

COMPLIANCE AUDIT

Kenhorst Borough Non-Uniformed Pension Plan Berks County, Pennsylvania For the Period January 1, 2017 to December 31, 2020

February 2022



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



**Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov**

**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

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

We have conducted a compliance audit of the Kenhorst Borough Non-Uniformed Pension Plan for the period January 1, 2017 to December 31, 2020. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our 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 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. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. 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 that there were no employee contributions required by the plan's governing document and applicable laws and regulations for the years covered by our audit period.
- We determined whether retirement benefits calculated for the plan members who retired during the current audit period, and through the completion of our fieldwork procedures, 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 pension benefits due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients.
- We determined whether the January 1, 2017, and January 1, 2019 actuarial valuation reports were prepared and submitted by March 31, 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.

Kenhorst 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.

The Kenhorst Borough Non-Uniformed 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 Annual Comprehensive 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.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Kenhorst Borough Non-Uniformed 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 objectives.

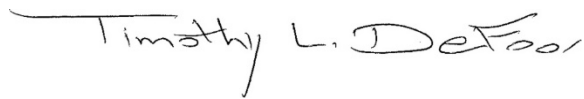
The results of our procedures indicated that, in all significant respects, the Kenhorst Borough Non Uniformed Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following 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 Kenhorst Borough and, where appropriate, their responses have been included in the report. We would like to thank borough officials for the cooperation extended to us during the conduct of the audit.



Timothy L. DeFoor
Auditor General
January 14, 2022

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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 Kenhorst Borough Non-Uniformed 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 Kenhorst Borough Non-Uniformed Pension Plan is a single-employer defined benefit pension plan that includes a cash balance component locally controlled by the provisions of Ordinance No. 593, effective January 1, 2020, which supersedes Ordinance No. 514, and a separately executed plan agreement with the Pennsylvania Municipal Retirement System (PMRS), adopted pursuant to Act 15. The plan was established November 16, 1967. Active members are not required to contribute to the plan, but may voluntarily contribute up to 10 percent of their compensation. The municipality is required to contribute 3 percent of compensation to each member's account. As of December 31, 2020, the plan had 5 active members, 3 terminated members eligible for vested benefits in the future, and 1 retiree receiving pension benefits.

KENHORST BOROUGH NON-UNIFORMED PENSION PLAN
STATUS OF PRIOR FINDING

Compliance With Prior Recommendation

Kenhorst Borough has complied with the prior recommendation concerning the following:

- Incorrect Data On Certification Form AG-385 Resulting In An Underpayment Of State Aid

During the current audit period, municipal officials complied with the instructions accompanying Certification Form AG 385s and accurately reported the required pension data.

KENHORST BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: The municipality did not deposit the full amount of its 2017 state aid allocation into the pension plan. The municipality received its 2017 state aid allocation in the total amount of \$14,631; however, as of the date of this report, only state aid totaling \$8,375 was actually deposited into the pension plan based on municipal records.

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: The full amount of 2017 state aid was not deposited into the pension plan because prior plan officials did not adequately reconcile the total allocation of state aid received, along with the forfeitures applied towards its cash balance component of the plan, with the total amount of state aid deposited into the pension plan during 2017.

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 borough's remaining 2017 state aid allocation (*refer to Auditor's Conclusion below*), plus interest earned during the period beyond the 30 day grace period allowed by Act 205, compounded annually into the pension plan. A copy of the interest calculation must be maintained by the borough for examination during our next audit of the plan.

We also recommend that plan officials ensure that future state aid is appropriately accounted for and deposited into the pension plan in accordance with Act 205.

Management's Response: Municipal officials agreed with the finding and will discuss this issue with PMRS. Officials further indicated that because this issue occurred during 2017, when current officials were not here, and since the borough overpaid its minimum municipal obligations (MMOs) for each year of the audit period due to the confusion of direction on MMO calculations and the plan is overfunded, the \$6,256 need not be deposited but should be credited and not a finding.

KENHORST BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Auditor’s Conclusion: Based on the management response and additional analysis of documentation provided by the borough, it appears that the borough included an additional \$5,762 of its 2017 state aid allocation in its 2018 deposit that was incorrectly classified as 2018 state aid. As such, we recommend that the borough deposit the remaining outstanding 2017 state aid in the amount of \$494 (*\$6,256 outstanding as noted in Condition above, less \$5,762 deposited in 2018*) plus interest earned during the period beyond the 30 day grace period allowed by Act 205, compounded annually into the pension plan and ensure that future state aid is appropriately accounted for and deposited into the pension plan in accordance with Act 205 as stated in the recommendation above. Additionally, it should be noted for subsequent periods that although the borough believes that an overpayment of the plan’s MMO in one year should be credited to another year, this assertion is contrary to the position of this department. It is this department’s opinion that because the entire proceeds of the insurance premium tax on foreign casualty insurance companies are distributed annually to each eligible recipient municipality, it is inappropriate to use state aid/employer contributions in one year to offset pension costs in other years. 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 borough record-keeping system did not provide effective control over the transactional activity of the non-uniformed pension plan during 2020. Municipal officials were unable to furnish annual financial statements or custodial account transaction statements for the non-uniformed 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 2020.

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 2020. 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.

KENHORST BOROUGH NON-UNIFORMED PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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 2020, 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.

Recommendation: We recommend that municipal officials contact the plan custodian and obtain annual financial statements of the custodial account of the non-uniformed pension plan for the year 2020 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: Municipal officials agreed with the finding without exception.

Auditor’s Conclusion: It was noted that PMRS recently went through a substantial upgrade to the plan administration software and implemented a new accounting system. The modernization process, along with the COVID-19 pandemic, resulted in unforeseen delays in the year-end reporting process for financial statements and GASB 68 reports. PMRS officials have taken active measures to resolve these issues and were to begin providing 2020 Year-End Financial Activity Reports and Annual Member Statements for their plans in the fall of 2021. However, PMRS has not provided these statements to the borough as of the date of this report. Compliance with the finding recommendation will be evaluated during our next audit of the plan.

KENHORST BOROUGH NON-UNIFORMED 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	\$ 459,028	\$ 461,355	\$ 2,327	99.5%
01-01-17	542,684	472,759	(69,925)	114.8%
01-01-19	610,696	528,255	(82,441)	115.6%

KENHORST BOROUGH NON-UNIFORMED 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.

KENHORST BOROUGH NON-UNIFORMED PENSION PLAN
 SUPPLEMENTARY INFORMATION
 (UNAUDITED)

SCHEDULE OF CONTRIBUTIONS

Year Ended December 31	Actuarially Determined Contribution	Actual Contributions	Contribution Deficiency (Excess) **	Covered- Employee Payroll*	Contributions as a Percentage of Covered- Employee Payroll*
2014	\$ 12,091	\$ 12,434	\$ (343)	\$ 198,119	6.28%
2015	14,141	14,141	-	180,503	7.83%
2016	14,659	17,916	(3,257)	167,480	10.70%
2017	15,486	8,375	7,111	195,765	4.28%
2018	16,287	20,280	(3,993)	224,729	9.02%
2019	10,789	19,251	(8,462)	223,390	8.62%
2020	12,180	21,961	(9,781)		

* Due to the timing of this audit, covered-employee payroll for 2020 was not provided in this schedule.

** In 2017, the borough met the plan's \$15,486 actuarially determined contribution through the deposit of \$8,375 in state aid and allocation of \$5,892 in terminated employee forfeitures (*towards the cash balance component of its plan*) per municipal records. The remainder of the 2017 required contribution was deposited in 2018.

KENHORST BOROUGH NON-UNIFORMED 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	N/A
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.

KENHORST BOROUGH NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Nickolas J. Hatzas
Mayor

Mr. Jonathan L. Smith, Sr.
Council President

Mr. Brian Cole
Borough Manager

Ms. Jennifer Frasso
Secretary/Treasurer

Ms. Cynthia Cranmer, CPA
Pennsylvania Municipal Retirement System

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