

NORRISTOWN BOROUGH POLICE PENSION PLAN

MONTGOMERY COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2008, TO DECEMBER 31, 2009



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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 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.



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, 2008, to December 31, 2009. 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 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. 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, 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 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 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. However, we are extremely concerned about the historical trend information 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 101.2% as of January 1, 2005, to a ratio of 65.1% as of January 1, 2009, which is the most recent date available. 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.

September 13, 2010

JACK WAGNER
Auditor General

NORRISTOWN BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Norristown Borough has not 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

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

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

Condition: As disclosed in the prior audit report, 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.). The police pension plan’s governing document contains benefit provisions that conflict with the collective bargaining agreement between the police officers and the borough and are not in compliance with Act 600, as noted below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Service increment	A police officer receiving a normal retirement benefit shall have the monthly benefit increased by \$25 for each full year of service over 25 years. <i>(No maximum threshold stated)</i>	Not addressed	Any borough ... may establish and pay length of service increments for years of service beyond 25 years for each completed year of service in excess of 25 years, not to exceed \$100 per month for each completed year of service in excess of 25 years up to a maximum of \$500 per month after 5 completed years of service in excess of 25 years.
Nonservice-related disability	An officer who becomes totally and permanently disabled as a result of a non-service-connected disability shall be entitled to receive a monthly benefit equal to 30% of final average salary.	An officer who becomes totally and permanently disabled as a result of a non-service-connected disability shall be entitled to receive a monthly benefit equal to 30% of final average salary.	Not authorized

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Early retirement	Available at age 45 with 15 years of service. Benefit shall be calculated the same as a vested pension and shall be actuarially reduced to reflect the early retirement date.	Not addressed	The ordinance or resolution establishing the police pension fund may provide for an early retirement benefit. The early retirement benefit shall be provided to a member of the police force with twenty or more years of service who terminates employment prior to the completion of superannuation retirement age and service requirements. The benefit shall be the actuarial equivalent of a partial superannuation retirement benefit.
Actuarial equivalents	The normal form of benefit is a single life annuity payable in monthly installments. A married officer has the right to elect the following actuarially equivalent forms: 10 year guaranteed benefit, joint and 50% survivor annuity, joint and 100% survivor annuity.	Not addressed	Not authorized

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Benefit Provision	Governing Document	Collective Bargaining Agreement	Act 600 (as amended)
Non-intervening military service credit	An officer may purchase up to 2 years of service for time spent in the military before becoming a police officer. The buyback amount equals 5% of the officer's current base salary for each year purchased. Payment is made at retirement.	Not addressed	...may provide full service credit for each year of military service or fraction thereof, not to exceed five years, to any member of the police force who was not employed by the political subdivision or regional police department prior to such military service. The amount due for the purchase of credit for military service other than intervening military service shall be computed by applying the average normal cost rate for borough, town, township and regional police pension plans as certified by the Public Employee Retirement Commission, but not to exceed ten per centum, to the member's average annual rate of compensation over the first three years of municipal service and multiplying the result by the number of years and fractional part of a year of creditable nonintervening military service being purchased together with interest at the rate of four and three-quarters per centum compounded annually from the date of initial entry into municipal service to the date of payment.

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Member contributions	Each officer shall make an employee contribution of 5% of salary. Officers with at least 25 years of service shall have their contributions capped at 2.5% of salary.	Not addressed	Members shall pay into the fund, monthly, an amount equal to not less than 5% nor more than 8% of monthly compensation, if not covered by Social Security. The governing body of the municipality may, on an annual basis, by ordinance or resolution, reduce or eliminate payments into the fund by members.

Criteria: A governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. In addition, 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.”

Cause: Municipal officials have failed to effect compliance with the prior audit recommendation through the collective bargaining process.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan. In addition, 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.

Providing unauthorized pension benefits increases the plan’s pension costs and reduces 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 excess pension benefits provided. However, the increased costs to the pension plan as a result of the excess 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.

We recommend that municipal officials take appropriate action to eliminate any benefits 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 will 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 excess benefits on the plan's future state aid allocations and submit this information to the department. To the extent that the borough has failed to provide benefits to its police officers which are mandated by Act 600, as amended, we recommend that municipal officials take appropriate action to adopt such benefits at their earliest opportunity to do so.

Management's Response: Municipal officials indicated that these benefits are the products of longstanding collective bargaining between the municipality and the Fraternal Order of Police. The Board of Trustees therefore will refer this finding to the bargaining parties for their review and appropriate action.

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, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2005, 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)]
01-01-05	\$ 25,677,301	\$ 25,377,540	\$ (299,761)	101.2%	\$ 4,629,052	(6.5%)
01-01-07	25,522,825	26,802,381	1,279,556	95.2%	5,294,164	24.2%
01-01-09	19,342,849	29,707,243	10,364,394	65.1%	5,683,212	182.4%

Note: The market values of the plan's assets at 01-01-05, 01-01-07 and 01-01-09, 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.

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.

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
2004	\$ 304,972	100.0%
2005	323,393	100.0%
2006	278,282	100.0%
2007	297,879	100.0%
2008	341,860	100.0%
2009	561,254	100.0%

NORRISTOWN 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, 2009
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	16 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return *	8.25%
Projected salary increases *	5.5%
* Includes inflation at	3.5%
Cost-of-living adjustments	5.0% of final average salary

NORRISTOWN BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

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

Mr. William Caldwell	Council President
Mr. David Forrest	Borough Manager
Mr. Richard Zawisza	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.