

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN

WASHINGTON COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2005, TO DECEMBER 31, 2007



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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.

Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign 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 Fallowfield 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 Fallowfield Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 142, 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.



Board of Township Supervisors
Fallowfield Township
Washington County
Charleroi, PA 15022

We have conducted a compliance audit of the Fallowfield Township Police Pension Plan for the period January 1, 2005, to December 31, 2007. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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. Fallowfield Township contracted with an independent certified public accounting firm for annual audits of its primary government 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 an internal control structure to provide reasonable assurance that the Fallowfield Township Police Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. To assist us in planning and performing our audit, we obtained an understanding of the township's internal control structure as it relates to the township's compliance with those requirements. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the Fallowfield 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 findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Cash Surrender Insurance Policy At Retirement

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information and, accordingly, express no form of assurance on it.

The contents of this report were discussed with officials of Fallowfield Township and, where appropriate, their responses have been included in the report.

August 14, 2008

JACK WAGNER
Auditor General

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Fallowfield Township has not complied with the prior audit recommendation concerning the following as further discussed in the Findings and Recommendations section of this report:

- Failure To Cash Surrender Insurance Policy At Retirement

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Cash
Surrender Insurance Policy At Retirement

Condition: As disclosed in our prior audit report, as of December 31, 2002, the plan held an endowment policy for an officer, which was purchased prior to January 1, 1986. On January 15, 2003, this policy was surrendered by the township and the proceeds were used to purchase a flexible premium adjustable life insurance policy on the same officer. On February 21, 2003, the officer retired and began receiving a monthly pension benefit of 50 percent of his final average salary in accordance with Act 600. However, the plan still holds the flexible premium adjustable life insurance policy in the name of the retired officer, with the officer’s spouse as the primary beneficiary.

Criteria: Section 5 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 member during not more than the last sixty nor less than the last thirty-six months of employment...

Also, the Commonwealth Court case Fedor v. Borough of Dormont et al., 36 Pa. Commonwealth. 449, 389 A.2d 217 (1978), affirmed 487 Pa. 249, 402 A.2d 334, upholds the position that Act 600 funds are to be used only to provide pensions for plan members, as follows:

Nothing in Section 1 of the Act of May 29, 1956 as it was originally enacted or in its amended version after 1970, suggests that the funds may be used otherwise than for the provision of pensions or annuities. No benefit other than by means of pension is mentioned in either the original or the amended version of the act. The word pension is defined by all dictionaries and is commonly used, to mean a fixed sum paid regularly to a person. We are therefore constrained to agree with the Auditor General and the Deputy Attorney General who advised him, that the expenditure of monies of a police pension plan created under the Act of May 29, 1956 for the purchase of a single payment life insurance policy to provide a death benefit for the participant would be improper.

Furthermore, Section 102 of Act 205 states, in part:

“Pension Fund.” The entity which is the repository for the assets amassed by a pension plan as reserves for the present and future periodic retirement payments and benefits of active and retired members of the pension plan.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

The primary purpose of life insurance is to provide death benefits – not periodic retirement benefits. Therefore, pension plans are not authorized to purchase or pay premiums for life insurance, except as noted below.

The Department of the Auditor General has issued several bulletins providing guidance regarding the purchase of life insurance by municipal pension plans. In 1985, Auditor General Municipal Pension Bulletin No. 2-85, “Purchase of Life Insurance for Municipal Pension Plans,” was issued. This bulletin disallowed any further purchase of life insurance with pension funds after January 1, 1986, but did allow the continuance of existing policies. Subsequently, in 1988, Auditor General Municipal Pension Bulletin No. 6-88, “Purchase of Insurance Coverage,” was issued and restated this position, by stating, in part:

Because the primary purpose of these policies is to fund death benefits rather than periodic retirement benefits, general municipal pension system state aid cannot be used to pay life insurance.

In 2003, following the passage of Act 30 of 2002, which amended Act 600 by mandating, among other things, that “pensions for families of members killed in service shall be calculated at one hundred per centum of the member’s salary at the time of death,” Auditor General Municipal Pension Bulletin No. 2003-01, “Purchase of Insurance Coverage,” was issued as a supplement to Bulletin No. 6-88 and stated, in part:

Criteria for Purchasing insurance Coverage – The principle underlying Bulletin No. 6–88 is that insurance coverage purchased for members of a pension plan and payable in a lump sum to the members’ survivors do not provide retirement benefits within the meaning of Act 205. However, policies that are carefully written (1) to cover only the liability associated with providing periodic lifetime benefits under Act 600 for a service-related death and (2) to be payable to the pension plan as beneficiary would not conflict with this principle. Municipalities that wish to insure against the risk presented by section 5(e)(2) of Act 600 should use these criteria to evaluate the acceptability of particular policies.

Therefore, when township officials cash surrendered the endowment policy on January 15, 2003, the proceeds should have been deposited into the police pension plan and used to fund the retired officer’s monthly retirement benefit.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Cause: Township officials have failed to adopt adequate internal control procedures to ensure compliance with the prior audit recommendation.

Effect: Because the retired officer is receiving a monthly pension benefit from the plan in accordance with Act 600, the continuation of the flexible premium adjustable life insurance policy could result in the receipt of additional benefits in excess of those authorized by Act 600. Also, the cash surrender value of the policy is not available to pay authorized plan expenses or for investment purposes.

Recommendation: We again recommend that the township cash surrender the flexible premium adjustable life insurance policy held for the retired police officer and deposit the proceeds into the police pension plan. We also recommend that no new life insurance policies be purchased with pension plan assets, unless the policies conform to the restrictions on such purchases outlined in Municipal Pension Bulletin No. 2003-01.

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

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The township overstated the total payroll of its police officers by \$1,664 in 2007 on Certification Form AG 385.

Criteria: Pursuant to the instructions that accompany Certification Form AG 385, the total payroll eligible to be certified should be Internal Revenue Service Form W-2 earnings pertaining to full-time positions.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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. Since the township’s state aid allocation was based on pension costs, the effect of the incorrect certification of pension data on the township’s state aid allocation is identified below:

<u>Normal Cost</u>	<u>Payroll Overstated</u>	<u>State Aid Overpayment</u>
27.54001%	\$ 1,664	\$ 458

Recommendation: We recommend that the overpayment of state aid, in the amount of \$458, 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, 1205 Pittsburgh State Office Building, 300 Liberty Avenue, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with the check.

We also recommend that, in the future, plan officials implement adequate internal control procedures to ensure the accuracy of the information reported on Certification Form AG 385.

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

FALLOWFIELD 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, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2003, 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)]
01-01-03	\$ 765,051	\$ 681,667	\$ (83,384)	112.2%	\$ 138,305	(60.3%)
01-01-05	998,311	717,240	(281,071)	139.2%	138,021	(203.6%)
01-01-07	1,307,922	798,080	(509,842)	163.9%	87,689	(581.4%)

The amounts in the above table at 01-01-03 and 01-01-05 have been adjusted, as appropriate, for insurance/annuity contracts maintained preretirement to fund a portion of the benefits provided by the pension plan at retirement.

FALLOWFIELD 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. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

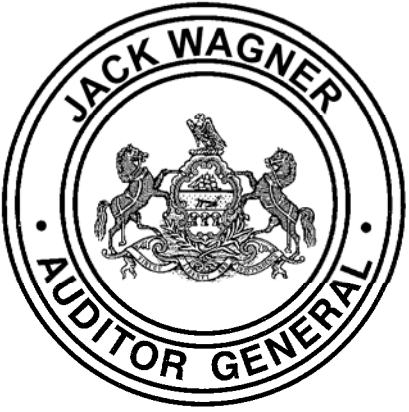
SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
 AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2002	None	N/A
2003	\$ 1,187	283.3%
2004	14,328	1004.8%
2005	22,105	100.0%
2006	9,647	100.0%
2007	None	N/A

FALLOWFIELD 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, 2007
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	6.0%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0%



FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Fallowfield Township Police Pension Plan
Washington County
9 Memorial Drive
Charleroi, PA 15022

Mr. Herman L. Pennline Chairman, Board of Township Supervisors

Ms. Bonnie Mraz Secretary

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.