



PENN TOWNSHIP POLICE PENSION PLAN

YORK COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2010, TO DECEMBER 31, 2012

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL



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EUGENE A. DePASQUALE
AUDITOR GENERAL

Board of Township Commissioners
Penn Township
York County
Hanover, PA 17331

We have conducted a compliance audit of the Penn Township Police Pension Plan for the period January 1, 2010, to December 31, 2012. 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. Our methodology addressed determinations about the following:

- Whether state aid was properly determined and deposited in accordance with Act 205 requirements.
- Whether employer contributions are determined and deposited in accordance with the plan's governing document and applicable laws and regulations.
- Whether employee contributions are required and, if so, are determined, deducted and deposited into the pension plan and are in accordance with the plan provisions and applicable laws and regulations.

- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.
- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and 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.
- Whether the terms of the unallocated insurance contract, including ownership and any restrictions, are in compliance with plan provisions, investment policies and state regulations.
- Whether benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.

Penn Township contracted with an independent certified public accounting firm for annual audits of its financial statements prepared in conformity with the accounting practices prescribed or permitted by the Department of Community and Economic Development of the Commonwealth of Pennsylvania, 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 Penn 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, 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 tests indicated that, in all significant respects, the Penn 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 – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

As previously noted, one of the objectives of our audit of the Penn Township 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 historical trend information contained in the schedule of funding progress included in this report which indicates a continued decline of assets available to satisfy the long-term liabilities of the plan. For example, the plan's funded ratio went from 92.9% as of January 1, 2007, **to a ratio of 61.5% as of January 1, 2011**, which is the most recent date available. Based on this information, the Public Employee Retirement Commission issued a notification that the township is currently in Level II moderate distress status. We encourage township 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 Penn 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.



JOHN M. LORI
Deputy Auditor General for Audits

July 23, 2013

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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 Penn 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 Penn Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 465, as amended, adopted pursuant to Act 600 and a separately executed plan agreement with the plan's custodian. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers. As of December 31, 2012, the plan had 22 active members and 12 retirees receiving pension benefits.

PENN TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Audit Recommendation

Penn Township has complied with the prior audit recommendation concerning the following:

- Pension Benefit Not Authorized By The Plan's Governing Document And Act 600

During the current audit period, the township adjusted the retiree's monthly pension benefit to be in accordance with the plan's governing document and Act 600 provisions.

PENN TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding - Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: The municipality did not fully pay the minimum municipal obligation (MMO) that was due to the police pension plan for the year 2011, as required by Act 205. Based upon an estimate prepared by the township, the municipality had an unpaid MMO balance of \$68,373 for the year 2011. The township reduced the budgeted MMO by the amount of employee contributions deposited into the police pension plan during 2011 which is not authorized by Act 205.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year. The minimum obligation of the municipality with respect to the pension plan shall be equal to the financial requirements of the pension plan reduced by the following amounts:

- (1) The amount of any member contributions anticipated as receivable for the following year.
- (2) If the actuarial value of the assets of the pension plan exceed the actuarial accrued liability of the pension plan, an amount equal to one-tenth of the amount by which the actuarial value exceeds the actuarial accrued liability.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

PENN TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Cause: In 2010 when plan officials determined the 2011 MMO due to the plan, there were no anticipated member contributions included in the calculation since member contributions were not being deducted at the time of the MMO determination. Subsequently, member contributions began to be deducted pursuant to the plan agreement and the collective bargaining agreement and the municipality deducted the amount of member contributions made in 2011 from the township's MMO due to the plan.

Effect: The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the 2011 MMO by the December 31, 2011, deadline, the municipality must add the 2011 MMO balance to the current year's MMO and include interest, as required by Act 205.

Recommendation: We recommend that the municipality pay the outstanding MMO due to the police pension plan for the year 2011, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the township for examination during our next audit of the plan.

Management's Response: The township realizes that the modification of a previously approved MMO is not specifically allowed for in Act 205. The township also recognizes, however, that the entire obligation was met within the necessary time frame. Moving forward, the 2012 and 2013 MMOs have been calculated correctly and the plan has received the exact amount of revenue required by statute. The township considers this to be a non-issue.

Auditor's Conclusion: When the municipality determined the 2011 MMO due to the plan, they correctly assumed that no member contributions were to be made since member contributions were not being deducted at the time of the MMO determination. Act 205 does not contain any provisions that would enable a municipality to subsequently adjust a previously determined MMO based on updated information; therefore, the finding and recommendation remain as stated.

PENN 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, 2007, 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)]
01-01-07	\$ 5,850,427	\$ 6,295,157	\$ 444,730	92.9%	\$ 1,308,661	34.0%
01-01-09	5,234,830	7,853,632	2,618,802	66.6%	1,298,391	201.7%
01-01-11	5,648,205	9,189,122	3,540,917	61.5%	1,607,556	220.3%

Note: The market values of the plan's assets at 01-01-07, 01-01-09 and 01-01-11, have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period subject to a corridor between 70 to 130 percent of the market value of assets. 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.

PENN 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. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

PENN 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
2007	\$ 156,629	100.0%
2008	250,574	100.0%
2009	236,310	100.0%
2010	474,533	100.0%
2011	495,892	86.2%
2012	633,179	100.0%

PENN 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, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 years
Asset valuation method	4-year smoothing, subject to a corridor between 70-130% of market value
Actuarial assumptions:	
Investment rate of return *	7.0%
Projected salary increases *	4.5%
Cost-of-living adjustments	3.0%

* Includes inflation at 2.25%

PENN TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Penn Township Police Pension Plan
York County
20 Wayne Avenue
Hanover, PA 17331

Mr. Wendell Felix	Chairman, Board of Township Commissioners
Mr. Jeffrey R. Garvick	Township Manager
Ms. Kristina J. Rodgers	Township Secretary

This report is a matter of public record and is available online at www.auditorgen.state.pa.us. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 231 Finance Building, Harrisburg, PA 17120; via email to: news@auditorgen.state.pa.us.