

COMPLIANCE AUDIT

Lansdowne Borough Police Pension Plan Delaware County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

September 2017



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and Borough Council
Lansdowne Borough
Delaware County
Lansdowne, PA 19050

We have conducted a compliance audit of the Lansdowne Borough Police Pension Plan for the period January 1, 2015 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 our 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 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. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has 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 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 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, 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 provisions of the Deferred Retirement Option Plan (DROP) were in accordance with the provisions of Act 205 by examining provisions stated in the plan's governing documents.

Lansdowne Borough contracted with an independent certified public accounting firm for annual audits of its financial statements prepared in conformity with the accounting practices prescribed or permitted by the Department of Community and Economic Development of the Commonwealth of Pennsylvania, 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 Lansdowne 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 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 objectives.

The results of our procedures indicated that, in all significant respects, the Lansdowne 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 finding further discussed later in this report:

Finding – Noncompliance With Prior Audit Recommendations – Pension
Benefit Provision Not In Compliance With Act 600

The finding contained in this audit report repeats a condition that was cited in our previous audit report that has not been corrected by borough officials. We are concerned by the borough's failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation 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 Lansdowne Borough and, where appropriate, their responses have been included in the report. We would like to thank borough officials for the cooperation extended to us during the conduct of the audit.

August 21, 2017



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 Lansdowne Borough 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 Lansdowne Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1267, 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 plan was established December 9, 1957. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2016, the plan had 14 active members, no terminated members eligible for vested benefits in the future, and 17 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 50 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, plus a service increment of \$250 per month for each year of service in excess of 25 years, up to a maximum of \$1,200.

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:

Members hired before January 1, 2011, 70% of the member's final average salary. Members hired on or after January 1, 2011, 50% of the member's final average salary. Both reduced so that the total pension, Social Security disability, and Worker's Compensation benefits does not exceed 100% of salary for the last 12 months of employment. (See Finding.)

LANSDOWNE BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

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

- Pension Benefit Provision Not In Compliance With Act 600

LANSDOWNE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Noncompliance With Prior Audit Recommendation – Pension Benefit Provision Not In Compliance With Act 600

Condition: As disclosed in the prior audit report, the provision for service-related disability benefits contained in the plan’s governing document and the collective bargaining agreement does not comply with Act 600 as illustrated in the table below; however, it is consistent with an arbitration award for the years 2010 through 2012. During the prior audit period, the borough signed a Memorandum of Agreement to extend the existing collective bargaining agreement until December 31, 2015, and during the current audit period, the borough signed a Memorandum of Agreement to extend the existing collective bargaining agreement until December 31, 2018.

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Service-related disability	<p>If hired prior to 1/1/11, 70% of average 36 month compensation provided that the disability benefit, social security disability benefits and workers compensation payments do not exceed 100% of the member’s compensation.</p> <p>If hired after 1/1/11, 50% of average 36 month compensation provided that the disability benefit, social security disability benefits and workers compensation payments do not exceed 100% of the member’s compensation.</p>	<p>If hired prior to 1/1/11, 70% of average 36 month compensation provided that the disability benefit, social security disability benefits and workers compensation payments do not exceed 100% of the member’s compensation.</p> <p>If hired after 1/1/11, 50% of average 36 month compensation provided that the disability benefit, social security disability benefits and workers compensation payments do not exceed 100% of the member’s compensation.</p>	<p>In the case of the payment of pensions for permanent injuries incurred in service, the amount and commencement of the payments shall be fixed by regulations of the governing body of the borough, town, township or regional police department and shall be calculated at a rate no less than fifty per centum of the member’s salary at the time the disability was incurred, <u>provided that any member who receives benefits for the same injuries under the Social Security Act (49 Stat. 620, 42 U.S.C. § 301 et. seq.) shall have his disability benefits offset or reduced by the amount of such benefits.</u> All such pensions as shall be allowed to those who are retired by reason of disabilities shall be in conformity with a uniform scale. [Emphasis added]</p>

LANSDOWNE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Criteria: The pension plan's governing document and the collective bargaining agreement should contain a service-related disability benefit provision that is in compliance with Act 600, as amended.

Cause: The amended service-related disability benefit provision was granted pursuant to an arbitration award.

Effect: Maintaining a benefit structure which is not in compliance with Act 600 could result in plan members or their beneficiaries receiving incorrect benefit amounts or being denied benefits to which they are statutorily entitled.

Recommendation: We again recommend that municipal officials, after consulting with their solicitor, take whatever action is necessary to bring the plan's service-related disability benefit provision into compliance with Act 600, as amended, at their earliest opportunity to do so.

Management's Response: The borough repeats its response from the prior audit report. As you are aware, Lansdowne Borough has taken exception to the proposed finding concerning the borough's police pension plan. The issue relates to your Department's interpretation of the Act 30 minimum service connected disability benefit.

Let the borough first give some background as it relates to the issue of disabilities within the borough's police pension plan. As of January 1, 2011, out of 17 retired participants, 9 went out on a disability benefit. Over the years, these disabilities have significantly increased the borough's municipal obligation to the police pension plan. The borough began to look at this issue and decided that this issue needed to change. In 2010, Lansdowne Borough elected to go to arbitration. A major topic in making this decision was the disability benefit. On January 31, 2011, the arbitration award was issued whereas officers hired on or after January 1, 2011 would receive a disability benefit equal to fifty percent (50%) of all reportable W-2 income for the thirty-six (36) months immediately preceding retirement or death, less severance payments made at time of retirement or death, e.g., unused sick leave and vacation. No severance payments shall be subject to payroll deduction for the police pension fund (Act 600). However, the total of the pension, social security disability benefits, and workers' compensation payments (or the annuity value of a lump sum workers' compensation settlement), may not exceed 100% of the W-2 income received in the prior twelve months. The workers' compensation benefits shall not be reduced (offset) by the pension received. The disability pension paid under this provision shall be offset to meet that requirement. This award was a 20% reduction of what officers hired prior to January 1, 2011 currently would be entitled to receive. This award was a significant help to the borough for the future financial stability of the plan as well as the borough's general fund.

LANSDOWNE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

You stated that it is your Department's position that the arbitration award is in conflict with Section 5(e)(i) of Act 600 which states as follows:

In the case of the payment of pensions for permanent injuries incurred in service, the amount and commencement of the payments shall be fixed by regulations of the governing body of the borough, town, township, or regional police department and shall be calculated at a rate no less than fifty per centum of the member's salary at the time the disability was incurred, provided that any member who receives benefits for the same injuries under the Social Security Act (49 Stat. 620, 42 U.S.C. § 301 et. seq.) shall have his disability benefits offset or reduced by the amount of such benefits.

You stated that the arbitration award is granting less than 50% of the officer's salary at the time the disability incurred and does not provide for a social security offset.

The borough totally disagrees with your Department's position. Let me explain our reasoning. Act 600 states that the disability benefit cannot be less than 50% of the officer's salary. The Borough has taken the position that the definition for salary is the officer's base wage. The arbitration award is based upon the average of the last 36 months earnings. These figures shall be based on W-2 earnings in which all forms of earnings are derived from the terms and conditions of the officer's employment, including base wage, longevity, overtime, shift differential, education, etc. The average 36 month W-2 earnings are significantly higher than a single year's base wage. With that being said, the arbitration award is therefore granting a disability benefit that is greater than 50% of the officer's salary at the time of disability.

The second issue that your Department raised was the lack of a social security offset. It is the borough's position that Act 600 provides this offset as a minimum requirement, and that the social security offset can be eliminated through negotiation. As your Department should be aware, Act 600 provides for a social security offset for a normal retirement benefit but the offset can be reduced or eliminated through negotiation. The arbitration award states that the total disability pension, social security disability benefits, and workers' compensation payments, may not exceed 100% of the W-2 income received by the officer in the prior twelve months. This language certainly addresses the offset and reflects a greater benefit than 50% of the salary at the time the disability was incurred.

The Borough respectfully requests that your Department reconsider its position and remove this finding from the audit of the police pension plan. The borough looks forward to your Department's response.

LANSDOWNE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Auditor’s Conclusion: The Department appreciates the Borough’s continued efforts to address the plan’s service-related disability benefit provision in light of the associated costs that have been incurred. The Lansdowne Borough Police Pension Plan has defined salary as W-2 wages less severance payments and has deducted member contributions from W-2 wages; therefore, in the case of members hired after 1/1/11 who retire on service related disability, 50% of the average of the last 36 months salary would generally be less than the 50% of salary at the time of disability based on the plan’s definition of salary; however, the final determination of compliance would be subject to a case by case analysis of each individual police officer’s earnings for the respective periods.

Regarding the provision for a Social Security offset, we agree that the Social Security offset provision for normal retirement benefit contained in Act 600 is an optional provision; however, given the language regarding the Social Security offset in Section 5(e) of Act 600, which includes the word “shall” as opposed to “may,” it remains our position that the offset for disability benefits is mandatory and not subject to negotiation.

Therefore, based on the Criteria previously cited, the finding and recommendation remain as stated.

LANSDOWNE BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 8 and 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, 2015 AND 2016

	<u>2015</u>	<u>2016</u>
Total Pension Liability		
Service cost	\$ 285,471	\$ 299,745
Interest	763,022	798,499
Difference between expected and actual experience	(263,402)	-
Changes of assumptions	233,997	-
Benefit payments, including refunds of member contributions	(574,394)	(605,074)
Net Change in Total Pension Liability	<u>444,694</u>	<u>493,170</u>
Total Pension Liability - Beginning	10,204,751	10,649,445
Total Pension Liability - Ending (a)	<u><u>\$ 10,649,445</u></u>	<u><u>\$ 11,142,615</u></u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 414,303	\$ 415,682
Contribution – member	70,268	62,477
Net investment income	(176,950)	629,378
Benefit payments, including refunds of member contributions	(574,394)	(605,074)
Administrative expense	(8,926)	(7,454)
Net Change in Plan Fiduciary Net Position	<u>(275,699)</u>	<u>495,009</u>
Plan Fiduciary Net Position - Beginning	8,216,739	7,941,040
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 7,941,040</u></u>	<u><u>\$ 8,436,049</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 2,708,405</u></u>	<u><u>\$ 2,706,566</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	74.6%	75.7%
Estimated Covered Employee Payroll	\$ 1,330,926	\$ 1,421,932
Net Pension Liability as a Percentage of Covered Employee Payroll	203.5%	190.3%

LANSDOWNE BOROUGH 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 borough as of December 31, 2015 and 2016, calculated using the discount rate of 7.50%, as well as what the borough'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 (6.50%)	Current Discount Rate (7.50%)	1% Increase (8.50%)
Net Pension Liability – 12/31/15	\$ 3,908,874	\$ 2,708,405	\$ 1,690,644
Net Pension Liability – 12/31/16	\$ 3,950,353	\$ 2,706,566	\$ 1,651,359

SCHEDULE OF INVESTMENT RETURNS

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

2016	7.93%
2015	(2.22%)
2014	5.16%

LANSDOWNE 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. 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	\$ 6,757,898	\$ 9,300,931	\$ 2,543,033	72.7%
01-01-13	7,452,178	9,420,806	1,968,628	79.1%
01-01-15	8,260,337	10,175,346	1,915,009	81.2%

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing of gains and/or losses at 130 percent of market value. The market values of the plan's assets at 01-01-13 and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses at 120 percent of market value. These methods 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.

LANSDOWNE 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.

LANSDOWNE 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
2011	\$ 378,497	152.3%
2012	378,069	100.0%
2013	420,359	109.6%
2014	386,044	116.5%
2015	380,737	108.8%
2016	415,682	100.0%

LANSDOWNE BOROUGH 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
Remaining amortization period	24 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	7.5%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0%

LANSDOWNE BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Anthony Campuzano
Mayor

Mr. Michael F. Schleigh
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