

LIMITED PROCEDURES ENGAGEMENT

Fallowfield Township Police Pension Plan Washington County, Pennsylvania For the Period January 1, 2014 to December 31, 2017

June 2018



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 conducted a Limited Procedures Engagement (LPE) of the Fallowfield Township Police Pension Plan for the period January 1, 2014 to December 31, 2017 to determine its compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. We also evaluated compliance with some requirements subsequent to that period when possible. The LPE was conducted pursuant to authority derived from Section 402(j) of the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.) but was not conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. 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. We believe that the evidence obtained provides a reasonable basis to support our LPE results.

Our LPE was limited to determining the following:

- Whether municipal officials took appropriate corrective action to address the finding contained in our prior audit report, by inquiring of plan officials and evaluating supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken.
- 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 engagement period.
- 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.

- Whether the January 1, 2013, January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2014, 2016 and 2018 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.
- 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.
- 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 contracts with the plan's provisions, investment policies, and state regulations.

Based on the results of our procedures performed during our LPE, nothing came to our attention indicating that the Fallowfield Township Police Pension Plan was not being 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

The Finding contained in this LPE report 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 report.

Our determination to perform a LPE for this engagement period does not preclude the Department from conducting an audit in accordance with *Government Auditing Standards* of the pension plan in subsequent periods. The township should continue to maintain documentation related to this pension plan.

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 this report. We would like to thank township officials for the cooperation extended to us during the conduct of this LPE.



EUGENE A. DEPASQUALE
Auditor General

May 4, 2018

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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 previously disclosed in the prior 4 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 February 21, 2003, the police officer retired and began receiving a monthly pension benefit in accordance with Act 600 from the pension plan. 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: As previously disclosed, 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 such 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 continue to disagree with the finding because the township believes that the original policy, which was surrendered and used to purchase the insurance contract in question, 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 insurance policy, which is owned by the police pension plan, is not available to pay other 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's response was provided by the township's solicitor at the request of township officials and is as follows:

To better understand the Township's position on this issue of reimbursement to the pension plan, we need to look at the history of the insurance policy and its funding sources. On November 15, 1973, the township had issued, through the Colonial Life Insurance Company of America, a \$35,000.00 income endowment life insurance contract with an annuity rider. Said policy had an annual premium of \$1,085.85. The annuity rider was to provide a retirement benefit for the aforementioned individual. We have written documentation that this policy, which included retirement benefits, was to be the same or similar to the insurance and retirement benefits that were provided by the Township to its first police officer and former chief, who retired and this individual replaced as chief. (*Auditor's Note: The individuals' names and individual policy numbers cited by the solicitor in the response provided were specifically excluded from this management response.*)

The Auditor General in 1985 issued Bulletin No. 2-85, regarding the *Purchase of Life Insurance for Municipal Pension Plans*, which disallowed any further purchase of life insurance with pension funds after January 1, 1986, but did allow the continuance of existing policies. Accordingly, it was entirely proper for the Township to continue this policy that was established many years prior to January 1, 1986 as it was "grandfathered in." Pursuant to Auditor General Municipal Pension Bulletin No. 6-88, *Purchase of Insurance Coverage*, which was issued in 1988, this position changed and no longer could general municipal pension system state aid be used to pay life insurance. It is our position that no state monies were used to pay the life insurance premium from 1988-2003. Further, this individual's first policy predated Pension Bulletin 2003-01 by thirty years.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

A prior Township Secretary/Treasurer, without authorization from the Board of Supervisors, surrendered this individual's policy on January 15, 2003 and the proceeds were used to purchase the flexible premium adjustable life insurance policy that remains in effect through Lincoln Financial Group. This policy currently has a cash surrender value of approximately \$83,727.31. Said policy has an \$180,000.00 death benefit.

The Fallowfield Township Supervisors respectfully disagree with your finding that the Township remains in non-compliance with the prior audit recommendation. It is stated that the Township has failed to surrender the cash value of the flexible premium adjustable life insurance policy that was issued for this individual. However, said policy was funded by the entire proceeds from the earlier insurance policy. When the original policy was terminated, its cash surrender value was the only premium paid into the current life insurance policy. Accordingly, the Township does not feel it is non-compliance and should not be required to cash in the current life insurance policy and pay its surrender proceeds of approximately \$83,727.31 into the police pension plan.

At the present time, it is unknown what the exact amount of the cash surrender proceeds were on January 15, 2003 when the original policy was terminated. The Township has been trying for years to get the complete records on these policies. Again, the only premium that has been paid into the current policy was the cash surrender value of the original policy. The current policy is a "self-sustaining" one, and, as such, the Township has never contributed any money out of its police pension funds to pay for the current policy, so as to run afoul of Act 600.

There are several undisputed facts. One the original policy was issued in 1973 and the current policy was issued 2003. This is thirty years of valid and legal payments by the Township. Second, the Township agreed to provide this individual with a life insurance policy and a retirement plan. The insurance and retirement benefit was provided and is a legal obligation of the Township. These funds belong to Fallowfield Township and were paid from Township taxes.

Auditor's Conclusion: We continue to disagree with the township's position related to this issue. As previously stated and as disclosed in our prior audit report, 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.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

It is also noted that the premiums on the purchase of the original endowment contract, which as mentioned in the response above was subsequently surrendered and replaced with the aforementioned flexible premium adjustable life insurance policy, were originally satisfied with state funds (distributed under Act 120). We were unable to substantiate from our records the municipality's claim that funds belonging to the township and paid from Township taxes were ever contributed to its police pension fund. As such, the continued payment of subsequent premiums through the accumulated earnings within the insurance contract appear to represent earnings on those original state funds which in turn were utilized to satisfy subsequent annual premiums on this policy for the sole purpose of providing a lump-sum benefit upon the death of the retired member and not for the funding of the retired officer's monthly retirement benefit.

Although we do understand that a life insurance provision was provided to active members in the collective bargaining agreement (CBA) covering members of the police force and is a legal obligation of the township, according to the CBA, upon retirement, the township was to maintain insurance in the amount of \$35,000 on each retiree. However, the CBA did not indicate that this was the responsibility of the pension plan; moreover, it was not contained in the pension plan provisions section of the CBA. Therefore, based on the criteria previously cited, the finding and recommendation remain as stated above.

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 5 and 6 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2014, 2015, AND 2016

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Total Pension Liability			
Interest	\$ 45,353	\$ 42,610	\$ 45,079
Difference between expected and actual experience	6,071	-	(13,391)
Changes of assumptions	71,403	-	37,404
Benefit payments, including refunds of member contributions	(56,901)	(57,246)	(57,263)
Net Change in Total Pension Liability	<u>65,926</u>	<u>(14,636)</u>	<u>11,829</u>
Total Pension Liability - Beginning	<u>703,313</u>	<u>769,239</u>	<u>754,603</u>
Total Pension Liability - Ending (a)	<u><u>\$ 769,239</u></u>	<u><u>\$ 754,603</u></u>	<u><u>\$ 766,432</u></u>
Plan Fiduciary Net Position			
Net investment income	\$ 23,806	\$ 2,985	\$ 25,247
Benefit payments, including refunds of member contributions	(56,901)	(57,246)	(57,263)
Administrative expense	(750)	(750)	(2,650)
Net Change in Plan Fiduciary Net Position	<u>(33,845)</u>	<u>(55,011)</u>	<u>(34,666)</u>
Plan Fiduciary Net Position - Beginning	<u>1,213,024</u>	<u>1,179,179</u>	<u>1,124,168</u>
Plan Fiduciary Net Position - Ending (b)	<u><u>\$ 1,179,179</u></u>	<u><u>\$ 1,124,168</u></u>	<u><u>\$ 1,089,502</u></u>
Net Pension Liability - Ending (a-b)	<u><u>\$ (409,940)</u></u>	<u><u>\$ (369,565)</u></u>	<u><u>\$ (323,070)</u></u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	153.29%	148.97%	142.15%
Estimated Covered Employee Payroll	-	-	-
Net Pension Liability as a Percentage of Covered Employee Payroll	N/A	N/A	N/A

FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the township as of December 31, 2014, and 2015, calculated using the discount rate of 5.75%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	<u>1% Decrease (4.75%)</u>	<u>Current Discount Rate (5.75%)</u>	<u>1% Increase (6.75%)</u>
Net Pension Liability - 12/31/14	\$ (332,532)	\$ (409,940)	\$ (475,943)
Net Pension Liability - 12/31/15	\$ (293,630)	\$ (369,565)	\$ (434,312)

As of December 31, 2016, the following presents the net pension liability of the township calculated using the discount rate of 5.00%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	<u>1% Decrease (4.00%)</u>	<u>Current Discount Rate (5.00%)</u>	<u>1% Increase (6.00%)</u>
Net Pension Liability - 12/31/16	\$ (246,226)	\$ (323,070)	\$ (388,680)

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2016	2.66%
2015	0.56%
2014	2.01%
2013	8.93%
2012	11.03%
2011	(0.03%)
2010	12.15%
2009	31.43%
2008	(33.79%)
2007	9.63%

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, 2013, 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)
01-01-13	\$ 1,191,721	\$ 717,306	\$ (474,415)	166.1%
01-01-15	1,191,703	769,239	(422,464)	154.9%
01-01-17	1,176,473	766,432	(410,041)	153.5%

Note: The market values of the plan's assets at 01-01-13, 01-01-15, and 01-01-17 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. 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.

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.

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
2012	None	N/A
2013	None	N/A
2014	None	N/A
2015	None	N/A
2016	None	N/A
2017	None	N/A

FALLOWFIELD TOWNSHIP POLICE 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, 2017
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	5.00%
Projected salary increases	4.00%
Cost-of-living adjustments	2.25%

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

Mr. Bruce Smith
Chairman, Board of Township Supervisors

Mr. Earl P. Sadler
Vice-Chairman, Board of Township Supervisors

Mr. Ronald Large
Township Supervisor

Ms. Karen Talbert
Secretary/Treasurer

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