COMPLIANCE AUDIT

Kennett Township Non-Uniformed Pension Plan

Chester County, Pennsylvania

For the Period
January 1, 2014 to December 31, 2017

January 2019

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

Board of Township Supervisors
Kennett Township
Chester County
Chadds Ford, PA 19317

We have conducted a compliance audit of the Kennett Township Non-Uniformed Pension Plan for the period January 1, 2014 to December 31, 2017. We also evaluated compliance with some requirements subsequent to that period when possible. 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. 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 both of the 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 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, 2013, January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2014, 2016 and 2018, 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.

- We determined whether the terms of the contractual agreement with the Pennsylvania Municipal Retirement System were in accordance with the plan's governing document, if separately stated, and applicable laws and regulations by comparing the terms of the contractual agreement with the plan's governing document, if separately stated, and applicable laws and regulations.

The Kennett Township 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 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 Kennett Township Non-Uniformed 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 township's internal controls as they relate to the township'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 and as previously described, 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 procedures indicated that, in all significant respects, the Kennett Township 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 Properly Determine And Fully Pay The Minimum Municipal Obligation Of The Plan

Finding No. 2 – Incorrect Data On Certification Form AG385 Resulting In An Overpayment Of State Aid

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 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.

January 22, 2019

Eugene A. DePasquale

EUGENE A. DEPASQUALE
Auditor General

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BACKGROUND

On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.). The Act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to Pennsylvania's public pension plans. 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.

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 Township Non-Uniformed Pension Plan is also governed by implementing regulations adopted by the former 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 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 Kennett Township Non-Uniformed Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 214, adopted pursuant to Act 15. The plan was established August 1, 1975. Active members are not required to contribute to the plan, but may voluntarily contribute up to 20 percent of compensation. As of December 31, 2017, the plan had 13 active members, no terminated members eligible for vested benefits in the future, and 4 retirees receiving benefits.

BACKGROUND – (Continued)

As of December 31, 2017, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Available upon attainment of age 60.
Early Retirement	A voluntary early retirement is available after 24 years of service. An involuntary early retirement is available after 8 years of service.
Vesting	A member is 100% vested after 5 years of service.

Retirement Benefit:

Benefit equals 1.25% times credited service times Final Average Salary (FAS). FAS based upon final 3 years annualized salary.

Survivor Benefit:

If eligible to retire at the time of death, beneficiary receives present value of accrued benefit. At retirement, member may select a survivor benefit.

Disability Benefit:

Service Related	A 50% disability benefit is provided to a member who is unable to perform gainful employment regardless of age or service, offset by available Workers' Compensation benefits.
Non-service Related	A 30% disability benefit is provided to a member who has at least 10 years of service and who is unable to perform gainful employment.

Finding No. 1 – Failure To Properly Determine And Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: Plan officials did not properly determine or fully pay the minimum municipal obligation (MMO) of the non-uniformed pension plan for the year 2016, as required by Act 205. The MMO determined by the municipality understated payroll by $138,666 resulting in a shortfall amounting to $11,596 for the 2016 MMO. In addition, the municipality did not fully pay the required MMO that was due to the pension plan for the years 2015, 2017, and 2018, as required by Act 205. Based upon an estimate prepared by this department, the municipality had a total unpaid MMO balance amounting to $83,105 for the years 2015, 2016, 2017, and 2018.

Criteria: With regard to the MMO, Section 302(c) of Act 205 states, in part:

> Annually, the chief administrative officer of the pension plan shall determine the minimum obligation of the municipality with respect to the pension plan for the following plan year.

With regard to the payroll estimate used in the preparation of the MMO, the Pennsylvania Code, Title 16, Section 204.1(c)(1) states, in part:

> The payroll used in determining the minimum municipal obligation of a pension plan under section 302(c) of the act shall be based on the payroll to be reported on the Internal Revenue Service Form W-2 and shall be calculated as the total payroll for active members of the plan as of the date of the determination, plus the payroll for the same active members of the plan projected to the year's end using the payroll rates in effect as of the date of the determination.

Section 302(d) of Act 205 states, in part:

> The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

Furthermore, Section 302(e) of Act 205 states:

> Any amount of the minimum obligation of the municipality which remains unpaid as of December 31 of the year in which the minimum obligation is due shall be added to the minimum obligation of the municipality for the following year, with interest from January 1 of the year in which the minimum obligation was first due until the date the payment is paid at a rate equal to the interest assumption used for the actuarial valuation report or the discount rate applicable to treasury bills issued by the Department of Treasury of the United States with a six-month maturity as of the last business day in December of the plan year in which the obligation was due, whichever is greater, expressed as a monthly rate and compounded monthly.

Finding No. 1 – (Continued)

Cause: Plan officials did not comply with the Act 205 requirements because payroll estimates utilized in preparation of original MMO calculations were significantly understated, and although the township revised each of the MMO calculations for 2015, 2017 and 2018, there was confusion between the township and the plan custodian, PMRS, as to which MMO amounts were actually due and payable to the pension plan for each of the years. The township failed to verify the annual MMO amounts actually billed by PMRS for the aforementioned years and ultimately paid the original, incorrect MMO amounts for each of the impacted years instead of the township-revised MMOs. For 2016, the township was not aware that a payroll error existed during determination of the original 2016 MMO and procedures were not adequate to detect this deficiency; and accordingly, no revision to the original 2016 MMO was made and the township paid the underestimated MMO.

Effect: The proper determination of the plan's MMO ensures plan officials can properly allocate the necessary resources to the pension plan for the upcoming year. The failure to properly determine and/or fully pay the MMO could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the municipality's failure to fully pay the 2015, 2016, 2017 and 2018 MMOs by the December 31, deadlines, the municipality must add the outstanding MMO balances to the current year's MMO and include interest, as required by Act 205.

Furthermore, the township's future state aid allocations may be withheld until the finding recommendation is complied with.

Recommendation: We recommend that the municipality pay the outstanding MMO due to the non-uniformed pension plan for the years 2015, 2016, 2017 and 2018, with interest, in accordance with Section 302(e)/303(e) of Act 205. A copy of the interest calculation must be maintained by the township for examination during our next audit of the plan.

Furthermore, we recommend that, in the future, plan officials properly determine the amount of payroll to be used in the MMO calculation, as aforementioned in the Criteria section above, and pay the full MMO due the plan in accordance with Act 205.

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

Auditor's Conclusion: Due to the potential withhold of state aid, the township's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through our next audit of the plan.

Finding No. 2 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The township certified an ineligible non-uniformed employee (1 unit) and overstated payroll by $23,651 on the Certification Form AG 385 filed in 2017. The data contained on this certification form is based on prior calendar year information.

Criteria: Pursuant to Act 205, at Section 402(e)(2), in order to be eligible for certification, an employee must have been employed on a full-time basis for at least six consecutive months and must have been participating in a pension plan during the certification year.

Cause: Plan officials failed to establish adequate internal control procedures to ensure the accuracy of the data certified.

Effect: The data submitted on this certification form is used, in part, to calculate the state aid due to the municipality for distribution to its pension plans. Because the township's state aid allocation was based on unit value, the incorrect certification of pension data affected the township's state aid allocation, as identified below:

Year	Units Overstated	Unit Value	State Aid Overpayment
2017	1	$ 4,588	$ 4,588

In addition, the township used the overpayment of state aid towards the MMO due to the pension plan; therefore, if the reimbursement to the Commonwealth is made from the pension plan, the plan's MMO will not be fully paid.

Recommendation: We recommend that the total excess state aid, in the amount of $4,588, plus interest, be returned to the Commonwealth. A check in this amount, with interest compounded annually from date of receipt to date of repayment, at a rate earned by the pension plan, should be made payable to: Commonwealth of Pennsylvania and mailed to: Department of the Auditor General, Municipal Pension & Fire Relief Programs Unit, 321 Finance Building, Harrisburg, PA 17120. A copy of the interest calculation must be submitted along with the check.

We also recommend that in the future, plan officials establish adequate internal control procedures, such as having at least two people review the data certified, to ensure compliance with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data.

Finding No. 2 – (Continued)

In addition, if the reimbursement to the Commonwealth is made from non-uniformed pension plan funds, we recommend that any resulting MMO deficiency be paid to the pension plan with interest, at a rate earned by the pension plan.

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

Auditor's Conclusion: Compliance will be monitored subsequent to the release of the audit report and through our next audit of the plan.

KENNETT TOWNSHIP NON-UNIFORMED PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

A condition such as that reported by Finding No. 1 contained in this audit report may lead to a total withholding of state aid in the future unless that finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 314 Finance Building, Harrisburg, PA 17120.

KENNETT TOWNSHIP NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 8 through 10 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2015

	2014	2015
Total Pension Liability		
Service cost	$ 60,054	$ 109,166
Interest	63,815	81,796
Transfers	-	20,054
Difference between expected and actual experience	169,961	-
Changes of assumptions	-	(6,158)
Benefit payments, including refunds of member contributions	(16,920)	(19,069)
Net Change in Total Pension Liability	276,910	185,789
Total Pension Liability – Beginning	1,115,931	1,392,841
Total Pension Liability – Ending (a)	$ 1,392,841	$ 1,578,630
Plan Fiduciary Net Position		
Contributions – employer	$ 69,081	$ 81,371
PMRS assessment	-	280
Contributions – member	14,521	30,175
PMRS investment income	49,139	55,693
Market value investment income	291	(61,758)
Transfers	-	20,054
Benefit payments, including refunds of member contributions	(16,920)	(19,069)
PMRS administrative expense	(220)	(260)
Additional administrative expense	(1,884)	(2,322)
Net Change in Plan Fiduciary Net Position	114,008	104,164
Plan Fiduciary Net Position – Beginning	883,176	997,184
Plan Fiduciary Net Position – Ending (b)	$ 997,184	$ 1,101,348
Net Pension Liability – Ending (a-b)	$ 395,657	$ 477,282
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	71.59%	69.77%
Estimated Covered Employee Payroll	$ 540,668	$ 938,579
Net Pension Liability as a Percentage of Covered Employee Payroll	73.18%	50.85%

KENNETT TOWNSHIP NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2017

	2016	2017
Total Pension Liability		
Service cost	$ 121,905	$ 130,881
Interest	91,639	106,888
Transfers	(9,860)	-
Difference between expected and actual experience	112,686	-
Changes of assumptions	60,978	-
Benefit payments, including refunds of member contributions	(19,069)	(21,885)
Net Change in Total Pension Liability	358,279	215,884
Total Pension Liability – Beginning	1,578,630	1,936,909
Total Pension Liability – Ending (a)	$ 1,936,909	$ 2,152,793
Plan Fiduciary Net Position		
Contributions – employer	$ 94,441	$ 101,912
PMRS assessment	340	340
Contributions – member	39,656	41,511
PMRS investment income	65,337	71,246
Market value investment income	25,366	159,361
Transfers	(9,860)	-
Benefit payments, including refunds of member contributions	(19,069)	(21,885)
PMRS administrative expense	(280)	(320)
Additional administrative expense	(3,201)	(3,277)
Net Change in Plan Fiduciary Net Position	192,730	348,888
Plan Fiduciary Net Position – Beginning	1,101,348	1,294,078
Plan Fiduciary Net Position – Ending (b)	$ 1,294,078	$ 1,642,966
Net Pension Liability – Ending (a-b)	$ 642,831	$ 509,827
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	66.81%	76.32%
Estimated Covered Employee Payroll	$ 1,031,206	$ 1,047,387
Net Pension Liability as a Percentage of Covered Employee Payroll	62.34%	48.68%

KENNETT TOWNSHIP NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the township as of December 31, 2014 and 2015, calculated using the discount rate of 5.5%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (4.5%)	Current Discount Rate (5.5%)	1% Increase (6.5%)
Net Pension Liability – 12/31/14	$ 594,042	$ 395,657	$ 228,622
Net Pension Liability – 12/31/15	$ 696,576	$ 477,282	$ 294,088

In addition, the following presents the net pension liability of the township as of December 31, 2016 and 2017, calculated using the discount rate of 5.25%, as well as what the township's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (4.25%)	Current Discount Rate (5.25%)	1% Increase (6.25%)
Net Pension Liability – 12/31/16	$ 914,831	$ 642,831	$ 413,982
Net Pension Liability – 12/31/17	$ 812,144	$ 509,827	$ 255,471

KENNETT TOWNSHIP 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, 2013, 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)
01-01-13	$ 808,085	$ 1,031,181	$ 223,096	78.4%
01-01-15	1,014,288	1,392,841	378,553	72.8%
01-01-17	1,368,668	1,936,909	568,241	70.7%

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 TOWNSHIP NON-UNIFORMED PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2012	$ 42,716	100.1%
2013	50,679	100.1%
2014	69,061	100.0%
2015	93,709	87.1%*
2016	106,397	89.1%*
2017	134,388	76.1%*

* See Finding No. 1 contained in the Findings and Recommendations section of this report.

KENNETT TOWNSHIP 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, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	9 years
Asset valuation method	The Actuarial Value of Assets equals the plan's member, municipal, DROP (if applicable) reserve accounts plus the retiree actuarial liability. This asset smoothing 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, all of which are subject to comply with the Actuarial Standards of Practice No. 44, Selection and Use of Asset Valuation Methods when defining the actuarial Value of Assets.
Actuarial assumptions:	
Investment rate of return	5.25%, compounded annually, net of investment and administration expenses
Salary scale	Total rate (including inflation) (e.g. age 25 – 7.05%; age 35 – 4.55%; age 45 – 3.97%; age 55 – 3.44%; age 65 – 2.80%)
Cost-of-living adjustments	2.8% per year, subject to plan limitations

KENNETT TOWNSHIP NON-UNIFORMED PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
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