

HANOVER TOWNSHIP POLICE PENSION PLAN

LUZERNE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2008, TO DECEMBER 31, 2009



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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 Hanover Township 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 Hanover Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 003-2010, as amended, and an amended and restated plan agreement, effective January 1, 2009, adopted pursuant to Act 600. Prior to January 1, 2009, the pension plan was locally controlled by the provisions of Ordinance No. 203, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers.



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

We have conducted a compliance audit of the Hanover Township Police Pension Plan for the period January 1, 2008, to December 31, 2009. 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. 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 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 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 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 Hanover Township 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 –
Improper Service Increment Granted To A Retiree

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In
An Overpayment Of State Aid

As previously noted, one of the objectives of our audit of the Hanover Township Police Pension Plan was to determine compliance with applicable state laws, contracts, administrative procedures, and local ordinances and policies. During the current audit period, 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 bill provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
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 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 61.8% as of January 1, 2009, which is the most recent date available. Based on this information, the Public Employee Retirement Commission issued a notification that Hanover Township is currently in Level II moderate distress status. We encourage township officials to monitor the funding of the police 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.

January 28, 2011

JACK WAGNER
Auditor General

HANOVER TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Status Of Prior Audit Recommendations

· Pension Benefits Not Authorized By Act 600

The prior audit reports for the period January 1, 2003, to December 31, 2005, and January 1, 2006, to December 31, 2007, contained a finding that the pension plan's governing document provided for cost of living adjustments (COLAs) up to 100 percent of a member's salary used to calculate a disability retirement benefit. On March 8, 2010, township officials adopted Ordinance No. 003-2010 which brings the police pension plan's benefit structure into compliance with Act 600 regarding COLAs for members who begin receiving disability retirement benefits on or after January 1, 2009. However, excess benefits are still being paid to existing retirees. Since the township received state aid based on unit value during the current audit period, it did not receive state aid attributable to the excess benefits being provided to retirees. The Department will continue to monitor the effect of the excess benefits being provided to existing retirees during our next audit of the plan; and

· Pension Benefit Not Authorized By Act 600

The prior audit report for the period January 1, 2006, to December 31, 2007, disclosed that the township included accumulated unused sick leave earned outside the averaging period in pension calculations which is a practice not authorized by Act 600. During the current audit period, 2 police officers had accumulated lump-sum payments included in their pension calculations. The township has eliminated the inclusion of lump-sum payments for unused sick and vacation days that were not earned during the final 36 months of employment in pension benefit calculations for police officers per the amended and restated pension plan agreement dated March 8, 2010. However, excess benefits are still being paid to existing retirees. The retirees are receiving total excess benefits of \$581 per month, which totaled approximately \$15,204 from the date of the members' retirements through the date of this audit report. Since the township received state aid based on unit value during the audit period, it did not receive state aid attributable to the excess benefits being provided to retirees. The Department will continue to monitor the effect of the excess benefits being provided to existing retirees during our next audit of the plan.

Noncompliance With Prior Audit Recommendations

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

· Improper Service Increment Granted

HANOVER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Improper Service Increment Granted To A Retiree

Condition: As disclosed in the prior audit report, the township improperly granted a \$500 per month service increment to a plan member who retired in May of 2008. While Act 600 authorizes service increment benefits up to \$500 per month, the service increment granted to the plan member exceeded the provisions contained in the plan's governing document at the time of the member's retirement.

Criteria: Section 15(C) of Ordinance No. 203, as amended, states, in part:

The total amount of length-of-service increments to be paid to any retired member shall not exceed one hundred dollars (\$100.00) per month.

It was noted that Ordinance No. 003-2010 dated March 8, 2010, which amended and restated the plan agreement, at Section 3.2(d) states, in part:

Service Increment Benefit – Effective January 1, 2006, each eligible participant shall receive a service increment benefit of \$100 per month for each completed year of benefit service in excess of 25. The total service increment benefit shall not exceed \$500 per month.

Cause: Municipal officials believed that passing an amendment to the plan's governing document that was retroactive to the member's retirement date would authorize the service increment being paid to the retired member.

Effect: The plan is paying pension benefits to a retiree in excess of those authorized by the plan's governing document in effect at the time of the member's retirement. The retiree is receiving excess benefits of \$400 per month, which totaled approximately \$13,200 from the date of retirement through the date of this audit 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 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.

HANOVER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Recommendation: We recommend that the township prospectively adjust the retiree’s pension benefit to the amount authorized by the plan’s governing document in effect at the time of the member’s retirement. To the extent that the township has already obligated itself to pay benefits to the retiree in excess of those authorized by the plan’s governing document, 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 unauthorized 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.

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The township certified 1 ineligible police officer (2 units) and overstated payroll by \$62,588 in 2009 on Certification Form AG 385.

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

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

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. Because the township’s state aid allocation was based on unit value, the incorrect certification of pension data affected the township’s state aid allocation, as identified below:

<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2	\$ 3,128	\$ 6,256

HANOVER TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

In addition, the township used the overpayment of state aid to pay the minimum municipal obligation (MMO) due to the police pension plan; therefore, if the reimbursement to the Commonwealth is made from the pension plan, the plan's MMO will not be fully paid.

Recommendation: We recommend that the total excess state aid, in the amount of \$6,256, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with the check.

We also recommend that plan officials establish adequate internal control procedures to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

In addition, if the reimbursement to the Commonwealth is made from police pension plan funds, we recommend that any resulting MMO deficiency be paid to the pension plan with interest, at a rate earned by the pension plan.

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

HANOVER TOWNSHIP 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, 2005, 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)]
01-01-05	\$ 3,470,880	\$ 5,835,671	\$ 2,364,791	59.5%	\$ 852,684	277.3%
01-01-07	4,116,889	6,260,925	2,144,036	65.8%	927,710	231.1%
01-01-09	4,363,431	7,058,352	2,694,921	61.8%	946,434	284.7%

Note: The market value of the plan's assets at 01-01-09 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. 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.

HANOVER TOWNSHIP 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.

HANOVER TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2004	\$ 234,688	100.0%
2005	292,390	100.0%
2006	277,171	100.0%
2007	281,567	110.1%
2008	306,474	100.0%
2009	317,330	100.0%

HANOVER TOWNSHIP 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, 2009
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 130% and a minimum of 70% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	5.5%
Cost-of-living adjustments	3.0% per year postretirement

HANOVER TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Hanover Township Police Pension Plan
Luzerne County
1267 San 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.