

COMPLIANCE AUDIT

Fallowfield Township Police Pension Plan Washington County, Pennsylvania For the Period January 1, 2011 to December 31, 2013

April 2015



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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**EUGENE A. DePASQUALE
AUDITOR GENERAL**

Board of Township Supervisors
Fallowfield Township
Washington County
Charleroi, PA 15022

We have conducted a compliance audit of the Fallowfield Township Police Pension Plan for the period January 1, 2011 to December 31, 2013. 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. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit 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 that there were no employee contributions required by the plan's governing document and applicable laws and regulations for the years covered by our audit period.
- We determined that there were no benefit calculations prepared for the years covered by our audit period.
- We determined whether the January 1, 2011 and January 1, 2013 actuarial valuation reports were prepared and submitted to the Public Employee Retirement Commission (PERC) by March 31, 2012 and 2014, 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.
- We determined whether the terms of the plan's unallocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contract with the plan's provisions, investment policies, and state regulations.
- We determined whether the terms of the plan's allocated insurance contract, including ownership and any restrictions, were in compliance with plan provisions, investment policies, and state regulations by comparing the terms of the contract with the plan's provisions, investment policies, and state regulations.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Fallowfield 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 and as previously described, 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 procedures indicated that, in all significant respects, the Fallowfield 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:

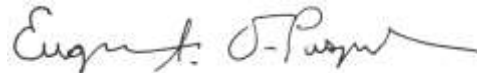
Finding – Noncompliance With Prior Audit Recommendation – Failure To
Cash Surrender Insurance Policy At Retirement.

This finding repeats a condition that was cited in our previous audit report that has not been corrected by township officials. We are concerned by the township's failure to correct this previously reported audit 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 Fallowfield Township and, where appropriate, their responses have been included in the report.

February 23, 2015



EUGENE A. DEPASQUALE
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. 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 Fallowfield 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 Fallowfield Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 142, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers. The plan was established February 13, 1970. Active members are not required to contribute to the plan. As of December 31, 2013, the plan had no active members, no terminated members eligible for vested benefits in the future, and 2 retirees receiving pension benefits from the plan.

At its regular meeting held on May 26, 2010, the Fallowfield Township Board of Supervisors adopted Ordinance No. 196, which abolished, terminated, and disbanded the Fallowfield Township Police Department, effective midnight, December 31, 2010; consequently, the plan will no longer have any active members.

BACKGROUND – (Continued)

As of December 31, 2013, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 25 years of service.
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

Retirement Benefit:

Benefit equals 50% of final 36 months average compensation.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	A monthly benefit equal to 50% of the pension the member was receiving or was entitled to receive on the day of the member's death.

Service Related Disability Benefit:

Benefit equals 50% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Fallowfield Township has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Failure To Cash Surrender Insurance Policy At Retirement

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Noncompliance With Prior Audit Recommendation – Failure To Cash Surrender Insurance Policy At Retirement

Condition: As disclosed in the prior 3 audit reports, as of December 31, 2002, the plan held an endowment policy for a police officer, which was purchased prior to January 1, 1986. On January 15, 2003, this policy was surrendered by the township and the proceeds were used to purchase a flexible premium adjustable life insurance policy on the same police officer. On February 21, 2003, the police officer retired and began receiving a monthly pension benefit in accordance with Act 600. However, the plan still holds the flexible premium adjustable life insurance policy in the name of the retired officer, with the officer’s spouse as the primary beneficiary.

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

In addition, the Commonwealth Court case Fedor v. Borough of Dormont et al., 36 Pa. Commonwealth. 449, 389 A.2d 217 (1978), affirmed 487 Pa. 249, 402 A.2d 334, upholds the position that Act 600 funds are to be used only to provide pensions for plan members, as follows:

Nothing in Section 1 of the Act of May 29, 1956 as it was originally enacted or in its amended version after 1970, suggests that the funds may be used otherwise than for the provision of pensions or annuities. No benefit other than by means of pension is mentioned in either the original or the amended version of the act. The word pension is defined by all dictionaries and is commonly used, to mean a fixed sum paid regularly to a person. We are therefore constrained to agree with the Auditor General and the Deputy Attorney General who advised him, that the expenditure of monies of a police pension plan created under the Act of May 29, 1956 for the purchase of a single payment life insurance policy to provide a death benefit for the participant would be improper.

Furthermore, Section 102 of Act 205 states, in part:

“Pension Fund.” The entity which is the repository for the assets amassed by a pension plan as reserves for the present and future periodic retirement payments and benefits of active and retired members of the pension plan.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Consequently, the primary purpose of life insurance is to provide death benefits, not the provision of periodic retirement benefits. Therefore, pension plans are not authorized to purchase or pay premiums for life insurance, except as noted below.

The Department of the Auditor General has issued several bulletins providing guidance regarding the purchase of life insurance by municipal pension plans. In 1985, Auditor General Municipal Pension Bulletin No. 2-85, “Purchase of Life Insurance for Municipal Pension Plans,” was issued. This bulletin disallowed any further purchase of life insurance with pension funds after January 1, 1986, but did allow the continuance of existing policies. Subsequently, in 1988, Auditor General Municipal Pension Bulletin No. 6-88, “Purchase of Insurance Coverage,” was issued and restated this position, by stating, in part:

Because the primary purpose of these policies is to fund death benefits rather than periodic retirement benefits, general municipal pension system state aid cannot be used to pay life insurance.

Furthermore, Bulletin No. 6-88 states, in part:

To avoid the losses which might be sustained by municipal pension plans that previously invested in life insurance policies, we will not object to the continued payment of premiums for existing policies which were previously authorized (i.e. grandfathering). However, we would recommend cash surrender of such policies or conversion to annuities at the time when the optimum return is available. As an alternative, the municipality could transfer existing life insurance policies from the pension plan to a municipal general fund provided the pension plan is adequately compensated.

In 2003, Auditor General Municipal Pension Bulletin No. 2003-01, “Purchase of Insurance Coverage,” was issued as a supplement to Bulletin No. 6-88 and stated, in part:

Criteria for Purchasing Insurance Coverage – The principle underlying Bulletin No. 6-88 is that insurance coverage purchased for members of a pension plan and payable in a lump sum to the members’ survivors do not provide retirement benefits within the meaning of Act 205.

Therefore, when township officials cash surrendered the endowment policy on January 15, 2003, the proceeds should have been deposited into the police pension plan and used to fund the retired officer’s monthly retirement benefit.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Cause: Municipal officials disagree with the finding because the policy was purchased prior to the issuance of Auditor General Bulletin No. 2-85.

Effect: Because the retired officer is receiving a monthly pension benefit from the plan in accordance with Act 600, the continuation of the flexible premium adjustable life insurance policy could result in the receipt of additional benefits in excess of those authorized by Act 600.

Furthermore, the cash surrender value of the policy is not available to pay authorized plan expenses or for investment purposes.

Recommendation: We again recommend that the township cash surrender the flexible premium adjustable life insurance policy held for the retired police officer and deposit the proceeds into the police pension plan.

As an alternative, the municipality could transfer the existing life insurance policy from the pension plan to the municipal general fund provided the pension plan is adequately compensated.

Management's Response: The township disagrees with the finding and recommendation. The township solicitor indicated that the policy does not have to be surrendered since it was purchased prior to Auditor General Bulletin No. 2-85, and the initial policy was purchased using township monies as opposed to state aid. In addition, the township has never had to pay premiums on the policy since the interest earned on the policy covered any premiums due. The township, therefore, believes that they should be permitted to maintain the life insurance policy, which they are obligated to provide to retired police officers, and the full amount of the cash surrender value of the policy should not be deposited into the police pension plan.

Auditor's Conclusion: As previously stated, based on previous bulletins issued by the Department and a prior Commonwealth court case, municipal pension plan funds should not be used for the purchase and payment of life insurance policies. While the original policy was purchased by the township prior to January 1, 1986, that policy was ultimately surrendered in 2003, long after the issuance of the above referenced bulletins which recommended that life insurance policies should be either cash surrendered or, as an alternative, transferred to the municipal general fund provided the pension plan was adequately compensated. Therefore, based on the criteria previously cited, the finding and recommendation remain as stated.

FALLOWFIELD 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, 2009, 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)]
01-01-09	\$ 1,139,680	\$ 783,790	\$ (355,890)	145.4%	\$ 81,089	(438.9%)
01-01-11	1,192,489	737,670	(454,819)	161.7%	None	N/A
01-01-13	1,191,721	717,306	(474,415)	166.1%	None	N/A

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 70 to 130 percent of the market value of assets. The market values of the plan's assets at 01-01-11 and 01-01-13 have been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 80 to 120 percent of the market value of assets. These methods 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.

FALLOWFIELD 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.

FALLOWFIELD 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
2008	None	N/A
2009	None	N/A
2010	None	N/A
2011	None	N/A
2012	None	N/A
2013	None	N/A

FALLOWFIELD 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, 2013
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 80-120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	6.0%
Projected salary increases	4.0%

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

Fallowfield Township Police Pension Plan
Washington County
9 Memorial Drive
Charleroi, PA 15022

Mr. Wilbur D. Caldwell, Jr. President, Board of Township Supervisors

Ms. Karen Talbert Secretary/Treasurer

This report is a matter of public record and is available online at www.PaAuditor.gov. 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@PaAuditor.gov.