

WEST HAZLETON BOROUGH POLICE PENSION PLAN

LUZERNE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2007, TO DECEMBER 31, 2008



WEST HAZLETON BOROUGH POLICE PENSION PLAN

LUZERNE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2007, TO DECEMBER 31, 2008

CONTENTS

| | <u>Page</u> |
|-------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| Background | 1 |
| Letter from the Auditor General | 3 |
| Status of Prior Findings | 5 |
| Findings and Recommendations: | |
| Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Adopt Benefit Provisions Mandated By Act 30 | 6 |
| Finding No. 2 – Noncompliance With Prior Audit Recommendation – Incorrect Data Supplied To Actuary For Actuarial Valuation Report..... | 9 |
| Finding No. 3 – Pension Benefits In Excess of Act 600 | 10 |
| Finding No. 4 – Pension Benefits Modified Without Prior Cost Estimate | 12 |
| Supplementary Information | 13 |
| Report Distribution List | 17 |

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 West Hazleton 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 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.

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 West Hazleton Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 30 of 1976, adopted pursuant to Act 600. 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
West Hazleton Borough
Luzerne County
West Hazleton, PA 18202

We have conducted a compliance audit of the West Hazleton Borough Police Pension Plan for the period January 1, 2007, to December 31, 2008. 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. West Hazleton Borough contracted with an independent certified public accounting firm for an audit of its financial statements for the year ended December 31, 2007, prepared in conformity with the accounting practices prescribed or permitted by the Department of Community and Economic Development of the Commonwealth of Pennsylvania, and an audit of its basic financial statements for the year ended December 31, 2008, which are available at the borough's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the West Hazleton 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 West Hazleton 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 findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Adopt Benefit Provisions Mandated By Act 30

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Incorrect Data Supplied To Actuary For Actuarial Valuation Report Preparation

Finding No. 3 – Pension Benefits In Excess Of Act 600

Finding No. 4 – Pension Benefits Modified Without Prior Cost Estimate

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

December 21, 2009

JACK WAGNER
Auditor General

WEST HAZLETON BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

West Hazleton Borough has complied with the prior audit recommendation concerning the following:

- Vested Pension Benefit Calculation Not Adequately Supported

Plan officials provided adequate documentation to support the salary amount used in the vested pension benefit calculation.

Noncompliance With Prior Audit Recommendations

West Hazleton Borough has not complied with the prior audit recommendations concerning the following as further discussed in the Findings and Recommendations section of this report:

- Failure To Adopt Benefit Provisions Mandated By Act 30

- Incorrect Data Supplied To Actuary For Actuarial Valuation Report Preparation

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Adopt Benefit Provisions Mandated By Act 30

Condition: As disclosed in the prior audit report, on April 17, 2002, Act 600 was amended by Act 30, which made significant changes to the statutorily prescribed benefit structure of police pension plans subject to Act 600. Municipal officials have not amended the police pension plan’s benefit structure to adopt all of the changes mandated by Act 30. The specific inconsistencies are as follows:

| <u>Benefit Provision</u> | <u>Governing Document</u> | <u>Collective Bargaining Agreement</u> | <u>Act 600 (as amended)</u> |
|--------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Survivor’s benefit | A joint and 50% contingent annuity if the officer is married. This would provide post-retirement death benefits to a widow who has not remarried, or else to the children under age 18 of a policeman who dies after having obtained eligibility to receive a pension benefit. The amount of the benefit is to be set at one-half of the pension the officer was receiving or would have been entitled to receive had he been retired when he died. | The spouse of a member of the police force or a member who retires on pension who dies or if no spouse survives or if such person survives and subsequently dies or remarries, then the child or children under the age of 18 years of the deceased member, shall, during said spouse’s lifetime or so long as such surviving spouse does not remarry, or until reaching the age of 18 years in the case of a child or children, be entitled to receive a pension calculated at the rate of 50% of the pension that the member was receiving or would have been receiving had he been eligible and retired at the time of his death. | 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.) |

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

| <u>Benefit Provision</u> | <u>Governing Document</u> | <u>Collective Bargaining Agreement</u> | <u>Act 600 (as amended)</u> |
|------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Service-related disability benefit | <p>Benefits shall be equal to 100% of the pension the member would have received if the date of disability had been the member's normal retirement date.</p> <p>Normal retirement benefits shall be computed at one-half the monthly average salary of such member during the last 36 months of employment.</p> | Police officers who become unable to perform police duties shall be eligible for immediate retirement benefits calculated at 100% of his or her highest monthly compensation. | The benefit must be in conformity with a uniform scale and fixed by the plan's governing document at no less than 50% of the member's salary at the time the disability was incurred, reduced by the amount of Social Security disability benefits received for the same injury. |

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

| <u>Benefit Provision</u> | <u>Governing Document</u> | <u>Collective Bargaining Agreement</u> | <u>Act 600 (as amended)</u> |
|---------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Pre-vesting death benefit | If such ineligibility is due to death, such monies shall be paid to his designated beneficiary or, in the absence thereof, to his estate. | If such discontinuance is due to death, such monies shall be paid to his designated beneficiary or, in the absence thereof, to his estate. | The surviving spouse of a member of the police force who dies before his pension has vested or if no spouse survives or if he or she survives and subsequently dies, the child or children under the age of eighteen years, or, if attending college, under or attaining the age of twenty-three years, of the member of the police force shall be entitled to receive repayment of all money which the member invested in the pension fund plus interest or other increases in value of the member's investment in the pension fund, unless the member has designated another beneficiary for this purpose. |

Criteria: The police pension plan's benefit structure should be in compliance with Act 600, as amended by Act 30.

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

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

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 again recommend that municipal officials, after consulting with their solicitor, take whatever action is necessary to bring the police pension plan's benefit structure into compliance with Act 600, as amended by Act 30, at their earliest opportunity to do so.

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

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Incorrect Data Supplied
To Actuary For Actuarial Valuation Report Preparation

Condition: As disclosed in the prior audit report, actuarial valuation report forms 201C, with valuation dates January 1, 1999, January 1, 2001, January 1, 2003, and January 1, 2005, submitted to the Public Employee Retirement Commission (PERC) failed to include a service increment benefit that is contained in the plan's governing document. In addition, the actuarial valuation report form 201C with a valuation date of January 1, 2007, submitted to PERC also failed to include the service increment benefit provision.

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.

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

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Effect: Since the municipality received its state aid allocations during the audit period based on unit value, it did not receive any incorrect allocations of state aid; however, the submission of incorrect data to the plan’s actuary may result in the municipality receiving an incorrect allocation of state aid in the future.

Recommendation: We again recommend that, in the future, municipal officials review and verify all information submitted to and received from the plan’s actuary 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.

Finding No. 3 – Pension Benefits In Excess Of Act 600

Condition: The collective bargaining agreement between the police officers and the borough grants benefits not authorized by Act 600, as follows:

| Benefit Provision | Collective Bargaining Agreement | Act 600 (as amended) |
|--------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Normal retirement | For all officers hired before January 1, 1995, they shall be eligible for full retirement upon completion of twenty years of service and attainment of fifty years of age. | A minimum period of total service in the aggregate of twenty-five years in the same borough, town, township or regional police department and shall fix the age of the members of the force at fifty-five years, or, if an actuarial study of the cost shows that such reduction in age is feasible, may fix the age of the members of the force at fifty years. |
| Pension benefit at normal retirement | For all officers hired before January 1, 1995, a pension calculated at fifty percent of the highest twelve months compensation during the last five years of employment. | Monthly pension or retirement benefits other than length of service increments shall be computed at one-half the monthly average salary of such member during not more than the last sixty nor less than the last thirty-six months of employment. |

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Criteria: The pension plan's benefit structure should be in compliance with the provisions of Act 600.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure that the pension benefit provisions contained in the collective bargaining agreement were in compliance with Act 600.

Effect: The plan is paying pension benefits to a retiree in excess of those authorized by Act 600. A police officer who retired on June 1, 2007, is receiving excess benefits of \$2,022 per month, which totaled approximately \$60,646 from the date of his retirement through the date of this report.

Providing unauthorized pension 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. Since the borough received state aid based on unit value for its pension plans during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, the increased costs to the pension plan as a result of the excess pension benefits could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

Recommendation: We recommend that the borough comply with Act 600 at its earliest opportunity to do so. To the extent that the borough is not in compliance with Act 600 and/or is contractually obligated to pay benefits in excess of those authorized by Act 600, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, such benefits will be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the excess benefits on the plan's future state aid allocations and submit this information to the department.

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

WEST HAZLETON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – Pension Benefits Modified Without Prior Cost Estimate

Condition: During the audit period, the municipality reduced the plan’s normal retirement age from 55 to age 50; however, the municipality failed to obtain a cost estimate for this benefit modification as required by Act 205.

Criteria: Section 305(a) of Act 205 states:

Prior to the adoption of any benefit plan modification by the governing body of the municipality, the chief administrative officer of each pension plan shall provide to the governing body of the municipality a cost estimate of the effect of the proposed benefit plan modification.

Furthermore, Section 305(b) of Act 205 states, in part:

If the pension plan is a defined benefit plan which is self-insured in whole or in part, the cost estimate shall be prepared by an approved actuary. . . .

Cause: Plan officials were unaware of the applicable Act 205 guidelines that require a cost study before the implementation of any benefit modifications.

Effect: Benefit increases without a prior cost estimate could have a negative effect on the plan’s ability to meet its current or future obligations. Act 205 requires that any unfunded liability resulting from a benefit change for active members must be amortized in 20 years and for retired members in 10 years.

Recommendation: We recommend that the municipality implement adequate internal control procedures to ensure that all future benefit modifications are preceded by a cost study in accordance with Act 205 requirements.

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

WEST HAZLETON 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 | \$ 852,344 | \$ 1,336,336 | \$ 483,992 | 63.8% | \$ 44,010 | 1,099.7% |
| 01-01-05 | 1,016,996 | 1,326,172 | 309,176 | 76.7% | 48,494 | 637.6% |
| 01-01-07 | 1,132,250 | 1,321,732 | 189,482 | 85.7% | 48,517 | 390.5% |

WEST HAZLETON 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.

WEST HAZLETON 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 |
|------------------------|------------------------------|------------------------|
| 2003 | \$ 39,190 | 119.8% |
| 2004 | 39,334 | 101.1% |
| 2005 | 77,537 | 100.0% |
| 2006 | 34,001 | 100.0% |
| 2007 | 33,927 | 100.0% |
| 2008 | 10,618 | 100.0% |

WEST HAZLETON 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 | Level dollar |
| Remaining amortization period | Undeterminable |
| Asset valuation method | Fair value |
| Actuarial assumptions: | |
| Investment rate of return | 7.0% |
| Projected salary increases | 5.0% |

WEST HAZLETON BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

West Hazleton Borough Police Pension Plan
Luzerne County
12 South Fourth Street
West Hazleton, PA 18202

| | |
|------------------------------|-------------------|
| The Honorable Mark Rockovich | Mayor |
| Mr. William Sharkey, Jr. | Council President |
| Ms. Jane Mikulca | Secretary |

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.