

HUGHESTOWN BOROUGH POLICE PENSION PLAN

LUZERNE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2008, TO DECEMBER 31, 2010



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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 Hughestown 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 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 Hughestown Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 6 of 2005. The plan is also affected by the provisions of collective bargaining agreements between the borough and its police officers.



The Honorable Mayor and Borough Council
Hughestown Borough
Luzerne County
Hughestown, PA 18640

We have conducted a compliance audit of the Hughestown Borough Police 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 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 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Hughestown 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 the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the Hughestown 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 – Partial Compliance With Prior Audit Recommendation – Payment
Of An Unauthorized Survivor Benefit 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 Hughestown Borough and, where appropriate, their responses have been included in the report.

August 30, 2011

JACK WAGNER
Auditor General

HUGHESTOWN BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Partial Compliance With Prior Audit Recommendation

Hughestown Borough has partially complied with the prior audit recommendation concerning the following:

- Payment Of An Unauthorized Survivor Benefit Resulting In An Overpayment Of State Aid

The borough determined that it is obligated to pay the unauthorized survivor benefit. In compliance with the prior audit recommendation, the excess benefit is being paid from the police pension plan, included in the plan's actuarial valuation report and funded in accordance with Act 205 funding standards. In addition, the plan's actuary has determined the effect of the unauthorized survivor benefit on the borough's state aid allocations received in the years 2006, 2007 and 2008, and submitted this information to the department on Certification Form AG-MP-1. Furthermore, the plan's actuary has been instructed to prepare the Certification Form AG-MP-1 dated January 1, 2009, to determine the impact of the unauthorized survivor benefit on the borough's state aid allocations received in the years 2010 and 2011. However, the impact of the payment of the unauthorized survivor benefit on the borough's state aid allocations has resulted in receipt of excess state aid which has not been reimbursed to the Commonwealth as further discussed in the Finding and Recommendation section of this report.

Rescission Of Prior Audit Recommendation

The following prior audit recommendation has been rescinded:

- Undocumented Pension Benefit Paid

Municipal officials provided adequate documentation to support the validity of the service-related disability benefit payments granted during the prior audit period.

HUGHESTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Partial Compliance With Prior Audit Recommendation – Payment Of An Unauthorized Survivor Benefit Resulting In An Overpayment Of State Aid

Condition: As disclosed in the prior audit report, an active member of the police pension plan died on April 22, 2003. Effective October 1, 2003, his surviving spouse was improperly awarded a survivor benefit, retroactive to April 2003. The benefit awarded to the surviving spouse is not authorized by the plan's governing document and municipal officials were unable to provide any documentation to support the amount or basis of the benefit being paid. Furthermore, the benefit is not authorized by Act 581 since the plan member was not killed in service nor retired based on a service-related disability. It was recommended that the borough determine whether it was obligated to continue to pay the unauthorized survivor benefit and determine the impact on the borough's state aid allocations.

The borough has determined that it is obligated to pay the unauthorized survivor benefit. In addition, the excess benefit is being paid from the police pension plan, included in the plan's actuarial valuation report and funded in accordance with Act 205 funding standards. The plan's actuary submitted Certification Forms AG-MP-1 dated January 1, 2005, and January 1, 2007, which determined the effect of the payment of the unauthorized survivor benefit on the borough's state aid allocations received in the years 2006, 2007 and 2008, resulting in excess state aid amounting in the amount of \$14,670; however, the borough has not reimbursed these excess funds to the Commonwealth. In addition, the plan's actuary has determined that the borough received additional excess state aid in the amount of \$3,310 in 2009. Furthermore, through the date of this audit report, the impact of the excess benefit on the borough's state aid allocations received in 2010 and 2011 has yet to be determined.

Criteria: The plan's governing document in effect at the time of the deceased police officer's retirement, Resolution No. 1 of 1981, as amended, did not provide for a survivor benefit.

Furthermore, Act 581, at Section 1131, states, in part:

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 (emphasis added). Any allowances made to those who are retired by reason of disability or age shall be in conformity with a uniform scale.

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

HUGHESTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Effect: The pension plan has paid \$50,500 in unauthorized survivor benefits from April 1, 2003, through the date of this audit report. Providing unauthorized benefits increases the plan's pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses.

Furthermore, the payment of the unauthorized survivor benefit has resulted in the borough receiving excess state aid allocations and has increased the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

Recommendation: We again recommend that the borough review the continued payment of the unauthorized survivor benefit with its solicitor.

In addition, we recommend that the borough reimburse the \$17,980 of excess state aid received in the years 2006, 2007, 2008 and 2009 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.

In addition, we recommend that the impact, if any, of the excess benefit payments on the borough's 2010 and 2011 state aid allocations be determined and submitted to the Department of the Auditor General, along with any excess state aid received.

Management's Response: Municipal officials indicated that the borough will continue paying the unauthorized benefit to the surviving spouse and also indicated that the borough does not have the funds available to reimburse the Commonwealth from its general fund. However, municipal officials also indicated that the borough will work with its solicitor and pension consultant to produce something in writing to forward to the department to try and get this issue resolved. It was also noted by plan officials that there was some confusion due to the timing of the receipt of the prior audit report and that is why the Certification Form AG-MP-1 dated January 1, 2009, was not completed. The borough has instructed the plan's actuary to complete the form and forward it to the Department of the Auditor General.

Auditor's Conclusion: The Department of the Auditor General has been in communication with the borough's solicitor and the plan consultant regarding compliance with the finding recommendation. The borough's efforts to comply with the finding recommendation will be evaluated going forward and through our next audit of the plan.

HUGHESTOWN BOROUGH POLICE 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 total amount of \$17,980. A condition of a finding of this nature may lead to a total withholding of state aid in the future unless the 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, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222.

HUGHESTOWN 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, 2005, 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)]
01-01-05	\$ 178,678	\$ 101,857	\$ (76,821)	175.4%	\$ 30,305	(253.5%)
01-01-07	186,835	164,887	(21,948)	113.3%	32,839	(66.8%)
01-01-09	188,010	184,559	(3,451)	101.9%	37,467	(9.2%)

HUGHESTOWN 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. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

HUGHESTOWN 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
2005	\$ 7,034	101.2%
2006	7,329	113.5%
2007	5,153	100.8%
2008	9,247	100.0%
2009	10,142	100.0%
2010	10,341	100.0%

HUGHESTOWN 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, 2009
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%

HUGHESTOWN BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Hughestown Borough Police Pension Plan
Luzerne County
42 Center Street
Hughestown, PA 18640

The Honorable Paul T. Hindmarsh	Mayor
Mr. Wayne Quick, Jr.	Council President
Ms. Angela B. Acierno	Secretary/Treasurer

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.