



**KENNETT SQUARE BOROUGH POLICE
PENSION PLAN**

CHESTER COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2010, TO DECEMBER 31, 2012

COMMONWEALTH OF PENNSYLVANIA

EUGENE A. DEPASQUALE - AUDITOR GENERAL

DEPARTMENT OF THE 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. Section 402(j) of Act 205 specifically requires the Auditor General, as deemed necessary, to make an audit of every municipality which receives general municipal pension system State aid and of every municipal pension plan and fund in which general municipal pension system State aid is deposited.

Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign fire insurance tax designated for paid firefighters and any investment income earned on the collection of these taxes. Generally, municipal pension plans established prior to December 18, 1984, are eligible for state aid. For municipal pension plans established after that date, the sponsoring municipality must fund the plan for three plan years before it becomes eligible for state aid. In accordance with Act 205, a municipality's annual state aid allocation cannot exceed its actual pension costs.

In addition to Act 205, the Kennett Square Borough Police Pension Plan is also governed by implementing regulations adopted by the Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

Act 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 761 et seq.

The Kennett Square Borough Police Pension Plan is a single-employer defined benefit pension plan 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.



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EUGENE A. DePASQUALE
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, 2010, to December 31, 2012. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our 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. Our methodology addressed determinations about the following:

- Whether state aid was properly determined and deposited in accordance with Act 205 requirements.
- Whether employer contributions are determined and deposited in accordance with the plan's governing document and applicable laws and regulations.
- Whether employee contributions are required and, if so, are determined, deducted and deposited into the pension plan and are in accordance with the plan provisions and applicable laws and regulations.
- Whether benefit payments, if any, represent payments to all (and only) those entitled to receive them and are properly determined in accordance with applicable laws and regulations.

- Whether obligations for plan benefits are accurately determined in accordance with plan provisions and based on complete and accurate participant data; and whether actuarial valuation reports are prepared and submitted to the Public Employee Retirement Commission (PERC) in accordance with state law and selected information provided on these reports is accurate, complete and in accordance with plan provisions to ensure compliance for participation in the state aid program.
- Whether the terms of the unallocated insurance contract, including ownership and any restrictions, are in compliance with plan provisions, investment policies and state regulations.
- Whether disability/killed-in-service insurance premiums are proper and in accordance with plan provisions and applicable laws, regulations, and policies.

Kennett Square Borough contracted with an independent certified public accounting firm for audits of its basic financial statements for the years ending December 31, 2010 and 2011, 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. In conducting our audit, we obtained an understanding of the borough's internal controls as they relate to the borough's compliance with those requirements and that we considered to be significant within the context of our audit objective, and assessed whether those significant controls were properly designed and implemented. Additionally, we tested transactions, assessed official actions, performed analytical procedures and interviewed selected officials to provide reasonable assurance of detecting instances of noncompliance with legal and regulatory requirements or noncompliance with provisions of contracts, administrative procedures, and local ordinances and policies that are significant within the context of the audit objective.

The results of our tests indicated that, in all significant respects, the 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 findings further discussed later in this report:

Finding No. 1 – Untimely Deposit Of State Aid

Finding No. 2 – Unauthorized Provision For A Killed In Service Benefit

The accompanying supplementary information is presented for purposes of additional analysis. We did not audit the information or conclude on it and, accordingly, express no form of assurance on it.

The contents of this report were discussed with officials of Kennett Square Borough and, where appropriate, their responses have been included in the report.



May 21, 2013

EUGENE A. DEPASQUALE
Auditor General

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Untimely Deposit Of State Aid

Condition: The municipality did not timely deposit its 2011 state aid allocation into an eligible pension plan within the 30 day grace period allowed by Act 205. The municipality received its 2011 state aid allocation in the amount of \$207,068 on September 23, 2011. The municipality allocated \$117,141 of the 2011 state aid allocation to its police pension plan; however, the amounts of \$94,329 and \$22,812 were not deposited until December 22, 2011, and April 9, 2012, respectively.

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 funds or the alternate funding mechanisms applicable to the respective pension plans.

Cause: Plan officials failed to establish adequate internal control procedures to ensure that the 2011 state aid allocation was deposited timely in accordance with Act 205 requirements.

Effect: Although the state aid allocation was deposited into the plan, the interest earned beyond the 30 day grace period was not deposited into the plan. When state aid is not deposited into a pension plan account in a timely manner, 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 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 develop and implement adequate internal control procedures to ensure that future state aid allocations are deposited into an eligible pension plan within 30 days of receipt by the municipal treasurer.

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

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 - Unauthorized Provision For A Killed In Service Benefit

Condition: Kennett Square Borough maintains a police pension plan governed by the provisions of Act 600, as amended. Prior to the adoption of Act 51 of 2009, Act 600 contained a mandatory killed in service benefit provision; however, Act 51 specifically repealed the section of Act 600 that referenced the mandatory killed in service benefit. During the prior audit period, a verbal observation was given to plan officials notifying them of the passage of Act 51. It was recommended that plan officials review the act's implications for the police pension plan and the collective bargaining agreement in effect for the period January 1, 2011, to December 31, 2013, with their municipal solicitor. During the current audit period, it has been determined that the pension plan's governing document and the current collective bargaining agreement for the period January 1, 2011, to December 31, 2013, continue to provide for a killed in service benefit that is no longer authorized by Act 600.

Section 6.03 of Ordinance No. 851 states:

A survivor benefit shall be payable in the event of the death of a Participant who is killed in service. In the event such a benefit becomes payable, the surviving spouse or dependent children of the Participant shall receive a benefit payable in accordance with section 6.04, in an amount equal to one hundred percent (100%) of the Member's Salary at the Time Of Death.

In addition, the killed in service benefit provision is included in the plan's January 1, 2011, actuarial valuation report.

Criteria: Section 1(a) of Act 51 of 2009 states, in part:

In the event a law enforcement officer, ambulance service or rescue squad member, firefighter, certified hazardous material response team member or National Guard member dies as a result of the performance of his duties, such political subdivision, Commonwealth agency or, in the case of National Guard members, the Adjutant General, or, in the case of a member of a Commonwealth law enforcement agency, the authorized survivor or the agency head, within 90 days from the date of death, shall submit certification of such death to the Commonwealth.

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

In addition, Section 1(d) of Act 51 of 2009 states, in part:

. . . the Commonwealth shall, from moneys payable out of the General Fund, pay to the surviving spouse or, if there is no surviving spouse, to the minor children of the paid firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty the sum of \$100,000, adjusted in accordance with subsection (f) of this section, and an amount equal to the monthly salary, adjusted in accordance with subsection (f) of this section, of the deceased paid firefighter, ambulance service or rescue squad member or law enforcement officer, less any workers' compensation or pension or retirement benefits paid to such survivors, and shall continue such monthly payments until there is no eligible beneficiary to receive them. For the purpose of this subsection, the term "eligible beneficiary" means the surviving spouse or the child or children under the age of eighteen years or, if attending college, under the age of twenty-three years, of the firefighter, ambulance service or rescue squad member or law enforcement officer who died as a result of the performance of his duty. When no spouse or minor children survive, a single sum of \$100,000, adjusted in accordance with subsection (f) of this section, shall be paid to the parent or parents of such firefighter, ambulance service member, rescue squad member or law enforcement officer. (Emphasis added)

Furthermore, Section 2 of Act 51 of 2009 states:

Repeals are as follows:

- (1) The General Assembly declares that the repeals under paragraph (2) are necessary to effectuate the amendment of section 1 of the act.
- (2) The following parts of acts are repealed:
 - (i) Section 5(e)(2) of the act of May 29, 1956 (1955 P.L.1804, No. 600), referred to as the Municipal Police Pension Law.
 - (ii) Section 202(b)(3)(vi) and (4)(vi) of the act of December 18, 1984 (P.L.1005, No. 205), known as the Municipal Pension Plan Funding Standard and Recovery Act.

Therefore, since Act 51 specifically repealed the killed in service provision of Act 600 and the funding provisions for the killed in service benefit that were contained in Act 205, the provision of a killed in service benefit is no longer authorized.

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Cause: Plan officials were unsuccessful in removing the killed in service benefit through the collective bargaining process.

Effect: Since Section 1 of Act 51 provides that the Commonwealth is obligated to pay the killed in service benefit less any pension or retirement benefits paid to eligible survivors, the continued provision of a killed in service benefit could result in the pension plan being obligated to pay a benefit that is no longer authorized by Act 600, and would have been paid entirely by the Commonwealth absent such provision.

Recommendation: We recommend that the municipality review the plan's killed in service benefit with its solicitor in conjunction with Act 51 of 2009, and make any adjustments deemed necessary at its earliest opportunity to do so.

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

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, 2007, is as follows:

| | (1) | (2) | (3) | (4) | (5) | (6) |
|--------------------------|----------------------------------|--|---|-------------------------|------------------------|---|
| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) - Entry Age (b) | Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a) | Funded Ratio (a)/(b) | Covered Payroll (c) | Unfunded (Assets in Excess of) Actuarial Accrued Liability as a % of Payroll [(b-a)/(c)] |
| 01-01-07 | \$ 2,224,082 | \$ 1,770,644 | \$ (453,438) | 125.6% | \$ 841,346 | (53.9%) |
| 01-01-09 | 2,014,978 | 2,301,933 | 286,955 | 87.5% | 838,925 | 34.2% |
| 01-01-11 | 2,268,936 | 2,502,696 | 233,760 | 90.7% | 712,160 | 32.8% |

Note: The market values of the plan's assets at 01-01-09 and 01-01-11 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.

Trends in unfunded (assets in excess of) actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded (assets in excess of) actuarial accrued liability as a percentage of annual covered payroll (Column 6) approximately adjusts for the effects of inflation and aids analysis of the plan's progress made in accumulating sufficient assets to pay benefits when due. Generally, where there is an unfunded actuarial accrued liability, the smaller this percentage, the stronger the plan. However, when assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

| Year Ended December 31 | Annual Required Contribution | Percentage Contributed |
|------------------------|------------------------------|------------------------|
| 2007 | \$ 31,489 | 103.4% |
| 2008 | 23,363 | 114.9% |
| 2009 | 27,560 | 114.3% |
| 2010 | 20,945 | 100.0% |
| 2011 | 94,329 | 124.2% |
| 2012 | 118,845 | 119.2% |

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
 SUPPLEMENTARY INFORMATION
 NOTES TO SUPPLEMENTARY SCHEDULES
 (UNAUDITED)

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation date follows:

| | |
|-------------------------------|--|
| Actuarial valuation date | January 1, 2011 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar |
| Remaining amortization period | 13 years |
| 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 * | 7.5% |
| Projected salary increases * | 5.5% |
| * Includes inflation at | Not disclosed |
| Cost-of-living adjustments | None assumed |

KENNETT SQUARE BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

Kennett Square Borough Police Pension Plan
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120 Marshall Street
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|---------------------------------|-------------------|
| The Honorable Matthew W. Fetick | Mayor |
| Mr. Danilo P. Maffei | Council President |
| Mr. Brant Kucera | Borough Manager |

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