

**QUAKERTOWN BOROUGH POLICE PENSION PLAN**

**BUCKS COUNTY**

**COMPLIANCE AUDIT REPORT**

**FOR THE PERIOD**

**JANUARY 1, 2009, TO DECEMBER 31, 2010**





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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 Quakertown 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 600 - Police Pension Fund Act, Act of May 29, 1956, (P.L. (1955) 1804, No. 600), as amended, 53 P.S. § 767, et seq.

The Quakertown Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 988, 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.





Borough Council  
Quakertown Borough  
Bucks County  
Quakertown, PA 18951

We have conducted a compliance audit of the Quakertown Borough Police Pension Plan for the period January 1, 2009, to December 31, 2010. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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 findings 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. Quakertown Borough contracted with an independent certified public accounting firm for annual audits of its basic 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 Quakertown 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 the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the Quakertown 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 Accordance With Act 600

As previously noted, one of the objectives of our audit of the Quakertown Borough Police Pension Plan was to determine compliance with applicable state laws, contracts, administrative procedures, and local ordinances and policies. During the current audit period, Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the bill provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information and, accordingly, express no form of assurance on it. However, we are extremely concerned about the funded status of the plan contained in the schedule of funding progress included in this report which indicates the plan's funded ratio is 59.0% as of January 1, 2009, which is the most recent date available. Based on this information, the Public Employee Retirement Commission issued a notification that the borough is currently in Level II moderate distress status. 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 Quakertown Borough and, where appropriate, their responses have been included in the report.

February 1, 2012

JACK WAGNER  
Auditor General

QUAKERTOWN BOROUGH POLICE PENSION PLAN  
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

Quakertown Borough has complied with the prior audit recommendation concerning the following:

- Pension Benefit Not Authorized By Act 600

The borough reduced the pension benefit for the police officer who retired on January 1, 2009, to be in accordance with Act 600 provisions; and

Partial Compliance With Prior Audit Recommendation

Quakertown Borough has partially complied with the prior audit recommendation concerning the following:

- Pension Benefits Not In Accordance With Act 600

The borough adopted Ordinance No. 1167 which brought the pre-vesting death benefit provision into compliance with Act 600, as amended. However, the plan's governing document still contains an intervening military service credit provision that is not in full compliance with Act 600, as discussed in the Finding and Recommendation section of this report.

QUAKERTOWN BOROUGH POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

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

Condition: As disclosed in the prior audit report, the pension plan’s governing document, Ordinance No. 988, as amended, contained benefit provisions that were not in compliance with Act 600.

During the current audit period, the borough adopted Ordinance No. 1167 which brought the plan’s pre-vesting death benefit provision into compliance with Act 600, as amended. However, the plan’s governing document still contains an intervening military service credit provision that is not in full compliance with Act 600. The specific inconsistency is as follows:

Benefit Provision	Governing Document	Act 600 (as amended)
Intervening military service credit	Any member of the police force shall be eligible to receive service credit for intervening or non-intervening military service provided that he is not entitled to receive, eligible to receive now or in the future, or is receiving retirement benefits for such service under a retirement system administered and wholly or partially paid for by any other governmental agency, with the exception of a member eligible to receive or receiving military pay...	<p>Any member of the police force employed by a borough, town, township or regional police department, who has been a regularly appointed employee of any such political subdivision or regional police department for a period of at least six months and who thereafter shall enter into the military service of the United States, shall have credited to his employment record for pension or retirement benefits all of the time spent by him in such military service, if such person returns or has heretofore returned to his employment within six months after his separation from the service. <i>Section 4(a)</i></p> <p>Any member of the police force shall be eligible to receive service credit for intervening or nonintervening military service as provided in subsections (a) and (b) provided that he is not entitled to receive, eligible to receive now or in the future or is receiving retirement benefits for such service under a retirement system administered and wholly or partially paid for by any other governmental agency with the exception of a member eligible to receive or receiving military retirement pay earned by a combination of active duty and nonactive duty with a reserve or national guard component of the armed forces which retirement pay is payable only upon the attainment of a specified age and period of service under 10 U.S.C. Ch. 67 (relating to retired pay for non-regular service). <i>Section 4(c)</i></p>

QUAKERTOWN BOROUGH POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

Finding – (Continued)

Therefore, while the plan’s governing document does provide for intervening military service credit, it does not contain the minimum 6 month employment/return to employment requirements referenced at Section 4(a) of Act 600.

Criteria: The plan’s governing document should contain benefit provisions that are in full compliance with Act 600, as amended.

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

Effect: Maintaining a benefit structure which is not in compliance with Act 600 could result in plan members or their beneficiaries receiving incorrect benefit amounts or being denied benefits to which they are statutorily entitled.

Recommendation: We again recommend that municipal officials, after consulting with their solicitor, take whatever action is necessary to bring the plan’s intervening military service credit provision into full compliance with Act 600, as amended, at their earliest opportunity to do so.

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

QUAKERTOWN 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, 2005, 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)]
01-01-05	\$ 2,525,257	\$ 3,801,600	\$ 1,276,343	66.4%	\$ 927,123	137.7%
01-01-07	2,859,924	4,584,888	1,724,964	62.4%	1,121,934	153.7%
01-01-09	3,332,507	5,645,512	2,313,005	59.0%	1,387,429	166.7%

Note: The market values of the plan's assets at 01-01-05 and 01-01-07 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period. The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period subject to a corridor between 70 to 130 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.

QUAKERTOWN 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.

QUAKERTOWN 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
2005	\$ 149,186	100.0%
2006	163,571	100.0%
2007	246,697	100.0%
2008	320,583	100.0%
2009	349,601	100.0%
2010	354,154	100.0%



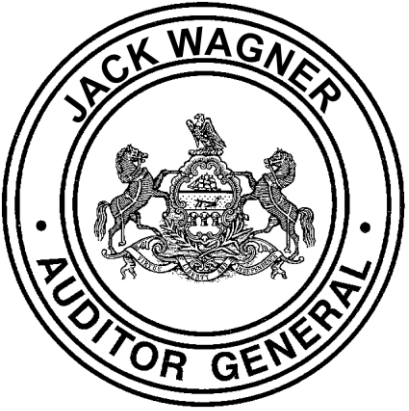
QUAKERTOWN BOROUGH POLICE PENSION PLAN  
 SUPPLEMENTARY INFORMATION  
 NOTES TO SUPPLEMENTARY SCHEDULES  
 (UNAUDITED)

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, 2009
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 years
Asset valuation method	4-year smoothing – plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 70-130% of the market value of assets.

Actuarial assumptions:

Investment rate of return *	7.5%
Projected salary increases *	5.0%
* Includes inflation at	Not disclosed
Cost-of-living adjustments	3.0%



QUAKERTOWN BOROUGH POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett  
Governor  
Commonwealth of Pennsylvania

Quakertown Borough Police Pension Plan  
Bucks County  
35 North Third Street  
Quakertown, PA 18951

Mr. James Roberts, Jr.      Council President

Mr. Scott McElree          Borough Manager

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at [www.auditorgen.state.pa.us](http://www.auditorgen.state.pa.us).