

HANOVER TOWNSHIP NONUNIFORMED PENSION PLAN

LUZERNE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2006, TO DECEMBER 31, 2007



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ABBREVIATION

PMRS - Pennsylvania Municipal Retirement System

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 Hanover Township 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 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 Nonuniformed 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 nonuniformed employees.



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

We have conducted a compliance audit of the Hanover Township 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 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. 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 an internal control structure to provide reasonable assurance that the Hanover Township 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 township's internal control structure as it relates to the township'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 Hanover Township 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 – Noncompliance With Prior Audit Recommendation – Improper Pension Benefit

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 Hanover Township and, where appropriate, their responses have been included in the report.

January 20, 2009

JACK WAGNER
Auditor General

HANOVER TOWNSHIP NONUNIFORMED PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Hanover Township has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Improper Pension Benefit

HANOVER TOWNSHIP NONUNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Noncompliance With Prior Audit Recommendation – Improper Pension Benefit

Condition: As disclosed in our prior audit report, municipal officials improperly revised a monthly pension benefit of a member who retired on April 1, 2001. At the time of the member's retirement, the township's nonuniformed pension plan participated in PMRS, and his monthly pension benefit of \$705.87 was determined in accordance with the existing PMRS agreement. On June 2, 2001, the township adopted Ordinance No. 008-2001, which authorized the township to withdraw from PMRS. On September 27, 2001, the township changed the member's monthly pension benefit to \$1,025.48 per month. This was based on increasing the multiplier from 1 percent of the member's final average salary to 1.5 percent of the member's final average salary.

On November 7, 2001, the township adopted Ordinance No. 014-2001. Section 2 of the ordinance states:

The Township further agrees to the restatement and upgrade of pension benefits for all members of the Non-Uniformed employees pension plan effective the 1st day of January, 2001. This pension benefit upgrade includes all members of the pension plan active on January 1, 2001, including those who may have retired after January 1, 2001, but prior to the adoption of this ordinance.

Subsequently, on November 10, 2003, the township adopted Ordinance No. 015-2003, which states, at Section 2.10:

BASIC BENEFITS: The basic annual benefit shall be equal to 1.5% of the final average salary multiplied by all years of credited service. The amount of monthly pension is equal to 1.5% of average monthly compensation based on the final average salary multiplied by the years of credited service.

Ordinance No. 015-2003 was made retroactive to January 1, 2001.

Criteria: Resolution No. 010-96, at Sections 3 and 4, states, in part:

Basic Benefit

The basic annual benefit shall be equal to one percent of the member's final salary multiplied by all years of credited service.

Final Salary

The final salary shall be the average annual compensation earned and paid during the member's final five consecutive years of employment.

HANOVER TOWNSHIP NONUNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Furthermore, Article III, Section 26 of the Pennsylvania Constitution provides as follows:

No bill shall be passed giving any extra compensation to any public officer, servant, employe, agent or contractor, after services shall have been rendered or contract made, nor providing for the payment of any claim against the Commonwealth without previous authority of law: Provided, however, That nothing in this Constitution shall be construed to prohibit the General Assembly from authorizing the increase of retirement allowances or pensions of members of a retirement or pension system now in effect or hereafter legally constituted by the Commonwealth, its political subdivisions, agencies or instrumentalities, after the termination of the services of said member. [Emphases added.]

In *Denbow v. Borough of Leetsdale*, 556 Pa. 567, 577, 729 A.2d 1113, 1118-1119 (1999), the Supreme Court of Pennsylvania held that “the principles embodied in Article III, Section 26’s circumscription of the General Assembly’s legislative authority relative to the appropriation of funds from the state treasury apply with equal force to municipalities as regards the appropriation of funds from local treasuries.”¹

Furthermore, in *Debow*, the Supreme Court noted the following:

As the Commonwealth Court has observed, ‘[i]t is fundamental that municipal corporations are creatures of the State and that the authority of the Legislature over their powers is supreme....Municipal corporations have no inherent powers and may do only those things which the Legislature has expressly or by necessary implication placed within their power to do’....The legislature, in turn, may delegate or grant only those legislative powers which are constitutionally permitted....‘Any fair, reasonable doubt as to the existence of power [in a municipality] is resolved by the courts against its existence.’ *Id.* at 576-77.

In *Thelin v. Warren*, 118 Pa. Cmwlth. 336, 338, 544 A.2d 1135, 1136 (1988), the Commonwealth Court, citing *Koehnlein v. Allegheny County Employees’ Retirement System*, 373 Pa. 535, 544, 97 A.2d 88, 92 (1953), stated that “a municipality cannot raise a former employee’s retirement benefits after that employee’s service to the municipality has ended.” The Commonwealth Court went on to say that “[t]o do so could adversely affect a plan’s actuarial soundness, thus depriving contributing members of their pension benefits.”

¹ The Supreme Court thereby affirmed the Commonwealth Court’s decision in *Denbow v. Borough of Leetsdale*, 699 A.2d 838, 843, (Pa. Cmwlth., 1997), in which the lower court held that the borough had violated the constitutional prohibition in Article III, Section 26 of the Pennsylvania Constitution by passing pay increase resolutions for police officers while their collective bargaining agreement was still in effect.

HANOVER TOWNSHIP NONUNIFORMED PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Therefore, it is the department's opinion that township officials were not authorized to adjust the retiree's pension benefit after his retirement to provide retroactive pension benefits that were not in effect as of the date of his retirement.

Cause: Municipal officials felt that the retiree's pension benefit could be adjusted based on the plan's withdrawal from PMRS and the subsequent ordinances adopted by the township.

Effect: The plan paid the revised pension benefits to the retiree until his death in March of 2003, and then began paying pension benefits to his surviving spouse based on the revised pension determination. As of the date of this report, the retiree received total excess benefits of \$320 per month and the survivor is receiving total excess benefits of \$160 per month, which totaled approximately \$16,939 from the member's 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 township 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 again recommend that the surviving spouse's monthly pension benefit be adjusted, prospectively, to the correct amount. Furthermore, any benefits paid from the plan in excess of those authorized by the governing document in effect at the time of the member's retirement 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: At our exit conference held on January 20, 2009, management indicated that they would provide a written response to this finding; however, no such response has been provided.

HANOVER TOWNSHIP 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	\$ 1,819,918	\$ 2,660,690	\$ 840,772	68.4%	\$1,050,506	80.0%
01-01-05	2,207,233	2,934,732	727,499	75.2%	1,110,783	65.5%
01-01-07	2,624,624	3,358,831	734,207	78.1%	1,113,142	66.0%

HANOVER TOWNSHIP 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.

HANOVER TOWNSHIP 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	\$ 4,181	2,386.1%
2003	102,245	100.0%
2004	108,638	100.0%
2005	132,080	100.0%
2006	124,954	100.0%
2007	122,137	100.0%

HANOVER TOWNSHIP 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	12 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	5.0%
Includes inflation at	Not disclosed
Cost-of-living adjustments	None assumed

HANOVER TOWNSHIP NONUNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Hanover Township Nonuniformed Pension Plan
Luzerne County
1267 Sans Souci Parkway
Hanover Township, PA 18706

Mr. Albert J. Bagusky Chairman, Board of Township Commissioners

Mr. John J. Sipper Township Manager

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.