



**FOSTER TOWNSHIP POLICE
PENSION PLAN**

MCKEAN COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2010 TO DECEMBER 31, 2012

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL



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**EUGENE A. DePASQUALE
AUDITOR GENERAL**

Board of Township Supervisors
Foster Township
McKean County
Bradford, PA 16701

We have conducted a compliance audit of the Foster Township Police Pension Plan for the period January 1, 2010 to December 31, 2012. 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. 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.
- Whether the terms of the unallocated insurance contract, including ownership and any restrictions, are in compliance with plan provisions, investment policies and state regulations.
- Whether benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Foster Township 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 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 objective, 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 objective.

The results of our tests indicated that, in all significant respects, the Foster Township 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 findings further discussed later in this report:

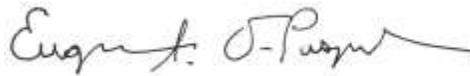
- Finding No. 1 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid
- Finding No. 2 – Unauthorized Compensation Used To Calculate Pension Benefit
- Finding No. 3 – Pension Benefits Not In Compliance With Act 600 Provisions
- Finding No. 4 – Unauthorized Provision For A Killed In Service Benefit

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 a decline of assets available to satisfy the long-term liabilities of the plan. For example, **the plan's funded ratio went from 76.1% as of January 1, 2009, to a ratio of 65.5% as of January 1, 2011**, which is the most recent date available. We encourage township officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of Foster Township and, where appropriate, their responses have been included in the report. We would like to thank township officials for the cooperation extended to us during the conduct of the audit.

January 13, 2014



EUGENE A. DEPASQUALE
Auditor General

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ABBREVIATION:

PSATS – Pennsylvania State Association of Township Supervisors

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 Foster Township 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 761 et seq.

The Foster Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution 2012-14, effective January 1, 2011, adopted pursuant to Act 600. Prior to the adoption of Resolution No. 2012-14, the pension plan was controlled by the provisions of Resolution No. 112, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers. The plan was established September 9, 1985. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2012, the plan had 4 active members, no terminated members eligible for vested benefits in the future and 2 retirees receiving pension benefits from the plan.

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The township overstated payroll by \$5,521 on the Certification Form AG 385 filed in 2011 by including pay received by the former township police chief for work he performed for the McKean County Drug Task Force. The data contained on this certification form is based on prior calendar year information.

Criteria: Pursuant to the instructions that accompany Certification Form AG 385, the total payroll eligible to be certified should be Internal Revenue Service Form W-2 earnings pertaining to full-time positions.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified and failed to follow the instructions accompanying the certification form.

Effect: The data submitted on this certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. The incorrect certification of pension data affected the township’s state aid allocation, as identified below:

| <u>Normal Cost %</u> | <u>Payroll Overstatement</u> | <u>State Aid Overpayment</u> |
|--------------------------|----------------------------------|----------------------------------|
| 12.274% | \$ 5,521 | \$ 678 |

Recommendation: We recommend that the total excess state aid, in the amount of \$678, 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.

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

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Unauthorized Compensation Used To Calculate Pension Benefit

Condition: A monthly pension benefit being paid to the former police chief was based, in part, on compensation earned outside of the duties and responsibilities of his full-time position of police chief. Compensation totaling \$7,187 paid for work performed for the McKean County Drug Task Force was included as part of the 3-year final average salary used in calculating the monthly retirement benefit. In addition, a \$2,000 payroll transposition error occurred in 2008 resulting in the chief’s payroll for the year being understated in his pension calculation.

The comparison between the authorized compensation attributable to the former township police chief’s full-time municipal employment and the total wages provided to PSATS to determine the pension benefit is illustrated below:

| <u>Year</u> | <u>Police Chief’s Pensionable Compensation</u> | <u>Total Compensation Reported To PSATS</u> | <u>Excess Compensation Included In Benefit Calculation</u> |
|-------------|------------------------------------------------|---------------------------------------------|------------------------------------------------------------|
| 2008 | \$ 57,853 | \$ 58,775 | \$ 922 |
| 2009 | 56,022 | 56,766 | 744 |
| 2010 | 64,881 | 70,402 | <u>5,521</u> |
| 2008 | | Less: Payroll Error | 7,187 <u>2,000</u> |
| | | Total | <u>\$ 5,187</u> |

Criteria: Since the compensation paid to the former police chief for work performed for the McKean County Drug Task Force was not regular salary attributable to his full-time duties for the municipality, it should not have been included in his pension benefit determination.

Cause: Plan officials failed to establish adequate internal control procedures to ensure that the compensation reported to PSATS only included compensation attributable to the police chief’s full-time position with police department.

Effect: Due to the inclusion of the unauthorized compensation and the payroll reporting error, the former police chief is receiving a retirement benefit of \$72 per month in excess of the amount to which he is entitled.

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Recommendation: We recommend that municipal officials consult with PSATS to recalculate the retirement benefit using the correct and authorized compensation and adjust the monthly benefit prospectively.

We also recommend that in the future, plan officials establish adequate internal control procedures, such as having at least 2 people review the pensionable wages certified to PSATS, to ensure their accuracy of pension benefit determinations.

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

Finding No. 3 – Pension Benefits Not In Compliance With Act 600 Provisions

Condition: In an effort to consolidate previous plan documents, the township enacted an adoption agreement through Resolution No. 2012-14, on May 14, 2012, effective January 1, 2011. This agreement contains benefit provisions that are not in compliance with Act 600, as illustrated below:

| <u>Benefit Provision</u> | <u>Governing Document</u> | <u>Act 600 (as amended)</u> |
|--------------------------|---------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Survivor’s benefit | Life annuity to the retiree with optional form provisions for 10 year certain, 50% survivor and 100% survivor. (Sections 6-1(7), 9-1) | A lifetime survivor’s benefit must be provided to the surviving spouse (or if no spouse survives or if he or she subsequently dies, the child or children under 18 years of age or if attending college, under or attaining the age of 23) of no less than 50% of the pension the member was receiving or would have been entitled to receive had he been retired at the time of death. (“Attending college” shall mean the eligible children are registered at an accredited institution of higher learning and are carrying a minimum course load of 7 credit hours per semester.) |

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Condition – (Continued)

| <u>Benefit Provision</u> | <u>Governing Document</u> | <u>Act 600 (as amended)</u> |
|---------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Payment of vested benefit | The surviving spouse is entitled to an <u>immediate</u> monthly benefit equal to 50% of the participant’s vested (12 years) accrued benefit at the time of death. (<u>emphasis added</u>). (Sections 6-5(f), 8-2(c)) | A vested benefit after the completion of 12 years of total service, payable on the date the <u>member</u> meets or would have met superannuation. (<u>Emphasis added</u>) |

Criteria: A governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. In addition, the police pension plan’s benefit structure should be in compliance with Act 600, as amended.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure the new governing document was in full compliance with Act 600.

Effect: Maintaining a benefit structure which is not in compliance with Act 600 could result in plan members or their beneficiaries receiving incorrect benefit amounts or being denied benefits to which they are statutorily entitled.

Recommendation: We recommend that municipal officials take whatever action is necessary to bring the police pension plan’s benefit structure into compliance with Act 600, as amended, at their earliest opportunity to do so.

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

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – Unauthorized Provision For A Killed In Service Benefit

Condition: Foster Township maintains a police pension plan governed by the provisions of Act 600, as amended. Prior to the adoption of Act 51 of 2009, Act 600 contained a mandatory killed in service benefit provision; however, Act 51 specifically repealed the section of Act 600 that referenced the mandatory killed in service benefit. During the prior audit period, a verbal observation was given to plan officials notifying them of the passage of Act 51. It was recommended that plan officials review the act's implications for the police pension plan and the collective bargaining agreement in effect for the period January 1, 2008 to December 31, 2010, with their municipal solicitor. During the current audit period, it has been determined that the pension plan's governing document and the current collective bargaining agreement for the period January 1, 2012 to December 31, 2015, continue to provide for a killed in service benefit that is no longer authorized by Act 600.

Section 6-5 (f) of the plan agreement adopted by Resolution No. 2012-14, states in part:

...In the case of a Participant killed in service, the survivor's benefit shall be equal to 100% of the participant's salary at time of death...

In addition, Article X, Section F, of the current collective bargaining agreement states, in part:

...if the member dies as a result of illness or injury incurred in service, the member's survivors shall receive a pension calculated at the rate of one-hundred percent (100%) of the member's salary at the time of his/her death,...

In addition, the township continues to fund a killed in service benefit due to its inclusion in the plan's January 1, 2011, actuarial valuation report.

Criteria: Section 1(a) of Act 51 of 2009 states, in part:

In the event a law enforcement officer, ambulance service or rescue squad member, firefighter, certified hazardous material response team member or National Guard member dies as a result of the performance of his duties, such political subdivision, Commonwealth agency or, in the case of National Guard members, the Adjutant General, or, in the case of a member of a Commonwealth law enforcement agency, the authorized survivor or the agency head, within 90 days from the date of death, shall submit certification of such death to the Commonwealth.

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

In addition, Section 1(d) of Act 51 of 2009 states, in part:

... the Commonwealth shall, from moneys payable out of the General Fund, pay to the surviving spouse or, if there is no surviving spouse, to the minor children of the paid firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty the sum of \$100,000, adjusted in accordance with subsection (f) of this section, and an amount equal to the monthly salary, adjusted in accordance with subsection (f) of this section, of the deceased paid firefighter, ambulance service or rescue squad member or law enforcement officer, less any workers' compensation or pension or retirement benefits paid to such survivors, and shall continue such monthly payments until there is no eligible beneficiary to receive them. For the purpose of this subsection, the term "eligible beneficiary" means the surviving spouse or the child or children under the age of eighteen years or, if attending college, under the age of twenty-three years, of the firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty. When no spouse or minor children survive, a single sum of \$100,000, adjusted in accordance with subsection (f) of this section, shall be paid to the parent or parents of such firefighter, ambulance service member, rescue squad member or law enforcement officer. (Emphasis added)

Furthermore, Section 2 of Act 51 of 2009 states:

Repeals are as follows:

- (1) The General Assembly declares that the repeals under paragraph (2) are necessary to effectuate the amendment of section 1 of the act.
- (2) The following parts of acts are repealed:
 - (i) Section 5(e)(2) of the act of May 29, 1956 (1955 P.L.1804, No. 600), referred to as the Municipal Police Pension Law.
 - (ii) Section 202(b)(3)(vi) and (4)(vi) of the act of December 18, 1984 (P.L.1005, No. 205), known as the Municipal Pension Plan Funding Standard and Recovery Act.

Therefore, since Act 51 specifically repealed the killed in service provision of Act 600 and the funding provisions for the killed in service benefit that were contained in Act 205, the provision of a killed in service benefit is no longer authorized.

FOSTER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

Cause: Plan officials failed to establish adequate internal control procedures to ensure the plan's governing document is in compliance with Act 600, as amended. In addition, plan officials were unsuccessful in removing the killed in service benefit through the collective bargaining process.

Effect: Since Section 1 of Act 51 provides that the Commonwealth is obligated to pay the killed in service benefit less any pension or retirement benefits paid to eligible survivors, the continued provision of a killed in service benefit could result in the pension plan being obligated to pay a benefit that is no longer authorized by Act 600, and would have been paid entirely by the Commonwealth absent such provision.

Recommendation: We recommend that the municipality review the plan's killed in service benefit with its solicitor in conjunction with Act 51 of 2009, and eliminate this unauthorized benefit provision at its earliest opportunity to do so.

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

FOSTER TOWNSHIP 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, 2007, 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)] |
| 01-01-07 | \$ 651,554 | \$ 544,100 | \$ (107,454) | 119.7% | \$ 223,684 | (48.0%) |
| 01-01-09 | 677,953 | 891,201 | 213,248 | 76.1% | 187,617 | 113.7% |
| 01-01-11 | 663,071 | 1,012,288 | 349,217 | 65.5% | 132,465 | 263.6% |

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 subject to a corridor between 70 to 130 percent of the 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.

FOSTER TOWNSHIP 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.

FOSTER TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|------------------------|------------------------------|------------------------|
| 2007 | \$ 23,832 | 100.1% |
| 2008 | 21,691 | 100.0% |
| 2009 | 19,308 | 102.3% |
| 2010 | 41,878 | 100.0% |
| 2011 | 42,941 | 108.4% |
| 2012 | 61,488 | 100.0% |

FOSTER TOWNSHIP 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, 2011 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar |
| Remaining amortization period | 13.2 years |
| Asset valuation method | Fair value |
| Actuarial assumptions: | |
| Investment rate of return | 6.0% |
| Projected salary increases | 3.5% |

FOSTER TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Foster Township Police Pension Plan
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1185 East Main Street
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| | |
|----------------------|-----------------------------------------|
| Mr. John A. Sullivan | Chairman, Board of Township Supervisors |
| Ms. Shannon Morgan | Secretary/Treasurer |

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