



**SHILLINGTON BOROUGH POLICE
PENSION PLAN**

BERKS COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2009, TO DECEMBER 31, 2011

RELEASED MONTH 2013

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE AUDITOR GENERAL



SHILLINGTON BOROUGH POLICE PENSION PLAN

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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 Shillington 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. 1804, No. 600), as amended, 53 P.S. § 761 et seq.

The Shillington Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1092, and a separately executed plan agreement with the plan's custodian, 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

The Honorable Mayor and Borough Council
Shillington Borough
Berks County
Shillington, PA 19607

We have conducted a compliance audit of the Shillington Borough Police Pension Plan for the period January 1, 2009, 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 objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

The objective of the audit was 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 objective 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 benefit payments have only been made to living recipients, based on the Social Security numbers found in the pension records for retirees and beneficiaries.

Shillington 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Shillington 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 objective, 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 objective.

The results of our tests indicated that, in all significant respects, the Shillington 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 – Improper Pension Benefit

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 Shillington Borough and, where appropriate, their responses have been included in the report.

A handwritten signature in black ink, appearing to read "Eugene A. DePasquale". The signature is fluid and cursive, with a long horizontal stroke at the end.

October 25, 2012

EUGENE A. DEPASQUALE
Auditor General



SHILLINGTON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Improper Pension Benefit

Condition: The borough improperly granted a police officer an additional service credit for the period of time the police officer was on unpaid administrative leave, which is not authorized by Act 600 or the plan’s governing document. Through a settlement agreement negotiated between the borough and the police officer, even though the police officer had not worked full-time or received any compensation from the borough since October 15, 2011, the police officer received service credit from October 16, 2011, through February 25, 2012, when his employment was terminated. Since the police officer was hired on February 23, 1992, the provision of this additional service credit enabled the borough to grant the police officer an early retirement benefit based on 20 years of credited service. Since the police officer did not have the required 20 years of service for an early retirement benefit, the police officer is only eligible to receive a vested pension benefit payable on his normal retirement date of April 1, 2019.

Criteria: Section 5(i) of Act 600 states, in part:

The ordinance or resolution establishing the police pension fund may provide for an early retirement benefit. The early retirement benefit shall be provided to a member of the police force with twenty or more years of service who terminates employment prior to the completion of superannuation retirement age and service requirements and who files a written application for an early retirement benefit with the governing body of the municipality or regional police department. (Emphasis added)

Furthermore, Section 5(h) of Act 600 states, in part:

The ordinance or resolution establishing the police pension fund may provide for a vested benefit provided that such would not impair the actuarial soundness of the pension fund. Under the provisions of such benefit, should a police officer, before completing superannuation retirement age and service requirements but after having completed twelve years of total service, for any reason cease to be employed as a full-time police officer by the municipality or regional police department in whose pension fund he has been a member, he shall be entitled to vest his retirement benefits by filing with the governing body within ninety days of the date he ceases to be a full-time police officer a written notice of his intention to vest. Upon reaching the date which would have been his superannuation retirement date if he had continued to be employed as a full-time police officer he shall be paid a partial superannuation retirement allowance determined by applying the percentage his years of service bears to the years of service which he would have rendered had he continued to work until his superannuation retirement date to the gross pension...

SHILLINGTON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

In addition, Section 1.10(g)(2) of the separately executed pension plan agreement, states the following:

Service may be credited for the purpose of eligibility to participate, vesting, benefit accrual, or determining the benefit payable under the normal retirement benefit formula. Generally, no service shall be credited for periods during which the employee performs no services for the employer. Further, no more than one year of service will be credited for any 12-consecutive month period. (Emphasis added)

Finally, the separately executed plan agreement at Article II states:

Section 2.1 – Plan Participation

- (a) **Eligibility** – An employee who is a member of the eligible class of employees shall be eligible for plan participation provided that he agrees to make the mandatory contributions as set forth in Section 6.2.
- (b) **Eligible Class of Employees** – Employees of the employer who are employed as police officers on a regularly scheduled, full time basis shall be eligible to be covered under the plan. Any police officer employed as a temporary, special, part-time, or permanent part-time officer of the employer shall not be considered a member of the eligible class of employees.
- (c) **Entry Date** – An eligible employee shall participate in the plan on the first day he performs one hour of service.

Section 2.2 – Termination of Participation

A participant shall continue to be an active participant of the plan so long as he is a member of the eligible class of employees and he does not terminate employment. He shall become an inactive participant immediately if he ceases to be a member of the eligible class of employees or terminates employment. He shall cease participation completely upon the later of his receipt of a total distribution of his nonforfeitable accrued benefit under the plan or the forfeiture of the nonvested portion of the accrued benefit.

SHILLINGTON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Section 2.3 – Re-Participation

- (a) If a participant becomes an inactive participant, because he is no longer a member of the eligible class of employees; such inactive participant shall become an active participant immediately upon returning to the eligible class of employees. In the event an employee who is not a member of an eligible class of employees becomes a member of an eligible class, such employee shall participate immediately.
- (b) If a participant incurs a break in service, he shall become an active participant immediately upon returning to employment.

Cause: The borough felt that the settlement agreement negotiated between the borough and the police officer was justification to grant the additional service credit, even though the police officer had not worked full-time or received any compensation from the borough since October 15, 2011.

Effect: The retiree is receiving excess pension benefits of \$1,165 per month.

Providing unauthorized pension benefits increases the plan's pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. Furthermore, the increased costs to the pension plan as a result of the excess 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.

Recommendation: We recommend that all pension benefits be determined in accordance with the provisions contained in Act 600 and the plan's governing document in effect at the time of a plan member's retirement. To the extent that the borough has already obligated itself to pay benefits in excess of those authorized by Act 600, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Any excess benefit payments made from the plan will be deemed ineligible for funding with state aid. Accordingly, the pension plan's actuary may be required to determine the impact, if any, of the excess benefit payments on the borough's future state aid allocations and submit this information to the Department. If it is determined the excess benefit payments had an impact on the borough's future state aid allocations after the submission of this information, the plan's actuary would then be required to contact the Department to verify the overpayment of state aid received. Plan officials would then be required to reimburse the overpayment to the Commonwealth.

SHILLINGTON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Management’s Response: This will serve as the Borough’s response to the Draft Pension Audit (“Audit”) which the Borough received for the above period. As you know, the sole finding in the Audit was that the Borough is paying a benefit in excess of those permitted by Act 600 with respect to the former Chief of Police of the Borough’s Police Department. The basis for this initial determination is that the Borough credited the police officer with approximately four (4) months of service during which he was not actually paid by the Borough and did not perform any work, notwithstanding the fact that he remained a Borough employee. For the reasons set forth herein, the Borough respectfully submits that no finding should be issued as the Borough’s actions, from both a practical and legal standpoint were both sound and appropriate.

As the Department is aware, the Borough negotiated a separation agreement with the police officer under which he would remain on unpaid administrative leave for the approximately four-month period from October 16, 2011, to February 23, 2012, at which time the police officer agreed to resign from employment. During this four-month period, the Borough and the police officer agreed that he was subject to reporting for duty on an as-needed basis to consult with Borough officials, perform police duties or assist in the transition. Notwithstanding this Agreement, the Borough did not have a need to call the police officer in to duty. As noted above, for periods when the Borough did not need the police officer, he received no compensation. This agreement was an effort by the Borough to resolve potential claims by the police officer, including, but not limited to, a claim for a work-related disability benefit.

In addition, from the Borough’s perspective, placing the police officer on an unpaid administrative leave saved both the Borough General Fund and the Police Pension Fund monies. Specifically, had the Borough simply placed the police officer on paid administrative leave or granted him additional leave time, such action would likely have been approved by the Auditor General because the police officer was being paid during that time, notwithstanding the fact that he was still performing no services for the Borough. However, such action would have increased the Borough’s expenses from its General Fund and unnecessarily increased the police officer’s monthly pension to which he was otherwise entitled. In contrast, of the thirty-six months of his pension calculation under the Borough’s agreement, nearly four months or 1/6 of the time he had no earnings, obviously resulting in an overall larger (sic) pension benefit.

Moreover, as noted by the Commonwealth Court in Upper Moreland Township v. Upper Moreland Township Police Benevolent Association, 55 A.3d 541 (Pa. Cmwlth. 2012), although Act 600 requires a minimum period of total *service*, it does not define what constitutes service for pension purposes. The Court went on to note that, in the absence of express language in Act 600, it is for the parties to define what service means. Notably, in Upper Moreland, the language at issue permitted the employer to credit a full year of service after the employee worked only 1,000 hours, or slightly less than half of a year.

SHILLINGTON BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

In the present case, as cited by the Audit, the Borough's pension document defines service loosely, indicating that, "generally, service shall not be credited for periods during which the employee performs no service for the employer." Obviously, this does not foreclose the possibility or the ability of the Borough to credit service in discreet cases where, although employed, the employee performs no work. Indeed, were the Department's analysis on this point accepted, then any employee who performed no work by virtue of work-related injury, military service or even sporadic use of leave/vacation time, would have those periods of time excluded from pension service as they performed no work for the Borough. Although the Borough does not and has not made it a practice of routinely providing service credit in periods of unpaid leave of absence, as noted above, it did so for compelling financial and policy reasons in this case.

In summary, the Borough reacted to a narrow, unique issue by crediting an employee for approximately four months of pension service, notwithstanding the fact that the employee, though still employed, performed no work during that period. From the Borough's standpoint, it was a cost-effective manner of addressing this issue which lowered the ultimate costs to both the Borough and the Fund, as the pension benefit received by the police officer, although paid immediately, was actuarially reduced to reflect the early payout in accordance with Act 600. Likewise, excluding the four-months of pension service provided by the Borough would most likely result in a higher monthly pension benefit paid to the employee as his full thirty-six month pension calculation period would be populated by earnings. Taking the above information into account, the Borough respectfully requests that the final pension audit not contain a finding on this point.

Auditor's Conclusion: The Department acknowledges the costs savings to the Borough's general fund and the pension plan by placing the police officer on unpaid administrative leave and including the period where the police officer had no earnings in his pension calculation. However, Shillington Borough's pension plan agreement does not permit service credit for periods when no services are performed and a plan member is only eligible for service credit while a scheduled full-time employee. Although the police officer was allegedly "on call" during the last four months prior to his official termination of employment, he was not scheduled nor was he called for any services during that time. Pennsylvania caselaw does not permit service credit for time when the officer/plan member is not providing services unless that period of time is attributable to a permitted statutory exception. Therefore, the finding and recommendation remain as stated.

SHILLINGTON 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	\$ 1,208,000	\$ 1,609,654	\$ 401,654	75.0%	\$ 507,089	79.2%
01-01-09	1,440,051	1,997,588	557,537	72.1%	495,328	112.6%
01-01-11	1,800,996	2,137,878	336,882	84.2%	586,704	57.4%

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.

SHILLINGTON 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.

SHILLINGTON 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	\$ 71,070	100.0%
2007	92,676	100.0%
2008	88,498	100.0%
2009	91,734	100.0%
2010	89,191	100.0%
2011	103,440	100.0%

SHILLINGTON 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	6 years
Asset valuation method	Fair value, 5-year smoothing
Actuarial assumptions:	
Investment rate of return *	8.0%
Projected salary increases *	5.0%
* Includes inflation at	Not disclosed
Cost-of-living adjustments	None assumed



SHILLINGTON BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Shillington Borough Police Pension Plan
Berks County
2 East Lancaster Avenue
Shillington, PA 19607

The Honorable Andrew R. Hivner	Mayor
Mr. Ronald Dunkelberger, Sr.	Council President
Mr. Michael Mountz	Borough Manager
Ms. Jan Boyd	Secretary/Treasurer

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