

# COMPLIANCE AUDIT

---

## Cheltenham Township Police Pension Plan Montgomery County, Pennsylvania For the Period January 1, 2011 to December 31, 2013

---

October 2014



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



Commonwealth of Pennsylvania  
Department of the Auditor General  
Harrisburg, PA 17120-0018  
Facebook: Pennsylvania Auditor General  
Twitter: @PAAuditorGen

**EUGENE A. DePASQUALE**  
**AUDITOR GENERAL**

Board of Township Commissioners  
Cheltenham Township  
Montgomery County  
Elkins Park, PA 19027

We have conducted a compliance audit of the Cheltenham Township 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. 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 the special ad hoc postretirement adjustment granted to eligible pensioners is in accordance with applicable laws and regulations and whether the ad hoc reimbursement received by the municipality was treated in accordance with applicable laws and regulations.
- 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 Deferred Retirement Option Plan (DROP) participants' benefit payments are properly determined in accordance with the provisions of the DROP and any other applicable laws and regulations.

Cheltenham Township contracted with an independent certified public accounting firm for annual audits of its basic financial statements which are available at the township's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Cheltenham Township 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 township's internal controls as they relate to the township'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 Cheltenham Township 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 – Pension Benefits Not In Compliance With Act 600 Provisions

The finding contained in this audit report repeats a condition that was cited in our previous audit report that has not been corrected by township officials. We are concerned by the township's failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation noted in this audit report.

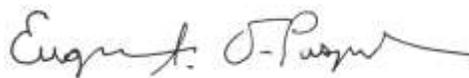
As previously noted, one of the objectives of our audit of the Cheltenham Township Police Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

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. For example, **the plan's funded ratio went from 70.8% as of January 1, 2011, to a ratio of 65.9% as of January 1, 2013**, which is the most recent date available. **Based on this information, the Public Employee Retirement Commission issued a notification that the township is currently in Level II moderate distress status.** We encourage township 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 Cheltenham Township and, where appropriate, their responses have been included in the report

September 18, 2014

  
EUGENE A. DEPASQUALE  
Auditor General

## CONTENTS

	<u>Page</u>
Background.....	1
Status of Prior Finding.....	3
Finding and Recommendation:	
Finding – Noncompliance With Prior Audit Recommendation – Pension Benefits Not In Compliance With Act 600 Provisions .....	4
Supplementary Information .....	7
Report Distribution List .....	11

## 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 Cheltenham Township 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 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1178, No. 177), as amended, 53 Pa.C.S. § 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 Cheltenham Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 911, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers. The plan was established January 1, 1967. Active members are required to contribute 5 percent of salary to the plan. As of December 31, 2013, the plan had 68 active members, no terminated members eligible for vested benefits in the future and 76 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 52 and 25 years of service, but no later than age 60 and 20 years service.
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

### Retirement Benefit:

Benefit equals 50% of average monthly pay based on highest 36 months of last 60 months plus an incremental monthly benefit (maximum \$100) of 2% of average monthly pay times years of service over 25.

### Survivor Benefit:

After Retirement Eligibility: Benefit equal to 100% of pension amount.

### Disability Benefit:

Service Related: Computed at 60% of monthly pay averaged over the highest 36 months out of the final 60 months preceding the occurrence of the disability reduced by any benefits payable from workers' compensation.

Non-Service Related: Computed at 30% of monthly pay averaged over the highest 36 consecutive months out of the final 60 months preceding the occurrence of the disability.

CHELTENHAM TOWNSHIP POLICE PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

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

- Noncompliance With Prior Audit Recommendation – Pension Benefits Not In Compliance With Act 600 Provisions

CHELTENHAM TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation – Pension Benefits Not In Compliance With Act 600 Provisions**

Condition: As disclosed in the prior audit report, the township operates pursuant to a home rule charter prescribed by the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. §2901 et seq. (previously 53 P.S. §1-101 et seq.). Our audit of the police pension plan has revealed that the township has provided benefits to its police officers that are not in compliance with Act 600.

Additionally, Act 600 was amended by Act 30 on April 17, 2002, which made significant changes to the statutorily prescribed benefit structure of police pension plans subject to Act 600. As previously disclosed, municipal officials have not amended the police pension plan’s benefit structure to adopt all of the changes mandated by Act 30. The specific inconsistencies are as follows:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Act 600 (as amended)</u>
Survivor’s benefit	Surviving spouse of a retired officer receives 100% of the pension that officer was receiving at time of death. Benefit is payable until death.	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 or if attending college, under or attaining the age of 23) 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.)
Service-related disability benefit	Computed at 60% of monthly pay averaged over the highest 36 months out of the final 60 months preceding the occurrence of the disability reduced by any benefits payable from workers’ compensation.	The benefit must be in conformity with a uniform scale and fixed by the plan’s governing document at no less than 50% of the member’s salary at the time the disability was incurred, reduced by the amount of Social Security disability benefits received for the same injury.

CHELTENHAM TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Act 600 (as amended)</u>
Normal retirement benefit	Computed at one half of monthly average pay during the highest 36 consecutive months out of the final 60 months of employment.	Monthly benefits other than length of service increments shall be computed at one half the monthly average salary during not more than the last 60 nor less than the last 36 months of employment.
Non-service related disability benefit	Computed at 30% of monthly pay averaged over the highest 36 consecutive months out of the final 60 months preceding the occurrence of the disability.	Not authorized
Normal retirement date	Age 60 with 20 years of service, or age 52 with 25 years of service.	Age 55 with 25 years of service. If actuarially feasible, age 50 with 25 years of service.

Criteria: On January 24, 2001, the Commonwealth Court of Pennsylvania issued its opinion in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee*. Therein, the court held that Section 2962(c)(5) of the Home Rule Charter and Optional Plans Law, 53 Pa.C.S. §2962(c)(5), “clearly precludes home rule municipalities from providing pension benefits different from those prescribed in general law including Act 600.” The court’s holding was in accord with the position taken by this Department since at least January 1995.

Cause: Municipal officials were unable to fully comply with the prior audit recommendation through the collective bargaining process. The township did negotiate benefits in compliance with Act 600 for police officers hired after January 1, 2013, but did not update the plan’s governing document to reflect the updated benefit provisions.

Effect: The provision of unauthorized benefits increases the plan’s pension costs and reduces the amount of funds available for investment purposes or the payment of authorized benefits or administrative expenses. In addition, although the township did not receive excess state aid allocations during the current audit period due to the provision of benefits that are not in compliance with Act 600, it could result in the receipt of excess state aid in the future and increase required municipal contributions to the plan.

CHELTENHAM TOWNSHIP POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Furthermore, 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: The Department acknowledges that its position has changed over the years and that, until *Monroeville*, there was no definitive decision as to whether home rule municipalities were obliged to comply with applicable pension law. The Department seeks, therefore, to implement the decision in as equitable a fashion as possible, while paying necessary deference to the court's ruling. Accordingly, the Department will not penalize a home rule municipality for granting benefits not authorized by Act 600 to existing retirees or to individuals who began full-time employment before January 24, 2001 (the date *Monroeville* was issued). However, the department expects the township to restrict pension benefits to those authorized by Act 600 for all employees who began full-time employment on or after that date.

Special note should be taken that the department's application of *Monroeville* only to employees hired on or after January 24, 2001, does not sanction (1) a municipality's granting excess benefits to existing or future employees when none had been granted as of January 24, 2001, or (2) a municipality's increasing excess benefits for existing or future employees beyond those that had been granted as of that date.

Management's Response: The Township has new management in place and will make every effort to correct the plan's governing document as stated in this finding.

Auditor's Conclusion: We acknowledge the township's efforts to comply with the prior audit finding through the provision of benefits in compliance with Act 600 for police officers hired after January 1, 2013; however, we are concerned the township has not fully complied with the prior audit finding and encourage compliance at the earliest opportunity to do so.

CHELTENHAM TOWNSHIP 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	\$ 22,828,280	\$ 33,330,327	\$ 10,502,047	68.5%	\$ 6,870,605	152.9%
01-01-11	25,852,835	36,503,644	10,650,809	70.8%	6,619,641	160.9%
01-01-13	26,648,089	40,414,016	13,765,927	65.9%	6,670,001	206.4%

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 5-year averaging period. 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.

CHELTENHAM TOWNSHIP 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.

CHELTENHAM TOWNSHIP 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	\$ 1,253,999	100.0%
2009	1,085,881	100.0%
2010	1,089,927	100.0%
2011	1,374,906	100.0%
2012	1,432,827	100.0%
2013	1,896,397	100.0%

CHELTENHAM TOWNSHIP 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	11 years
Asset valuation method	5-year smoothing – the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.0%
Cost-of-living adjustments	None assumed

CHELTENHAM TOWNSHIP POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett  
Governor  
Commonwealth of Pennsylvania

Cheltenham Township Police Pension Plan  
Montgomery County  
8230 Old York Road  
Elkins Park, PA 19027

Mr. Harvey Portner	President, Board of Township Commissioners
Mr. Bryan Havir	Township Manager
Mr. Bruce Rangnow	Director of Fiscal Affairs

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