

COMPLIANCE AUDIT

Morton Borough Police Pension Plan Delaware County, Pennsylvania For the Period January 1, 2012 to December 31, 2015

July 2016



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
Morton Borough
Delaware County
Morton, PA 19070

We have conducted a compliance audit of the Morton Borough Police Pension Plan for the period January 1, 2012 to December 31, 2015. 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the 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 2 plan members 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 retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to recipients.
- × We determined whether the January 1, 2011, January 1, 2013, and January 1, 2015 actuarial valuation reports were prepared and submitted to the 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.
- × 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Morton 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 Morton Borough Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation - Plan's Governing Document Contains An Unauthorized Nonservice-Related Disability Benefit Provision

Finding No. 2 – Unauthorized Provision For A Killed In Service Benefit

Finding No. 1 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 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 Morton 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.

June 13, 2016



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 Morton Borough Police Pension Plan is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

- Act 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.
- Act 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 761 et seq.

The Morton Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 580, 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 July 1, 1962. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2015, the plan had 2 active members, no terminated members eligible for vested benefits in the future, and 4 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2015, 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 \$100 per month for each year of service in excess of 25 years, up to a maximum of \$500 per month.

Survivor Benefit:

Killed in Service The member's family shall receive a pension calculated at 100% of the member's salary at the time of death.

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:

70% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

Nonservice-Related Disability Benefit:

A member permanently disabled from performing police work shall receive a nonservice connected disability benefit computed at 50% of average monthly pay as of the date the disability payments begin.

MORTON BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

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

- Plan's Governing Document Contains An Unauthorized Nonservice-Related Disability Benefit Provision

MORTON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Plan’s Governing Document Contains An Unauthorized Nonservice-Related Disability Benefit Provision

Condition: As disclosed in the prior audit report, the pension plan’s governing document, Ordinance No. 580, as amended, at Section IV inappropriately contains a provision for the payment of a nonservice-related disability benefit. This provision is not authorized by Act 600.

Criteria: Regarding disability benefits, Section 5(e)(1) of Act 600 states:

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. [Emphasis added]

Furthermore, the Supreme Court of Pennsylvania in *Chirico v. Board of Supervisors for Newtown Township*, 518 Pa. 572, 544A.2d 1313 (1988) held that Act 600 does not provide for the payment of pension benefits for non-service related injuries.

Cause: Plan officials were unable to amend the plan’s governing document through the collective bargaining process.

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

Recommendation: We again recommend that the plan’s governing document be amended to be in compliance with Act 600 at the borough’s earliest opportunity to do so.

MORTON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Management’s Response: Municipal officials stated that the borough negotiated a new collective bargaining agreement for the years 2016-2020 but was unsuccessful in removing the nonservice-related disability benefit provision from the contract. Municipal officials indicated they will try again to negotiate to remove the nonservice-related disability benefit provision.

Auditor’s Conclusion: This finding repeats a condition that was cited in our previous three audit reports 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.

Finding No. 2 – Unauthorized Provision For A Killed In Service Benefit

Condition: Morton Borough maintains a police pension plan governed by the provisions of Act 600, as amended. Prior to the adoption of Act 51 of 2009, Act 600 contained a mandatory killed in service benefit provision; however, Act 51 specifically repealed the section of Act 600 that referenced the mandatory killed in service benefit. During the prior audit period, a verbal observation was given to plan officials notifying them of the passage of Act 51. It was recommended that plan officials review the act’s implications for the police pension plan. During the current audit period, the borough removed the killed in service benefit provision from the collective bargaining agreement; however, the pension plan’s governing document continues to provide for a killed in service benefit that is no longer authorized by Act 600.

Section 5.03 of Ordinance No. 638 states:

In the event a MEMBER is killed in service the MEMBER’s family shall receive a pension calculated at 100% of the MEMBER’s salary at the time of death.

In addition, the borough continues to fund a killed in service benefit due to its inclusion in the plan’s January 1, 2015, actuarial valuation report.

Criteria: Section 1(a) of Act 51 of 2009 states, in part:

In the event a law enforcement officer, ambulance service or rescue squad member, firefighter, certified hazardous material response team member or National Guard member dies as a result of the performance of his duties, such political subdivision, Commonwealth agency or, in the case of National Guard members, the Adjutant General, or, in the case of a member of a Commonwealth law enforcement agency, the authorized survivor or the agency head, within 90 days from the date of death, shall submit certification of such death to the Commonwealth.

MORTON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

In addition, Section 1(d) of Act 51 of 2009 states, in part:

. . . the Commonwealth shall, from moneys payable out of the General Fund, pay to the surviving spouse or, if there is no surviving spouse, to the minor children of the paid firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty the sum of \$100,000, adjusted in accordance with subsection (f) of this section, and an amount equal to the monthly salary, adjusted in accordance with subsection (f) of this section, of the deceased paid firefighter, ambulance service or rescue squad member or law enforcement officer, less any workers' compensation or pension or retirement benefits paid to such survivors, and shall continue such monthly payments until there is no eligible beneficiary to receive them. For the purpose of this subsection, the term "eligible beneficiary" means the surviving spouse or the child or children under the age of eighteen years or, if attending college, under the age of twenty-three years, of the firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty. When no spouse or minor children survive, a single sum of \$100,000, adjusted in accordance with subsection (f) of this section, shall be paid to the parent or parents of such firefighter, ambulance service member, rescue squad member or law enforcement officer. [Emphasis added]

Furthermore, Section 2 of Act 51 of 2009 states:

Repeals are as follows:

- (1) The General Assembly declares that the repeals under paragraph (2) are necessary to effectuate the amendment of section 1 of the act.
- (2) The following parts of acts are repealed:
 - (i) Section 5(e)(2) of the act of May 29, 1956 (1955 P.L.1804, No. 600), referred to as the Municipal Police Pension Law.
 - (ii) Section 202(b)(3)(vi) and (4)(vi) of the act of December 18, 1984 (P.L.1005, No. 205), known as the Municipal Pension Plan Funding Standard and Recovery Act.

Therefore, since Act 51 specifically repealed the killed in service provision of Act 600 and the funding provisions for the killed in service benefit that were contained in Act 205, the provision of a killed in service benefit is no longer authorized.

MORTON BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Cause: Plan officials failed to establish adequate internal control procedures to ensure the plan's governing document is in compliance with Act 600, as amended.

Effect: Since Section 1 of Act 51 provides that the Commonwealth is obligated to pay the killed in service benefit less any pension or retirement benefits paid to eligible survivors, the continued provision of a killed in service benefit could result in the pension plan being obligated to pay a benefit that is no longer authorized by Act 600 and would have been paid entirely by the Commonwealth absent such provision.

Recommendation: We recommend that the municipality review the plan's killed in service benefit with its solicitor in conjunction with Act 51 of 2009 and eliminate this unauthorized benefit provision at its earliest opportunity to do so.

Management's Response: Municipal officials stated that the referenced unauthorized Act 600 benefit was successfully removed by way of the recently negotiated collective bargaining agreement for the years 2016-2020. Morton Borough believes this finding is premature and arbitrary due to the fact that the collective bargaining agreement was approved in February of 2016 and the borough is currently taking the steps necessary to remove the Act 600 language from the police pension plan's governing document.

Auditor's Conclusion: The Department acknowledges that the borough is in the process of complying with the recommendation to remove the killed in service benefit provision from the plan's governing document; however, the borough must ensure its removal from the plans' governing document and that it is not included in the plan's next actuarial valuation report. Full compliance with the finding recommendation will be evaluated during our next audit of the plan.

MORTON BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 8 and 9 reflect 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 AND 2015

	<u>2014</u>	<u>2015</u>
Total Pension Liability		
Service cost	\$ 45,276	\$ 49,933
Interest	197,563	215,156
Difference between expected and actual experience	-	(23,550)
Changes of assumptions	-	73,740
Benefit payments, including refunds of member contributions	<u>(64,166)</u>	<u>(91,372)</u>
Net Change in Total Pension Liability	178,673	223,907
Total Pension Liability - Beginning	<u>2,456,341</u>	<u>2,635,014</u>
Total Pension Liability - Ending (a)	<u><u>\$ 2,635,014</u></u>	<u><u>\$ 2,858,921</u></u>
Plan Fiduciary Net Position		
Contributions - Employer	\$ 138,811	\$ 183,450
Contributions - State Aid	37,870	35,288
Contributions - Member	16,078	13,547
Net investment income	115,933	(14,030)
Benefit payments, including refunds of member contributions	(64,166)	(91,372)
Administrative expense	<u>(3,100)</u>	<u>(6,600)</u>
Net Change in Plan Fiduciary Net Position	241,426	120,283
Plan Fiduciary Net Position - Beginning	<u>1,705,713</u>	<u>1,947,139</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 1,947,139</u></u>	<u><u>\$ 2,067,422</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 687,875</u></u>	<u><u>\$ 791,499</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	73.9%	72.3%
Covered Employee Payroll	\$ 393,686	\$ 301,430
Net Pension Liability as a Percentage of Covered Employee Payroll	174.7%	262.6%

Notes to Schedule:

Assumption Changes - In 2015, the mortality assumption was changed from the Blue Collar RP-2000 Table to the Blue Collar RP-2000 Table projected to 2015 using Scale AA.

MORTON 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, calculated using the discount rate of 8.0%, 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 (7.0%)	Current Discount Rate (8.0%)	1% Increase (9.0%)
Net Pension Liability	\$ 1,054,429	\$ 791,499	\$ 564,865

SCHEDULE OF INVESTMENT RETURNS

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

2015	(1.04%)
2014	6.94%

MORTON 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	\$ 1,346,849	\$ 1,833,093	\$ 486,244	73.5%
01-01-13	1,661,243	2,293,059	631,816	72.4%
01-01-15	2,095,016	2,685,204	590,188	78.0%

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.

MORTON 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.

MORTON 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
2010	\$ 94,379	100.0%
2011	105,979	100.0%
2012	107,629	100.0%
2013	107,578	100.0%
2014	176,681	100.0%
2015	218,738	100.0%

MORTON 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	3 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	8.0%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0% per year

MORTON BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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