

COMPLIANCE AUDIT

South Heidelberg Township Non-Uniformed Pension Plan Berks County, Pennsylvania For the Period January 1, 2017 to December 31, 2019

February 2021



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

Board of Township Supervisors
South Heidelberg Township
Berks County
Sinking Spring, PA 19608

We have conducted a compliance audit of the South Heidelberg Township Non-Uniformed Pension Plan for the period January 1, 2017 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.

- 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 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 lone plan member who retired and the plan members who elected to vest their benefits 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 payable to the recipients.
- 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.

South Heidelberg Township contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2017 and annual audits of its financial statements prepared in conformity with the accounting practices prescribed or permitted by the Department of Community and Economic Development of the Commonwealth of Pennsylvania for the years ended December 31, 2018 and 2019, which are available at the township's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the South Heidelberg 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 South Heidelberg 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 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

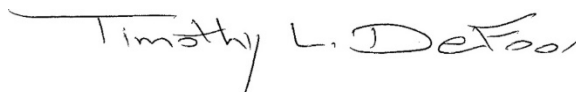
Finding No. 2 – Incorrect Pension Benefit Calculations

As previously noted, the objective of our audit of the South Heidelberg Township Non-Uniformed Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Among several provisions relating to municipal pension plans, Act 205, which was amended on September 18, 2009, through the adoption of Act 44 of 2009, provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

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. However, we are extremely concerned about the funded status of the plan contained in the schedule of funding progress included in this report, which indicates a decline of assets available to satisfy the long-term liabilities of the plan. The plan's funded ratio went from 77.4% as of January 1, 2015, to a ratio of 56.1% as of January 1, 2019, which is the most recent data available. Based on this information, the Municipal Pension Reporting Program issued a notification that the township is currently in Level II moderate distress status. We encourage township officials to monitor the funding of the non-uniformed pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of South Heidelberg 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. Include this final sentence when applicable.



TIMOTHY L. DEFOOR
Auditor General

February 12, 2021

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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.

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 South Heidelberg 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 South Heidelberg Township Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 98, as amended. The plan was established January 1, 1986. Active members are not required to contribute to the plan. As of December 31, 2019, the plan had 9 active members, 5 terminated members eligible for vested benefits in the future, and 3 retirees receiving pension benefits.

SOUTH HEIDELBERG TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: The township certified an ineligible non-uniformed employee (1 unit) and overstated payroll by \$20,941 on the Certification Form AG 385 filed in 2020. The data contained on this certification form 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.

Cause: The township lacked adequate procedures, such as having another individual review the accuracy of the data reported on the certification form, to ensure compliance with the instructions that accompany Certification Form AG 385 in accurately reporting the required pension data prior to submission.

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 plan. Because the township’s state aid allocation was based on unit value, the incorrect certification of pension data affected the township’s state aid allocation, as identified below:

<u>Year</u>	<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2020	1	\$ 4,923	\$ 4,923

In addition, the township used the overpayment of state aid to pay the minimum municipal obligation (MMO) due to the pension plan; therefore, if the reimbursement to the Commonwealth is made from the pension plan, the plan’s MMO will not be fully paid.

Recommendation: We recommend that the total excess net overpayment of state aid, in the amount of \$4,923, 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.

SOUTH HEIDELBERG TOWNSHIP NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

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.

Finding No. 2 – Incorrect Pension Benefit Calculations

Condition: A member of the pension plan who retired on September 30, 2019 and two members who terminated employment and elected a vested monthly pension benefit had their pension benefits incorrectly determined because municipal officials failed to accurately calculate the members’ final monthly average salaries in accordance with the plan’s governing document.

Criteria: Ordinance No. 250, at Section 2, states, in part:

Each Plan participant shall be credited with one percent (1%) for each year of service (to a maximum of twenty-five percent 25%), multiplied times the average monthly compensation for the twenty-four (24) month period immediately preceding the date of retirement.

Cause: The township lacked adequate internal control procedures to ensure that pension benefits were properly determined in accordance with provisions of the plan’s governing document.

Effect: The plan is paying pension benefits to a retiree in excess of those authorized by the plan’s governing document. Additionally, if not corrected, the plan could pay excess pension benefits in the future, to the vested members upon attainment of their normal retirement age.

Recommendation: We recommend that municipal officials adjust the retirees’ monthly pension benefits in accordance with provisions contained in the plan’s governing document.

Management’s Response: Municipal officials agreed with the finding without exception. Subsequent to the audit, the plan’s actuary recalculated the pension benefits in accordance with the provisions contained in the plan’s governing document.

Auditor’s Conclusion: Based on the management response, it appears municipal officials have complied with the finding recommendation. Compliance will be evaluated during our next audit of the plan.

SOUTH HEIDELBERG TOWNSHIP 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, 2015, 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)
01-01-15	\$ 263,924	\$ 340,989	\$ 77,065	77.4%
01-01-17	303,377	515,354	211,977	58.9%
01-01-19	378,202	673,749	295,547	56.1%

Note: The market value of the plan’s assets at 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period subject to a maximum of 120 percent and a minimum of 80 percent of the market value of assets. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

The Actuarial Accrued Liability as of 01-01-17 and 01-01-19, reflects increases due to changes in plan benefit provisions made during 2016 and an actuarial loss on investments and changes in assumptions incurred during 2018.

SOUTH HEIDELBERG TOWNSHIP 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.

SOUTH HEIDELBERG TOWNSHIP NON-UNIFORMED PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

<u>Year Ended December 31</u>	<u>Actuarially Determined Contribution</u>	<u>Actual Contributions</u>	<u>Contribution Deficiency (Excess)</u>	<u>Covered- Employee Payroll</u>	<u>Contributions as a Percentage of Covered- Employee Payroll</u>
2014	\$ 15,567	\$ 19,395	\$ (3,828)	\$ 365,301	5.31%
2015	16,932	16,932	-	388,373	4.36%
2016	18,233	25,899	(7,666)	429,831	6.03%
2017	26,069	26,069	-	421,695	6.18%
2018	26,174	26,174	-	424,869	6.16%
2019	54,163	54,163	-	466,258	11.62%

SOUTH HEIDELBERG TOWNSHIP 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, 2019
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	10 years
Asset valuation method	5-year smoothing, subject to a maximum of 120% and a minimum of 80% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	4.5%
Cost-of-living adjustments	None assumed

SOUTH HEIDELBERG TOWNSHIP NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
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Mr. John N. Musante
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Ms. Tiffany L. Billingsley
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