



**NORRISTOWN BOROUGH POLICE
PENSION PLAN**

MONTGOMERY COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2010, TO DECEMBER 31, 2011

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE 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.

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 Norristown Borough 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 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.
- Act 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1178, No. 177), as amended, 53 Pa.C.S. § 101 et seq.
- 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 Norristown Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 05-30-2005, as amended, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the borough and its police officers.





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EUGENE A. DePASQUALE
AUDITOR GENERAL

Borough Council
Norristown Borough
Montgomery County
Norristown, PA 19401

We have conducted a compliance audit of the Norristown Borough Police Pension Plan for the period January 1, 2010, to December 31, 2011. 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 the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit report; and
2. To determine if the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

Our audit was limited to the areas related to the objectives identified above. Our methodology addressed determinations about the following:

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

- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.
- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and selected information provided on these reports is accurate, complete and in accordance with plan provisions to ensure compliance for participation in the state aid program.
- Whether the special ad hoc postretirement adjustment granted to eligible pensioners is in accordance with applicable laws and regulations and whether the ad hoc reimbursement received by the municipality was treated in accordance with applicable laws and regulations.
- Whether benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.
- Whether the terms and methodologies of the issuance of bonds by the municipality, and any restrictions are in compliance with plan provisions and state regulations.
- Whether Deferred Retirement Option Plan (DROP) participants' benefit payments are properly determined in accordance with the provisions of the DROP and any other applicable laws and regulations.

Norristown Borough contracted with an independent certified public accounting firm for annual audits of the Norristown Borough Police Pension Plan's financial statements which are available at the borough's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Norristown Borough 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 borough's internal controls as they relate to the borough's compliance with those requirements and that we considered to be significant within the context of our audit objectives, and assessed whether those significant controls were properly designed and implemented. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to provide reasonable assurance of detecting instances of noncompliance with legal and regulatory requirements or noncompliance with provisions of contracts, administrative procedures, and local ordinances and policies that are significant within the context of the audit objectives.

The results of our tests indicated that, in all significant respects, the Norristown Borough 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 – Partial Compliance With Prior Audit Recommendation – Pension Benefits Not In Compliance With Act 600

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information or conclude on it and, accordingly, express no form of assurance on it. However, we are extremely concerned about the historical trend information contained in the schedule of funding progress included in this report which indicates a continued decline of assets available to satisfy the long-term liabilities of the plan. For example, **the plan's funded ratio went from 95.2% as of January 1, 2007, to a ratio of 67.9% as of January 1, 2011**, which is the most recent date available. We encourage borough officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

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



EUGENE A. DEPASQUALE
Auditor General

February 25, 2013



NORRISTOWN BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Partial Compliance With Prior Audit Recommendation

Norristown Borough has partially 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

During the current audit period, the borough adopted Amendment 2012-1 to the Norristown Borough Police Pension Plan which contained provisions which corrected five of the six benefit provisions that were cited in the prior audit report as not being in compliance with Act 600; however, the plan's normal retirement benefit options continue to provide for actuarial equivalent benefits that are not in compliance with Act 600, as further discussed in the Finding and Recommendation section of this report.

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

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

Condition: As disclosed in the prior audit report, the borough operates under a home rule charter pursuant to the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2901 et seq. (previously 53 P.S. § 1-101 et seq.). During the current audit period, the borough adopted Amendment 2012-1 to the Norristown Borough Police Pension Plan which contained provisions which corrected five of the six benefit provisions that were cited in the prior audit report as not being in compliance with Act 600; however, the plan’s normal retirement benefit options continue to provide for actuarial equivalent benefits that are not in compliance with Act 600, and which conflicts with the collective bargaining agreement between the police officers and the borough, as noted below:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>	<u>Act 600 (as amended)</u>
Normal retirement benefit options	A married police officer may elect a joint and 100% survivor annuity instead of a joint and 50% survivor annuity when he retires. That means that the plan will pay benefits in the same equal monthly installments to such a police officer and to his surviving spouse for the duration of their lifetimes. The surviving spouse shall continue to receive this benefit even if she remarries. If no spouse survives, or if she survives and subsequently dies, the child or children under the age of 18 years, or if attending college under or attaining the age of 23 years, shall receive the same benefit. <u>The joint and 100% survivor annuity will be the actuarial equivalent of a fully subsidized joint and 50% survivor annuity.</u> (emphasis added)	Not addressed	Not authorized

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding - (Continued)

Criteria: On January 24, 2001, the Commonwealth Court of Pennsylvania issued its opinion in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee*. Therein, the court held that Section 2962(c)(5) of the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. §2962(c)(5), “clearly precludes home rule municipalities from providing pension benefits different from those prescribed in general law including Act 600.”

Furthermore, 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.

In addition, Section 1(a)(4) of Act 600 provides that the governing body shall prescribe a survivor’s benefit “calculated at no less than fifty per centum of the pension the member was receiving or would have been receiving had he been retired at the time of his death.”

Cause: Municipal officials failed to establish adequate internal control procedures to ensure full compliance with the prior audit recommendation.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan. In addition, providing actuarial equivalent benefits that are 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.

Providing unauthorized pension benefits could increase the plan’s pension costs and reduce 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 unauthorized pension benefits provided. However, the provision of unauthorized 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.

NORRISTOWN BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding - (Continued)

Recommendation: The department has determined that it will not penalize a home rule municipality for granting benefits not authorized by Act 600 to existing retirees or to individuals who began full time employment before January 24, 2001 (the date *Monroeville* was issued). However, the department expects the borough to restrict pension benefits to those authorized by Act 600 for all employees who began full time employment on or after that date.

Special note should be taken that the department's application of *Monroeville* only to employees hired on or after January 24, 2001, does not sanction (1) a municipality's granting excess benefits to existing or future employees when none had been granted as of January 24, 2001, or (2) a municipality's increasing excess benefits for existing or future employees beyond those that had been granted as of that date.

Therefore, we again recommend that municipal officials take appropriate action to eliminate any benefits not authorized by Act 600 for police officers hired on or after January 24, 2001, at their earliest opportunity to do so. Furthermore, such benefits may 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 unauthorized benefits on the borough's future state aid allocations and submit this information to the department. To the extent that the borough has failed to provide benefits to its police officers which are mandated by Act 600, as amended, we recommend that municipal officials take appropriate action to provide such benefits at their earliest opportunity to do so.

Management's Response: Municipal officials indicated that Section 13.4 of the Plan provides that effective May 1, 2002, all married participants receive a fully subsidized joint and 50% survivor annuity (or upon election a joint and 100 percent survivor annuity which is the actuarial equivalent of a fully subsidized joint and 50 percent survivor benefit). Accordingly, the Pension Ordinance is in compliance with Act 600, as amended by Act 30.

Auditor's Conclusion: As noted in the management response, the election of a 100 percent joint and survivor annuity is an actuarial equivalent of an authorized Act 600 pension benefit; therefore, based on the criteria previously cited, the finding and recommendation remain as stated.

NORRISTOWN BOROUGH POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF FUNDING PROGRESS

Historical trend information about the plan is presented herewith as supplementary information. It is intended to help users assess the plan's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other state and local government retirement systems.

The actuarial information is required by Act 205 biennially. The historical information, beginning as of January 1, 2007, is as follows:

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)	Covered Payroll (c)	Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)]
01-01-07	\$ 25,522,825	\$ 26,802,381	\$ 1,279,556	95.2%	\$ 5,294,164	24.2%
01-01-09	19,342,849	29,707,243	10,364,394	65.1%	5,683,212	182.4%
01-01-11	21,549,200	31,749,111	10,199,911	67.9%	6,086,480	167.6%

Note: The market values of the plan's assets at 01-01-07, 01-01-09 and 01-01-11, have been adjusted to reflect the smoothing of gains and/or losses over a 5-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.

NORRISTOWN BOROUGH 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.

NORRISTOWN BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2006	\$ 278,282	100.0%
2007	297,879	100.0%
2008	341,860	100.0%
2009	561,254	100.0%
2010	629,124	100.0%
2011	1,342,405	100.0%

NORRISTOWN BOROUGH POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 NOTES TO SUPPLEMENTARY SCHEDULES
 (UNAUDITED)

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation date follows:

Actuarial valuation date	January 1, 2011
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	14 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return *	8.25%
Projected salary increases *	5.5%
* Includes inflation at	3.5%
Cost-of-living adjustments	5.0% of final average salary

NORRISTOWN BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Norristown Borough Police Pension Plan
Montgomery County
235 East Airy Street
Norristown, PA 19401

Mr. Gary Simpson	Council President
Mr. David Forrest	Borough Manager
Mr. Richard Zawisza	Finance Director

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