

COMPLIANCE AUDIT

Hanover Borough Employees Pension Plan York County, Pennsylvania For the Period January 1, 2013 to December 31, 2014

October 2015



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
Hanover Borough
York County
Hanover, PA 17331

We have conducted a compliance audit of the Hanover Borough Employees Pension Plan for the period January 1, 2013 to December 31, 2014. 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 finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding 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 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 all 5 of the plan members who retired 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 benefit due to retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to recipients. We also determined whether retirement benefits calculated for the plan member who elected to vest during the current audit 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.
- × We determined whether the January 1, 2011 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, 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.

Hanover 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 Hanover Borough Employees 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 Hanover Borough Employees 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 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

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 Hanover 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.

September 3, 2015


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 Hanover Borough Employees 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.

The Hanover Borough Employees Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2145, as amended. The plan is also affected by the provisions of collective bargaining agreements between the borough and its non-uniformed employees. The plan was established July 1, 1966. Active members are required to contribute 3 percent of compensation to the plan. As of December 31, 2014, the plan had 106 active members, 2 terminated members eligible for vested benefits in the future and 51 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 55 and 25 years of service but not later than 62 and 10 years of service
Early Retirement	None
Vesting	Member is 100% vested after 10 years of service.

Retirement Benefit:

Benefit equals 1.50% of average monthly salary based on the highest 36 months of compensation out of the final 60 months preceding retirement times years of benefit service rounded to the nearest one-half year.

Survivor Benefit:

If 10 years of service and age plus service equals 60 or more, a monthly benefit equal to 50% of benefit accrued to date is payable to the surviving spouse or child under 19.

Service Related Disability Benefit:

Pension is equal to the projected normal retirement pension based upon years of service that would be credited to the member until attainment of age 62.

Non-Service Related Disability Benefit:

If age 45 and completed 15 years of service, an accrued benefit is payable after 6 months of disability.

HANOVER BOROUGH EMPLOYEES PENSION PLAN
FINDING AND RECOMMENDATION

Finding - Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The borough certified 2 ineligible police officers (4 units) and overstated payroll by \$104,035 and certified 1 ineligible non-uniformed employee (1 unit) and overstated payroll by \$58,330 on the Certification Form AG 385 filed in 2014. The data contained on these certification forms 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: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified AG 385 form submitted during 2014.

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the borough’s state aid allocation was based on unit value, the incorrect certification of pension data affected the borough’s state aid allocation, as identified below:

<u>Year</u>	<u>Type Of Plan</u>	<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2014	Police	4	\$ 3,873	\$ 15,492
	Employees	1	3,873	<u>3,873</u>
Total Overpayment of State Aid				<u><u>\$ 19,365</u></u>

In addition, the borough used the overpayment of state aid to pay the minimum municipal obligations (MMOs) due to the police and employees pension plans; therefore, if the reimbursement to the Commonwealth is made from the pension plans, the plans’ MMOs will not be fully paid.

Furthermore, the borough’s future state aid allocations may be withheld until the finding recommendation is complied with.

HANOVER BOROUGH EMPLOYEES PENSION PLAN
FINDING AND RECOMMENDATION

Finding - (Continued)

Recommendation: We recommend that the overpayment of state aid, in the amount of \$19,365, 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, 320 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 2 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.

In addition, if the reimbursement to the Commonwealth is made from police or employees pension plan funds, we recommend that any resulting MMO deficiencies be paid to the pension plan with interest, at a rate earned by the pension plan.

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

Auditor's Conclusion: Due to the potential withhold of state aid, the borough'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.

HANOVER BOROUGH EMPLOYEES PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

The finding contained in this audit report cites an overpayment of state aid to the borough in the amount of \$19,365. 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, 320 Finance Building, Harrisburg, PA 17120.

HANOVER BOROUGH EMPLOYEES PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

The supplementary information contained on Pages 6 and 7 reflect 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
 2014

Total Pension Liability	
Service cost	\$ 551,759
Interest	1,795,624
Benefit payments, including refunds of member contributions	(715,865)
Net Change in Total Pension Liability	1,631,518
Total Pension Liability - Beginning of Year	25,457,946
Total Pension Liability - End of Year (a)	\$ 27,089,464
Plan Fiduciary Net Position	
Contributions – employer	\$ 448,010
Contributions – member	160,897
Net investment income	722,392
Benefit payments, including refunds of member contributions	(715,865)
Administrative expense	(7,900)
Net Change in Plan Fiduciary Net Position	607,534
Plan Fiduciary Net Position - Beginning of Year	27,470,418
Plan Fiduciary Net Position - End of Year (b)	\$ 28,077,952
Net Pension Liability (a-b)	\$ (988,488)
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	103.65%
Covered Employee Payroll	\$ 5,239,612
Net Pension Liability as a Percentage of Covered Employee Payroll	(18.87%)

HANOVER BOROUGH EMPLOYEES 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, calculated using the discount rate of 7%, 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 (6%)	Current Discount Rate (7%)	1% Increase (8%)
Net Pension Liability	\$ 1,726,279	\$ (988,488)	\$ (3,183,798)

SCHEDULE OF INVESTMENT RETURN
 DECEMBER 31, 2014

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2014	2.38%
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HANOVER BOROUGH EMPLOYEES 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)
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)
01-01-09	\$ 18,768,887	\$ 19,271,506	\$ 502,619	97.4%
01-01-11	21,669,484	21,885,499	216,015	99.0%
01-01-13	24,143,044	23,834,834	(308,210)	101.3%

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period which would be limited to a maximum of 120 percent and a minimum of 80 percent of the fair 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.

HANOVER BOROUGH EMPLOYEES 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.

HANOVER BOROUGH EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2009	\$ 461,088	100.0%
2010	460,768	100.0%
2011	458,651	100.0%
2012	482,645	100.0%
2013	574,943	100.0%
2014	448,010	100.0%

HANOVER BOROUGH EMPLOYEES 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, 2013
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	5.0%

HANOVER BOROUGH EMPLOYEES PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Hanover Borough Employees Pension Plan
York County
44 Fredrick Street
Hanover, PA 17331

The Honorable Ben Adams	Mayor
Mr. John Gerken	Council President
Ms. Cynthia Wyatt	Administrative Assistant/Treasurer

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.