

COMPLIANCE AUDIT

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

November 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
Midland Borough
Beaver County
Midland, PA 15059

We have conducted a compliance audit of the Midland Borough Non-Uniformed Pension Plan for the period January 1, 2014 to December 31, 2017. 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 the plan member who retired during the current audit period represents 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 benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to the recipient. We also determined whether retirement benefits calculated for the plan member who elected to vest during the current audit period represents 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.
- We 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.
- 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.
- We determined whether all payments made to the multi-employer union pension plan were in accordance with the provisions contained in the collective bargaining agreement for the period January 1, 2017 to December 31, 2019.
- We determined whether refunds made to plan members were authorized in accordance with plan provisions and applicable laws and regulations by testing the refund disbursed to a plan member during the current audit period.

Midland Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements for the years ended December 31, 2014, 2015, and 2016 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Midland 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 Midland 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 findings further discussed later in this report:

- Finding No. 1 – Failure To Timely File Certification Form AG 385 Resulting In An Untimely Receipt Of State Aid
- Finding No. 2 – Participant Agreement Not Adopted By Ordinance
- Finding No. 3 – Failure To File Actuarial Valuation Report
- Finding No. 4 – Failure To Maintain An Adequate Record-Keeping System

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 **the plan's funded ratio is 62.8% as of January 1, 2017**, which is the most recent data available. We encourage borough 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 Midland Borough and, where appropriate, their responses have been included in the report.

November 8, 2018


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 Midland 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 Midland Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 683, as amended. The plan was established June 1, 1975. For the years 2014, 2015, and 2016, non-uniformed employees were required to contribute 7 percent of monthly compensation to the plan. As of December 31, 2017, the plan had no active members, 1 terminated member eligible for vested benefits in the future, and 7 retirees receiving pension benefits from the plan.

As further described in the Findings and Recommendations section of this report, borough officials entered into an agreement with the United Steelworkers Pension and Retirement Fund to develop a union pension plan effective January 1, 2017 (see Finding Nos. 2 and 3). Active members are not required to contribute to the union plan. As of December 31, 2017, the plan had 1 active member, no terminated members eligible for vested benefits in the future, and no retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2017, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 55 and 10 years of service – office employees Age 62 and 15 years of service – union employees
Early Retirement	Age 50 and 15 years of service – office employees Age 60 and 15 years of service – union employees
Vesting	100% after 10 years of service 100% after 15 years of service

Retirement Benefit:

Office employees – \$400 plus \$30 for each year of credited service over 10 years
Union employees – \$25 for each year of credited service at retirement

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	According to option elected by participant at retirement.

Service Related Disability Benefit:

Office employees – None
Union employees – Total and permanent after 15 years of credited service, benefit equal to accrued benefit.

MIDLAND BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Failure To Timely File Certification Form AG 385 Resulting In An Untimely Receipt Of State Aid

Condition: The borough failed to timely file the Certification Form AG 385 in 2017 for the police and non-uniformed pension plans by the March 31, 2017 deadline. Although the borough did eventually certify accurate information for the plans, the form was not submitted to the Department of the Auditor General until March 22, 2018 and the borough did not receive its 2017 state aid allocation until April of 2018.

Criteria: The general instructions that accompany Certification Form AG 385 disclose that municipalities must complete and return the Certification Form AG 385 to the Department of the Auditor General by March 31st of the given year.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the timely submission of the certification form.

Effect: The data submitted on this form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Although the borough received its 2017 allocation of state aid in April of 2018, the state aid was not available to be deposited timely and therefore was not available to pay operating expenses or for investment.

Recommendation: We recommend that in the future, plan officials establish adequate internal control procedures to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in timely 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.

Finding No. 2 – Participation Agreement Not Adopted By Ordinance

Condition: The terms, provisions and conditions of the non-uniformed pension plan for the borough’s public works employees were included in a separately executed collectively bargained union agreement with the United Steelworkers Pension and Retirement Fund effective January 1, 2017, covering the period January 1, 2017 to December 31, 2019; however, the participation agreement has not been formally adopted by a properly executed ordinance that would properly adopt the plan’s benefit structure.

MIDLAND BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Criteria: Proper internal control procedures dictate that the provisions of the pension plan be formally adopted by a municipal ordinance or resolution.

Cause: Plan officials were unaware that the borough must formally adopt the provisions of the union plan agreement.

Effect: The borough has not established a formal acknowledgement of the agreement between its public works employees and the union.

Recommendation: We recommend that municipal officials take appropriate action to formally adopt the collectively bargained agreement through a properly executed ordinance.

Management's Response: Municipal officials agreed with the finding without exception. A new ordinance was created for the United Steelworkers Agreement and will be appropriately advertised and adopted at the December 13, 2018 Midland Borough council meeting.

Auditor's Conclusion: The borough's full compliance with the finding recommendation will be evaluated during our next audit of the plan.

Finding No. 3 – Failure To File Actuarial Valuation Report

Condition: Actuarial valuation report form 203A covering the borough's public works employees, with a valuation date of January 1, 2017, was not submitted to the Municipal Pension Reporting Program (formerly the Public Employee Retirement Commission) by the March 31, 2018, deadline, as required by Act 205.

Criteria: Section 201(d) of Act 205 states:

Responsibility for preparation and filing of reports and investigations. The actuarial valuation report or experience investigation required pursuant to subsection (a) shall be prepared under the supervision and at the discretion of the chief administrative officer of the municipality, who shall be responsible for the filing of the document. The actuarial valuation report or experience investigation shall be signed by the chief administrative officer, indicating that to the extent of the understanding and knowledge of the officer, the report or investigation represents a true and accurate portrayal of the actuarial, financial and demographic condition of the pension plan of the municipality.

MIDLAND BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Cause: Municipal officials entered into an agreement with the United Steelworkers effective January 1, 2017 with the intention to create a new pension plan for its non-uniformed public works employees; however, plan officials failed to file the appropriate report with the Municipal Pension Reporting Program.

Effect: Because the municipality's state aid allocations are determined, in part, by the information contained in the actuarial valuation reports for each of its plan, the failure to file an actuarial valuation report for the public works employees' pension plan resulted in that plan's actuarial data not being included in the calculation of the borough's 2018 state aid allocation, and may have resulted in an incorrect state aid allocation.

Recommendation: We recommend that municipal officials prepare and submit an actuarial valuation report with a valuation date of January 1, 2017 for the public works employees' pension plan to the Municipal Pension Reporting Program.

Management's Response: Municipal officials agreed with the finding without exception and in November 2018 prepared an actuarial valuation report for the public works employees' pension plan with a valuation date of January 1, 2017 which they intend to submit to the Municipal Pension Reporting Program.

Auditor's Conclusion: The borough's full compliance with the finding recommendation will be evaluated during our next audit of the plan.

Finding No. 4 – Failure To Maintain An Adequate Record-Keeping System

Condition: The pension plan's record-keeping system did not establish adequate accounting procedures to allow plan officials to effectively monitor the pension plan's financial operations. Additionally, many of the records requested in February 2018 for the audit were not provided until September 2018, if at all. The deficiencies are as follows:

- A journal was not maintained to record financial transactions of the pension plan;
- Ledgers were not utilized to record receipts and disbursements;
- A chart of accounts was not maintained;

MIDLAND BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

- Custodial account statements were not provided upon request;
- Documentation of active members' annual payroll amounts and member contribution deductions reported to the plan's custodian were not maintained;
- A minute book and/or ordinances pertaining to pension plan were not provided upon request;
- Pension benefit calculations and lump-sum distribution letters for terminated members were not maintained;
- Financial statements for all years of the audit period were not provided upon request; and
- Copies of actuarial valuation reports were not maintained.

In addition, plan officials have not prepared management guidelines which describe the duties and responsibilities of municipal and plan officials in the operation of the non-uniformed pension plan.

Criteria: An adequate system of accounting and record keeping is a prerequisite for sound administration of pension plans. In addition, management guidelines are necessary to ensure an acceptable transition of duties in the event of changes in management personnel. Without such measures, the risk exists that important filing deadlines may be overlooked, fundamental plan obligations to active or retired members may not be correctly fulfilled, state aid may be adversely affected and/or delayed and investment opportunities may be lost.

Cause: Plan officials were unaware of their various record-keeping responsibilities and experienced turnover in personnel during the audit period.

Effect: Although we were able to obtain copies from a third-party source in order to complete our audit procedures, the failure of plan officials to maintain adequate records prohibits municipal officials from effectively monitoring the plan's financial operations.

MIDLAND BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

Recommendation: We recommend that plan officials establish and maintain a financial record-keeping system that allows plan officials to effectively monitor the plan's financial operations. In addition, the borough should consider preparing a written operations manual which describes, in detail, the duties of municipal and plan officials responsible for the operation of the pension plan. This manual should be kept on file with other important plan documents. Plan officials should refer to the Auditor General's Bulletin No. 2-88 entitled "Preparation, Maintenance and Auditability of Financial Records" for further guidance in establishing adequate accounting procedures.

Management's Response: Municipal officials agreed with the finding without exception and stated that procedures will be written and utilized to ensure an adequate record-keeping system.

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

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

The supplementary information contained on Pages 8 and 9 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 YEAR ENDED DECEMBER 31, 2015

Total Pension Liability	
Service cost	\$ 7,764
Interest	14,216
Benefit payments, including refunds of member contributions	(32,111)
Net Change in Total Pension Liability	<u>(10,131)</u>
Total Pension Liability - Beginning	415,810
Total Pension Liability - Ending (a)	<u><u>\$ 405,679</u></u>
Plan Fiduciary Net Position	
Contributions – employer	\$ 26,508
Contributions – member	9,594
Net investment income	7,444
Benefit payments, including refunds of member contributions	(32,111)
Administrative expense	(11,938)
Net Change in Plan Fiduciary Net Position	<u>(503)</u>
Plan Fiduciary Net Position - Beginning	258,952
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 258,449</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 147,230</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	63.71%
Estimated Covered Employee Payroll	\$ 196,384
Net Pension Liability as a Percentage of Covered Employee Payroll	74.97%

MIDLAND 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, 2015, calculated using the discount rate of 3.50%, 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 (2.50%)	Current Discount Rate (3.50%)	1% Increase (4.50%)
Net Pension Liability	\$ 188,084	\$ 147,230	\$ 112,952

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

DEFINED BENEFIT PLAN

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	\$ 253,221	\$ 403,753	\$ 150,532	62.7%
01-01-15	258,952	428,647	169,695	60.4%
01-01-17	254,512	405,465	150,953	62.8%

MIDLAND 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.

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

DEFINED BENEFIT PLAN

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2012	\$ 25,568	100.0%
2013	25,484	100.0%
2014	26,089	100.0%
2015	26,508	100.0%
2016	29,935	100.0%
2017	30,871	100.0%

MIDLAND BOROUGH NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

DEFINED BENEFIT PLAN

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	5 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	3.5%

MIDLAND 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 Angela M. Adkins
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Mr. Peter Quinn, Esq.
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Mr. Albert Troiani, Jr.
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