

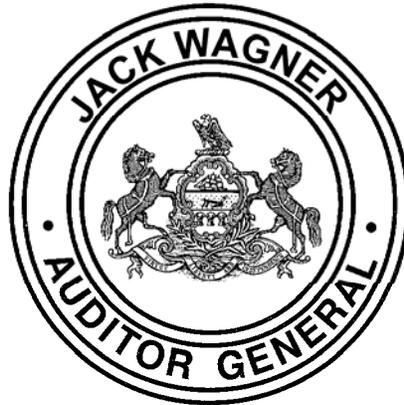
UPPER MERION TOWNSHIP POLICE PENSION PLAN

MONTGOMERY COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2004, TO DECEMBER 31, 2006



UPPER MERION TOWNSHIP POLICE PENSION PLAN

MONTGOMERY COUNTY

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BACKGROUND

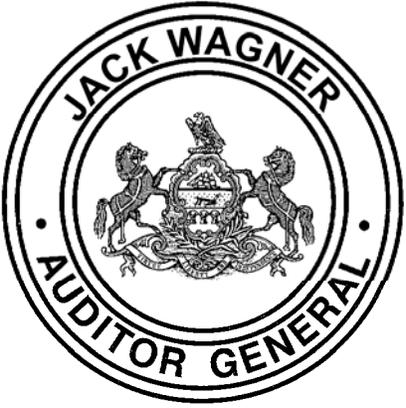
On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, 53 P.S. §895.101, et seq.). The act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to 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 Upper Merion 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. (1955) 1804, No. 600), as amended, 53 P.S. § 767, et seq.

The Upper Merion Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 2003-727, 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
Upper Merion Township
Montgomery County
King of Prussia, PA 19406

We have conducted a compliance audit of the Upper Merion Township Police Pension Plan for the period January 1, 2004, to December 31, 2006. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 of 1984 and in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

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.

The Department of the Auditor General (Department) is mandated by state statute to calculate state aid provided to municipal pension funds and to audit municipal pension funds having received such aid. State aid is calculated by an administrative unit that is not involved in the audit process. The Department's Comptroller Office then pre-audits the calculation and submits requests to the Commonwealth's Treasury Department for the disbursement of state aid to the municipality. The Department has implemented procedures to ensure that Department audit personnel are not directly involved in the calculation and disbursement processes. The Department's mandatory responsibilities are being disclosed in accordance with *Government Auditing Standards*.

Township officials are responsible for establishing and maintaining an internal control structure to provide reasonable assurance that the Upper Merion 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 Upper Merion 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 – Noncompliance With Prior Audit Recommendation – Pension
Benefits Not In Compliance With Act 600 Provisions

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 Upper Merion Township and, where appropriate, their responses have been included in the report.

August 7, 2007

JACK WAGNER
Auditor General

UPPER MERION TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Upper Merion Township 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 Provisions

UPPER MERION TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

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

Condition: As disclosed in the prior audit report, the pension plan’s governing document, Ordinance No. 2003-727, as amended, and the collective bargaining agreement (CBA) contain benefit provisions that are not in compliance with Act 600, as follows:

<u>Benefit Provision</u>	<u>Governing Document/CBA</u>	<u>Act 600 (as amended)</u>
Service-related disability benefit	There is no provision for an offset of Social Security disability benefits received for the same injury.	The benefit must be reduced by the amount of Social Security disability benefits received for the same injury.
Cost of living adjustments	Each January, there shall be a cost of living increase provided to retired members not to exceed the percentage increase in the All Urban Consumers CPI for the Philadelphia Metropolitan Area for the year in which the member last worked. In no case shall the total pension benefit exceed 75% of the salary for computing retirement benefits or the total COLA increases exceed 30%. COLAs shall be calculated on the member’s average applicable compensation and shall apply to all members receiving benefits who have not maximized their COLA benefit. Members shall include all eligible survivors who receive benefits under this plan and those members in the DROP plan.	The ordinance or resolution establishing the police pension fund may provide for a cost of living increase <u>for members of the police force</u> receiving retirement benefits. The cost of living increase shall not exceed the percentage increase in the Consumer Price Index from the year in which the police member last worked, shall not cause the total police pension benefits to exceed seventy-five per centum of the salary for computing retirement benefits and shall not cause the total cost of living increase to exceed thirty per centum. No cost of living increase shall be granted which would impair the actuarial soundness of the pension fund. (Emphasis added)

UPPER MERION TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

<u>Benefit Provision</u>	<u>Governing Document/CBA</u>	<u>Act 600 (as amended)</u>
Definition of compensation	Compensation is defined as all taxable payments from the township and any pre-tax contributions made to an IRC Sec. 457 or 414(n) plan and payments made pursuant to the Heart and Lung Act.	Monthly pension or retirement benefits other than length of service increments shall be computed at one-half the monthly average salary of such member during not more than the last sixty nor less than the last thirty-six months of employment.

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, the police pension plan’s benefit structure should be in compliance with Act 600, as amended.

Although Act 600 does not explicitly state the basis on which cost of living benefits should be calculated, it is the opinion of this department that such increases should be calculated based on a retiree’s benefit amount not the final average salary used in the determination of a retiree’s pension benefit. In addition, survivors are not eligible for cost of living adjustments in Act 600 plans.

Furthermore, although Act 600 does not define “salary,” the department has concluded, based on a line of court opinions, that the term does not encompass lump-sum payments for leave that was not earned during the pension computation period.

Cause: Plan officials have failed to adopt adequate internal control procedures to ensure compliance with the prior audit recommendation. Also, plan officials do not agree with this department’s opinion regarding the definition of compensation and the cost of living adjustments provision.

Effect: As a result of the unauthorized benefit provisions, the plan is paying benefits to 23 retirees and 4 surviving spouses that are in excess of those authorized by Act 600.

Also, 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. In addition, because the municipality’s state aid allocations were based on pension costs, the provisions of unauthorized pension benefits may have resulted in the receipt of excess state aid and could also increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

UPPER MERION TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We again recommend that municipal officials, after consulting with their solicitor, take whatever action is necessary to bring the police pension plan's benefit structure into compliance with Act 600, as amended, at their earliest opportunity to do so.

To the extent that the township has already obligated itself to pay benefits to existing retirees and surviving spouses in excess of those authorized by Act 600, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, such benefits will be deemed ineligible for funding with state pension aid. Therefore, the plan's actuary must determine the impact, if any, of the unauthorized benefits on the plan's state aid allocations received during the audit period and submit this information to the department.

Management's Response: Regarding the service related disability benefits, the township concedes that there is no provision in either the CBA or the governing document for an offset for Social Security disability benefits received for the same injury and will attempt to address this at the next collective bargaining session. Regarding the definition of compensation, the township is relying on the use of its past practice, limits on the maximum amount of leave time that can be accumulated per federal law and the Pennsylvania Supreme Court case in the Borough of Nazareth v. Nazareth Borough Police Association to state that the methodology of including W-2 earnings in retirement calculations is proper and is not in violation of Act 600. Regarding the cost of living adjustment provision, it is the township's position that since Act 600 does not explicitly state the basis on which cost of living benefits should be calculated, that the methodology used in the determination which is based upon a retiree's average monthly compensation rather than monthly pension benefit is appropriate. In addition, Act 600 states, in part, that members receiving retirement benefits may be provided cost of living increases. It is the township's position per the governing document and CBA that all retirees including survivors are members of the pension plan, thus are eligible for cost of living increases.

Auditor's Conclusion: Based on the criteria cited above, it remains the Department's position that only retired police officers, and not surviving spouses are eligible for cost of living adjustments. In addition, it is the Department's position that cost of living adjustments should be determined based on the retiree's monthly pension benefit amount, not the amount of the final average salary used in the pension benefit determination. Furthermore, the department has concluded that compensation for pension benefit determinations should not include lump-sum payments for leave that was not earned during the pension computation period. Therefore, the finding and recommendation remain as stated.

UPPER MERION 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, 2001, is as follows:

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Liability as a % of Payroll [(b-a)/(c)]
01-01-01	\$29,962,994	\$18,462,605	\$ (11,500,389)	162.3%	\$ 3,689,524	(311.7%)
01-01-03	31,000,359	25,954,887	(5,045,472)	119.4%	4,316,081	(116.9%)
01-01-05	32,750,945	28,360,383	(4,390,562)	115.5%	4,411,387	(99.5%)

Note: The market value of the plan's assets at 01-01-03 has been adjusted to reflect the smoothing of gains and/or losses over a 3-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.

UPPER MERION 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.

UPPER MERION 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
2001	None	N/A
2002	None	N/A
2003	None	N/A
2004	None	N/A
2005	\$ 300,170	100.0%
2006	335,195	103.2%

UPPER MERION 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, 2005
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	8.0%
Projected salary increases	5.0%

UPPER MERION TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Upper Merion Township Police Pension Plan
Montgomery County
175 West Valley Forge Road
King of Prussia, PA 19406

Mr. Scott Sibley	Chairman, Board of Township Supervisors
Mr. Ronald G. Wagenmann	Township Manager
Mr. Nicholas Hiriak	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.