

# COMPLIANCE AUDIT

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## Fallowfield Township Police Pension Plan Washington County, Pennsylvania For the Period January 1, 2018 to December 31, 2019

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March 2021



Commonwealth of Pennsylvania  
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR  
AUDITOR GENERAL**

Board of Township Supervisors  
Fallowfield Township  
Washington County  
Charleroi, PA 15022

We have conducted a compliance audit of the Fallowfield Township Police Pension Plan for the period January 1, 2018 to December 31, 2019. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the 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 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. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action had been appropriately taken. 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 by the plan's governing document and applicable laws and regulations for the years covered by our audit period.
- We determined that there were no benefit calculations prepared for the years covered by our audit period.
- We determined whether the January 1, 2017 and January 1, 2019, actuarial valuation reports were prepared and submitted by March 31, 2018 and 2020, 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.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Fallowfield Township Police Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 objectives.

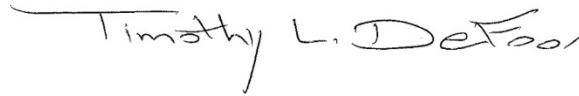
The results of our procedures indicated that, in all significant respects, the Fallowfield Township Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding and further discussed later in this report:

Finding – Noncompliance With Prior Audit Recommendation – Failure  
To Cash Surrender Insurance Policy At Retirement

The finding contained in this audit report repeats a condition that was cited in five previous audit reports that has not been corrected by township officials. We are concerned by the township's continued failure to correct this previously reported finding and strongly encourage timely implementation of the recommendations noted in this audit report.

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 Fallowfield 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.

A handwritten signature in black ink that reads "Timothy L. DeFoor". The signature is written in a cursive style with a long horizontal line extending to the left of the first letter.

TIMOTHY L. DEFOOR  
Auditor General

February 18, 2021

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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.

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 Fallowfield Township Police Pension Plan is also governed by implementing regulations 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 Fallowfield Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 142, as amended, adopted pursuant to Act 600. The plan was established February 13, 1970. On May 26, 2010, the Fallowfield Township Board of Supervisors adopted Ordinance No. 196, which effectively abolished, terminated and disbanded the former Fallowfield Township Police Department effective December 31, 2010; consequently, the plan no longer has any active plan members. As of December 31, 2019, the plan had 2 retirees receiving pension benefits.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Recommendation

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

- Failure To Cash Surrender Insurance Policy At Retirement

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation – Failure To Cash Surrender Insurance Policy At Retirement**

Condition: As disclosed in the five most recent prior audit reports, as of December 31, 2002, the plan held an endowment policy for a police officer, which was purchased prior to January 1, 1986. On January 15, 2003, the policy was surrendered by the township and the proceeds were used to purchase a flexible premium adjustable life insurance policy on the same police officer. On February 21, 2003, the police officer retired and began receiving a monthly pension benefit in accordance with Act 600. However, the plan still maintains the life insurance policy (*in the name of the retired officer with the officer's spouse as the primary beneficiary*) which is contrary to Act 600 and 205.

Criteria: Section 5 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 member during not more than the last sixty nor less than the last thirty-six months of employment...

In addition, the Commonwealth Court case Fedor v. Borough of Dormont et al., 389 A.2d 217 (Pa.Cmmw. 1978), which was affirmed by the Pennsylvania Supreme Court, See 487 Pa. 249, 409 A.2d 334 (1979), upholds the position that Act 600 funds are to 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 the present and future periodic retirement payments and benefits of active and retired members of the pension plan.



FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Consequently, the primary purpose of life insurance is to provide death benefits, not the provision of periodic retirement benefits. Therefore, pension plans are not authorized to purchase or pay premiums for life insurance, except as noted below.

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:

Because the primary purpose of these policies is to fund death benefits rather than periodic retirement benefits, general municipal pension system state aid cannot be used to pay life insurance.

Furthermore, Bulletin No. 6-88 states, in part:

To avoid the losses which might be sustained by municipal pension plans that previously invested in life insurance policies, we will not object to the continued payment of premiums for existing policies which were previously authorized (i.e. grandfathering). However, we would recommend cash surrender of such policies or conversion to annuities at the time when the optimum return is available. 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.

In 2003, Auditor General Municipal Pension Bulletin No. 2003-01, “Purchase of Insurance Coverage,” was issued as a supplement to Bulletin No. 6-88 and stated, in part:

Criteria for Purchasing Insurance Coverage – The principle underlying Bulletin No. 6-88 is that insurance coverage purchased for members of a pension plan and payable in a lump sum to the members’ survivors do not provide retirement benefits within the meaning of Act 205.

Therefore, when township officials cash surrendered the endowment policy on January 15, 2003, the proceeds should have been deposited into the police pension plan and used to fund the retired officer’s monthly retirement benefit.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Cause: Municipal officials disagree with the finding because the policy was purchased prior to the issuance of Auditor General Bulletin No. 2-85.

Effect: Because the retired officer is receiving a monthly pension benefit from the plan in accordance with Act 600, the continuation of the flexible premium adjustable life insurance policy could result in the receipt of additional benefits in excess of those authorized by Act 600.

Furthermore, the cash surrender value of the policy is not available to pay authorized plan expenses or for investment purposes.

Recommendation: We again recommend that the township cash surrender the flexible premium adjustable life insurance policy held for the retired police officer and deposit the proceeds into the police pension plan. As an alternative, the municipality could transfer the existing life insurance policy from the pension plan to the municipal general fund provided the pension plan is adequately compensated.

Management's Response: The following response as provided by the township's solicitor at the request of township officials, was included in the audit report covering the period January 1, 2014 to December 31, 2017 as follows:

To better understand the Township's position on this issue of reimbursement to the pension plan, we need to look at the history of the insurance policy and its funding sources. On November 15, 1973, the township had issued, through the Colonial Life Insurance Company of America, a \$35,000.00 income endowment life insurance contract with an annuity rider. Said policy had an annual premium of \$1,085.85. The annuity rider was to provide a retirement benefit for the aforementioned individual. We have written documentation that this policy, which included retirement benefits, was to be the same or similar to the insurance and retirement benefits that were provided by the Township to its first police officer and former chief, who retired and this individual replaced as chief. *(Auditor's Note: The individuals' names and individual policy numbers cited by the solicitor in the response provided were specifically excluded from this management response.)*

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

The Auditor General in 1985 issued Bulletin No. 2-85, regarding the *Purchase of Life Insurance for Municipal Pension Plans*, which disallowed any further purchase of life insurance with pension funds after January 1, 1986, but did allow the continuance of existing policies. Accordingly, it was entirely proper for the Township to continue this policy that was established many years prior to January 1, 1986 as it was “grandfathered in.” Pursuant to Auditor General Municipal Pension Bulletin No. 6-88, *Purchase of Insurance Coverage*, which was issued in 1988, this position changed and no longer could general municipal pension system state aid be used to pay life insurance. It is our position that no state monies were used to pay the life insurance premium from 1988-2003. Further, this individual’s first policy predated Pension Bulletin 2003-01 by thirty years.

A prior Township Secretary/Treasurer, without authorization from the Board of Supervisors, surrendered this individual’s policy on January 15, 2003 and the proceeds were used to purchase the flexible premium adjustable life insurance policy that remains in effect through Lincoln Financial Group. This policy currently has a cash surrender value of approximately \$83,727.31. Said policy has an \$180,000.00 death benefit.

The Fallowfield Township Supervisors respectfully disagree with your finding that the Township remains in non-compliance with the prior audit recommendation. It is stated that the Township has failed to surrender the cash value of the flexible premium adjustable life insurance policy that was issued for this individual. However, said policy was funded by the entire proceeds from the earlier insurance policy. When the original policy was terminated, its cash surrender value was the only premium paid into the current life insurance policy. Accordingly, the Township does not feel it is non-compliance and should not be required to cash in the current life insurance policy and pay its surrender proceeds of approximately \$83,727.31 into the police pension plan.

At the present time, it is unknown what the exact amount of the cash surrender proceeds were on January 15, 2003 when the original policy was terminated. The Township has been trying for years to get the complete records on these policies. Again, the only premium that has been paid into the current policy was the cash surrender value of the original policy. The current policy is a “self-sustaining” one, and, as such, the Township has never contributed any money out of its police pension funds to pay for the current policy, so as to run afoul of Act 600.

There are several undisputed facts. One the original policy was issued in 1973 and the current policy was issued 2003. This is thirty years of valid and legal payments by the Township. Second, the Township agreed to provide this individual with a life insurance policy and a retirement plan. The insurance and retirement benefit was provided and is a legal obligation of the Township. These funds belong to Fallowfield Township and were paid from Township taxes.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

On February 11, 2021, at the request of township officials, the township's solicitor provided the following additional response:

It is the Township's position that the Auditor General's office should look at this issue as an unauthorized or excess benefit under Act 600 since the Township feels contractually obligated to keep this policy in effect for the benefit of the retired police officer. I am aware of other situations where the Auditor General's office allows the excess benefits to be paid but stipulates that no state aid may be used to fund the excess benefit. The Township has no active police force, and the plan is approximately \$400,000.00 overfunded presently. The Township no longer receives state aid on behalf of the police. The approximately \$84,492.88, when it is distributed as a death benefit, will not affect the plan's overfunded status.

If the Auditor General's office will not treat this issue as an unauthorized of excess benefit, please provide the Township with a written response that addresses the issues raised in this letter and provides the amount of money that the Auditor General claims was used improperly from the police pension monies to provide the insurance and retirement benefits to this individual under the current policy. It is clear to the Township that the full amount of the approximately \$84,492.88 cash surrender value of the current life insurance policy should not be paid into the police pension plan.

We await your response and if you have any questions, please do not hesitate to contact our office.

Auditor's Conclusion: As disclosed in the prior audit, although we understand the position taken by the township, we respectfully disagree with the township's position relative to this issue. As previously stated in prior reports, based on the bulletins issued by the Department and a prior Commonwealth court case, municipal pension plan funds should not be used for the purchase and payment of life insurance policies. While the original policy was purchased by the township prior to January 1, 1986, that policy was ultimately surrendered in 2003, long after the issuance of the above referenced bulletins which recommended that life insurance policies should be either cash surrendered or, as an alternative, transferred to the municipal general fund provided the pension plan was adequately compensated.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

It was also previously noted that the premiums on the purchase of the original endowment contract, which as mentioned in the response above was subsequently surrendered and replaced with the aforementioned flexible premium adjustable life insurance policy, were originally satisfied with state funds (distributed under Act 120). We were unable to substantiate from our records the municipality's claim that funds belonging to the township and paid from Township taxes were ever contributed to its police pension fund. As such, the continued payment of subsequent premiums through the accumulated earnings within the insurance contract appear to represent additional earnings on those original state funds which in turn were utilized to satisfy subsequent annual premiums on this policy for the sole purpose of providing a lump-sum benefit upon the death of the retired member and not for the funding of the retired officer's monthly retirement benefit.

Although we do understand that a life insurance provision was provided to active members in the collective bargaining agreement (CBA) covering members of the police force and is a contractual obligation of the township, according to the CBA, upon retirement, the township was to maintain insurance in the amount of \$35,000 on each retiree. However, the CBA did not indicate that this was the responsibility of the pension plan; moreover, it was not contained in the pension plan provisions section of the CBA. The township has further indicated in the most recent response provided on February 11, 2021 that it is the Township's position currently that the department "should look at this issue as an unauthorized or excess benefit under Act 600 since the Township feels it is contractually obligated to keep this policy in effect for the benefit of the retired police officer". Although we do not disagree that the township feels contractually obligated to maintain the policy for the retired police officer, it is not an accepted obligation of the pension plan for the reasons aforementioned. In regards to an excess benefit, the township typically is required to fund the excess benefit through subsequent actuarial reports and through municipal contributions; not state aid already received under the general municipal state aid program. However, since the actuarial value of assets exceeds the actuarial present value of future benefits, the municipality does not have a funding obligation, and as such, the excess benefit would not be properly funded by the township. Instead, it would remain an obligation of the pension plan which as noted earlier, is not a proper use of pension plan assets. Therefore, based on the criteria previously cited, the finding and recommendation remain as stated above.

FALLOWFIELD 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, 2015, 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)
01-01-15	\$ 1,191,703	\$ 769,239	\$ (422,464)	154.9%
01-01-17	1,176,473	766,432	(410,041)	153.5%
01-01-19	1,128,754	733,449	(395,305)	153.9%

Note: The market values of the plan's assets at 01-01-15, 01-01-17, and 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 80 to 120 percent of the 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.

FALLOWFIELD 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.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 (UNAUDITED)

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
2010	\$ -	\$ -	\$ -	\$ -	N/A
2011	-	-	-	-	N/A
2012	-	-	-	-	N/A
2013	-	-	-	-	N/A
2014	-	-	-	-	N/A
2015	-	-	-	-	N/A
2016	-	-	-	-	N/A
2017	-	-	-	-	N/A
2018	-	-	-	-	N/A
2019	-	-	-	-	N/A

N/A – Not applicable. As noted in the Background section of this report, the township disbanded the police force in 2010 and consequently, the plan no longer has any active plan members

\* This schedule is presented pursuant to the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans* by reporting entities responsible for administering the pension plan to improve financial reporting by state and local governmental pension plans.



FALLOWFIELD 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, 2019
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Method described in Act 205, Section 210(a) Asset corridor +/- 20%
Actuarial assumptions:	
Investment rate of return	5.0%
Projected salary increases	4.0%
Cost-of-living adjustments	2.25%

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

**The Honorable Tom W. Wolf**  
Governor  
Commonwealth of Pennsylvania

**Mr. Bruce Smith**  
Chairman, Board of Township Supervisors

**Mr. Joseph Sopcak**  
Vice-Chairman, Board of Township Supervisors

**Mr. Earl Sadler**  
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**Ms. Karen Talbert**  
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