

SMETHPORT BOROUGH NONUNIFORMED PENSION PLAN

MCKEAN COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2006, TO DECEMBER 31, 2007



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CONTENTS

	<u>Page</u>
Background.....	1
Letter from the Auditor General	3
Finding and Recommendation:	
Finding – Failure To Properly Determine The Minimum Municipal Obligation Of The Plan.....	5
Supplementary Information	7
Report Distribution List	11

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 Smethport Borough 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 Smethport Borough Nonuniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution No. 298, as amended.



The Honorable Mayor and Borough Council
Smethport Borough
McKean County
Smethport, PA 16749

We have conducted a compliance audit of the Smethport Borough Nonuniformed Pension Plan for the period January 1, 2006, 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 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 this objective.

Borough officials are responsible for establishing and maintaining an internal control structure to provide reasonable assurance that the Smethport Borough 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 borough's internal control structure as it relates to the borough'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 objective.

The results of our tests indicated that, in all significant respects, the Smethport Borough 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 finding further discussed later in this report:

Finding – Failure To Properly Determine The Minimum Municipal
Obligation Of The Plan

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 Smethport Borough and, where appropriate, their responses have been included in the report.

January 15, 2009

JACK WAGNER
Auditor General

SMETHPORT BOROUGH NONUNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Failure To Properly Determine The Minimum Municipal Obligation Of The Plan

Condition: Plan officials did not properly determine the minimum municipal obligation (MMO) of the nonuniformed pension plan for the year 2008, as required by Act 205. The normal cost percentage and amortization contribution used in the calculation do not reconcile to the most current actuarial valuation report filed with PERC. Based upon an estimate prepared by this department, the borough has an unpaid 2008 MMO balance of \$10,236.

Criteria: With regard to the financial requirements of a pension plan, Section 302(b)(1) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the financial requirements of the pension plan for the following plan year. The financial requirements of the pension plan for the following plan year shall be based on the most recent actuarial valuation report of the pension plan prepared pursuant to Chapter 2. Unless the assets of the pension plan equal the present value of future benefits as reported pursuant to section 202(b)(2), the financial requirements of the pension plan shall be the normal cost and administrative expense requirements for the following plan year and, if the pension plan has an unfunded actuarial accrued liability pursuant to the most recent actuarial valuation report, the amortization contribution requirement for the following plan year.

Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states, in part:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid. . . .

SMETHPORT BOROUGH NONUNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Cause: Plan officials failed to establish adequate internal control procedures to ensure the data used in the MMO determination reconciled with the actuarial valuation report.

Effect: The proper determination of the plan's MMO ensures plan officials can properly allocate the necessary resources to the pension plan for the upcoming year. The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Recommendation: We recommend that the borough pay the outstanding MMO due to the nonuniformed pension plan for the year 2008, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

Furthermore, we recommend that, in the future, plan officials determine the MMO in accordance with Act 205 requirements.

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

SMETHPORT BOROUGH NONUNIFORMED 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, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2003, 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)]
01-01-03	\$ 566,360	\$ 554,935	\$ (11,425)	102.1%	\$ 351,643	(3.2%)
01-01-05	658,495	688,729	30,234	95.6%	332,467	9.1%
01-01-07	769,735	922,664	152,929	83.4%	342,742	44.6%

SMETHPORT BOROUGH NONUNIFORMED 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.

SMETHPORT BOROUGH NONUNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2002	\$ 23,303	100.0%
2003	26,602	100.0%
2004	29,453	103.6%
2005	33,786	100.0%
2006	41,597	100.0%
2007	43,205	100.0%

SMETHPORT BOROUGH NONUNIFORMED 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, 2007
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return *	5.0%
Projected salary increases *	4.0%
* Includes inflation at	Not disclosed
Cost-of-living adjustments	None assumed

SMETHPORT BOROUGH NONUNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Smethport Borough Nonuniformed Pension Plan
McKean County
201 West Main Street
Smethport, PA 16749

The Honorable Ross Porter	Mayor
Mr. Gregory Rounsville	Council President
Ms. Cheryl O'Rourke	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.