

MIDDLETOWN BOROUGH POLICE PENSION PLAN

DAUPHIN COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2007, TO DECEMBER 31, 2008



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ABBREVIATION

PERC - Public Employee Retirement Commission

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 Middletown 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 Middletown Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1210, 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 Honorable Mayor and Borough Council
Middletown Borough
Dauphin County
Middletown, PA 17057

We have conducted a compliance audit of the Middletown Borough Police Pension Plan for the period January 1, 2007, to December 31, 2008. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

The objective of the audit was 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 objective identified above. Middletown Borough contracted with an independent certified public accounting firm for annual audits of its basic 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 Middletown 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 objective, 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 the extent necessary to satisfy the audit objective.

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

Finding No. 1 – Plan’s Governing Document Contains An Unauthorized Nonservice-Related Disability Benefit Provision

Finding No. 2 – Incorrect Data Supplied To Actuary For Actuarial Valuation Report Preparation

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 Middletown Borough and, where appropriate, their responses have been included in the report.

February 12, 2010

JACK WAGNER
Auditor General

MIDDLETOWN BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Plan’s Governing Document Contains An Unauthorized Nonservice-Related Disability Benefit Provision

Condition: The pension plan’s governing document, Ordinance No. 1210, which adopts a separately executed agreement with the plan’s custodian, inappropriately contains a provision for the payment of a nonservice-related disability benefit. This provision is not authorized by Act 600.

Criteria: Regarding disability benefits, Section 5(e)(1) of Act 600 states:

In the case of the payment of pensions for permanent injuries incurred in service, the amount and commencement of the payments shall be fixed by regulations of the governing body of the borough, town, township or regional police department and shall be calculated at a rate no less than fifty per centum of the member’s salary at the time the disability was incurred, provided that any member who receives benefits for the same injuries under the Social Security Act (49 Stat. 620, 42 U.S.C. § 301 et. seq.) shall have his disability benefits offset or reduced by the amount of such benefits. (Emphasis added)

Furthermore, the Supreme Court of Pennsylvania in *Chirico v. Board of Supervisors for Newtown Township*, 518 Pa. 572, 544A.2d 1313 (1988) held that Act 600 does not provide for the payment of pension benefits for non-service related injuries.

Cause: Plan officials failed to establish adequate internal control procedures to ensure that only benefit provisions that are authorized by Act 600 are contained in the plan’s governing document.

Effect: This benefit is only available to police officers hired prior to January 22, 1998. While no plan members are currently receiving this benefit, 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 and could increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

Recommendation: We recommend that the borough ensure the police pension plan’s benefit provisions are in compliance with Act 600 at its earliest opportunity to do so.

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

MIDDLETOWN BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – Incorrect Data Supplied To Actuary For Actuarial Valuation Report Preparation

Condition: Actuarial valuation report forms 201-C, with valuation dates of January 1, 2007, and January 1, 2009, submitted to the Public Employee Retirement Commission (PERC), failed to include an early retirement benefit provision that was enacted on July 7, 2006.

Criteria: Section 201(d) of Act 205 states:

Responsibility for preparation and filing of reports and investigations. The actuarial valuation report or experience investigation required pursuant to subsection (a) shall be prepared under the supervision and at the discretion of the chief administrative officer of the municipality, who shall be responsible for the filing of the document. The actuarial valuation report or experience investigation shall be signed by the chief administrative officer, indicating that to the extent of the understanding and knowledge of the officer, the report or investigation represents a true and accurate portrayal of the actuarial, financial and demographic condition of the pension plan of the municipality.

Cause: The discrepancy in the data submitted to the plan's actuary occurred because plan officials did not verify that the information was consistent with the plan's governing document.

Effect: Because the municipality's state aid allocation is determined, in part, by the information contained in the actuarial valuation report, the submission of incorrect data to the actuary may have resulted in the municipality receiving an incorrect allocation of state aid.

In addition, the information contained in the actuarial valuation report is used to determine the municipality's minimum municipal obligation (MMO); therefore, the incorrect data may have resulted in an erroneous MMO calculation.

Recommendation: We recommend that plan officials contact PERC to determine if a revised January 1, 2009, actuarial valuation report needs to be filed. If a revised report is prepared and accepted by PERC, a copy should be submitted to: Department of the Auditor General, Bureau of Municipal Pension Audits, 406 Finance Building, Harrisburg, PA 17120.

We also recommend that, in the future, plan officials review and verify all information submitted to and received from the plan's actuary so that future actuarial valuation reports properly reflect the status of the pension plan.

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

MIDDLETOWN 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, 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	\$ 2,738,039	\$ 3,155,967	\$ 417,928	86.8%	\$ 861,754	48.5%
01-01-05	3,315,532	3,790,705	475,173	87.5%	963,001	49.3%
01-01-07	3,753,302	4,293,415	540,113	87.4%	1,116,854	48.4%

The amounts in the above table valued 1-01-03, have been adjusted, as appropriate, for insurance contracts maintained preretirement to fund a portion of the benefits provided by the pension plan at retirement.

Note: The market values of the plan's assets at 01-01-03, 01-01-05 and 01-01-07, 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.

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

MIDDLETOWN 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
2003	\$ 117,814	100.0%
2004	121,387	138.8%
2005	194,866	100.0%
2006	201,691	100.0%
2007	209,458	100.0%
2008	213,823	100.0%

MIDDLETOWN 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, 2007
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	20 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return *	7.75%
Projected salary increases *	5.0%
* Includes inflation at	Not disclosed
Cost-of-living adjustments	None assumed

MIDDLETOWN BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Middletown Borough Police Pension Plan
Dauphin County
60 West Emaus Street
Middletown, PA 17057

The Honorable Robert Reid	Mayor
Mr. Rodney Horton	Council President
Mr. Richard Grove	Finance Director

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.