

COMPLIANCE AUDIT

East Fallowfield Township Police Pension Plan Chester County, Pennsylvania For the Period January 1, 2016 to December 31, 2019

November 2020



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
East Fallowfield Township
Chester County
East Fallowfield, PA 19320

We have conducted a compliance audit of the East Fallowfield Township Police Pension Plan for the period January 1, 2016 to December 31, 2019. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402(j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings 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. To determine whether the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, our methodology included the following:

- We determined 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 period under audit.

- We determined 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.
- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- We determined whether retirement benefits calculated for the plan member who retired during the current audit period represent payments to all (and only) those entitled to receive them and were properly determined and disbursed in accordance with the plan's governing document, applicable laws, and regulations by recalculating the amount of the monthly pension benefits due to the retired individual and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient.
- We determined whether the January 1, 2017 and January 1, 2019 actuarial valuation reports were prepared and submitted by March 2018 and 2020, 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.

The East Fallowfield Township Police Pension Plan participates in the Pennsylvania Municipal Retirement System (PMRS), which is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating municipal pension plans. PMRS issues a separate Comprehensive Annual Financial Report, copies of which are available from the PMRS accounting office. PMRS's financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Township officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the East Fallowfield Township Police Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials and performed procedures to the extent necessary 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 procedures indicated that, in all significant respects, the East Fallowfield Township 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 – Failure To Deposit The Full Amount Of State Aid Into The Pension Plan

Finding No. 2 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The 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 East Fallowfield Township and, where appropriate, their responses have been included in the report. We would like to thank township officials for the cooperation extended to us during the conduct of the audit.

November 3, 2020



EUGENE A. DEPASQUALE
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.

Annual state aid allocations are provided from a 2 percent foreign (out-of-state) casualty insurance premium tax, a portion of the foreign (out-of-state) 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 East Fallowfield Township Police Pension Plan is also governed by implementing regulations 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 15 - Pennsylvania Municipal Retirement Law, Act of February 1, 1974
(P.L. 34, No. 15), as amended, 53 P.S. § 881.101 et seq.

The East Fallowfield Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1993-9, and a separately executed plan agreement with the Pennsylvania Municipal Retirement System (PMRS), adopted pursuant to Act 15. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers. The plan was established July 1, 1993. Active members are required to contribute 5 percent of their total compensation to the plan. As of December 31, 2019, the plan had 7 active members and 2 retirees receiving pension benefits.

EAST FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Failure To Deposit The Full Amount Of State Aid Into The Pension Plan

Condition: During the prior audit, a verbal observation was issued to plan officials notifying them that the township had not deposited the full amount of its 2012 state aid allocation into an eligible pension plan in accordance with Act 205. The municipality received an additional allotment of 2012 state aid in the amount of \$3,961 during 2013; however, as of the date of this report, only state aid totaling \$3,517 was actually deposited into its pension plans. Since the township previously met its non-uniformed, defined contribution pension plan's costs, the remaining state aid allocation in the amount of \$444 should be deposited into its defined benefit, police pension plan, accordingly.

Criteria: Section 402(g) of Act 205 states, in part:

. . . the total amount of the general municipal pension system State aid received by the municipality shall, within 30 days of receipt by the treasurer of the municipality, be deposited in the pension fund or the alternate funding mechanism applicable to the pension plan.

Cause: Current plan officials were unable to determine why the prior observation was not complied with. In addition, the township lacked adequate procedures to ensure compliance with the prior recommendation and the timely deposit of the outstanding state aid.

Effect: When state aid is not deposited into a pension plan account, the funds are not available to pay operating expenses or for investment and the risk of misapplication is increased.

Recommendation: We recommend that the municipality deposit the township's remaining state aid allocation of \$444, plus interest earned during the period beyond the 30 day grace period allowed by Act 205, compounded annually, into the police pension plan. A copy of the interest calculation must be maintained by the township for examination during our next audit of the plan.

We also recommend that plan officials implement procedures to ensure that future state aid is deposited into an eligible pension plan within 30 days of receipt by the municipal treasurer.

Management's Response: The township provided the following response:

The Township's Treasurer is currently on medical leave. The Township has been unable to determine why the full amount of 2012 state aid was not paid to PMRS for the pension plan. However, the Township intends to process a payment of \$444 (plus interest calculated at 6%) in the Township's October 2020 bill run. The total amount that will be paid toward the police pension plan will be \$750.13. A copy of this check will be provided to your office. On October 27, 2020 the township sent \$750.13 to PMRS.

EAST FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Auditor's Conclusion: Based on the management response, it appears municipal officials intend to comply with the finding recommendation. Compliance will be evaluated during our next audit of the plan.

Finding No. 2 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan

Condition: The township's record-keeping system did not provide effective control over the transactional activity of the police pension plan during 2019. Municipal officials were unable to furnish annual financial statements or custodial account transaction statements for the police pension plan. These annual financial and account statements have historically been provided by the plan's custodian, PMRS. However, as of the date of this report, annual financial and accounting statements summarizing the pension account activity have not been provided for the year 2019.

Criteria: An adequate system of accounting and record keeping is a prerequisite for sound administration of pension plans. In addition, assets held in a custodial 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: Municipal officials indicated that the plan's custodian, PMRS, failed to provide copies of the custodial account transaction statements summarizing activity of the pension plan account for the year 2019. In addition, municipal officials did not maintain a separate detailed accounting of pension plan transactions which, among other things, helps assure the production of proper financial statements to effectively monitor the annual activity of the pension plan.

Effect: Although we were able to obtain alternate documentation from the municipality to evidence the propriety of the individual transactions tested during performance of the audit for the year 2019, the failure to maintain annual financial and/or account transaction statements prohibits municipal officials from effectively monitoring the plan's financial operations. Additionally, inadequate monitoring of the pension plan account could lead to undetected errors or improprieties in account transactions as well as deficiencies in authorizing and implementing pension plan policies and procedures.

EAST FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Recommendation: We recommend that municipal officials contact the plan custodian and obtain annual financial statements of the custodial account of the police pension plan for the year 2019 to ensure the accuracy and propriety of the transaction activity. In addition, we recommend that municipal officials establish and maintain a financial record-keeping system that allows the municipality to effectively monitor the plan’s financial operations, even in the absence of statements from the plan custodian. Municipal officials should refer to the Auditor General’s Bulletin No. 2-88 entitled “Preparation, Maintenance and Auditability of Financial Records,” for further guidance in establishing adequate accounting and record-keeping procedures.

Management’s Response: The township provided the following response:

East Fallowfield Township contacted PMRS by email regarding the status of the 2019 PMRS statements; however, as of October 21, 2020, PMRS has not responded regarding such status. East Fallowfield Township will continue to follow up with PMRS to check on the status of the financial statements and provide them to the Auditor General as soon as the Township receives the statements.

Auditor’s Conclusion: PMRS has indicated that they are in the process of preparing 2019 Year-End Financial Activity Reports and Annual Member Statements for all municipalities. PMRS has also indicated that they recently went through a substantial upgrade to the plan administration software and implemented a new accounting system. This transition in addition to disruptions in normal government operation due to COVID-19 has resulted in a three to four month delay in the 2019 year-end reporting process. Compliance with the finding recommendation will be evaluated during our next audit of the plan.

EAST 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, 2015, 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)
01-01-15	\$ 1,371,543	\$ 1,671,407	\$ 299,864	82.1%
01-01-17	1,656,696	1,668,254	11,558	99.3%
01-01-19	1,998,044	2,013,937	15,893	99.2%

EAST 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.

EAST FALLOWFIELD TOWNSHIP POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

<u>Year Ended December 31</u>	<u>Actuarially Determined Contribution</u>	<u>Actual Contributions</u>	<u>Contribution Deficiency (Excess)</u>	<u>Covered- Employee Payroll*</u>	<u>Contributions as a Percentage of Covered- Employee Payroll*</u>
2014	\$ 63,825	\$ 63,825	\$ -	\$ 550,404	11.60%
2015	84,768	84,768	-	602,929	14.06%
2016	95,445	94,465	(20)	575,049	16.60%
2017	89,482	89,502	(20)	563,431	15.89%
2018	83,417	83,417	-	629,144	13.26%
2019	45,638	45,638	-		

* Due to the timing of this audit, covered-employee payroll for 2019 was not provided in this schedule.

EAST 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, 2019
Actuarial cost method	Entry age normal
Amortization method	Level dollar for plan bases and an average for Aggregate Gain/Loss, 10% of surplus is credited against aggregate cost where applicable.
Remaining amortization period	5 years
Asset valuation method	The Actuarial Value of Assets equal the sum of all audited reserve funds as of the valuation date, including Member, Municipal, Retired, Disability, and DROP Reserves, when applicable, and a one year administration expense reserve, plus the portion of any additional investment income to be distributed as excess interest, based on PMRS Policy Statement 05-2. This asset valuation is based on the unique legislative structure of PMRS and the administrative rules adopted by the PMRS Board in conjunction with Pennsylvania Municipal Retirement Law. ¹

Actuarial assumptions:

Investment rate of return *	5.25%, compounded annually, net of investment and administration expenses
Projected salary increases *	2.8%-7.05%
* Includes inflation at	2.8%
Cost-of-living adjustments	2.8% per year, subject to plan limitations

¹ The administrative rules adopted by the PMRS Board, which are not subject to comply with Actuarial Standards of Practice (ASOP), when defining the Actuarial Value of Assets (AVA), does not necessarily meet the requirement of ASOP 44 Selection and Use of Asset Valuation Methods for Pension Valuations. The AVA provided within this report follow the Pennsylvania Municipal Retirement Law and the PMRS policy statement.

EAST 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. Wilson T. Lambert Jr.
Chairman, Board of Township Supervisors

Mr. Scott Swichar
Township Manager

Ms. Charity Rosenberry, CPA
Pennsylvania Municipal Retirement System

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.