

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN

WARREN COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2005, TO DECEMBER 31, 2007



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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.

Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign 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 Brokenstraw Township Nonuniformed 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 Brokenstraw Township Nonuniformed Pension Plan is a single-employer defined contribution pension plan locally controlled by the provisions of Resolution No. 3288B, as amended. Active members are not required to contribute to the plan. The municipality was required to annually contribute \$1,400 per member in the year 2005, and \$1,600 per member in the years 2006 and 2007.



Board of Township Supervisors
Brokenstraw Township
Warren County
Youngsville, PA 16371

We have conducted a compliance audit of the Brokenstraw Township Nonuniformed Pension Plan for the period January 1, 2005, to December 31, 2007. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings 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. The township has elected to purchase allocated insurance contracts to fund the pension benefits for plan members. Under an allocated funding arrangement, the insurer receives and retains consideration in exchange for a legally enforceable obligation to pay future benefits. In accordance with Statement No. 25 of the Governmental Accounting Standards Board, allocated insurance contracts are excluded from the pension plan's assets. Consequently, the plan has no reportable assets.

Township officials are responsible for establishing and maintaining an internal control structure to provide reasonable assurance that the Brokenstraw Township Nonuniformed Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. To assist us in planning and performing our audit, we obtained an understanding of the township's internal control structure as it relates to the township's compliance with those requirements. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the Brokenstraw Township Nonuniformed 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 – Unauthorized Funding Mechanism

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information and, accordingly, express no form of assurance on it.

The contents of this report were discussed with officials of Brokenstraw Township and, where appropriate, their responses have been included in the report.

October 3, 2008

JACK WAGNER
Auditor General

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
STATUS OF PRIOR FINDING

Rescission Of Prior Audit Recommendation

The following prior audit recommendation has been rescinded:

- Improper Ownership Of Allocated Insurance Contracts

During the current audit period, it was determined that the allocated insurance contracts were of a type whereby ownership could not be changed, making them ineligible as a pension plan funding vehicle (See Finding No. 2).

BROKENSTRAW TOWNSHIP NONUNIFORMED 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 nonuniformed pension plan's defined contribution pension costs in the year 2005, as illustrated below:

State aid allocation	\$ 3,696
Actual municipal pension costs	<u>(2,800)</u>
Excess state aid	<u>\$ 896</u>

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.

Cause: Plan officials were unaware of the need to annually reconcile the amount of state aid allocated to the pension plan with the plan's actual defined contribution pension costs.

Effect: It is this department's opinion that since 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 in the year 2005, in the total amount of \$896, must be returned to the Commonwealth for redistribution.

Recommendation: We recommend that the municipality return the \$896 of excess state aid received in the year 2005 to the Commonwealth from township funds. 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, 1205 Pittsburgh State Office Building, 300 Liberty Avenue, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with evidence of payment.

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Furthermore, we recommend that, in the future, plan officials reconcile the amount of state aid allocated to the nonuniformed pension plan with the plan's defined contribution pension costs.

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

Finding No. 2 – Unauthorized Funding Mechanism

Condition: During the current audit period, it was determined that the allocated insurance contracts maintained by the pension plan are tax sheltered annuities which require ownership by the annuitants. Furthermore, should the contracts be surrendered or ownership changed, the owner may be charged a tax as the entire value may be reported as income.

Criteria: Section 102 of Act 205 defines a pension plan as follows:

The various aspects of the relationship between a municipality and its employees with respect to the retirement coverage provided by a municipality to the employees.

Section 201.2 of Part IV of Title 16 of the Pennsylvania Code further elaborates on the definition included in Act 205, stating, in part:

The term does not include a plan, program, or arrangement that is funded solely by municipal employee earnings or compensation reported as municipal employee earnings or compensation to the Internal Revenue Service on the Form W-2 Wage and Tax Statement or established under sections 8.1-8.3 of the act of March 30, 1811 (P.L. 145 Sm.L. 228) (72 P.S. 4521.1-4521.3).

Cause: Municipal officials were not aware that funding arrangements similar to deferred compensation plans were not eligible funding vehicles for pension plans participating in the general municipal pension system state aid program.

Effect: Since the funding mechanism does not meet the definition of a pension plan as prescribed above, it is not eligible for participation in the general municipal pension system state aid program. In addition, since the individual employees rather than the municipality own these types of contracts, the municipality cannot ensure the integrity of these pension assets and the related benefits funded through state aid allocations from surrender by members prior to reaching retirement.

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Recommendation: We recommend that municipal officials cease paying premiums to the allocated insurance contracts and ensure that the contracts are placed on a paid-up status.

In addition, we recommend that future state aid allocations be deposited into a funding mechanism eligible for participation in the general municipal pension system state aid program.

Management's Response: Municipal officials agreed with the finding without exception. Municipal officials have deposited the 2008 state aid allocation into a certificate of deposit until they select an alternative funding mechanism for the plan's assets.

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

BROKENSTRAW TOWNSHIP NONUNIFORMED 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 \$896. 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, 1205 Pittsburgh State Office Building, 300 Liberty Avenue, Pittsburgh, PA 15222.

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF STATE AID
AND EMPLOYER CONTRIBUTIONS

Year Ended December 31	State Aid Deposited	Employer Contributions
2002	\$ 3,654	\$ 546
2003	3,816	384
2004	2,800	None
2005	2,800	None
2006	3,205	None
2007	3,150	50

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Brokenstraw Township Nonuniformed Pension Plan
Warren County
770 Rouse Avenue
Youngsville, PA 16371

Mr. C. W. Hendrickson	Chairman, Board of Township Supervisors
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Ms. Beverly L. Moore	Secretary
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This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.