COMPLIANCE AUDIT

Chippewa Township Police Pension Plan

Beaver County, Pennsylvania

For the Period

January 1, 2014 to December 31, 2016

April 2018

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 Supervisors
Chippewa Township
Beaver County
Beaver Falls, PA 15010

We have conducted a compliance audit of the Chippewa Township Police Pension Plan for the period January 1, 2014 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 that there were no employee contributions required for the years covered by our audit period due to the fact that employee contributions were appropriately waived by the municipality.

- We determined whether retirement benefits calculated for the 2 plan members who retired during the current audit period, and through the completion of our fieldwork procedures, 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 retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to 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.

- We determined whether transfers were properly authorized, timely, and appropriately recorded by plan officials by examining supporting documentation for all four of the transfers made during the audit period and through the completion of our fieldwork procedures.

Chippewa 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 Chippewa 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 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 Chippewa 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 finding further discussed later in this report:

Finding - Custodial Accounts Not Adequately Monitored By The Municipality.

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.

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

February 22, 2018

EUGENE A. DEPASQUALE
Auditor General

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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.

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 Chippewa Township Police 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 767 et seq.

The Chippewa Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 226, 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. The plan was established June 11, 1979. Active members are required to contribute 5 percent of the participant's compensation to the plan; however, member contributions were waived during the audit period. As of December 31, 2016, the plan had 8 active members, no terminated members eligible for vested benefits in the future, 3 retirees receiving pension benefits from the plan, and 1 retiree receiving benefits funded through annuities purchased with plan assets.

BACKGROUND – (Continued)

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

Eligibility Requirements:

Normal Retirement	Age 55 and 25 years of service
Early Retirement	None
Vesting	Member is 100% vested after 12 years of service

Retirement Benefit:

Benefit equals 50% of final 36 months average salary.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	A monthly benefit equal to 50% of the pension the member was receiving or was entitled to receive on the day of the member's death.

Service Related Disability Benefit:

Benefit equals 50% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

Finding – Custodial Accounts Not Adequately Monitored By The Municipality

Condition: Plan officials did not effectively monitor the activity of the police pension plan and its checking and custodial accounts as evidenced by the following discrepancies:

- Procurement of investment and advisory services was not conducted in accordance with Act 44 provisions. The township changed investment and advisory services contractors; however, there was no evidence provided to support that the change was conducted in accordance with Act 44 and that the solicitation for the proposed change in providers was approved by the Board of Township Supervisors;

- Inadequate internal controls over cash assets of the plan. As of December 31, 2016, the pension plan's checking and money market balances with financial institutions amounted to $449,446, or 14.2% of the total asset balance of the pension plan and included one depository account ($252,016) which exceeded FDIC insurance coverage limits; and

- Improper segregation of duties over financial transactions of the pension plan. The accounting and record keeping for the police pension plan is performed exclusively by one individual with minimal oversight.

Criteria: Regarding professional services contracts, Chapter 7-A of Act 205, as amended by Act 44 of 2009, states the following:

> Act 44 defines "Professional Services Contract", at Section 701-A, as "a contract to which the municipal pension system is a party that is:
> (1) for the purpose or provision of professional services, including investment services, legal services, real estate services and other consulting services; and
> (2) not subject to a requirement that the lowest bid be accepted."

In addition, as outlined in Chapter 7-A of Act 205, municipal officials shall advertise, review, disclose, examine conflicts of interest, and provide public information during the selection process. Furthermore, the solicitation of professional services shall not be initiated without prior board approval.

Finding – (Continued)

Further, Sections 702-A (c), (e), (f), and (h) of Act 205 state, in part:

> **Review.** Procedures to select the most qualified person shall include a review of the person's qualifications, experience and expertise and the compensation to be charged.
>
> **Conflict of Interest.** The municipal pension system shall adopt policies relating to potential conflicts of interest in the review of a proposal or the negotiation of a contract.
>
> **Public Information.** Following the award of a professional services contract, all applications and disclosure forms shall be public except for proprietary information or other information protected by law.
>
> **Notice and Summary.** The relevant factors that resulted in the award of the professional services contract must be summarized in a written statement to be included in or attached to the documents awarding the contract. Within ten days of the award of the professional services contract, the original application, a summary of the basis for the award and all required disclosure forms must be transmitted to all unsuccessful applications and posted on the municipal pension system's Internet website, if an Internet website is maintained, at least seven days prior to the execution of the professional services contract.

Relative to deposit accounts including checking and money market accounts, the Federal Deposit Insurance Corporation (FDIC) is an independent agency of the United States government that protects the funds depositors place in banks and savings associations. FDIC insurance is backed by the full faith and credit of the United States government.

FDIC insurance covers all deposit accounts, including:

- Checking accounts
- Savings accounts
- Money market accounts
- Certificates of deposit

FDIC insurance does not cover other financial products and services that banks may offer, such as stocks, bonds, mutual funds, life insurance policies, annuities, and securities. The standard insurance amount is $250,000 per depositor, per insured bank, for each account ownership category.

Finding – (Continued)

Prudent business practice dictates that in addition to performing monthly bank reconciliations, pension plan officials should ensure the pension plan's cash balances do not exceed FDIC limits set by banking regulations.

Finally, an adequate system of accounting and record-keeping and the appropriate segregation of duties over the financial transactions of the pension plan is a prerequisite for sound administration and appropriate safeguarding of plan assets.

Cause: Plan officials were unaware that the municipality's procurement of investment and advisory services for the pension plan was not conducted in accordance with Act 44 provisions. In addition, plan officials were not aware of their fiduciary responsibility to monitor the police pension plan's custodial accounts and to ensure that cash balances are maintained in amounts not to exceed FDIC coverage limits to safeguard plan assets. Furthermore, plan officials were unaware that one individual with complete control over the financial activities of the pension plan negates the internal controls associated with the segregation of duties and safeguarding of plan assets.

Effect: We were unable to determine whether the township complied in all respects with the provisions stipulated in Act 44 regarding the procurement of professional investment and advisory services for the township's pension plan. Also, by failing to maintain appropriate supporting documentation evidencing the review of proposals, the corresponding documentation summarizing the relevant factors that resulted in the award of the contract, as well as the proper notifications and inclusion of the required disclosures to unsuccessful applicants and the making of these applications and disclosures public (except for proprietary information and information protected by law) after awarding the contract, it denotes a general lack of overall transparency of the actions taken by plan officials relative to the awarding of the contract for investment and advisory services for the township's pension plan.

In addition, a lack of effective monitoring of pension plan cash and/or investments places the pension plan funds at greater risk for loss.

Furthermore, inadequate segregation of duties could prevent plan officials and members of the pension plan from effectively monitoring the pension plan's financial transactions and negates the checks and balances necessary to detect and correct financial errors or irregularities in the pension plan's accounting system.

Finding – (Continued)

Recommendation: We recommend that municipal officials obtain a comprehensive understanding of Act 44 and develop and implement procedures for the procurement of professional services for the pension plan to ensure compliance with provisions of Act 44 while maintaining appropriate and sufficient supporting documentation evidencing every phase of the process in the awarding of future professional services contracts for the pension plan including authorizations/approvals of township officials in the official minutes of formal board meetings and especially required notifications and disclosures to ensure transparency of the actions taken by plan officials relative to the awarding of the professional services contracts for the township's pension plan.

In addition, pension plan officials should monitor all cash and investment assets that are eligible for FDIC insurance and ensure the balance of those assets per banking institution does not exceed FDIC coverage limits.

Finally, we recommend that municipal officials review their accounting and internal control procedures to ensure that there is adequate segregation of duties over the financial transaction of the pension plan so that pension plan assets are adequately safeguarded.

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

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

CHIPPEWA TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 7 through 9 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2014, 2015, AND 2016

	2014	2015	2016
Total Pension Liability			
Service cost	$ 50,040	$ 53,983	$ 56,412
Interest	184,335	197,868	212,558
Difference between expected and actual experience	-	(13,885)	-
Benefit payments, including refunds of member contributions	(12,988)	(19,579)	(37,248)
Net Change in Total Pension Liability	221,387	218,387	231,722
Total Pension Liability - Beginning	2,792,272	3,013,659	3,232,046
Total Pension Liability - Ending (a)	$ 3,013,659	$ 3,232,046	$ 3,463,768
Plan Fiduciary Net Position			
Contributions - employer	$ 183,544	$ 189,083	$ 186,366
Net investment income	143,566	25,481	128,114
Benefit payments, including refunds of member contributions	(12,988)	(19,579)	(37,248)
Administrative expense	(19,200)	(27,726)	(23,635)
Net Change in Plan Fiduciary Net Position	294,922	167,259	253,597
Plan Fiduciary Net Position - Beginning	2,461,477	2,756,399	2,923,658
Plan Fiduciary Net Position - Ending (b)	$ 2,756,399	$ 2,923,658	$ 3,177,255
Net Pension Liability - Ending (a-b)	$ 257,260	$ 308,388	$ 286,513
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	91.5%	90.5%	91.7%
Estimated Covered Employee Payroll	$ 558,384	$ 528,583	$ 528,052
Net Pension Liability as a Percentage of Covered Employee Payroll	46.1%	58.3%	54.3%

CHIPPEWA TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the township as of December 31, 2014, 2015, and 2016, calculated using the discount rate of 6.5%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (5.5%)	Current Discount Rate (6.5%)	1% Increase (7.5%)
Net Pension Liability - 12/31/14	$ 597,779	$ 257,260	$ (28,332)
Net Pension Liability - 12/31/15	$ 672,454	$ 308,388	$ 2,148
Net Pension Liability - 12/31/16	$ 653,766	$ 286,513	$ (22,497)

SCHEDULE OF CONTRIBUTIONS

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	Covered-Employee Payroll*	Contributions as a Percentage of Covered-Employee Payroll
2007	$ 52,360	$ 52,360	$ -		
2008	51,796	51,796	-	$ 378,979	13.7%
2009	52,510	52,510	-	-	
2010	55,044	55,044	-	452,972	12.2%
2011	92,218	92,218	-	-	
2012	158,444	158,444	-	492,420	32.2%
2013	161,002	161,002	-	-	
2014	183,544	183,544	-	558,384	32.9%
2015	189,083	189,083	-	528,583	35.8%
2016	186,366	186,366	-	528,052	35.3%

* Due to GASB Statement No. 67, *Financial Reporting for Pension Plans,* being implemented only recently, the amount of Covered-Employee Payroll was not provided for odd years prior to 2014.

CHIPPEWA TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2016	4.37%
2015	0.92%
2014	5.80%

CHIPPEWA 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. 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	$ 1,665,799	$ 2,205,697	$ 539,898	75.5%
01-01-13	1,974,818	2,575,365	600,547	76.7%
01-01-15	2,648,243	2,999,774	351,531	88.3%

Note: The market values of the plan's assets at 01-01-11, 01-01-13, and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses over a 4-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.

CHIPPEWA 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.

CHIPPEWA TOWNSHIP POLICE 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, closed
Remaining amortization period	5 years
Asset valuation method	Market value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	6.5%
Projected salary increases *	4.5%
Cost-of-living adjustments	None assumed

* Includes inflation at 3.0%

CHIPPEWA TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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