

SMETHPORT BOROUGH POLICE 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
Status of Prior Finding	5
Finding and Recommendation:	
Finding – Restated Plan Document Lacks Clearly Defined Provisions.....	6
Supplementary Information	8
Report Distribution List	13

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 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 120 - Foreign Casualty Insurance Premium Tax Allocation Law, Act of May 12, 1943 (P.L. 259, No. 120), as amended, 72 P.S. § 2263.1 et seq.
- 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 Smethport Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 354 effective June 18, 2007. Prior to the adoption of Ordinance No. 354, the pension plan was controlled by the provisions of Resolution No. 299, 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 Police 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 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 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.

Borough officials are responsible for establishing and maintaining an internal control structure to provide reasonable assurance that the Smethport Borough Police 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 objectives.

The results of our tests indicated that, in all significant respects, the Smethport 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 – Restated Plan Document Lacks Clearly Defined Provisions

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 POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

Smethport Borough has complied with the prior audit recommendation concerning the following:

- Pension Benefits In Excess Of Act 581

The borough adopted Ordinance No. 354 which removed the unauthorized survivor benefit provision. However, the service requirement for retirement eligibility and the definition of accrued benefit are not clearly stated in the new governing document as noted in the finding contained in this report.

SMETHPORT BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Restated Plan Document Lacks Clearly Defined Provisions

Condition: On June 18, 2007, borough officials adopted Ordinance No. 354, which restated the police pension plan. The years of service required for retirement benefit eligibility is not clearly stated and the term “accrued benefit” is not defined, as noted below:

Section VI of Ordinance No. 354 states:

To qualify for a pension under the provisions hereof, a participant of the Borough of Smethport Police Pension Plan shall have a minimum of twenty-five (20) years service with the borough. (emphasis added)

Furthermore, Section VII states:

The Normal Retirement Benefit for any participant who shall complete the minimum service requirement shall be the accrued benefit provided by an annuity contract at the time an election to retire is made. (emphasis added)

Criteria: Section 1131 of Act 581 states:

Where a police force of less than three members is being maintained, the borough may, unless there is a private organization or association constituting and managing an existing pension fund for the members of the police force in such borough, by ordinance, provide for the purchase of annuity contracts for the payment of pensions, or establish a police pension fund into which each member of the police force shall pay an equal and proportionate monthly charge to be withheld from the pay of such member. 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. Any allowances made to those who are retired by reason of disability or age shall be in conformity with a uniform scale.

SMETHPORT BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Cause: Borough officials failed to establish adequate internal control procedures to ensure the restated plan document contained clearly stated and defined benefit provisions.

Effect: The failure to have clearly defined terms and benefit provisions could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: We recommend that borough officials review the plan's governing document with their solicitor and take appropriate action to ensure all benefit provisions and terms are consistent and clearly defined.

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

SMETHPORT 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, 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	\$ 329,588	\$ 108,886	\$ (220,702)	302.7%	\$ 56,238	(392.4%)
01-01-05	346,795	135,514	(211,281)	255.9%	62,820	(336.3%)
01-01-07	365,704	134,534	(231,170)	271.8%	39,495	(585.3%)

SMETHPORT 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.

SMETHPORT BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

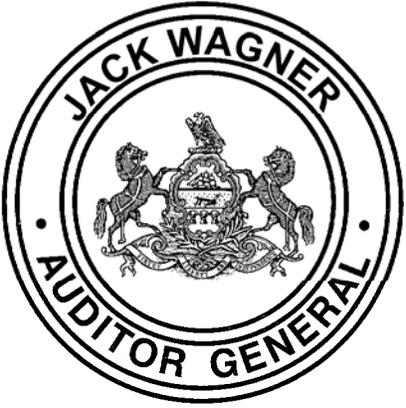
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2002	None	N/A
2003	None	N/A
2004	None	N/A
2005	None	N/A
2006	None	N/A
2007	None	N/A

SMETHPORT 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, 2007
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
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 POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

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

The Honorable Ross Porter	Mayor
Mr. Greg 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.