# COMPLIANCE AUDIT

# Hanover Township
# Non-Uniformed Pension Plan

## Luzerne County, Pennsylvania

### For the Period
### January 1, 2015 to December 31, 2016

## December 2017

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

Board of Township Commissioners
Hanover Township
Luzerne County
Hanover Township, PA 18706

We have conducted a compliance audit of the Hanover Township Non-Uniformed Pension Plan for the period January 1, 2015 to December 31, 2016. We also evaluated compliance with some requirements subsequent to that period when possible. 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 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 the objective identified above. To determine whether the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, our methodology included the following:

- We determined whether state aid was properly determined and deposited in accordance with Act 205 requirements by verifying the annual deposit date of state aid and determining whether deposits were made within 30 days of receipt for all years within the period under audit.

- We determined whether annual employer contributions were calculated and deposited in accordance with the plan's governing document and applicable laws and regulations by examining the municipality's calculation of the plan's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plan as evidenced by supporting documentation.

- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.

- We determined whether retirement benefits calculated for both plan members who retired during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the monthly pension benefit due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients.

- We determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2014 and 2016, respectively, in accordance with Act 205 and whether 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 by comparing selected information to supporting source documentation.

Hanover Township contracted with an independent certified public accounting firm for annual audits of its basic financial statements which are available at the township's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Hanover Township Non-Uniformed 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 and as previously described, 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 procedures indicated that, in all significant respects, the Non-Uniformed 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 – Pension Benefit Payments Made to Deceased Individual

As previously noted, the objective of our audit of the Hanover Township Non-Uniformed Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

| Level | Indication | Funding Criteria |
|---|---|---|
| I | Minimal distress | 70-89% |
| II | Moderate distress | 50-69% |
| III | Severe distress | Less than 50% |

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 **the plan's funded ratio is 68.2% as of January 1, 2015,** which is the most recent data available. **Based on this information, and the funding status of the township's police pension plan, the former Public Employee Retirement Commission issued a notification that the township is currently in Level II moderate distress status.** We encourage township officials to monitor the funding of the non-uniformed employee's pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of Hanover 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.

December 14, 2017

EUGENE A. DEPASQUALE
Auditor General

CONTENTS

Page

Background ........................................................................................................................1

Finding and Recommendation:

Finding – Pension Benefit Payments Made To Deceased Individual ...................................3

Supplementary Information .........................................................................................5

Report Distribution List ...............................................................................................9

## 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 Hanover Township Non-Uniformed Pension Plan is also governed by implementing regulations adopted by the former 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 331 - The First Class Township Code, Act of June 24, 1931 (P.L. 1206, No. 331), as amended, 53 P.S. § 55101 et seq.

The Hanover Township Non-Uniformed Employee's Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 015-2003, as amended, adopted pursuant to Act 331. The plan is also affected by the provisions of collective bargaining agreements between the township and its non-uniformed employees. The plan was established February 1, 1973. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2016, the plan had 27 active members, no terminated members eligible for vested benefits in the future, and 16 retirees receiving pension benefits from the plan.

## BACKGROUND – (Continued)

As of December 31, 2016, selected plan benefit provisions are as follows:

Eligibility Requirements:

| | |
|---|---|
| Normal Retirement | Age 62 |
| Early Retirement | Age 55 and 10 years of service or involuntary after 8 years of service. |
| Vesting | 10 years of service |

Retirement Benefit:

Benefit equals 1.5% of average monthly compensation based on final 3 years times years of service.

Survivor Benefit:

If eligible for voluntary early or normal retirement, a death benefit is payable equal to the present value of the accrued benefit at the time of death.

Service Related Disability Benefit:

Benefit equals 50% of average monthly compensation, reduced by Workers' Compensation benefits received by the member.

HANOVER TOWNSHIP NONP-UNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

**Finding – Pension Benefit Payments Made To Deceased Individual**

Condition: The township made improper monthly pension benefit payments from the non-uniformed pension plan during the period August 11, 2012 until August 1, 2017, in the amount of $16,494, to a retiree who died on August 11, 2012 according to municipal records. Subsequent to the audit period, plan officials were able to obtain partial reimbursement in the amount of $3,355 from the plan custodian representing 12 months of excess payments.

Criteria: An adequate system of internal controls is a prerequisite for the sound administration of the pension plan and should include procedures to monitor the continued eligibility of individuals receiving pension benefits and to ensure that each eligible individual receives only the benefits to which he or she is entitled.

Cause: The township did not have adequate internal control procedures in place to ensure the continued eligibility of recipients to receive benefits and timely detect and stop payments to deceased individuals.

Effect: The township made improper pension benefit payments from the non-uniformed pension plan for 59 months amounting to $16,494 and although plan officials were able to recover excess payments amounting to $3,355 from the plan custodian, there remains a balance of unauthorized payments from the pension plan in the amount of $13,139. In addition, the failure to timely detect and stop payments to deceased individuals reduces the amount of funds available for investment purposes or for the payment of other authorized benefits or administrative expenses.

Recommendation: We recommend that pension plan officials implement procedures to monitor the continued eligibility of individuals receiving pension benefits and timely detect and stop future payments to deceased benefit recipients. In addition, in this instance where pension benefit payments to a deceased individual have been confirmed, we recommend that, to the extent possible, plan officials pursue recovery of the improper payments and determine whether referral to appropriate law enforcement agencies is warranted.

Management's Response: In response to the department's preliminary finding rendered relative to pension benefit payments made to deceased individuals, officials indicated the following:

> Hanover Township wishes to advise that we do not agree, nor is there any policy or legislation relative to, the municipality being responsible for death notification of a pension recipient. Hanover Township, like most municipalities, does not handle the actual processing of pension payments to our retired individuals. We have a contracted and compensated third party administrator/plan custodian handle that aspect of our pension. Hanover Township considers it to be the responsibility of the family (spouse/next of kin) or executor (trix) of the will to notify the firm that handles our pension system immediately with an original death certificate.

**Finding – (Continued)**

> In additional response to the draft audit finding, as noted Hanover Township through efforts of the plan's custodian and third party administrative agent, has been able to recover $3,354.72 of the funds due to the plan. Hanover Township further references that it did advise the deceased retiree's spouse at the time of death of the retiree, to contact either the plan's custodian or the plan's third party administrative agent to advise of the retiree's passing. However, the deceased retiree's spouse failed to do so and continued to accept payments and corresponding tax reporting forms in the name of the deceased retiree. Hanover Township is working with the Township's Solicitor and the plan's third party administrative agent, to continue the recovery of the remaining funds the deceased individual's spouse continued to indecorously accept after failing to provide notification.
>
> Hanover Township, along with the Plan Administrator, will be discussing a strategy to provide courtesy follow-up to ensure the family, or executor of the will, has done their duty in reporting the death of the pension recipient.

Auditor Conclusion: We commend the municipality for its efforts in the partial recovery of a portion of the improper pension payments with the assistance of its plan custodian. However, although the municipality may contract with a custodian or third party to administer benefits of the plan, the overall fiduciary responsibility for the plan remains with the municipality and as such, the township should establish and implement procedures to monitor the continued eligibility of individuals receiving pension benefits and to timely detect and stop future payments to deceased benefit recipients to prevent this situation from occurring again in the future. Moreover, to the extent possible, plan officials should continue to pursue recovery of the remaining improper payments and determine whether referral to appropriate law enforcement agencies is warranted. The finding remains as stated.

HANOVER TOWNSHIP NON-UNIFORMED 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, 2011, is as follows:

| | (1) | (2) | (3) | (4) |
|---|---|---|---|---|
| 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) |
| 01-01-11 | $ 3,227,504 | $ 4,624,093 | $ 1,396,589 | 69.8% |
| 01-01-13 | 3,249,979 | 4,986,512 | 1,736,533 | 65.2% |
| 01-01-15 | 3,750,353 | 5,495,491 | 1,745,138 | 68.2% |

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period which will be limited to a maximum of 130 percent and a minimum of 70 percent of the fair market value of assets. The market values of the plan's assets at 01-01-13, and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period which will be limited to a maximum of 120 percent and a minimum of 80 percent of the fair market value of assets. These methods 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.

HANOVER TOWNSHIP NON-UNIFORMED 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.

HANOVER TOWNSHIP NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2011 | $ 145,712 | 100.0% |
| 2012 | 146,946 | 100.0% |
| 2013 | 200,160 | 100.0% |
| 2014 | 198,250 | 100.0% |
| 2015 | 283,879 | 100.0% |
| 2016 | 286,278 | 113.1% |

HANOVER TOWNSHIP NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the 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, 2015 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar |
| Remaining amortization period | 13 years |
| Asset valuation method | 5-year smoothing – the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair value of assets. |
| Actuarial assumptions: | |
| Investment rate of return | 7.5% |
| Projected salary increases | 5.0% |

HANOVER TOWNSHIP NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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