

COMPLIANCE AUDIT

Upper Perk Police District Pension Plan Montgomery County, Pennsylvania For the Period January 1, 2013 to December 31, 2016

June 2018



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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**EUGENE A. DePASQUALE
AUDITOR GENERAL**

Upper Perk Police Commission
Upper Perk Police District
Montgomery County
Pennsburg, PA 18073

We have conducted a compliance audit of the Upper Perk Police District Pension Plan for the period January 1, 2013 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 whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- We determined whether retirement benefits calculated for the plan member who retired during the current audit period 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 the retired individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to the recipient.
- We determined whether the January 1, 2011, 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, 2012, 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.

District officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Upper Perk Police District 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 district's internal controls as they relate to the district'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 Upper Perk Police District 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 – Pension Benefit Not Authorized By Act 600

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 Upper Perk Police District and, where appropriate, their responses have been included in the report.

This report is a revision of a previously issued audit report dated May 31, 2017. The report has been revised to reflect the correct normal retirement eligibility requirements disclosed in the Background section.

June 21, 2018

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

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 Upper Perk Police District 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 Upper Perk Police District Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution No. 03-01, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the district and its police officers. The plan was established January 1, 1976. Active members were not required to contribute to the plan for the year 2013, and were required to contribute 1.5 percent of compensation to the plan for the years 2014, 2015, and 2016. As of December 31, 2016, the plan had 8 active members, 1 terminated member eligible for vested benefits in the future, and 2 retirees receiving pension benefits from the plan.

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 20 years of service

Vesting 100% after 12 years of service

Retirement Benefit:

50% of final 36 months average salary offset by 25% of the primary insurance amount under Social Security.

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:

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

UPPER PERK POLICE DISTRICT PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Pension Benefit Not Authorized By Act 600

Condition: The pension plan’s governing document provides a pension benefit not authorized by Act 600. Section 1.03 of Resolution No. 03-01 states, in part:

For purposes of computing Average Applicable Compensation, actual monthly earnings shall be based on W-2 earnings in which all forms of earnings are derived from the terms and conditions of the employee’s employment.

Pursuant to this provision, the district included a lump-sum payment for accumulated unused sick leave that was not earned during the pension computation period in the pension benefit determination for a police officer who retired during the audit period.

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

Although Act 600 does not define “salary,” the Department has concluded, based on a line of court opinions, that the term does not encompass lump-sum payments for leave that was not earned during the pension computation period.

Cause: Plan officials were unaware that Act 600 does not authorize the inclusion of lump-sum payments for accumulated unused leave earned outside the pension computation period in pension calculations.

Effect: The plan is paying pension benefits to a retiree in excess of those authorized by Act 600. The retiree is receiving excess benefits of \$252.85 per month, which totaled approximately \$6,321 from the date of the member’s retirement through the date of this report.

Providing unauthorized pension benefits increases the plan’s pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Since the district 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.

UPPER PERK POLICE DISTRICT PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We recommend that the district comply with Act 600 at its earliest opportunity to do so. To the extent that the district is not in compliance with Act 600 and/or is contractually obligated to pay benefits to existing retirees in excess of those authorized by Act 600, 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, 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 excess benefits on the district's future state aid allocations and submit this information to the Department. If it is determined the excess benefits had an impact on the district's future state aid allocations after the submission of this information, the plan's actuary would then be required to contact the Department to verify the overpayment of state aid received. Plan officials would then be required to reimburse the overpayment to the Commonwealth.

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.

UPPER PERK POLICE DISTRICT PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 5 and 6 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

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Total Pension Liability			
Service cost	\$ 98,892	\$ 112,013	\$ 117,614
Interest	124,639	136,813	147,549
Difference between expected and actual experience	-	(31,012)	-
Changes of assumptions	-	37,428	-
Benefit payments, including refunds of member contributions	(17,504)	(120,800)	(81,320)
Net Change in Total Pension Liability	<u>206,027</u>	<u>134,442</u>	<u>183,843</u>
Total Pension Liability - Beginning	<u>1,690,417</u>	<u>1,896,444</u>	<u>2,030,886</u>
Total Pension Liability - Ending (a)	<u><u>\$ 1,896,444</u></u>	<u><u>\$ 2,030,886</u></u>	<u><u>\$ 2,214,729</u></u>
Plan Fiduciary Net Position			
Contributions – employer	\$ 91,633	\$ 88,309	\$ 104,715
Contribution – member	9,752	12,131	12,237
Net investment income	42,994	(38,609)	89,701
Benefit payments, including refunds of member contributions	(17,504)	(120,800)	(81,320)
Administrative expense	(3,500)	(7,100)	(4,700)
Net Change in Plan Fiduciary Net Position	<u>123,375</u>	<u>(66,069)</u>	<u>120,633</u>
Plan Fiduciary Net Position - Beginning	<u>1,523,225</u>	<u>1,646,600</u>	<u>1,580,531</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 1,646,600</u></u>	<u><u>\$ 1,580,531</u></u>	<u><u>\$ 1,701,164</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 249,844</u></u>	<u><u>\$ 450,355</u></u>	<u><u>\$ 513,565</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	86.8%	77.8%	76.8%
Estimated Covered Employee Payroll	\$ 719,734	\$ 700,000	\$ 697,294
Net Pension Liability as a Percentage of Covered Employee Payroll	34.7%	64.3%	73.7%

UPPER PERK POLICE DISTRICT 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 district as of December 31, 2014, 2015, and 2016, calculated using the discount rate of 7.0%, as well as what the district’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 (6.0%)	Current Discount Rate (7.0%)	1% Increase (8.0%)
Net Pension Liability – 12/31/14	\$ 528,244	\$ 249,844	\$ 18,306
Net Pension Liability – 12/31/15	\$ 746,064	\$ 450,355	\$ 203,264
Net Pension Liability – 12/31/16	\$ 816,658	\$ 513,565	\$ 258,354

SCHEDULE OF INVESTMENT RETURNS

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

2016	5.68%
2015	(2.34%)
2014	2.82%

UPPER PERK POLICE DISTRICT 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	\$ 1,204,410	\$ 1,198,857	\$ (5,553)	100.5%
01-01-13	1,463,483	1,502,577	39,094	97.4%
01-01-15	1,778,164	1,902,860	124,696	93.4%

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 subject to a ceiling of 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.

UPPER PERK POLICE DISTRICT 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.

UPPER PERK POLICE DISTRICT PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2011	\$ 83,531	103.3%
2012	84,147	100.0%
2013	93,421	100.0%
2014	91,633	100.0%
2015	88,309	100.0%
2016	104,715	100.0%

UPPER PERK POLICE DISTRICT 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
Remaining amortization period	17 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	5.0%
Cost-of-living adjustments	None assumed

UPPER PERK POLICE DISTRICT PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Mr. Kristopher Kirkwood
Chairman, Police Commission

Mr. Ryan Sloyer
Vice-Chairman, Police Commission

Ms. Vicki Lightcap
Police Commissioner

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