

ROCKLEDGE BOROUGH POLICE PENSION PLAN

MONTGOMERY COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2004, TO DECEMBER 31, 2006



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BACKGROUND

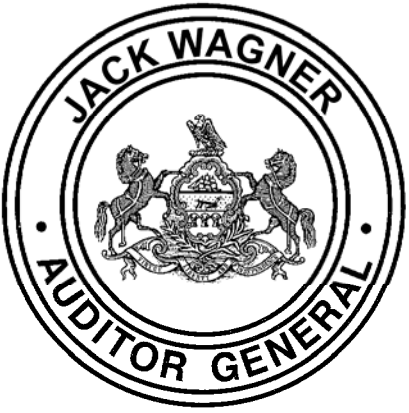
On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, 53 P.S. §895.101, et seq.). The act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to 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 Rockledge 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 Rockledge Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 415, 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.



The Honorable Mayor and Borough Council
Rockledge Borough
Montgomery County
Rockledge, PA 19046

We have conducted a compliance audit of the Rockledge Borough Police Pension Plan for the period January 1, 2004, to December 31, 2006. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 of 1984 and in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

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. Rockledge Borough contracted with an independent certified public accounting firm for annual audits of its financial statements prepared in conformity with the accounting practices prescribed or permitted by the Department of Community and Economic Development of the Commonwealth of Pennsylvania, 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.

The Department of the Auditor General (Department) is mandated by state statute to calculate state aid provided to municipal pension funds and to audit municipal pension funds having received such aid. State aid is calculated by an administrative unit that is not involved in the audit process. The Department's Comptroller Office then pre-audits the calculation and submits requests to the Commonwealth's Treasury Department for the disbursement of state aid to the municipality. The Department has implemented procedures to ensure that Department audit personnel are not directly involved in the calculation and disbursement processes. The Department's mandatory responsibilities are being disclosed in accordance with *Government Auditing Standards*.

Borough officials are responsible for establishing and maintaining an internal control structure to provide reasonable assurance that the Rockledge Borough Police Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. To assist us in planning and performing our audit, we obtained an understanding of the borough's internal control structure as it relates to the borough's compliance with those requirements. 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 Rockledge 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 findings further discussed later in this report:

- Finding No. 1 – Noncompliance With Prior Audit Recommendation - Failure To Adopt Benefit Provisions Mandated By Act 30
- Finding No. 2 – Failure To Fully Pay Minimum Municipal Obligation Of The Plan
- Finding No. 3 – Failure To Appoint A Chief Administrative Officer
- Finding No. 4 – Custodial Account Records Not Maintained By The Municipality

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.

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

JACK WAGNER
Auditor General

ROCKLEDGE BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

Rockledge Borough has not complied with the prior audit recommendation concerning the following as further discussed in the Findings and Recommendations section of this report:

- Failure To Adopt Benefit Provisions Mandated By Act 30

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Adopt Benefit Provisions Mandated By Act 30

Condition: As disclosed in the prior audit report, Act 600 was amended by Act 30 on April 17, 2002, which made significant changes to the statutorily prescribed benefit structure of police pension plans subject to Act 600. Municipal officials have not amended the police pension plan’s governing document to adopt all of the changes mandated by Act 30. The specific inconsistencies are as follows:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Act 600 (as amended)</u>
Pre-vesting death benefit	Not addressed	The surviving spouse of a member of the police force who dies before his pension has vested or if no spouse survives or if he or she survives and subsequently dies, the child or children under the age of eighteen years, or, if attending college, under or attaining the age of twenty-three years, of the member of the police force shall be entitled to receive repayment of all money which the member invested in the pension fund plus interest or other increases in value of the member’s investment in the pension fund, unless the member has designated another beneficiary for this purpose.

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - (Continued)

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Act 600 (as amended)</u>
Killed in service benefit	If the member's death is service-connected, the death benefit shall be a monthly annuity equal to 50% of the member's accrued benefit at the date of death payable to the member's spouse until the earlier of the spouse's death or remarriage. If no spouse survives or if the spouse survives and subsequently dies or remarries, payable to the child or children until age 18.	Pensions for the families of members killed in service shall be calculated at 100% of the member's salary at the time of death.
Survivor's benefit	In the event of the death of any Officer who has retired or is eligible to retire (superannuated) by reason of completing the age and service requirements, at the time of the Officer's death; then his or her surviving spouse shall be entitled to receive a pension calculated at 50% of the pension the deceased retired superannuated Officer was receiving or would have been entitled to receive, had said eligible officer been retired at the time of death. The surviving spouse of such deceased eligible officer shall continue to receive the pension until his or her death or remarriage and, at such time, the survivor's pension shall be paid to the child or children of said deceased eligible officer until the child or children shall reach 18 years of age.	A lifetime survivor's benefit must be provided to the surviving spouse (or if no spouse survives or if he or she subsequently dies, the child or children under 18 years of age or if attending college, under or attaining the age of 23) of no less than 50% of the pension the member was receiving or would have been entitled to receive had he been retired at the time of death. ("Attending college" shall mean the eligible children are registered at an accredited institution of higher learning and are carrying a minimum course load of 7 credit hours per semester.)

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 - (Continued)

Criteria: The police pension plan's benefit structure should be in compliance with Act 600, as amended.

Cause: Municipal officials failed to establish adequate internal control procedures to ensure the plan's governing document was updated to include the benefits provisions mandated by Act 30 and included in the collective bargaining agreement between the borough and the police officers covering the period January 1, 2004, through December 31, 2007.

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 police pension plan's governing document into compliance with Act 600, as amended, at their earliest opportunity to do so.

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

Finding No. 2 – Failure To Fully Pay Minimum Municipal Obligation Of The Plan

Condition: Plan officials did not fully pay the 2005 minimum municipal obligation (MMO) of the police pension plan as required by Act 205. Based upon an estimate prepared by this department, the municipality had an unpaid MMO balance of \$4,715.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

Section 302(d) of Act 205 states, in part:

The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 - (Continued)

Furthermore, Section 302(e) of Act 205 states, in part:

Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid. . . .

Cause: Plan officials failed to establish adequate internal control procedures to ensure the MMO was paid in accordance with Act 205 requirements.

Effect: The failure to fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the 2005 MMO by the December 31, 2005, deadline, the municipality must add the 2005 MMO balance to the current year's MMO and include interest, as required by Act 205.

Recommendation: We recommend that the municipality pay the outstanding MMO due to the police pension plan for the year 2005, with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

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

Finding No. 3 – Failure To Appoint A Chief Administrative Officer

Condition: Municipal officials did not appoint a chief administrative officer (CAO) for the pension plan by ordinance, resolution or by a motion recorded in the minutes.

Criteria: Section 102 of Act 205 defines the CAO as “The person who has primary responsibility for the execution of the administrative affairs of the municipality in the case of the municipality, or of the pension plan in the case of the pension plan, or the designee of that person.”

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Municipal officials may appoint two CAOs - one for the pension plan and one for the municipality or appoint one person to fill both positions. Act 205 identifies specific duties for each position, as follows:

CAO of the Municipality

- Supervise and direct the preparation of actuarial reports (Section 201(d));
- Certify and file actuarial valuation reports with the Public Employee Retirement Commission (Section 201(b)); and
- Make actuarial report information available to plan members (Section 201(e)).

CAO of the Pension Plan

- Annually, determine and submit to the governing body of the municipality the financial requirements of the pension plan and minimum municipal obligation (Section 302(b), Section 302(c), Section 303(b), Section 303(c) and Section 304); and
- Provide the governing body of the municipality with a cost estimate of the effect of any proposed benefit plan modification (Section 305(a)).

Cause: Plan officials were unaware of the need to appoint a CAO for the pension plan in accordance with Act 205 provisions.

Effect: The failure to formally appoint a CAO could result in important filing deadlines being overlooked, state aid being adversely affected or delayed and investment opportunities being lost.

Recommendation: Because of the significance of the CAO's responsibilities to the municipality and pension plan, we recommend that the CAO be formally appointed by ordinance, resolution or motion. Such ordinance, resolution or motion should detail the CAO's responsibilities and be filed with other plan documents.

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

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – Custodial Account Records Not Maintained By The Municipality

Condition: The municipality did not maintain adequate financial records documenting the account transactions of the plan’s custodial trust account.

Criteria: Assets held in a trust account for the purpose of plan management are to be governed by the terms and provisions of the account contract, provided that the terms and provisions of the contract are within the parameters of all prevailing pension legislation. Although the municipality may contract with a trustee to administer the financial management of the plan, the fiduciary responsibility for the plan remains with the municipality.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the account transactions of the plan’s custodial account would be adequately monitored.

Effect: Inadequate monitoring of the custodial trust account could lead to undetected errors or improprieties in account transactions as well as deficiencies in authorizing and implementing pension plan policies and procedures.

Recommendation: We recommend that the municipality obtain account statements for the custodial trust account and monitor the statements as to the accuracy and propriety of the transactions. The minimum steps that should be applied by a municipality to adequately monitor the account activity are:

- Verify the mathematical accuracy of the account statements;
- Reconcile the Commonwealth, municipal and members’ contributions shown on the account statements to the municipality’s records;
- Review investment income for accuracy and reasonableness;
- Reconcile any large or material receipt, other than contributions, shown on the account statements to the municipality’s records;
- Determine if investments are in accordance with applicable laws, regulations and policies. Reconcile investment income to the related investments;

ROCKLEDGE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 4 – (Continued)

- Review custodial statements at pension board meetings;
- Reconcile pension payments shown on the account statements to the municipality's records; and
- Reconcile any large or material disbursement, shown on the account statements to the municipality's records.

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

ROCKLEDGE 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, except for distressed pension plans, for which annual reporting was required through January 1, 2003. The historical information, beginning as of January 1, 2001, 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)]
01-01-01	\$ 845,683	\$ 766,491	\$ (79,192)	110.3%	\$ 252,707	(31.3%)
01-01-03	971,403	1,003,677	32,274	96.8%	273,903	11.8%
01-01-05	1,100,838	1,166,656	65,818	94.4%	237,361	27.7%

Note: The market values of the plan's assets at 01-01-03 and 01-01-05 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.

ROCKLEDGE 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.

ROCKLEDGE 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
2001	\$ 38,924	100.0%
2002	26,839	102.9%
2003	22,553	128.3%
2004	23,990	121.4%
2005	33,983	86.1%
2006	28,390	100.0%

ROCKLEDGE BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(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, 2005
Actuarial cost method	Entry age normal
Amortization method	N/A
Remaining amortization period	N/A
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	5.0%
Cost-of-living adjustments	3.0%

ROCKLEDGE BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania

Rockledge Borough Police Pension Plan
Montgomery County
121 Huntingdon Pike
Rockledge, PA 19046

The Honorable Kenneth Costello	Mayor
Mr. Joseph Denelsbeck	Council President
Mr. Michael J. Hartey	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.