

BOROUGH OF ELLWOOD CITY POLICE PENSION PLAN

LAWRENCE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2006, TO DECEMBER 31, 2007



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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 Borough of Ellwood City 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 Borough of Ellwood City Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Chapter 294 of the borough's codified ordinances. 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
Borough of Ellwood City
Lawrence County
Ellwood City, PA 16117

We have conducted a compliance audit of the Borough of Ellwood City 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 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 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. The Borough of Ellwood City contracted with an independent certified public accounting firm for annual audits of its basic financial statements 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 an internal control structure to provide reasonable assurance that the Borough of Ellwood City 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 Borough of Ellwood City 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 – Incorrect Data On Certification Form AG 385 Resulting In A
Net Underpayment Of State Aid

Finding No. 2 – Pension Benefit Not Authorized By Act 600

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 the Borough of Ellwood City and, where appropriate, their responses have been included in the report.

February 25, 2009

JACK WAGNER
Auditor General

BOROUGH OF ELLWOOD CITY POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

The Borough of Ellwood City has complied with the prior audit recommendation concerning the following:

- Failure To Prepare Timely Financial Statements

During the audit period, annual financial statements were prepared for the pension plan.

BOROUGH OF ELLWOOD CITY POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Incorrect Data On Certification Form AG 385 Resulting In A Net Underpayment
Of State Aid

Condition: The borough failed to certify one eligible police officer (2 units) and understated payroll by \$34,452 in 2008 on Certification Form AG 385. In addition, the borough certified one ineligible nonuniformed employee (1 unit) and overstated payroll by \$34,452 in 2008 on Certification Form AG 385. The certification errors were due to the borough certifying a police officer who began employment on May 21, 2007, as a member of the nonuniformed pension plan. The employee did not become a member of the nonuniformed pension plan until January 1, 2008.

Criteria: Pursuant to Act 205, at Section 402(e)(2), an employee who has been employed on a full-time basis for at least six consecutive months and has been participating in a pension plan during the certification year is eligible for certification.

Cause: Plan officials failed to follow the instructions that accompany Certification Form AG 385.

Effect: The data submitted on this certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. By certifying a member of the police pension plan as a member of the nonuniformed pension plan, the borough received an underpayment of state aid in the amount of \$3,186 (1 unit).

Although the borough will be reimbursed for the underpayment of state aid due to the borough's certification errors, the full amount of the 2008 state aid allocation was not available to be deposited timely and therefore was not available to pay operating expenses or for investment.

Recommendation: We recommend that, in the future, plan officials comply with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension plan data.

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

BOROUGH OF ELLWOOD CITY POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Pension Benefit Not Authorized By Act 600

Condition: Chapter 294 of the borough’s codified ordinances grants a benefit that is not authorized by Act 600. Section 294.01(18) states:

“Final monthly average salary” means the average monthly salary earned by the participant and paid by the employer during the final thirty-six months immediately preceding termination of active employment. Salary shall include payments made for unused vacation, earned vacation (calculated from employee’s anniversary date to the date of retirement), unused personal days, longevity (based on years of service at the time of retirement), accumulated unused sick leave (in accordance with the maximum allowed under the police contract), holiday pay (based on the number of holidays beginning with January 1 of the current year to the date of retirement at the rate of pay stated in the police contract).

In addition, we note that the collective bargaining agreement covering the period January 1, 2006, to December 31, 2008, provides for the payment of accumulated unused sick leave, up to a maximum of 250 days.

Criteria: Section 5(c) of Act 600 states, in part:

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.

Although Act 600 does not define “salary,” the department has concluded, based on a line of court opinions, that the term does not encompass lump-sum payments for leave that was not earned during the pension computation period.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure that the definition of the final average salary for the determination of pension benefits is in compliance with Act 600 provisions.

BOROUGH OF ELLWOOD CITY POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Effect: The plan is paying pension benefits to a retiree in excess of those authorized by Act 600. The retiree is receiving excess benefits of \$345 per month, which totaled approximately \$8,280 from the date of 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 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 ensure that the plan's governing document is in compliance with Act 600 at its earliest opportunity to do so. To the extent that the borough has already obligated itself to pay benefits to existing retirees 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, the unauthorized portion of 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.

BOROUGH OF ELLWOOD CITY 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	\$ 3,962,171	\$ 4,762,291	\$ 800,120	83.2%	\$ 692,781	115.5%
01-01-05	4,194,104	5,216,288	1,022,184	80.4%	806,865	126.7%
01-01-07	5,559,416	5,747,878	188,462	96.7%	885,549	21.3%

Note: The market values of the plan's assets at 01-01-03 and 01-01-05 have been adjusted to reflect the smoothing of gains and/or losses over a 5-year averaging period. This method 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.

BOROUGH OF ELLWOOD CITY 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.

BOROUGH OF ELLWOOD CITY 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	\$ 89,223	100.0%
2004	178,079	100.0%
2005	174,845	100.0%
2006	198,834	100.0%
2007	223,143	100.0%

BOROUGH OF ELLWOOD CITY 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, closed
Remaining amortization period	4 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.5%

BOROUGH OF ELLWOOD CITY POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Borough of Ellwood City Police Pension Plan
Lawrence County
525 Lawrence Avenue
Ellwood City, PA 16117

The Honorable Don Clyde	Mayor
Mr. Anthony Court	Council President
Mr. Domenic A. Viccari	Borough Manager
Ms. Linda M. List	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.