

COMPLIANCE AUDIT

Narberth Borough Police Pension Plan Montgomery County, Pennsylvania For the Period January 1, 2013 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
Narberth Borough
Montgomery County
Narberth, PA 19072

We have conducted a compliance audit of the Narberth Borough Police 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 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 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.
- 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.

Narberth Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements for the years ending December 31, 2013, 2014, and 2015 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 Narberth 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 Narberth 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 – Partial Compliance With Prior Audit Recommendation – Inconsistent Pension Benefits
- Finding No. 2 – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan
- Finding No. 3 – Deferred Retirement Option Plan Not Adopted By Ordinance
- Finding No. 4 – Failure To Maintain An Adequate Record-Keeping System

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 Narberth Borough and, where appropriate, their responses have been included in the report.

September 15, 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 Narberth 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 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. § 767 et seq.

The Narberth Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 478, 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 January 1, 1958. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2016, the plan had 5 active members, no terminated members eligible for vested benefits in the future, and 9 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 53 and 25 years of service
Early Retirement	Available after 20 years of service
Vesting	100% after 12 years of service

Retirement Benefit:

50% of average monthly salary based on last 36 months.

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. If spouse dies, children will receive the benefit until age 18 (or 23 if attending college).

Service Related Disability Benefit:

100% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

NARBERTH BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

Narberth Borough has partially complied with the prior audit recommendation concerning the following:

- Inconsistent Pension Benefits

The benefit provisions reported in the January 1, 2013 and January 1, 2015 actuarial valuation reports are consistent with the provisions contained in the plan's governing document; however, certain benefit provisions contained in the plan's governing document and the collective bargaining agreement continue to conflict with each other and Act 600, as amended, as disclosed in Finding No. 1 in the Findings and Recommendations section of this report.

NARBERTH BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Partial Compliance With Prior Audit Recommendation – Inconsistent Pension Benefits

Condition: As disclosed in the four prior audit reports, the benefit provisions contained in the plan’s governing document, the collective bargaining agreement between the police officers and the borough, and the actuarial valuation report dated January 1, 2011, conflicted with each other and Act 600. During the current audit period, the benefit provisions reported in the January 1, 2013 and January 1, 2015 actuarial valuation reports are consistent with the provisions contained in the plan’s governing document; however, certain benefit provisions contained in the plan’s governing document and the collective bargaining agreement continue to conflict with each other and Act 600, as amended, as noted below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement through 2018</u>	<u>Act 600</u>
Retirement age	Age 53	Age 53	Age 55 or, if actuarially feasible, age 50.
Member contributions	Set annually by resolution at 2% - 5% of Social Security wages and 5% - 8% of wages over Social Security wages.	No provision	5% of compensation but may be reduced or waived annually by resolution.
Service-connected disability	100% of base salary on the date of such disability.	70% of base salary on the date such disability is incurred.	At least 50% of the member’s salary at the time of disability.

Criteria: The benefit provisions contained in the plan’s governing document and collective bargaining agreement should be consistent and in compliance with Act 600, as amended, to ensure the proper administration of the pension plan.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure full compliance with the prior audit recommendation. In addition, there was a turnover in municipal officials and new management was unaware of this finding.

NARBERTH BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: We again recommend that borough officials take appropriate action to ensure the plan's benefit provisions are consistent within the various plan documents and in compliance with Act 600, as amended, at their earliest opportunity to do so.

Management Response: Municipal officials agreed with the finding without exception and stated that they will take the necessary steps to correct the finding.

Auditor's Conclusion: The finding repeats a condition that was cited in our previous four audit reports and 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.

Finding No. 2 – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: The municipality did not fully pay the minimum municipal obligation (MMO) that was due to the police pension plan for the year 2016, as required by Act 205. The municipality had an unpaid MMO balance of \$38,305 for the year 2016.

Criteria: Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

NARBERTH BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Cause: Plan officials did not have adequate internal control procedures in place to ensure the minimum municipal obligation was fully paid.

Effect: The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the 2016 MMO by the December 31, 2016, deadline, the municipality must add the 2016 MMO balance to the current year's MMO and include interest, as required by Act 205.

Recommendation: We recommend that the municipality pay the MMO due to the police pension plan for the year 2016, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

Furthermore, we recommend that, in the future, plan officials pay the full MMO due the plan.

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.

Finding No. 3 – Deferred Retirement Option Plan Not Adopted By Ordinance

Condition: The terms, provisions, and conditions of the Deferred Retirement Option Plan (DROP) were adopted in the collective bargaining agreement (CBA) between the borough and its police officers for the period January 1, 2011 through December 31, 2014, and are also contained in the CBA for the period January 1, 2015 through December 31, 2018. However, the DROP has not been formally adopted by an ordinance that would properly amend the plan's benefit structure.

Criteria: Act 600 at Section 1(a)(1) states, in part:

Each borough, town and township of this Commonwealth maintaining a police force of three or more full-time members and each regional police department shall, and all other boroughs, towns or townships may, establish, by ordinance or resolution, a police pension fund. . . .

NARBERTH BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Furthermore, in Wynne v. Lower Merion Township, 181 Pa. Superior Ct., 524, the Pennsylvania Superior Court held that an ordinance may be amended only by another ordinance and not by a resolution. Since the Narberth Borough Police Pension Plan was established by ordinance, it must be amended by ordinance.

Cause: Plan officials failed to establish internal control procedures to ensure that the DROP was formally adopted through a properly executed ordinance.

Effect: The failure to include the DROP benefit provisions in the plan's governing document could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: We recommend that municipal officials take appropriate action to formally adopt the DROP through a properly executed ordinance.

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.

Finding No. 4 – Failure To Maintain An Adequate Record-Keeping System

Condition: The pension plan's financial record-keeping system did not provide effective control over assets, revenues, and expenses. The deficiencies are as follows:

- Certification Forms AG 385, AG 490, and AG 64 were not maintained and kept on file at the borough's office;
- Financial statements and activity statements were not maintained;
- Pension calculations were not maintained; and
- Custodial account agreement was not maintained.

Criteria: An adequate system of accounting and record keeping is a prerequisite for sound administration of pension plans.

NARBERTH BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

Cause: Plan officials were unaware of their various record-keeping responsibilities.

Effect: Although we were able to obtain copies from a third-party source in order to complete our audit procedures, the failure of plan officials to maintain adequate records prohibits municipal officials from effectively monitoring the plan's financial operations.

Recommendation: We recommend that plan officials establish and maintain a financial record-keeping system that allows them to effectively monitor the plan's financial operations and provides effective control over assets, revenue, and expenses.

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.

NARBERTH BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 9 and 10 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 AND 2015

	<u>2014</u>	<u>2015</u>
Total Pension Liability		
Service cost	\$ 108,954	\$ 113,312
Interest	283,368	293,822
Difference between expected and actual experience	-	357,529
Benefit payments, including refunds of member contributions	<u>(242,123)</u>	<u>(243,823)</u>
Net Change in Total Pension Liability	150,199	520,840
Total Pension Liability - Beginning	4,169,173	4,319,372
Total Pension Liability - Ending (a)	<u><u>\$ 4,319,372</u></u>	<u><u>\$ 4,840,212</u></u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 104,847	\$ 234,300
Contribution – member	26,312	23,309
Net investment income	111,808	114
Benefit payments, including refunds of member contributions	(242,123)	(243,823)
Administrative expense	(21,645)	(50)
Other	-	150
Net Change in Plan Fiduciary Net Position	<u>(20,801)</u>	<u>14,000</u>
Plan Fiduciary Net Position - Beginning	2,442,080	2,421,279
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 2,421,279</u></u>	<u><u>\$ 2,435,279</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ 1,898,093</u></u>	<u><u>\$ 2,404,933</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	56.06%	50.31%
Estimated Covered Employee Payroll	\$ 431,319	\$ 471,170
Net Pension Liability as a Percentage of Covered Employee Payroll	440.07%	510.42%

NARBERTH 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, 2014 and 2015, calculated using the discount rate of 7.0%, 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 (6.0%)	Current Discount Rate (7.0%)	1% Increase (8.0%)
Net Pension Liability - 12/31/14	\$ 2,359,711	\$ 1,898,093	\$ 1,507,469
Net Pension Liability - 12/31/15	\$ 2,922,048	\$ 2,404,933	\$ 1,969,309

SCHEDULE OF INVESTMENT RETURNS

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

2015	0.00%
2014	7.75%

NARBERTH 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	\$ 2,565,074	\$ 2,943,602	\$ 378,528	87.1%
01-01-13	2,770,846	3,558,399	787,553	77.9%
01-01-15	2,859,061	4,063,786	1,204,725	70.4%

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 subject to a corridor between 70 to 130 percent of the market value of assets. 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 subject to a corridor between 80 to 120 percent of the market value of assets. 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.

NARBERTH 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.

NARBERTH 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	\$ 117,935	100.0%
2012	116,899	100.0%
2013	109,940	100.0%
2014	104,847	100.0%
2015	181,107	129.4%
2016	265,690	85.6%*

* See Finding No. 2 contained in the Findings and Recommendations section of this report.

NARBERTH 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	12 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 80-120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	4.0%
Cost-of-living adjustments	In accordance with Act 600

NARBERTH BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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