

COMPLIANCE AUDIT

Norristown Borough Police Pension Plan Montgomery County, Pennsylvania For the Period January 1, 2012 to December 31, 2014

August 2015



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
www.PaAuditor.gov

EUGENE A. DePASQUALE
AUDITOR GENERAL

Borough Council
Norristown Borough
Montgomery County
Norristown, PA 19401

We have conducted a compliance audit of the Norristown Borough Police Pension Plan for the period January 1, 2012 to December 31, 2014. 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 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 also determined whether retirement benefits calculated for the plan member who elected to vest during the current audit period, represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the pension benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined.
- × 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 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.
- × 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.

Norristown Borough contracted with an independent certified public accounting firm for annual audits of the Norristown Borough Police Pension Plan's financial statements 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 Norristown 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 Norristown 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 – Pension Benefits Not In Compliance With Act 600

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.

As previously noted, one of the objectives of our audit of the Norristown Borough 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 **the plan's funded ratio is 57.4% 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 Norristown Borough and, where appropriate, their responses have been included in the report.

July 22, 2015



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 Norristown 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 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 Norristown Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 05-30-2005, 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, 1945. Active members were required to contribute 6 percent of compensation to the plan for the year 2012, 6.5 percent of compensation for the year 2013, and 7 percent of compensation for the year 2014. As of December 31, 2014, the plan had 66 active members, 3 terminated members eligible for vested benefits in the future, and 79 retirees receiving pension benefits from plan assets.

BACKGROUND – (Continued)

As of December 31, 2014, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 25 years of service
Early Retirement	Age 45 and 15 years of service
Vesting	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 \$25 per month for each year of service in excess of 25 years. For officers who retired under the window (12/31/94- 12/31/95), the benefit was 65% of final average salary.

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:

Severe: Benefit equals 100% of final average salary
Moderate: Benefit equals 50% of final average salary

NORRISTOWN BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

Norristown Borough has partially complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Pension Benefits Not In Compliance With Act 600

During the current audit period, the borough adopted Amendment 2012-1 to the Norristown Borough Police Pension Plan which contains provisions correcting five of the six benefit provisions that were cited in the prior audit report as not being in compliance with Act 600; however, the plan's normal retirement benefit options continue to provide for actuarial equivalent benefits that are not in compliance with Act 600, and conflict with the collective bargaining agreement between the police officers and the borough as further disclosed in Finding No. 1 contained in this report.

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Partial Compliance With Prior Audit Recommendation - Pension Benefits Not In Compliance With Act 600

Condition: As disclosed in the Status of Prior Finding section of this report, the borough partially complied with the prior audit recommendation by adopting Amendment 2012-1 to the Norristown Borough Police Pension Plan which contains provisions correcting five of the six benefit provisions that were cited in the prior audit report as not being in compliance with Act 600. However, as previously disclosed, the borough operates under a home rule charter pursuant to the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2901 et seq. (previously 53 P.S. § 1-101 et seq.) and the plan’s normal retirement benefit options continue to provide for actuarial equivalent benefits that are not in compliance with Act 600, and conflict with the collective bargaining agreement between the police officers and the borough, as noted below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Normal retirement benefit options	A married police officer may elect a joint and 100% survivor annuity instead of a joint and 50% survivor annuity when he retires. That means that the plan will pay benefits in the same equal monthly installments to such a police officer and to his surviving spouse for the duration of their lifetimes. The surviving spouse shall continue to receive this benefit even if she remarries. If no spouse survives, or if she survives and subsequently dies, the child or children under the age of 18 years, or if attending college under or attaining the age of 23 years, shall receive the same benefit. <u>The joint and 100% survivor annuity will be the actuarial equivalent of a fully subsidized joint and 50% survivor annuity.</u> (emphasis added)	Not addressed	Not authorized

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

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.”

Furthermore, Section 5(c) of Act 600, states, in part:

Monthly pension or retirement benefits other than length of service increments shall be computed at one half the monthly average salary of such member during not more than the last sixty nor less than the last thirty-six months of employment.

In addition, Section 1(a)(4) of Act 600 provides that the governing body shall prescribe a survivor’s benefit “calculated at no less than fifty per centum of the pension the member was receiving or would have been receiving had he been retired at the time of his death.”

Cause: Although officials made strides to update the plan’s governing document, officials failed to ensure that all of the provisions in the plan’s governing document were in compliance with Act 600 and consistent among plan documents.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan. In addition, providing actuarial equivalent benefits that are 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.

Providing unauthorized pension benefits could increase the plan’s pension costs and reduce the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Since the borough received state aid based on unit value during the current audit period, it did not receive allocations attributable to the unauthorized pension benefits provided. However, the provision of unauthorized pension benefits could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: The department has determined that it 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 borough 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.

Therefore, we again recommend that municipal officials take appropriate action to eliminate the benefit not authorized by Act 600 for police officers hired on or after January 24, 2001, at their earliest opportunity to do so. Furthermore, such benefits may be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the unauthorized benefits on the borough's future state aid allocations and submit this information to the department.

Management's Response: Officials indicated that the matter regarding the identified finding Pension Benefits Not in Compliance with Act 600 re: Actuarial Equivalence will be presented to the Norristown Police Pension Board.

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

NORRISTOWN 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)
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)
01-01-09	\$ 19,342,849	\$ 29,707,243	\$ 10,364,394	65.1%
01-01-11	21,549,200	31,749,111	10,199,911	67.9%
01-01-13	20,249,399	35,302,532	15,053,133	57.4%

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 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.

NORRISTOWN 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.

NORRISTOWN 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
2009	\$ 561,254	100.0%
2010	629,124	100.0%
2011	1,342,405	100.0%
2012	1,294,190	100.0%
2013	1,567,645	100.0%
2014	1,580,660	100.0%

NORRISTOWN 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, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	8.25%
Projected salary increases	5.25%
Cost-of-living adjustments	The lifetime maximum COLA is 5% of final average salary.

NORRISTOWN BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Norristown Borough Police Pension Plan
Montgomery County
235 East Airy Street
Norristown, PA 19401

Ms. Linda Christian	Council President
Mr. Crandall Jones	Borough Manager
Ms. Chenora Burkett	Finance Director

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