

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN

WARREN COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2008, TO DECEMBER 31, 2010



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ABBREVIATION

PERC - Public Employee Retirement Commission

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 \$1,600 per member in the years 2008 and 2009, and \$1,800 per member in the year 2010.



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, 2008, to December 31, 2010. 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 findings 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 funds the pension benefits for plan members through tax sheltered annuities which are not eligible funding vehicles for pension plans participating in the general municipal pension system state aid program. Under this funding arrangement, the employees rather than the municipality own the annuity contracts; consequently, the plan has no reportable assets.

Township officials are responsible for establishing and maintaining effective internal controls 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. In conducting our audit, we obtained an understanding of the township's internal controls as they relate to the township'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 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 – Noncompliance With Prior Audit Recommendation –
Unauthorized Funding Mechanism

Finding No. 2 – Allocation Of State Aid In Excess Of Entitlement

Finding No. 3 – Incorrect Data Certified On Actuarial Valuation Report
Resulting In An Overpayment Of State Aid

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.

March 31, 2011

JACK WAGNER
Auditor General

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

Brokenstraw Township has complied with the prior audit recommendation concerning the following:

- Receipt Of State Aid In Excess Of Entitlement

The township reimbursed \$1,010 to the Commonwealth for the excess state aid received in 2005.

Noncompliance With Prior Audit Recommendation

Brokenstraw Township has not complied with the prior audit recommendation concerning the following as further discussed in the Findings and Recommendations section of this report:

- Unauthorized Funding Mechanism

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Unauthorized Funding Mechanism

Condition: As disclosed in the prior audit report, 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.

In addition, during the current audit period, municipal officials continued to deposit state aid allocations into these tax sheltered annuities.

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

Effect: Since the funding mechanism does not meet the definition of a pension plan as described 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 adequately safeguard these pension assets from surrender by plan members prior to reaching retirement benefit eligibility.

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

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

In addition, we again 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.

Finding No. 2 – Allocation Of State Aid In Excess Of Entitlement

Condition: In 2008 and 2009, the township allocated state aid to the nonuniformed pension plan in excess of the plan’s defined contribution pension costs, as illustrated below:

	<u>2008</u>	<u>2009</u>
State aid allocation	\$ 3,576	\$ 3,821
Actual municipal pension costs	(3,200)	(3,200)
Excess state aid	\$ 376	\$ 621

The total excess state aid of \$997 was equally allocated into the two plan members’ accounts.

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 failed to annually reconcile the amount of state aid allocated to the pension plan with the plan’s actual defined contribution pension costs.

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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 overpayments of state aid in the years 2008 and 2009, in the total amount of \$997, must be returned to the Commonwealth for redistribution.

Recommendation: We recommend that the municipality return the \$997 of excess state aid received in the years 2008 and 2009 from the members' accounts, if feasible, or from township funds, 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 plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with evidence of payment.

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. 3 – Incorrect Data Certified On Actuarial Valuation Report Resulting In An Overpayment Of State Aid

Condition: Actuarial valuation report (AVR) form 203A, with a valuation date of January 1, 2009, submitted to the Public Employee Retirement Commission (PERC), contained incorrect information. The township incorrectly reported payroll of \$53,767 on Line 14 of the AVR when the actual amount of payroll was \$91,767. By using incorrect payroll information, the normal cost percentage in the AVR was incorrectly calculated and the 2010 state aid allocation was based on the normal cost percentage of 5.9516%, instead of the correct normal cost percentage of 3.48713%.

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.

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Cause: Township officials failed to establish adequate internal control procedures to ensure the accuracy of the data included in the actuarial valuation report.

Effect: Because the municipality's state aid allocations are determined, in part, by the information contained in the actuarial valuation report, the submission of incorrect data resulted in the municipality receiving an overpayment of state for the year 2010 in the amount of \$2,116.

Recommendation: We recommend that plan officials contact PERC to determine if a revised actuarial valuation report may be filed. If a revised report is prepared and accepted by PERC, a copy should be submitted to: Department of the Auditor General, Bureau of Municipal Pension Audits, 406 Finance Building, Harrisburg, PA 17120.

We further recommend that the total excess state aid, in the amount of \$2,116, be returned 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 pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with evidence of payment.

We also recommend that, in the future, plan officials review and verify all information submitted to PERC so that future actuarial valuation reports properly reflect the status of the pension plan.

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

BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

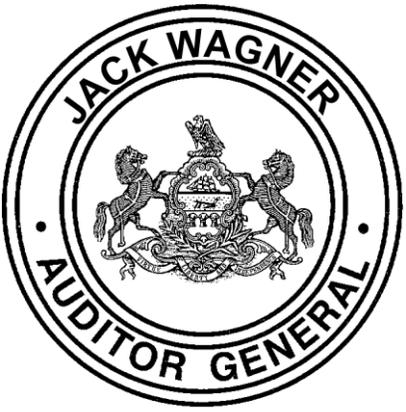
A condition of a repeat finding such as that reported by Finding No. 1 contained in this audit report may lead to a total withholding of state aid in the future unless that finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension Audits, 406 Finance Building, Harrisburg, PA 17120.

Finding Nos. 2 and 3 contained in this audit report cite overpayments of state aid to the township in the total amount of \$3,113. Conditions of this nature may lead to a total withholding of state aid in the future unless those findings are 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, 11 Stanwix Street, Suite 1450, 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
2005	\$ 2,800	None
2006	3,205	None
2007	3,150	\$ 50
2008	3,576	None
2009	3,821	None
2010	3,600	None



BROKENSTRAW TOWNSHIP NONUNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
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
Ms. Beverly L. Moore	Secretary
Mr. James P. McAneny	Public Employee Retirement Commission

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.