

# COMPLIANCE AUDIT

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## Fountain Hill Borough Police Pension Plan Lehigh County, Pennsylvania For the Period January 1, 2011 to December 31, 2013

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March 2015



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  
Fountain Hill Borough  
Lehigh County  
Fountain Hill, PA 18015

We have conducted a compliance audit of the Fountain Hill 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 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 2 plan members who retired during the current audit period and through the completion of our fieldwork procedures, 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 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, 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 the terms of the contractual agreement with the Pennsylvania State Association of Boroughs were in accordance with the plan's governing document, if separately stated, and applicable laws and regulations by comparing the terms of the contractual agreement with the plan's governing document, if separately stated, and applicable laws and regulations.
- We determined whether all annual special ad hoc postretirement reimbursements received by the municipality were authorized and appropriately deposited in accordance with Act 147 by tracing information to supporting documentation maintained by plan officials.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Fountain Hill 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.

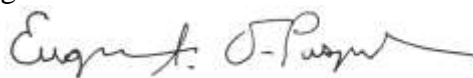
The results of our tests indicated that, in all significant respects, the Fountain Hill Borough Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further discussed later in this report:

Finding – Noncompliance With Prior Audit Recommendation – Incorrect Data  
On Certification Form AG 385 Resulting In An Overpayment Of  
State Aid

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. However, we are extremely concerned about the funded status of the plan contained in the schedule of funding progress included in this report which indicates a decline of assets available to satisfy the long-term liabilities of the plan. **The plan's funded ratio went from 72.3% as of January 1, 2009, to a ratio of 62.7% as of January 1, 2013**, which is the most recent data available. **Based on this information, the Public Employee Retirement Commission issued a notification that the borough is currently in Level II moderate distress status.** We encourage borough officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of Fountain Hill 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.



EUGENE A. DEPASQUALE  
Auditor General

March 5, 2015

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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 Fountain Hill 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 Fountain Hill Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 376, 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 August 5, 1946. Active members were required to contribute 2.5 percent of compensation to the plan. As of December 31, 2013, the plan had 6 active members, no terminated members eligible for vested benefits in the future, and 8 retirees 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     None

Vesting                100% after 12 years of service

### Retirement Benefit:

50% of final 36 months average salary, plus a service increment of \$25 per month for each year of service in excess of 25 years, up to a maximum of \$100 per month.

### 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:

75% of the member's final average salary at time of disability, but no less than 50% of salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

FOUNTAIN HILL BOROUGH POLICE PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

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

- Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

Municipal officials failed to comply with the recommendation in the prior audit report to establish adequate internal control procedures to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data for the police pension plan, as further discussed in the Finding and Recommendation section of this report.



FOUNTAIN HILL BOROUGH POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation - Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid**

Condition: As disclosed in the prior audit report, the borough failed to establish adequate internal control procedures to ensure compliance with the instructions that accompanied Certification Form AG 385, resulting in an underpayment of state aid in 2009. During the current period, the borough again failed to comply with the instructions that accompany Certification Form AG 385. The borough certified 1 ineligible police officer (2 units) and overstated payroll by \$9,757 on the Certification Form AG 385 filed in 2013. The data contained on this certification form is based on prior calendar year information.

Criteria: Pursuant to Act 205, at Section 402(e)(2), in order to be eligible for certification, an employee must have been employed on a full-time basis for at least six consecutive months and must have been participating in a pension plan during the certification year.

Cause: Plan officials have failed to adopt adequate internal control procedures to ensure compliance with this department’s prior audit recommendation.

Effect: The data submitted on this certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the borough’s state aid allocation was based on unit value, the incorrect certification of pension data affected the borough’s state aid allocation, as identified below:

<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2	\$3,884	\$ 7,768

In addition, the borough used the overpayment of state aid to pay the minimum municipal obligation (MMO) due to the police pension plan; therefore, if the reimbursement to the Commonwealth is made from the pension plan, the plan’s MMO will not be fully paid.

Recommendation: We recommend that the total excess state aid, in the amount of \$7,768, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 320 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

FOUNTAIN HILL BOROUGH POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

We also recommend that in the future, plan officials establish adequate internal control procedures, such as having at least 2 people review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

In addition, if the reimbursement to the Commonwealth is made from police pension plan funds, we recommend that any resulting MMO deficiency be paid to the pension plan with interest, at a rate earned by the pension plan.

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

Auditor's Conclusion: Compliance will be monitored subsequent to the release of the audit report and through our next audit of the pension plan.

FOUNTAIN HILL 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 Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Liability as a % of Payroll [(b-a)/(c)]
01-01-09	\$ 1,961,543	\$ 2,712,910	\$ 751,367	72.3%	\$ 556,555	135.0%
01-01-11	2,070,827	3,283,144	1,212,317	63.1%	643,160	188.5%
01-01-13	2,223,776	3,546,792	1,323,016	62.7%	598,685	221.0%

Note: The market values of the plan's assets at 01-01-09, 01-01-11, and 01-01-13 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period which will be limited to a maximum of 120 percent and a minimum of 80 percent of the fair market value of assets. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

FOUNTAIN HILL 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.

FOUNTAIN HILL 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	\$ 125,120	100.0%
2009	161,164	100.0%
2010	167,988	100.0%
2011	183,491	100.0%
2012	221,357	100.0%
2013	213,908	100.0%

FOUNTAIN HILL 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	Level dollar
Remaining amortization period	16 years
Asset valuation method	4-year smoothing and the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair value of assets.
Actuarial assumptions:	
Investment rate of return	7.25%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0%

FOUNTAIN HILL BOROUGH POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf  
Governor  
Commonwealth of Pennsylvania

Fountain Hill Borough Police Pension Plan  
Lehigh County  
941 Long Street  
Fountain Hill, PA 18015

The Honorable Jose Rosado	Mayor
Mr. Lawrence Rapp	Council President
Ms. Sook Lee Choi	Finance Director

This report is a matter of public record and is available online at [www.PaAuditor.gov](http://www.PaAuditor.gov). 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](mailto:news@auditorgen.state.pa.us).