

OLD FORGE BOROUGH POLICE PENSION PLAN

LACKAWANNA COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2006, TO DECEMBER 31, 2008



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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 Old Forge 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 761 et seq.

The Old Forge Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 96-14, as amended, 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
Old Forge Borough
Lackawanna County
Old Forge, PA 18518

We have conducted a compliance audit of the Old Forge Borough Police Pension Plan for the period January 1, 2006, 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. Old Forge Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements for the years 2006 and 2007, 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 Old Forge 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 Old Forge 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 –
Improper Pension Benefit Modification

Finding No. 2 – Noncompliance With Prior Audit Recommendation –
Improper Disposition Of The Proceeds Of A Cash
Surrendered Insurance Policy

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 Old Forge Borough and, where appropriate, their responses have been included in the report.

February 5, 2010

JACK WAGNER
Auditor General

OLD FORGE BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

Old Forge Borough has complied with the prior audit recommendations concerning the following:

- Failure To Adopt Benefit Provisions Mandated By Act 30

The borough adopted Ordinance No. 5 of 2007, to bring the police pension plan's benefit structure into compliance with Act 600, as amended by Act 30;

- Failure To File Actuarial Valuation Report

The January 1, 2005, actuarial valuation report was completed and submitted to the Public Employee Retirement Commission;

- Custodial Account Records Not Maintained And Custodial Account Transactions Not Adequately Monitored By The Municipality

The borough has established internal control procedures to ensure that custodial account records are properly segregated and filed, and that custodial account transactions are properly monitored. In addition, the borough has appointed an administrative agent and third-party administrator to further assist in the administration of the pension plan; and

- Related Party Situation

During the current audit period, the borough transferred the plan's funds to another plan custodian; consequently, the related party situation has been eliminated.

Noncompliance With Prior Audit Recommendations

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

- Improper Pension Benefit Modification

- Improper Disposition Of The Proceeds Of A Cash Surrendered Insurance Policy

OLD FORGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Improper Pension Benefit Modification

Condition: As disclosed in the prior audit report, on April 18, 2000, Old Forge Borough enacted Ordinance No. 4 of 2000, which established disability benefits “at the rate of 70 percent of the police officer’s average monthly salary.” The previous rate had been 50 percent. On the same date, the borough enacted Resolution No. 6 of 2000, which made the increased rate applicable to an existing retiree, retroactive to April 1, 1997.

Criteria: Act 600 mandates service-related disability benefits and, at Section 5(e), authorizes the governing body of the municipality to fix the amount and commencement of payments by regulation. Therefore, the increase in the disability benefit contained in Ordinance No. 4 of 2000 is authorized under Act 600 and unobjectionable, provided that the increased benefit is applied prospectively, i.e., only to those police officers who retire on service-related disability after the effective date of the ordinance.

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

Effect: 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 did not receive state aid for this pension plan during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, in the future, the increased costs to the pension plan as a result of the excess pension benefits could result in the receipt of excess state aid and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

Recommendation: We again recommend that municipal officials adjust the referenced retiree’s pension benefit to be in accordance with the ordinance that was in effect at the time of his retirement.

Management’s Response: Municipal officials agreed with the finding without exception. The borough is considering various options regarding this outstanding audit issue. The borough will be working with the plan’s consultant and the plan’s actuary to attempt to resolve the matter.

Auditor’s Conclusion: Compliance will be subject to verification during our next audit of the plan.

OLD FORGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Improper Disposition Of
The Proceeds Of A Cash Surrendered Insurance Policy

Condition: As disclosed in the prior audit report, on March 2, 2004, the borough cash surrendered an insurance policy on a plan member, who retired on January 31, 2005. The proceeds of \$29,476 were improperly paid to the retired member.

Criteria: The Commonwealth Court of Pennsylvania, in the case of Fedor v. Borough of Dormont, 36 Pa. Commw. 449, 389 A.2d 217 (1978), aff'd 487 Pa. 249, 409 A.2d 334 (1979), held that Act 600 funds can be used only to provide pensions for plan members, as follows:

Nothing in Section 1 of the Act of May 29, 1956 as it was originally enacted or in its amended version after 1970, suggests that the funds may be used otherwise than for the provision of pensions or annuities. No benefit other than by means of pension is mentioned in either the original or the amended version of the act. The word pension is defined by all dictionaries and is commonly used, to mean a fixed sum paid regularly to a person. We are therefore constrained to agree with the Auditor General and the Deputy Attorney General who advised him, that the expenditure of monies of a police pension plan created under the Act of May 29, 1956 for the purchase of a single payment life insurance policy to provide a death benefit for the participant would be improper.

Furthermore, Section 102 of Act 205 states, in part:

“Pension Fund.” The entity which is the repository for the assets amassed by a pension plan as reserves for present and future periodic retirement payments and benefits of active and retired members of the pension plan.

In addition, the Department of the Auditor General has issued several bulletins providing guidance regarding the purchase of life insurance by municipal pension plans. In 1985, Auditor General Municipal Pension Bulletin No. 2-85, “Purchase of Life Insurance for Municipal Pension Plans,” was issued. This bulletin disallowed any further purchase of life insurance with pension funds after January 1, 1986, but did allow the continuance of existing policies. Subsequently, in 1988, Auditor General Municipal Pension Bulletin No. 6-88, “Purchase of Insurance Coverage,” was issued and restated this position, by stating, in part:

...we would recommend cash surrender of such policies.... As an alternative, the municipality could transfer existing life insurance policies from the pension plan to a municipal general fund provided the pension plan is adequately compensated.

OLD FORGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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

Effect: The improper disposition of the proceeds from the surrendered life insurance policy reduces the amount of funds available to pay authorized plan expenses or for investment purposes.

Recommendation: We again recommend the pension plan be reimbursed, with interest, compounded annually at a rate earned by the plan, for the improper disposition of the proceeds of the life insurance policy.

Management's Response: Municipal officials agreed with the finding without exception. Subsequent to the audit period, the borough provided documentation that two settlement checks totaling \$34,500 were deposited into the pension plan, less legal fees of \$11,500, a net of \$23,000 was deposited into the pension plan.

Auditor's Conclusion: Compliance will be subject to verification during our next audit of the plan.

OLD FORGE 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	\$ 2,086,246	\$ 1,337,942	\$ (748,304)	155.9%	\$ 224,178	(333.8%)
01-01-05	2,233,817	1,491,710	(742,107)	149.7%	249,960	(296.9%)
01-01-07	2,278,580	1,900,090	(378,490)	119.9%	158,699	(238.5%)

OLD FORGE 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.

OLD FORGE 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	None	N/A
2004	None	N/A
2005	None	N/A
2006	None	N/A
2007	None	N/A
2008	None	N/A

OLD FORGE 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	N/A
Remaining amortization period	N/A
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	5.0%
Cost-of-living adjustments	4.0% per year postretirement

OLD FORGE BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Old Forge Borough Police Pension Plan
Lackawanna County
310 South Main Street
Old Forge, PA 18518

The Honorable Michele Petrini Awisato	Mayor
Mr. Michael Bartoletti	Council President
Ms. MaryLynn Bartoletti	Borough 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.