

COMPLIANCE AUDIT

Kennett Square Borough Police Pension Plan Chester County, Pennsylvania For the Period January 1, 2017 to December 31, 2019

April 2021



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
AUDITOR GENERAL**

The Honorable Mayor and Borough Council
Kennett Square Borough
Chester County
Kennett Square, PA 19348

We have conducted a compliance audit of the Kennett Square Borough Police Pension Plan for the period January 1, 2017 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 finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the findings contained in our prior 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 findings 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 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 plan members who retired and elected to vest 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 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.

Kennett Square Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements which are available at the borough's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Kennett Square Borough 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 objectives.

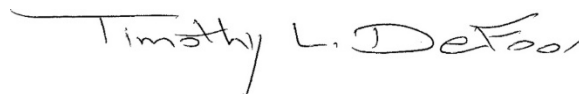
The results of our procedures indicated that, in all significant respects, the Kennett Square Borough Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further discussed later in this report:

Finding – Partial Compliance With Prior Recommendation – Inconsistent and
Unauthorized Pension Benefits

The finding contained in this audit report repeats a condition that was cited in our previous report that has not been corrected by borough officials. We are concerned by the borough's failure to correct this previously reported finding and strongly encourage timely implementation of the recommendation noted in this audit report.

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 Kennett Square 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

March 25, 2021

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

The Kennett Square Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 950, adopted pursuant to Act 600. Prior to January 1, 2018, the plan was locally controlled by the provisions of Ordinance No. 851, 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 plan was established April 4, 1960. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2019, the plan had 12 active members, 2 terminated members eligible for vested benefits in the future, and 7 retirees receiving pension benefits.

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Recommendations

Kennett Square Borough has complied with the prior recommendation concerning the following:

- Unauthorized Provision For A Killed In Service Benefit

Borough officials adopted Ordinance No. 950 which effectively removed the killed in service benefit provision from the plan's governing document.

Partial Compliance With Prior Recommendation

Kennett Square Borough has partially complied with the prior recommendation concerning the following:

- Inconsistent And Unauthorized Pension Benefits

Borough officials adopted Ordinance No. 950 which amended and restated the plan's governing document to reflect all benefit obligations of the pension plan and eliminated inconsistencies with the prior collective bargaining agreement covering the years 2017 through 2019 between the police officers and the borough. However, the early retirement provision remains inconsistent with Act 600 as well as the most recent collective bargaining agreement covering the years 2020 through 2024. In addition, a former vested member began receiving an early retirement benefit in accordance with the plan's governing document and the prior collective bargaining agreement as further discussed in the Finding and Recommendation section of this report.

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Partial Compliance With Prior Recommendation – Inconsistent And Unauthorized Pension Benefits

Condition: As disclosed in the Status of Prior Finding section of this report, the borough partially complied with the prior recommendation by adopting Ordinance No. 950 which amended and restated the plan’s governing document to reflect all benefit obligations of the pension plan and eliminated inconsistencies with the prior collective bargaining agreement between the police officers and the borough. However, the early retirement provision remains inconsistent with Act 600, as well as the most recent current collective bargaining agreement covering the years 2020 through 2024, as noted below:

Benefit Provision	Governing Document	Collective Bargaining Agreement 2020-2024	Act 600
Early retirement	<p>Effective January 1, 2014, a Participant shall be entitled to an Early Retirement Benefit upon retirement on or after attainment of Early Retirement Age and before Normal Retirement Age.</p> <p>Early Retirement Age shall mean the date on which the Participant has attained age fifty (50) and has completed twelve (12) years of Aggregate Service with the Employer.</p>	<p>The Borough Police Pension Ordinance shall provide for an early retirement benefit after 20 years of continuous service, regardless of age, as authorized by Act 24 of 1998, codified as 53 P.S. Section 771(i).</p>	<p>An early retirement benefit may be provided to a member of the police force with 20 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. The early retirement benefit shall become effective as of the date the application is filed with the governing body or the date designated on the application, whichever is later, and shall be the actuarial equivalent of the partial superannuation retirement benefit calculated in accordance with Section 5(i) of Act 600.</p>

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

In addition, the actuarial valuation report Form Type C, for the police pension plan, with a valuation date of January 1, 2019, submitted to the former Public Employee Retirement Commission, reported the benefit provisions included in the plan's governing document.

Moreover, a former vested member elected an early retirement benefit in accordance with the plan's governing document and the prior collective bargaining agreement after only 17 years of service, which is not in accordance with Act 600.

Criteria: A governing document which contains clearly defined and updated benefit provisions, including those awarded through the collective bargaining process, is a prerequisite for the consistent, sound administration of retirement benefits. In addition, the police pension plan's benefit structure should be in compliance with Act 600, as amended.

Cause: Plan officials again failed to establish adequate internal control procedures to ensure the plan's governing document and the collective bargaining agreement contained consistent benefit provisions and adherence with the provisions of Act 600 as previously recommended.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan. In addition, 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. Moreover, 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. Since the borough received state aid based on unit value during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, 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.

Furthermore, a former vested member began receiving an early retirement benefit amounting to \$1,466 effective June 1, 2019 instead of a vested benefit of \$2,561 payable at his superannuation retirement date, January 2, 2025.

Recommendation: We again recommend that municipal officials, with assistance from their solicitor, amend the plan's governing document as necessary, to reflect all benefit obligations of the pension plan, eliminate inconsistencies among the various plan documents and ensure compliance with Act 600 at their earliest opportunity to do so.

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Management's Response: Municipal officials agreed with the finding without exception. Since the Borough received the prior audit on January 4, 2018, the Borough negotiated a revised early retirement benefit with the union. Following the negotiation of the revised benefit, the Borough now expects to enact a pension plan amendment on April 5, 2021 to finalize the plan amendment, at which time the plan will be consistent with Act 600 and the CBA. The early retirement benefit awarded to a former vested member in 2019 was actuarially reduced in value to ensure that there was no excess benefit given to the member.

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.

KENNETT SQUARE 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, 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	\$ 3,250,230	\$ 3,121,035	\$ (129,195)	104.1%
01-01-17	3,895,511	3,576,789	(318,722)	108.9%
01-01-19	4,376,991	3,571,560	(805,431)	122.6%

Note: The market values of the plan’s assets at 01-01-15, 01-01-17 and 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses over a 4-year averaging period, which will be limited to a maximum of 120 percent and a minimum of 80 percent of the fair market value of assets. 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.

KENNETT SQUARE 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.

KENNETT SQUARE BOROUGH POLICE 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
2010	\$ 20,945	\$ 20,945	\$ -	\$ 712,160	2.94%
2011	94,329	117,141	(22,812)	-	
2012	118,845	118,845	-	956,197	12.43%
2013	117,374	117,374	-	-	
2014	97,078	97,078	-	945,276	10.27%
2015	120,291	120,291	-	981,476	12.26%
2016	125,729	125,729	-	1,000,048	12.57%
2017	74,767	74,767	-	983,653	7.60%
2018	95,565	95,565	-	1,125,058	8.49%
2019	99,719	99,719	-	1,117,490	8.92%

* This schedule is presented pursuant to the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans* by reporting entities responsible for administering the pension plan to improve financial reporting by state and local governmental pension plans. Due to the statement being implemented only recently, the amount of Covered-Employee Payroll was not provided for odd years prior to 2014.

KENNETT SQUARE BOROUGH 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	N/A
Remaining amortization period	N/A
Asset valuation method	4-year smoothing – the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return	7.25%
Projected salary increases	5.50%
Cost-of-living adjustments	None assumed

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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