

COMPLIANCE AUDIT

Upper Perk Police District Pension Plan

Montgomery County, Pennsylvania
For the Period
January 1, 2017 to December 31, 2020

November 2021



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

The Honorable Mayor and Borough Council
Pennsburg Borough
Montgomery County
Pennsburg, PA 18073

We have conducted a compliance audit of the Upper Perk Police District Pension Plan for the period January 1, 2017 to December 31, 2020. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the 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 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. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. To determine whether the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, our methodology included the following:

- We determined whether state aid was properly determined and deposited in accordance with Act 205 requirements by verifying the annual deposit date of state aid and determining whether deposits were made within 30 days of receipt for all years within the period under audit.
- We determined whether annual employer contributions were calculated and deposited in accordance with the plan's governing document and applicable laws and regulations by examining the municipality's calculation of the plan's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plan as evidenced by supporting documentation.
- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- We determined whether retirement benefits calculated for the plan member who retired during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws, and regulations by recalculating the amount of the monthly pension benefits due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient.
- We determined whether the January 1, 2017 and January 1, 2019 actuarial valuation reports were prepared and submitted by March 31, 2018 and 2020, respectively, in accordance with Act 205 and whether 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 by comparing selected information to supporting source documentation.

Pennsburg Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Upper Perk Police District Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 procedures indicated that, in all significant respects, the Upper Perk Police District 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:

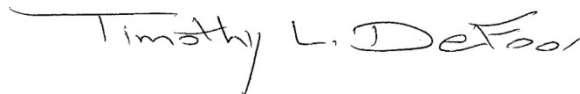
Finding No. 1 – Noncompliance With Prior Audit Recommendation - Pension Benefit Not Authorized By Act 600

Finding No. 2 – Inconsistent Pension Benefits And Failure To Adopt Plan Document By Borough

Finding No. 1 contained in this audit report repeats a condition that was cited in our previous report that has not been corrected by borough officials. We are concerned by the borough's failure to correct this previously reported finding and strongly encourage timely implementation of the recommendation noted in this audit report.

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.

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



November 9, 2021

Timothy L. DeFoor
Auditor General

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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.

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 Upper Perk Police District Pension Plan is also governed by implementing regulations published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes.

Act 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 767 et seq.

The Upper Perk Police District Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution No. 03-01, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of a collective bargaining agreement between Pennsburg Borough and the Upper Perk Police Department. The plan was established January 1, 1976. Active members were required to contribute 1.5 percent of compensation to the plan. As of December 31, 2020, the plan had 4 active members, no terminated members eligible for vested benefits in the future, and 3 retirees receiving pension benefits from the plan.

Prior to June 1, 2017, the Upper Perk Police District provided police services to Pennsburg Borough and East Greenville Borough. In 2017, East Greenville Borough withdrew from the Upper Perk Police District, effectively dissolving the Upper Perk Police District, and Pennsburg Borough adopted Ordinance No. 2-2017 to establish a police force for the borough effective June 1, 2017 to be known as the Upper Perk Police Department. The ordinance stated that "the initial composition of the Upper Perk Police Department would be the police officers for the Upper Perk Police Commission presently serving the Upper Perk Police District". No new pension plan governing document was adopted by Pennsburg Borough, and the pension plan continues to operate pursuant to the Upper Perk Police Commission's Resolution No. 03-01, dated June 23, 2003, which established a revised and restated pension plan and trust for the police officers of the Upper Perk Police District. A collective bargaining agreement was reached between Pennsburg Borough and the Upper Perk Police Department regarding compensation, retirement, pensions, working conditions, and other benefits incidental to the police officers' employment for the calendar years 2018 through 2030. The collective bargaining agreement amended some of the pension benefit provisions provided by Resolution No. 03-01 (see Finding No. 2).

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Recommendation

Plan officials have not complied with the prior recommendation concerning the following as further discussed in the Findings and Recommendations section of this report:

- Pension Benefit Not Authorized By Act 600

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Finding No. 1 – Noncompliance With Prior Recommendation – Pension Benefit Not Authorized By Act 600

Condition: As disclosed in the prior audit report, the pension plan’s governing document provides a pension benefit not authorized by Act 600. Section 1.03 of Resolution No. 03-01 states, in part:

For purposes of computing Average Applicable Compensation, actual monthly earnings shall be based on W-2 earnings in which all forms of earnings are derived from the terms and conditions of the employee’s employment.

Pursuant to this provision, plan officials included a lump-sum payment for accumulated unused sick leave that was not earned during the pension computation period in the pension benefit determination for a police officer who retired during the prior audit period. Plan officials also included a lump-sum payment for accumulated unused leave in the pension benefit determination for a police officer who retired during the current audit period, pursuant to a Retirement Agreement and Release, which specified a lump sum payment for accrued leave time and stated that this payment shall be included to calculate the officer’s final pension benefit. Plan officials were unable to provide supporting documentation regarding what comprised the lump-sum payment; therefore, we were unable to determine whether any of the accumulated unused leave was earned during the pension computation period, and the inclusion of the entire lump-sum payment in the pension benefit determination is considered to be in excess of benefits allowed per Act 600.

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

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 failed to ensure compliance with the department’s prior audit recommendation.

Effect: The plan is paying pension benefits to two retirees in excess of those authorized by Act 600. The retiree from the prior audit period continues to receive excess benefits of \$252.85 per month, in addition to the retiree during the current audit period who is receiving excess benefits of \$656.09 per month, which totaled approximately \$49,499 from the date of the members’ respective retirements through the date of this report.

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Finding No. 1 – (Continued)

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.

Recommendation: We again recommend that the borough comply with Act 600 at its earliest opportunity to do so. To the extent that the borough is not in compliance with Act 600 and/or is contractually obligated to pay benefits to existing retirees 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. In such case, the plan's actuary may be required to determine the impact, if any, of the excess benefits on the borough's future state aid allocations and submit this information to the Department. If it is determined the excess benefits had an impact on the borough's future state aid allocations after the submission of this information, the plan's actuary would then be required to contact the Department to verify the overpayment of state aid received. Plan officials would then be required to reimburse the overpayment to the Commonwealth.

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

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Finding No. 2 – Inconsistent Pension Benefits And Failure To Adopt Plan Document By Borough

Condition: Pennsburg Borough did not adopt a new pension plan governing document when the borough established its own police department effective June 1, 2017, known as the Upper Perk Police Department, after the Upper Perk Police District dissolved. The pension plan continues to operate pursuant to the former Upper Perk Police Commission’s Resolution No. 03-01, dated June 23, 2003, which established a revised and restated pension plan and trust for the police officers of the Upper Perk Police District. A collective bargaining agreement was reached between Pennsburg Borough and the Upper Perk Police Department regarding compensation, retirement, pensions, working conditions, and other benefits incidental to the police officers’ employment for the calendar years 2018 through 2030. The collective bargaining agreement amended some of the pension benefit provisions provided by Resolution No. 03-01, and we note the following inconsistencies between the documents:

<u>Benefit Provision</u>	<u>Resolution No. 03-01</u>	<u>Collective Bargaining Agreement</u>
Normal Retirement Date	“Normal Retirement Date” shall mean the first day following the date on which the member completes twenty-five (25) years of service, and the date on which the member attains age fifty-five (55).	<p>Pennsburg Borough shall maintain a pension fund...with benefits commencing at the normal retirement age of fifty-five (55)...</p> <p><i>Effective January 1st, 2021</i>, Pennsburg Borough shall maintain a pension fund...with benefits commencing at the normal retirement age of fifty-two (52)...</p> <p><i>Effective January 1st, 2025</i>, Pennsburg Borough shall maintain a pension fund for all officers hired prior to January 1, 2006...with benefits commencing at the normal retirement age of fifty (50)...</p> <p>Pennsburg Borough shall maintain a pension fund for officers hired after January 1, 2006...with benefits commencing at the normal retirement age of fifty-five (55)...</p>

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Finding No. 2 – (Continued)

<u>Benefit Provision</u>	<u>Resolution No. 03-01</u>	<u>Collective Bargaining Agreement</u>
Cost of Living Adjustment	Silent	<p><i>Effective January 1, 2023</i></p> <p>For officers hired prior to January 1st, 2006, an annual cost of living adjustment shall be provided to a retired participant effective the first January following at least one year from the initial date of retirement. The amount of such increase is subject to the limitations as noted hereinafter.</p> <ol style="list-style-type: none"> a. Such increment shall be equal to the percentage increase in the appropriate Consumer Price Index promulgated by the Bureau of Labor Statistics, U.S. Department of Labor, from the month in which the participant has worked. b. In no case may the participant’s total pension benefits exceed seventy-five percent (75%) of the retired participant’s salary for computing retirement benefits. c. The retired participant’s total cost of living adjustments shall not exceed ten percent (10%) of the retiree’s original pension benefit.

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Finding No. 2 – (Continued)

<u>Benefit Provision</u>	<u>Resolution No. 03-01</u>	<u>Collective Bargaining Agreement</u>
Deferred Retirement Option Plan	Silent	<p><i>Deferred Retirement Option Plan (DROP), Effective January 1st, 2021, the parties agree that the Borough will amend its Police Pension Plan to create a Deferred Retirement Option Plan, which will be governed by the following:</i></p> <ol style="list-style-type: none"> 1. Effective Date- Effective January 1, 2021, Members of the Upper Perk Police Department who have not retired prior to the implementation of the DROP program, may enter into DROP following completion of 25 years of credited service and attaining the age of 52. 2. Effective January 1, 2025, Members of the Upper Perk Police Department who were hired prior to January 1, 2006 and have not retired prior to implementation of the DROP program, may enter into DROP following completion of 25 years of credited service and attaining the age of 50. 3. Effective January 1, 2025, Members of the Upper Perk Police Department who were hired after January 1, 2006 and have not retired prior to the implementation of the DROP program, may enter in DROP following completion of 25 years of credited service and attaining the age of 55.

UPPER PERK POLICE DISTRICT PENSION PLAN
STATUS OF PRIOR FINDING

Finding No. 2 – (Continued)

Criteria: The provisions of the pension plan should be formally adopted by the current governing body, and the plan's governing document and the collective bargaining agreement should contain consistent benefit provisions to ensure the sound administration of retirement benefits.

Cause: Plan officials were unaware that the borough should formally adopt the plan provisions after the establishment of the police department under the borough.

Effect: Plan provisions that are not properly adopted and inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: We recommend that municipal officials take appropriate action to adopt the plan's benefit provisions by a borough ordinance or resolution at their earliest opportunity to do so. In addition, we recommend that municipal officials ensure the plan's new governing document and the collective bargaining agreement contain consistent benefit provisions.

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

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

UPPER PERK POLICE DISTRICT 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, 2015, is as follows:

	(1)	(2)	(3)	(4)
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)
01-01-15	\$ 1,778,164	\$ 1,902,860	\$ 124,696	93.4%
01-01-17	2,041,397	2,289,144	247,747	89.2%
01-01-19	2,183,525	2,452,215	268,690	89.0%

Note: The market values of the plan's assets at 01-01-15, 01-01-17, and 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses subject to a ceiling of 120 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.

UPPER PERK POLICE DISTRICT 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.

UPPER PERK POLICE DISTRICT PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

<u>Year Ended December 31</u>	<u>Actuarially Determined Contribution</u>	<u>Actual Contributions</u>	<u>Contribution Deficiency (Excess)</u>	<u>Covered- Employee Payroll</u>	<u>Contributions as a Percentage of Covered- Employee Payroll</u>
2014	\$ 91,633	\$ 91,633	\$ -	\$ 719,734	12.73%
2015	88,309	88,309	-	700,000	12.62%
2016	104,715	104,715	-	697,294	15.02%
2017	111,325	111,325	-	750,000	14.84%
2018	118,177	118,177	-	776,396	15.22%
2019	87,064	87,064	-	500,560	17.39%
2020	128,359	128,359	-	388,000	33.08%

UPPER PERK POLICE DISTRICT PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the 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, 2019
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	9 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	5.0%
Cost-of-living adjustments	None assumed

UPPER PERK POLICE DISTRICT PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Charles Shagg
Mayor, Pennsburg Borough

Ms. Diane Stevens
Council President, Pennsburg Borough

Ms. Lisa Hiltz
Borough Manager, Pennsburg Borough

Ms. Joanne Wentling
Police Administrative Assistant

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