COMPLIANCE AUDIT

Pequea Township Police Pension Plan

Lancaster County, Pennsylvania

For the Period

January 1, 2018 to December 31, 2020

October 2021

Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General

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TIMOTHY L. DEFOOR
AUDITOR GENERAL

Chairman, Board of Township Supervisors
Pequea Township
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We have conducted a compliance audit of the Pequea Township Police Pension Plan for the period January 1, 2018 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 findings 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 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 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 that there were no employee contributions required for the years covered by our audit period due to the fact that employee contributions were appropriately waived by the municipality.

- We determined whether retirement benefits calculated for plan members 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 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.

Pequea Township contracted with an independent certified public accounting firm for audits of its 2019 and 2020 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 township's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

The Pequea 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 Pequea 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 objectives.

The results of our procedures indicated that, in all significant respects, the Pequea 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 finding further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation-Failure To Deposit The Full Amount Of State Aid Into The Pension Plan

Finding No. 2 – Inconsistent And Unauthorized Pension Benefits

Finding No. 3 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan

Finding No. 1 contained in this audit report repeats a condition that was cited in our previous report that has not been corrected by township officials. We are concerned by the township'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 Pequea 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.

Timothy L. DeFoor

September 30, 2021

Timothy L. DeFoor
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 Pequea 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.

- 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 Pequea Township Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Resolution No. 564-2021, and a separately executed plan agreement with the Pennsylvania Municipal Retirement System (PMRS) adopted pursuant to Article IV of Act 15 for plans subject to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the township and its police officers. The plan was established June 7, 1974. Active members are required to contribute 5 percent of compensation to the plan; however, contributions were eliminated during the audit period. As of December 31, 2020, the plan had 4 active members, 1 terminated member eligible for vested benefits in the future, and 7 retirees receiving pension benefits.

Pursuant to Ordinance No. 205-2017, the former Southern Regional Police Commission was effectively dissolved on December 31, 2017 and the assets of the former commission were transferred to Pequea Township. In connection with the termination agreement, all interest, assets and liabilities of the former Southern Regional Police Commission in and of the pension plan were transferred and assigned to Pequea Township along with the duty and responsibility to perform any and all acts and obligations under the plan and applicable law and the liabilities arising thereunder. The township assumed responsibility for the former regional police pension plan effective January 1, 2018.

PEQUEA TOWNSHIP POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Recommendation – [Former Southern Regional Police Pension Plan]

Neither the former Southern Regional Police Commission nor Pequea Township has complied with the prior recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Failure To Deposit The Full Amount Of State Aid Into The Pension Plan

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Failure To Deposit The Full Amount Of State Aid Into The Pension Plan

Condition: As disclosed in the prior audit report of the former Southern Regional Police Pension Plan (SRPPP), the former regional police department received an allocation of state aid during 2016 in the amount of $69,994 on September 23, 2016; however, only state aid totaling $68,150 was deposited into the pension plan. During 2016, the plan was overseen by the former Southern Regional Police Commission (Commission) which was subsequently dissolved and taken over by Pequea Township. It was previously recommended that the remaining 2016 state aid allocation of $1,844, plus interest earned during the period beyond the 30 day grace period allowed by Act 205, be deposited into the police pension plan. As disclosed in the Background section of this report, the township assumed responsibility for the former SRPPP effective January 1, 2018. As of the date of this report, neither the former Commission nor the township have deposited the outstanding 2016 state aid allocation into the pension plan.

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.

In addition, Ordinance No. 205-2017 enacted by the township in connection with the dissolving of the former Commission and continuation of the police pension plan under the oversight and direction of the township, states, in part:

> TOWNSHIP hereby accepts transfer of any and all of COMMISSION's rights, title and interest in and to the Municipal Pension Plan, the duty and responsibility to perform any and all acts and obligations of COMMISSION under the Municipal Pension Plan and applicable law and the liabilities arising thereunder, and TOWNSHIP agrees to accept and assume the same as if TOWNSHIP had been an original party to the Municipal Pension Plan;

Cause: Former commission officials failed to ensure compliance with the department's recommendation prior to dissolution and subsequent transfer of the pension plan to the township. Additionally, during the 2018 transition, there was an oversight and the township was not made fully aware of the prior audit disclosure.

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.

Finding No. 1 – (Continued)

Recommendation: Since the township agreed to accept all of the former Commission's assets and obligations and the duty and responsibility to perform any and all acts and obligations under the municipal pension plan and applicable law and the liabilities arising thereunder as noted in the Criteria above, we recommend that the township deposit the remaining outstanding 2016 state aid allocation, $1,844, 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 plan officials for examination during our next audit of the plan.

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

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

Finding No. 2 – Inconsistent And Unauthorized Pension Benefits

Condition: The pension plan's separately executed plan agreement with PMRS, as initially adopted through Ordinance No. 205-2017 *(when responsibilities for administering the police pension plan were transferred to the township from the former Commission)* and restated in revised agreements executed during 2021, contains benefit provisions that conflict with the collective bargaining agreement between the police officers and the township and Act 600, as follows:

Benefit Provision	Governing Document	Collective Bargaining Agreement	Subject to Act 600
Age and service	The later of the date: Member attains age 50; Member completes 25 years of Vesting Service	Retirement after 12 years of continuous service and having reached age 50;	…a minimum period of total service in the aggregate of twenty-five years in the same…township or regional police department and shall fix the age of the members of the force at fifty-five years, or… fifty years…
Definition of attending college	None	None	For purposes of this act, the phrase "attending college" shall mean the eligible children must be registered at an accredited institution of higher learning and must be carrying a minimum course load of 7 credit hours per semester.

Finding No. 2 – (Continued)

In addition, the actuarial valuation report form C for the police pension plan, with a valuation date of January 1, 2019, submitted to the Municipal Pension Reporting Program, reported the benefit provisions included in the collective bargaining agreement.

Criteria: A governing document which contains clearly defined and updated benefit provisions is a prerequisite for the consistent, sound administration of retirement benefits. In addition, the pension plan's benefit structure should be in compliance with the provisions of Act 600. Furthermore, the plan's governing document and the collective bargaining agreement should contain consistent benefit provisions to ensure the sound administration of retirement benefits.

Cause: Former commission officials failed to ensure compliance with the department's verbal recommendation prior to dissolution and subsequent transfer of the pension plan to the township. Additionally, during the 2018 transition, there was an oversight and the township was not made fully aware of the prior disclosure.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

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 township 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.

Recommendation: We recommend that municipal officials take appropriate action to ensure the plan's governing document and the collective bargaining agreement contain consistent benefit provisions in accordance with Act 600 at their earliest opportunity to do so.

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

Auditor's Conclusion: Compliance will be evaluated during our next audit of the plan.

Finding No. 3 – Failure To Maintain An Adequate Record-Keeping System To Effectively Monitor Activity Of The Pension Plan

Condition: The borough's record-keeping system did not provide effective control over the transactional activity of the police pension plan during 2019 and 2020. 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 years 2019 and 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 years 2019 and 2020. In addition, municipal officials did not maintain a separate detailed accounting of pension plan transactions in 2018 during the year of transition from the regional pension plan into the township's management of the police 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, 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.

Finding No. 3 – (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 and 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. Additionally, PMRS failed to provide the township records and information for years 2019 and 2020. During the 2018 year of transition, the township had inadequate internal control procedures over the police pension plan. However, since that time, internal control procedures have been placed in effect to monitor the annual activity of the pension plan.

Auditor's Conclusion: PMRS has indicated that they have recently gone through a substantial upgrade to the plan administration software and implemented a new accounting system. The modernization process, along with the COVID-19 pandemic, has resulted in unforeseen delays in the 2019 and 2020 year-ends reporting process for financial statements and GASB 68 reports. PMRS also indicated that they are taking active measures to resolve these issues and will provide the outstanding reports as soon as the issues are resolved. PMRS anticipates that the process of completing and distributing 2019 Year-End Financial Activity Reports and Annual Member Statements for all of their plans will be completed by the fall, at which time they will transition to 2020 reports and statements. Compliance with the finding recommendation will be evaluated during our next audit of the plan.

PEQUEA 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	$ 2,136,326	$ 2,030,102	$ (106,224)	105.2%
01-01-17	2,561,016	2,595,385	34,369	98.7%
01-01-19	2,768,132	2,787,379	19,247	99.3%

PEQUEA 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.

PEQUEA TOWNSHIP 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*
2014	$ 60,184	$ 61,025	$ (841)	$ 527,623	11.57%
2015	73,267	81,759	(8,492)	485,209	16.85%
2016	68,130	68,150	(20)	431,948	15.78%
2017	98,314	104,383	(6,069)	563,471	18.52%
2018	76,997	77,057	(60)	394,485	19.53%
2019	76,738	76,738	-	437,688	17.53%
2020	59,593	70,778	(11,185)		

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

PEQUEA 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	11 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.

PEQUEA 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. Harry D. Lehman, III
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Mr. K. Scott Edwards
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Pennsylvania Municipal Retirement System

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