

COMPLIANCE AUDIT

Kittanning Borough Police Pension Plan Armstrong County, Pennsylvania For the Period January 1, 2017 to December 31, 2018

January 2020



Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General



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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and Borough Council
Kittanning Borough
Armstrong County
Kittanning, PA 16201

We have conducted a compliance audit of the Kittanning Borough Police Pension Plan for the period January 1, 2017 to December 31, 2018. 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 finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding 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 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 the lone plan member 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 individual and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient. We also determined whether retirement benefits calculated for the one plan member who elected to vest during the current audit period, represent payments to all (and only) those entitled to receive them and were properly determined in accordance with the plan's governing document, applicable laws and regulations by recalculating the amount of the pension benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined.
- We determined whether the January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 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 State Association of Boroughs 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.
- We determined whether provisions of the Deferred Retirement Option Plan (DROP) were in accordance with the provisions of Act 205 by examining provisions stated in the plan's governing documents.

Kittanning Borough contracted with an independent certified public accounting firm for an audit of its basic financial statements for the year ended December 31, 2017, which is 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 Kittanning 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 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 Kittanning 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 – Incorrect Data On Certification Form AG 385 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 Kittanning 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.

December 20, 2019


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

The Kittanning Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 437-2006, as amended, 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 May 6, 1957. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2018, the plan had 7 active members, 1 terminated member eligible for vested benefits in the future, and 7 retirees receiving pension benefits from the plan.

BACKGROUND

As of December 31, 2018, selected plan benefit provisions are as follows:

Eligibility Requirements:

Normal Retirement	Age 50 and 25 years of service.
Early Retirement	None
Vesting	100% vesting available after 12 years of service.

Retirement Benefit:

Benefit equals 50% of final 36 months average salary, plus a service increment of \$100 per month for the completion of 26 or more years of service.

Survivor Benefit:

Before Retirement Eligibility	Refund of member contributions plus interest.
After Retirement Eligibility	A monthly benefit equal to 50% of the pension the member was receiving or was entitled to receive on the day of the member's death.

Service Related Disability Benefit:

Benefit equals 50% of the member's salary at the time the disability was incurred, offset by Social Security disability benefits received for the same injury.

KITTANNING BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The borough certified an ineligible police officer (2 units) and overstated payroll by \$12,144 on the Certification Form AG 385 filed in 2019. The police officer terminated employment with the borough during January 2018 and did not meet the eligibility requirements authorized in Act 205 for certification purposes. 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 borough’s state aid allocation was based on unit value, the incorrect certification of pension data affected the borough’s state aid allocation, as identified below:

<u>Year</u>	<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2019	2	\$ 5,120	\$ 10,240

In addition, the borough used the overpayment of state aid to pay the minimum municipal obligations (MMOs) due to the borough’s pension plans; therefore, if the reimbursement to the Commonwealth is made from the police pension plan, the plan’s MMO will not be fully paid for 2019.

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

Recommendation: We recommend that the total excess state aid, in the amount of \$10,240, plus interest, be returned to the Commonwealth from the borough’s general fund. 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.

KITTANNING BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

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.

In addition, if the reimbursement to the Commonwealth is made from the pension plan, the plan's MMO will not be fully paid and any resulting MMO deficiency will also need to 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: The borough's compliance with the finding recommendation will be monitored subsequent to the release of the audit report and through our next audit of the pension plan.

KITTANNING BOROUGH POLICE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

The finding contained in this audit report cites an overpayment of state aid to the borough in the amount of \$10,240, plus interest. A condition/conditions of this nature may lead to a total withholding of state aid in the future unless that finding is corrected. A check in this amount with interest, 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.

KITTANNING BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 6 to 7 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, 2015, 2016, 2017, AND 2018

	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Total Pension Liability					
Service cost	\$ 95,962	\$ 97,846	\$ 102,738	\$ 97,831	\$ 102,723
Interest	273,573	264,198	279,469	284,630	298,730
Difference between expected and actual experience	-	(345,045)	-	(128,626)	-
Changes of assumptions	-	13,320	-	-	-
Benefit payments, including refunds of member contributions	(164,330)	(165,047)	(161,613)	(198,095)	(200,610)
Net Change in Total Pension Liability	<u>205,205</u>	<u>(134,728)</u>	<u>220,594</u>	<u>55,740</u>	<u>200,843</u>
Total Pension Liability – Beginning	3,633,842	3,839,047	3,704,319	3,924,913	3,980,653
Total Pension Liability – Ending (a)	<u>\$ 3,839,047</u>	<u>\$ 3,704,319</u>	<u>\$ 3,924,913</u>	<u>\$ 3,980,653</u>	<u>\$ 4,181,496</u>
Plan Fiduciary Net Position					
Contributions – Employer	\$ 66,215	\$ 137,959	\$ 113,593	\$ 120,231	\$ 144,989
Contributions – State Aid	116,180	61,987	70,411	72,244	57,820
Contributions – Member	26,668	27,008	28,349	24,577	25,719
Net investment income	230,724	(18,948)	146,452	417,370	(171,948)
Benefit payments, including refunds of member contributions	(164,330)	(165,047)	(161,613)	(198,095)	(200,610)
Administrative expense	(20,780)	(27,842)	(26,046)	(30,406)	(28,107)
Net Change in Plan Fiduciary Net Position	<u>254,677</u>	<u>15,117</u>	<u>171,146</u>	<u>405,921</u>	<u>(172,137)</u>
Plan Fiduciary Net Position – Beginning	2,773,196	3,027,873	3,042,990	3,214,136	3,620,057
Plan Fiduciary Net Position – Ending (b)	<u>\$ 3,027,873</u>	<u>\$ 3,042,990</u>	<u>\$ 3,214,136</u>	<u>\$ 3,620,057</u>	<u>\$ 3,447,920</u>
Net Pension Liability – Ending (a-b)	<u>\$ 811,174</u>	<u>\$ 661,329</u>	<u>\$ 710,777</u>	<u>\$ 360,596</u>	<u>\$ 733,576</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	78.9%	82.1%	81.9%	90.9%	82.5%
Estimated Covered Employee Payroll	\$ 476,502	\$ 535,166	\$ 545,070	\$ 602,650	\$ 470,898
Net Pension Liability as a Percentage of Covered Employee Payroll	170.2%	123.6%	130.4%	59.8%	155.8%

KITTANNING BOROUGH POLICE 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 borough as of December 31, 2015, 2016, 2017 and 2018, calculated using the discount rate of 7.5%, as well as what the borough'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 (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Net Pension Liability – 12/31/15	\$ 1,106,541	\$ 661,329	\$ 286,046
Net Pension Liability – 12/31/16	\$ 1,175,832	\$ 710,777	\$ 318,479
Net Pension Liability – 12/31/17	\$ 824,060	\$ 360,596	\$ (31,283)
Net Pension Liability – 12/31/18	\$ 1,215,506	\$ 733,576	\$ 325,845

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	\$ 182,395	\$ 182,395	\$ -	\$ 476,502	38.28%
2015	199,946	199,946	-	535,166	37.36%
2016	184,004	184,004	-	545,070	33.76%
2017	192,475	192,475	-	602,650	31.94%
2018	202,809	202,809	-	470,898	43.07%

SCHEDULE OF INVESTMENT RETURNS

Annual Money-Weighted Rate of Return, Net of Investment Expense:

2018	(4.75%)
2017	12.99%
2016	4.81%
2015	(0.64%)
2014	8.50%

KITTANNING 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, 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	\$ 2,579,846	\$ 3,448,333	\$ 868,487	74.8%
01-01-15	3,027,873	3,507,322	479,449	86.3%
01-01-17	3,214,136	3,796,287	582,151	84.7%

Note: The market value of the plan's assets at 01-01-13 has been adjusted to reflect the smoothing of gains and/or losses over a four-year averaging period. 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.

KITTANNING 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.

KITTANNING 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, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	7 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases *	5.0%
Cost-of-living adjustments	3.0%

* Includes inflation at 2.25%

KITTANNING BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Scott Kline
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Ms. Kimberly Fox
Council President, Ward 3

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Councilmember, Ward 3

Mr. Mike Johns
Councilmember, Ward 4

Ms. Cynthia McDermott
Borough Manager

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