

COMPLIANCE AUDIT

Freeport Borough Police Pension Plan Armstrong County, Pennsylvania For the Period January 1, 2011 to December 31, 2013

September 2014



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
Freeport Borough
Armstrong County
Freeport, PA 16229

We have conducted a compliance audit of the Freeport Borough Police Pension Plan for the period January 1, 2011 to December 31, 2013. 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. Our methodology addressed determinations about the following:

- Whether state aid was properly determined and deposited in accordance with Act 205 requirements.
- Whether employer contributions are determined and deposited in accordance with the plan's governing document and applicable laws and regulations.
- Whether employee contributions are required and, if so, are determined, deducted, and deposited into the pension plan and are in accordance with the plan provisions and applicable laws and regulations.

- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.
- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and 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.
- Whether benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.
- Whether transfers were properly authorized, accurate, timely and properly recorded.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Freeport 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, 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 tests indicated that, in all significant respects, the Freeport 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:

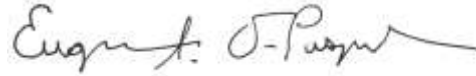
Finding No. 1 – Pension Benefits Not In Compliance With Act 600 Provisions

Finding No. 2 – Failure To Deposit The Full Amount Of State Aid Into An Eligible Pension Plan

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

September 9, 2014

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 Freeport 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 581 - The Borough Code, Act of February 1, 1966 (P.L. 1656, No. 581), Article XI(f), Police Pension Fund in Boroughs Having a Police Force of Less Than Three Members, as amended, 53 P.S. § 46131 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 Freeport Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 370, adopted pursuant to Act 600, as amended. Prior to January 1, 2012, the plan was locally controlled by the provisions of Ordinance No. 321, as amended, adopted pursuant to Act 581. 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, 1978. During the current audit period, active members were not required to contribute to the plan. As of December 31, 2013, the plan had 2 active members, no terminated members eligible for vested benefits in the future, and 1 retiree receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2013, 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	A member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit equals 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.

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:

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

FREEPORT BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Status Of Prior Audit Recommendation

· Pension Benefits In Excess Of Act 581

The prior audit reports for the periods January 1, 2005 to December 31, 2007, and January 1, 2008 to December 31, 2010, disclosed that the pension plan's governing document granted a survivor benefit that was not authorized by Act 581. Effective January 1, 2012, the borough adopted Ordinance No. 370 which amended and restated the police pension plan to operate in accordance with Act 600, accordingly, the plan is no longer governed by Act 581.

FREEPORT BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - Pension Benefits Not In Compliance With Act 600 Provisions

Condition: Through the adoption of Ordinance No. 370, the borough elected for the police pension plan to be governed by the provisions of Act 600, as amended; however, Ordinance No. 370 contains benefit provisions that are not in compliance with Act 600, as illustrated below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Act 600 (as amended)</u>
Survivor's benefit	A survivor benefit shall be paid to the surviving spouse, if any, of the Participant in an amount equal to 50% of the Participant's Accrued Benefit as of the date of death, until the death of the surviving spouse. Upon the death of the surviving spouse or if there is no surviving spouse, the benefit shall be paid to the dependent children of the deceased participant until the death or attainment of age 18 of each child.	A lifetime survivor's benefit must be provided to the surviving spouse (or if no spouse survives or if he or she subsequently dies, the child or children under 18 years of age <u>or if attending college, under or attaining the age of 23</u>) of no less than 50% of the pension the member was receiving or would have been entitled to receive had he been retired at the time of death. ("Attending college" shall mean the eligible children are registered at an accredited institution of higher learning and are carrying a minimum course load of 7 credit hours per semester (emphasis added).)
Pre-vesting death benefit	If a Participant shall die before payment of a benefit has commenced and without eligibility for payment of a survivor benefit, the Beneficiary shall be eligible to receive a distribution in an amount equal to the Accumulated Contributions of the Participant as of the date of death.	The surviving spouse of a member of the police force who dies before his pension has vested or if no spouse survives or if he or she survives and subsequently dies, the child or children under the age of eighteen years, <u>or, if attending college, under or attaining the age of twenty-three years</u> , of the member of the police force shall be entitled to receive repayment of all money which the member invested in the pension fund plus interest or other increases in value of the member's investment in the pension fund, unless the member has designated another beneficiary for this purpose (emphasis added).

FREEPORT BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Act 600 (as amended)</u>
Member contributions	Each Participant shall as a requirement of participation pay regular contributions to the Pension Fund in an amount equal to a percentage of the Participant's Compensation to be determined by Council. Until such time Council, by Ordinance or Resolution, requires that Participant Contributions shall be made, such contributions shall be zero.	Members shall pay into the fund, monthly, an amount equal to 5% of monthly compensation. The governing body of the municipality may, on an annual basis, by ordinance or resolution, reduce or eliminate payments into the fund by members.

Criteria: A governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. In addition, the police pension plan's benefit structure should be in compliance with Act 600, as amended.

Cause: Municipal officials were unaware that the governing document was not in compliance with Act 600.

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 recommend that municipal officials, after consulting with their solicitor, take whatever action is necessary to bring the police pension plan's benefit structure into compliance with Act 600 at their earliest opportunity to do so.

Management's Response: Municipal officials agreed with the finding without exception.

Auditor's Conclusion: Compliance will be subject to verification through our next audit.

FREEPORT BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 - Failure To Deposit The Full Amount Of State Aid Into An Eligible Pension Plan

Condition: During the current audit period, the municipality failed to deposit \$331 of its 2011 state aid allocation. Since both of the borough's police and non-uniformed pension plans had pension costs in 2011, the balance of the 2011 state aid allocation can be deposited into either plan.

Criteria: Section 402(g) of Act 205 states, in part:

. . . the total amount of the general municipal pension system State aid received by the municipality shall, within 30 days of receipt by the treasurer of the municipality, be deposited in the pension fund or the alternate funding mechanism applicable to the respective pension plan.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the full amount of its 2011 state aid allocation was deposited into an eligible pension plan.

Effect: When state aid is not deposited into a pension plan account, the funds are not available to pay operating expenses or for investment and the risk of misapplication is increased.

Recommendation: We recommend that the municipality deposit the remaining 2011 state aid allocation of \$331, plus interest earned during the period beyond the 30 day grace period allowed by Act 205, compounded annually, into their police or non-uniformed pension plan. 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 plan officials develop and implement adequate internal control procedures to ensure that future state aid allocations are deposited into an eligible pension plan within 30 days of receipt by the municipal treasurer.

Management's Response: Municipal officials agreed with the finding without exception.

Auditor's Conclusion: Compliance will be subject to verification through our next audit.

FREEPORT 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, 2009, is as follows:

	(1)	(2)	(3)	(4)	(5)	(6)
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)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-09	\$ 457,855	\$ 286,190	\$ (171,665)	160.0%	\$ 71,923	(238.7%)
01-01-11	603,813	338,027	(265,786)	178.6%	70,043	(379.5%)
01-01-13	640,809	382,377	(258,432)	167.6%	69,509	(371.8%)

FREEPORT 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.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

FREEPORT 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
2008	None	N/A
2009	None	N/A
2010	None	N/A
2011	\$ 5,290	100.0%
2012	5,054	100.0%
2013	None	N/A

FREEPORT BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the required 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, 2013
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	6.5%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0%

FREEPORT BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Freeport Borough Police Pension Plan
Armstrong County
414 Market Street
Freeport, PA 16229

The Honorable James E. Swartz, Jr.	Mayor
Mr. Donald Rehner	Council President
Mr. Richard G. Hill, Jr.	Treasurer/Chief Administrative Officer

This report is a matter of public record and is available online at www.auditorgen.state.pa.us. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 231 Finance Building, Harrisburg, PA 17120; via email to: news@auditorgen.state.pa.us.