

COMPLIANCE AUDIT

Smethport Borough Police Pension Plan McKean County, Pennsylvania For the Period January 1, 2011 to December 31, 2013

September 2014



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
Smethport Borough
McKean County
Smethport, PA 16749

We have conducted a compliance audit of the Smethport Borough Police Pension Plan for the period January 1, 2011 to December 31, 2013. 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 our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit report; and
2. 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 objectives identified above. Our methodology addressed determinations about the following:

- Whether state aid was properly determined and deposited in accordance with Act 205 requirements.
- Whether employer contributions are determined and deposited in accordance with the plan's governing document and applicable laws and regulations.
- Whether employee contributions are required and, if so, are determined, deducted, and deposited into the pension plan and are in accordance with the plan provisions and applicable laws and regulations.

- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.
- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and 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.

Smethport 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Smethport Borough Police 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 objectives, and assessed whether those significant controls were properly designed and implemented. Additionally, 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 objectives.

The results of our tests indicated that, in all significant respects, the Smethport Borough Police 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:

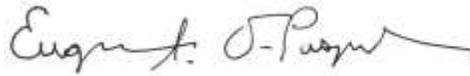
Finding – Noncompliance With Prior Audit Recommendation –
Restated Plan Document Lacks Clearly Defined Provisions

This finding repeats a condition that was cited in our previous two audit reports 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 recommendation noted in this audit report.

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 Smethport 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.

August 19, 2014

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

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 Smethport Borough Police Pension Plan is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

- Act 120 - Foreign Casualty Insurance Premium Tax Allocation Law, Act of May 12, 1943 (P.L. 259, No. 120), as amended, 72 P.S. § 2263.1 et seq.
- Act 581 - The Borough Code, Act of February 1, 1966 (P.L. 1656, No. 581), Article XI(f), Police Pension Fund in Boroughs Having a Police Force of Less Than Three Members, as amended, 53 P.S. § 46131 et seq.

The Smethport Borough Police Pension Plan is a single-employer pension plan locally controlled by the provisions of Ordinance No. 354. The plan was established February 2, 1970. Active members are not required to contribute to the plan. As of December 31, 2013, the plan had 2 active members, 1 terminated member eligible for vested benefits in the future, and no retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2013, selected plan benefit provisions provided by Ordinance No. 354 are as follows (refer to Finding):

Eligibility Requirements:

Normal Retirement	Not clearly defined.
Early Retirement	None
Vesting	A member is 100% vested after 5 years of service.

Retirement Benefit:

Not clearly defined.

Survivor Benefit:

Before Retirement Eligibility	Not clearly defined.
After Retirement Eligibility	The normal form of benefit is life, which is not clearly defined; however, the member may elect an actuarially reduced benefit form in order to provide a survivor benefit.

Service Related Disability Benefit:

Not clearly defined.

SMETHPORT BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Smethport Borough has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Restated Plan Document Lacks Clearly Defined Provisions

SMETHPORT BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation - Restated Plan Document
Lacks Clearly Defined Provisions**

Condition: As disclosed in the two prior audit reports, on June 18, 2007, borough officials adopted Ordinance No. 354, which restated the police pension plan. Prior to the adoption of Ordinance No. 354, the pension plan was a defined benefit pension plan, controlled by the provisions of Resolution No. 299 of 1992, as amended, adopted pursuant to Act 581.

Ordinance No. 354 adopted a pension plan with no defined benefits and was adopted pursuant to Act 120; however, the plan's actuarial valuation reports filed with the Public Employee Retirement Commission (PERC) have repeatedly indicated that the plan is a defined benefit plan and the benefit provisions listed in the reports are those provided by Resolution No. 299 of 1992, as amended, with the exception of the vesting provision provided by Ordinance No. 354.

Section VII of Ordinance No. 354 provides for the following undefined retirement benefit:

The Normal Retirement Benefit for any participant who shall complete the minimum service requirement shall be the accrued benefit provided by an annuity contract at the time an election to retire is made. (emphasis added)

Criteria: Section 1131 of Act 581 states:

Where a police force of less than three members is being maintained, the borough may, unless there is a private organization or association constituting and managing an existing pension fund for the members of the police force in such borough, by ordinance, provide for the purchase of annuity contracts for the payment of pensions, or establish a police pension fund into which each member of the police force shall pay an equal and proportionate monthly charge to be withheld from the pay of such member. All pension funds established under the provisions of this section shall be under the direction of the borough council, or such committee as it may designate, and shall be applied under such regulations as the council may by ordinance prescribe for the benefit of such members of the police force as shall receive honorable discharge therefrom by reason of age or disability and the families of such as may be injured or killed in the service. Any allowances made to those who are retired by reason of disability or age shall be in conformity with a uniform scale.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure compliance with the prior audit recommendation.

SMETHPORT BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Effect: The failure to have the plan’s benefit provisions clearly stated in the plan’s governing document could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: We again recommend that borough officials review and determine the benefit provisions to be provided by its police pension plan and take appropriate action to ensure that the intended benefit provisions are included in the plan’s governing document.

In addition, we recommend that plan officials review the data contained in future actuarial valuation reports submitted to PERC to ensure the reports properly reflect the status of the pension plan.

Management’s Response: Municipal officials agreed with the finding without exception. A third party has been engaged to prepare a new plan document in accordance with Act 581.

Auditor’s Conclusion: Due to the fact that this finding has been included in the prior two audits of the plan, we encourage municipal officials to comply with the recommendation at their earliest opportunity to do so. Compliance will be evaluated during our next audit of the plan.

SMETHPORT BOROUGH POLICE 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, 2009, is as follows:

	(1)	(2)	(3)	(4)	(5)	(6)
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)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-09	\$ 281,344	\$ 77,518	\$ (203,826)	362.9%	\$ 38,102	(534.9%)
01-01-11	338,073	111,530	(226,543)	303.1%	72,130	(314.1%)
01-01-13	350,529	51,902	(298,627)	675.4%	62,070	(481.1%)

SMETHPORT BOROUGH POLICE 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.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

SMETHPORT BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2008	None	N/A
2009	None	N/A
2010	None	N/A
2011	None	N/A
2012	None	N/A
2013	None	N/A

SMETHPORT BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the required 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, 2013
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	5.0%
Projected salary increases	4.0%

SMETHPORT BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Smethport Borough Police Pension Plan
McKean County
201 West Main Street
Smethport, PA 16749

The Honorable Wayne Foltz	Mayor
Mr. Gregory Rounsville	Council President
Ms. Cheryl A. O'Rourke	Secretary

This report is a matter of public record and is available online at www.auditorgen.state.pa.us. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 231 Finance Building, Harrisburg, PA 17120; via email to: news@auditorgen.state.pa.us.