

COMPLIANCE AUDIT

South Fayette Township Police Pension Plan Allegheny County, Pennsylvania For the Period January 1, 2013 to December 31, 2014

August 2015



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DEPASQUALE
AUDITOR GENERAL

Board of Township Commissioners
South Fayette Township
Allegheny County
Morgan, PA 15064

We have conducted a compliance audit of the South Fayette Township Police Pension Plan for the period January 1, 2013 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 that there were no benefit calculations prepared for the years covered by our audit period.
- × 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 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.

South Fayette 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 South Fayette 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 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 South Fayette 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 – Unauthorized Expenditure From Pension Plan Assets

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 South Fayette Township and, where appropriate, their responses have been included in the report. We would like to thank township officials for the cooperation extended to us during the conduct of the audit.

August 12, 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 South Fayette 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 761 et seq.

The South Fayette Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2 of 2010, 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, 1958. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2014, the plan had 12 active members, no terminated members eligible for vested benefits in the future, and 12 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

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

Eligibility Requirements:

Normal Retirement	Age 55 and 25 years of service.
Early Retirement	None
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 \$25 per month for each year of service in excess of 25 years, up to a maximum of \$400 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:

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

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

South Fayette Township has complied with the prior audit recommendation concerning the following:

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

The township reimbursed \$12,881 to the Commonwealth for the overpayment of state aid received in 2013. The township also accurately reported the required pension data on the Certification Forms AG 385 submitted for the years 2014 and 2015.

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Unauthorized Expenditure From Pension Plan Assets

Condition: South Fayette Township maintains a police pension plan governed by the provisions of Act 600, as amended. Prior to the adoption of Act 51 of 2009, Act 600 contained a mandatory killed in service benefit provision; however, Act 51 specifically repealed the section of Act 600 that referenced the mandatory killed in service benefit. The township amended the police pension plan with Ordinance No. 2 of 2010, effective January 1, 2010, to eliminate the killed-in-service benefit in accordance with Act 51 of 2009. However, the township has maintained a killed in service insurance policy and during 2013 and 2014, the pension plan paid insurance premiums in the amount of \$15,384, which are now considered unauthorized expenditures under Act 600.

Criteria: Section 1(a) of Act 51 of 2009 states, in part:

In the event a law enforcement officer, ambulance service or rescue squad member, firefighter, certified hazardous material response team member or National Guard member dies as a result of the performance of his duties, such political subdivision, Commonwealth agency or, in the case of National Guard members, the Adjutant General, or, in the case of a member of a Commonwealth law enforcement agency, the authorized survivor or the agency head, within 90 days from the date of death, shall submit certification of such death to the Commonwealth.

In addition, Section 1(d) of Act 51 of 2009 states, in part:

. . . the Commonwealth shall, from moneys payable out of the General Fund, pay to the surviving spouse or, if there is no surviving spouse, to the minor children of the paid firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty the sum of \$100,000, adjusted in accordance with subsection (f) of this section, and an amount equal to the monthly salary, adjusted in accordance with subsection (f) of this section, of the deceased paid firefighter, ambulance service or rescue squad member or law enforcement officer, less any workers' compensation or pension or retirement benefits paid to such survivors, and shall continue such monthly payments until there is no eligible beneficiary to receive them. For the purpose of this subsection, the term "eligible beneficiary" means the surviving spouse or the child or children under the age of eighteen years or, if attending college, under the age of twenty-three years, of the firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty. When no spouse or minor children survive, a single sum of \$100,000, adjusted in accordance with subsection (f) of this section, shall be paid to the parent or parents of such firefighter, ambulance service member, rescue squad member or law enforcement officer. (Emphasis added)

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Therefore, since Act 51 specifically repealed the killed in service provision of Act 600 and the funding provisions for the killed in service benefit that were contained in Act 205, neither the provision of a killed in service benefit nor the insurance premiums paid are considered authorized.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the plan did not pay unauthorized insurance premiums.

Effect: The funds used to pay for killed-in-service insurance premiums were not available to pay operating expenses or for investment purposes.

Recommendation: We recommend that the municipality review the maintenance of the killed in service policy with its solicitor and ensure no future premiums are paid from the plan. In addition, we recommend that the municipality refund the \$15,384 in unauthorized killed-in-service insurance premiums to the pension plan, with interest compounded annually at a rate earned by the pension plan, and discontinue paying the killed-in-service insurance premiums from the plan.

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

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

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CHANGES IN THE NET PENSION
 LIABILITY AND RELATED RATIOS

Total Pension Liability	
Service cost	\$ 200,338
Benefit payments and refunds	(378,741)
Interest	684,399
	505,996
Net Changes in Total Pension Liability	
Total Pension Liability – Beginning	9,110,928
Total Pension Liability – Ending (a)	\$ 9,616,924
Plan Fiduciary Net Position	
Contributions – employer	\$ 474,992
Contributions – member	60,299
Net investment income	439,329
Benefit payments, and refunds	(378,741)
Administrative expenses	(70,191)
Killed in service insurance premiums	(7,850)
	517,838
Net Changes in Plan Fiduciary Net Position	
Plan Fiduciary Net Position - Beginning	7,554,979
Plan Fiduciary Net Position – Ending (b)	\$ 8,072,817
Net Position Liability – Ending (a)-(b)	\$ 1,544,107
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	83.9%
Estimated Covered Employee Payroll	\$ 1,193,858
Net Position Liability as a Percentage of Covered Employee Payroll	129.3%

SOUTH FAYETTE TOWNSHIP 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 plan, calculated using the discount rate of 7.5%, as well as what the plan'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 (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
	<hr/>	<hr/>	<hr/>
Plan's Net Pension Liability	\$ 2,687,645	\$ 1,544,107	\$ 582,934

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

Year Ended December 31	(a) Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess)	(b) Covered-Employee Payroll	Contributions as a Percentage of Covered- employee Payroll
2007	\$ 243,429	\$ 243,429	\$ -		
2008	232,738	234,879	(2,141)	\$ 1,372,835	17.1%
2009	286,216	288,821	(2,065)		
2010	307,433	307,433	-	1,375,398	22.3%
2011	359,612	321,370	38,242		
2012	376,847	338,605	38,242	1,066,515	31.7%
2013	413,128	413,128	-		
2014	474,992	474,992	-	1,193,858	39.8%

(a) – Equal to the Minimum Municipal Obligation (MMO) under Act 205 of 1984.

(b) – Estimate of projected W-2 payroll for the preceding year as shown on the MMO calculation.

For 2011 and 2012, the contribution deficiency reflects the 25 percent reduction to the plan's amortization contribution elected by the municipality under Act 44, which allows for such reduction.

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF ESTIMATED RATES OF RETURN
ON PENSION PLAN INVESTMENTS

<u>Year</u>	<u>Estimated Annual Return, Net of Investment Expenses</u>
2014	5.56%

SOUTH FAYETTE 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)
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	\$ 5,181,875	\$ 6,570,619	\$ 1,388,744	78.9%
01-01-11	5,833,854	7,978,091	2,144,237	73.1%
01-01-13	6,472,880	8,507,827	2,034,947	76.1%

Note: The market values of the plan's assets at 01-01-09, 01-01-11 and 01-01-13 has been adjusted to reflect the smoothing of gains and/or losses over a 4-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.

SOUTH FAYETTE 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.

SOUTH FAYETTE TOWNSHIP 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, closed
Remaining amortization period	11 years aggregate
Asset valuation method	Fair value, 4-year smoothing
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases *	5.5%

* Includes inflation at 3.0%

SOUTH FAYETTE TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

South Fayette Township Police Pension Plan
Allegheny County
515 Millers Run Road
Morgan, PA 15064

Mr. Joseph D. Horowitz	President, Board of Township Commissioners
Mr. Ryan T. Eggleston	Township Manager
Ms. Nancy A. Degenhardt	Director of Finance

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