBUTIONS

Year Ended December 31	State Aid	Employer Contributions
2014	\$ 5,699	\$ 218
2015	5,917	1,036
2016	5,513	None
2017	2,664	None
2018	2,974	None
2019	6,524	7,576

INDEPENDENCE TOWNSHIP NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Mr. Thomas Jennings
Chairman, Board of Township Supervisors

Mr. Thomas Cowden
Township Supervisor

Ms. Joyce McKenzie
Township Supervisor

Ms. Cyndi Cecchini
Township Secretary

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