

# COMPLIANCE AUDIT

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## Municipality of Kingston Police Pension Plan Luzerne County, Pennsylvania For the Period January 1, 2015 to December 31, 2016

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January 2018



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 Municipal Council  
Municipality of Kingston  
Luzerne County  
Kingston, PA 18704

We have conducted a compliance audit of the Municipality of Kingston Police Pension Plan for the period January 1, 2015 to December 31, 2016. 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 our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit 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 finding contained in our prior audit report, we inquired of plan officials and evaluated supporting documentation provided by officials evidencing that the suggested corrective action has been appropriately taken. To determine whether the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, our methodology included the following:

- We determined whether state aid was properly determined and deposited in accordance with Act 205 requirements by verifying the annual deposit date of state aid and determining whether deposits were made within 30 days of receipt for all years within the period under audit.

- We determined whether annual employer contributions were calculated and deposited in accordance with the plan's governing document and applicable laws and regulations by examining the municipality's calculation of the plan's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plan as evidenced by supporting documentation.
- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.
- We determined whether retirement benefits calculated for the plan member who retired subsequent to the audit period and through the completion of our fieldwork procedures, 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 benefit due to the retired individual and comparing this amount to supporting documentation evidencing the amount determined and actually paid to the recipient.
- We determined whether the January 1, 2013 and January 1, 2015 actuarial valuation reports were prepared and submitted to the former Public Employee Retirement Commission (PERC) by March 31, 2014 and 2016, 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 all annual special ad hoc postretirement reimbursements received by the municipality were authorized and appropriately deposited in accordance with Act 147 by tracing information to supporting documentation maintained by plan officials.
- We determined whether the terms and methodologies of the issuance of pension obligation bonds by the municipality, and any restrictions were in compliance with plan provisions and Act 205 through inquiry of plan officials and examination of supporting documentation for pension obligation bonds issued during the current audit period.

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

Municipal officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Municipality of Kingston 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 municipality’s internal controls as they relate to the municipality’s compliance with those requirements and that we considered to be significant within the context of our audit objectives, 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 objectives.

The results of our procedures indicated that, in all significant respects, the Municipality of Kingston 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 – Noncompliance With Prior Audit Recommendation – Unauthorized Pension Benefits

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

As previously noted, one of the objectives of our audit of the Municipality of Kingston Police Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption of Act 44 of 2009. Among several provisions relating to municipal pension plans, the act provides for the implementation of a distress recovery program. Three levels of distress have been established:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
I	Minimal distress	70-89%
II	Moderate distress	50-69%
III	Severe distress	Less than 50%

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. However, we are extremely concerned about the funded status of the plan contained in the schedule of funding progress included in this report which indicates a decline of assets available to satisfy the long-term liabilities of the plan. **The plan's funded ratio went from 84.4% as of January 1, 2011, to a ratio of 65.9% as of January 1, 2015**, which is the most recent data available. Based on this information, **the former Public Employee Retirement Commission issued a notification that the municipality is currently in Level II moderate distress status.** We encourage municipal officials to monitor the funding of the police pension plan to ensure its long-term financial stability.

The contents of this report were discussed with officials of the Municipality of Kingston and, where appropriate, their responses have been included in the report. We would like to thank municipal officials for the cooperation extended to us during the conduct of the audit.

January 4, 2018



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 Municipality of Kingston 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 147 - Special Ad Hoc Municipal Police and Firefighter Postretirement Adjustment Act, Act of December 14, 1988 (P.L. 1192, No. 147), as amended, 53 P.S. § 896.101 et seq.
- Act 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1158, No. 177), as amended, 53 Pa.C.S. § 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 Municipality of Kingston Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of an ordinance dated April 4, 1983, as amended. The plan is also affected by the provisions of collective bargaining agreements between the municipality and its police officers. The plan was established December 29, 1970. Active members are required to contribute 5 percent of compensation to the plan. As of December 31, 2016, the plan had 19 active members, no terminated members eligible for vested benefits in the future, and 19 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2016, selected plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	Pre January 1, 1996: Age 50 and 25 years of service Post January 1, 1996: Age 55 and 25 years of service
Early Retirement	None
Vesting	Member is 100% vested after 12 years of service

### Retirement Benefit:

Benefit equals 65% of average monthly compensation for members hired before January 1, 1996 and 50% of average monthly compensation for members hired after January 1, 1996. Average monthly compensation is based upon final 36 months of employment.

### Survivor Benefit:

If member is retired or eligible for retirement, the benefit is 100% of pension.

### Service Related Disability Benefit:

Benefit equals 65% of average monthly compensation reduced by 100% of any Workman's Compensation benefits received by the member. The minimum disability pension is 50% of monthly salary at time of disability.

### Non-Service Related Disability Benefit:

For members hired before January 24, 2001: If member has 10 or more years of service, the benefit is equal to 30% of average monthly compensation.

MUNICIPALITY OF KINGSTON POLICE PENSION PLAN  
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

The Municipality of Kingston has not complied with the prior audit recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Unauthorized Pension Benefits

MUNICIPALITY OF KINGSTON POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Noncompliance With Prior Audit Recommendation – Unauthorized Pension Benefits**

Condition: As disclosed in the prior audit report, the pension plan’s governing document contains pension benefits that are not authorized by Act 600. Section 29-33A of the municipality’s codified ordinances states:

Upon normal or mandatory retirement date. Upon retirement at his normal or mandatory retirement date, an active member shall become a retired member and shall receive a monthly normal form of retirement income equal to one-twelfth of fifty percent (1/12 of 50%) of such member’s **average compensation**.

Section 29-21B of the codified ordinances, as amended, states, in part:

**Average compensation** – For officers hired before January 1, 1996, average compensation is defined as sixty-five percent (65%) of the officer’s average earnings for the last thirty-six (36) months of employment, with cost of living allowance, the maximum pension benefit to be received not to exceed seventy-five percent (75%) of the officer’s average earnings for the last thirty-six (36) months of employment.

For officers hired after January 1, 1996, average compensation is defined as Fifty percent (50%) of the officer’s average earnings for the last thirty-six (36) months of employment, with cost of living allowance, the maximum pension benefit to be received not to exceed seventy-five percent (75%) of the officer’s average earnings for the last thirty-six (36) months of employment.

Based on the above-cited provisions, it appears that the plan’s governing document, if strictly applied, inadvertently prescribes a pension benefit of 50 percent of 65 percent (or 32.5 percent) of the monthly average earnings for officers hired before January 1, 1996, and 50 percent of 50 percent (or 25 percent) of the monthly average earnings for officers hired after January 1, 1996. Such benefits would be contrary to Act 600 and do not appear to represent the municipality’s intent, which is evidenced by the fact that pension calculations for police officers hired prior to January 1, 1996, are based on 65 percent of the member’s average earnings over the last 36 months of employment.

MUNICIPALITY OF KINGSTON POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Criteria: On January 24, 2001, the Commonwealth Court of Pennsylvania issued its opinion in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee*. Therein, the court held that Section 2962(c)(5) of the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2962(c)(5), “clearly precludes home rule municipalities from providing pension benefits different from those prescribed in general law including Act 600.” The court’s holding was in accord with the position taken by this Department since at least January 1995.

Section 5(c) of Act 600 states, in part:

Monthly pension or retirement benefits other than length of service increments shall be computed at one-half the monthly average salary of such member during not more than the last sixty nor less than the last thirty-six months of employment.

Cause: Plan officials failed to update the governing document to reflect the plan’s actual pension benefits.

Effect: The plan’s governing document continues to contain unauthorized benefit provisions which could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: Again, the department acknowledges that its position has changed over the years and that, until *Monroeville*, there was no definitive decision as to whether home rule municipalities were obliged to comply with applicable pension law. The department seeks, therefore, to implement the decision in as equitable a fashion as possible, while paying necessary deference to the court’s ruling. Accordingly, the department will not penalize the municipality for granting benefits in excess of Act 600 to police officers who began full-time employment before January 1, 1996. However, plan officials should amend the plan’s governing document to clarify the municipality’s intent to provide pension benefits to police officers hired prior to January 1, 1996, that are based on 65 percent of a member’s average earnings over the last 36 months of employment.

Furthermore, the department expects the municipality to restrict pension benefits to those authorized by Act 600 for all police officers who began full-time employment on or after January 1, 1996. Therefore, we again recommend that municipal officials amend the plan’s governing document to clearly reflect the municipality’s intentions to provide pension benefits in accordance with Act 600 provisions that are based on 50 percent of a member’s average earnings over the last 36 months of employment for police officers hired after January 1, 1996.

MUNICIPALITY OF KINGSTON POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Management's Response: The Municipality attempted to bargain with the FOP concerning the repeat audit finding for the inclusion of lump sum benefits in the pension calculation. The Municipality was unsuccessful in this effort as there is only one remaining member on the force that is entitled to receive such benefits. It is important to note that this officer is currently eligible for retirement. The FOP is not willing to bargain away such benefits for one remaining officer. It is the position of the Municipality's Administration that this finding will dissolve with the retirement of the sole officer entitled to such benefits. The only other way of removing the finding is to arbitrate the matter which puts the Municipality in a position of great financial risk in other areas of the collective bargaining agreement.

Auditor's Conclusion: The intent of the recommendation is for the language in the governing document to be clarified regarding how the pension benefit is calculated. The finding is not taking exception to the provision of a 65 percent benefit to officers hired prior to January 1, 1996 and a 50 percent benefit to officers hired after January 1, 1996. As reported in the Condition, the Department is taking exception to the language in the plan's governing document that appears to provide a benefit of half of that. In addition, the finding makes no mention of lump sum benefits included in pension calculations. Compliance with the finding recommendation will be evaluated during our next audit of the plan.

MUNICIPALITY OF KINGSTON POLICE PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

The supplementary information contained on Pages 7 through 9 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, 2015 AND 2016

	<u>2015</u>	<u>2016</u>
Total Pension Liability		
Service cost	\$ 160,575	\$ 168,604
Interest	732,872	749,158
Difference between expected and actual experience	513,759	-
Benefit payments, including refunds of member contributions	(689,400)	(693,270)
Net Change in Total Pension Liability	<u>717,806</u>	<u>224,492</u>
Total Pension Liability - Beginning	9,126,776	9,844,582
Total Pension Liability - Ending (a)	<u>\$ 9,844,582</u>	<u>\$ 10,069,074</u>
Plan Fiduciary Net Position		
Contributions – employer	\$ 266,984	\$ 3,451,399
Contribution – member	60,199	64,548
Net investment income	(151,642)	204,776
Benefit payments, including refunds of member contributions	(689,400)	(693,270)
Administrative expense	-	(10,300)
Net Change in Plan Fiduciary Net Position	<u>(513,859)</u>	<u>3,017,153</u>
Plan Fiduciary Net Position - Beginning	5,296,144	4,782,285
Plan Fiduciary Net Position - Ending (b)	<u>\$ 4,782,285</u>	<u>\$ 7,799,438</u>
Net Pension Liability - Ending (a-b)	<u>\$ 5,062,297</u>	<u>\$ 2,269,636</u>
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	48.6%	77.5%
Estimated Covered Employee Payroll	\$ 1,207,647	\$ 1,264,562
Net Pension Liability as a Percentage of Covered Employee Payroll	419.2%	179.5%

MUNICIPALITY OF KINGSTON 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 municipality as of December 31, 2015 and 2016, calculated using the discount rate of 7.75%, as well as what the municipality'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 (6.75%)	Current Discount Rate (7.75%)	1% Increase (8.75%)
Net Pension Liability - 12/31/15	\$ 6,204,210	\$ 5,062,297	\$ 4,102,734
Net Pension Liability - 12/31/16	\$ 3,440,522	\$ 2,269,636	\$ 1,285,199

MUNICIPALITY OF KINGSTON 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
2007	\$ 154,288	\$ 154,288	\$ -		
2008	161,574	176,384	(14,810)		
2009	183,468	183,468	-		
2010	170,430	182,689	(12,259)		
2011	245,173	275,173	(30,000)		
2012	243,439	243,439	-		
2013	223,868	223,868	-		
2014	214,546	214,546	-	\$1,174,018	18.27%
2015	266,984	266,984	-	1,207,647	22.11%
2016**	268,573	3,451,399	(3,182,826)	1,264,562	272.93%

\* Due to GASB Statement No. 67, *Financial Reporting for Pension Plans*, being implemented only recently, the amount of Covered-Employee Payroll was not provided for years prior to 2014.

\*\* 2016 actual contributions include bond proceeds of \$3,285,162

MUNICIPALITY OF KINGSTON 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, 2011, 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)
01-01-11	\$ 6,580,296	\$ 7,797,578	\$ 1,217,282	84.4%
01-01-13	6,507,114	8,773,338	2,266,224	74.2%
01-01-15	6,355,373	9,640,535	3,285,162	65.9%

Note: The market value of the plan's assets at 01-01-11 has been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 70 to 130 percent of market value of assets. The market values of the plan's assets at 01-01-13 and 01-01-15 have been adjusted to reflect the smoothing of gains and/or losses subject to a corridor between 80 to 120 percent of the market value of assets. These methods 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.

MUNICIPALITY OF KINGSTON 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.

MUNICIPALITY OF KINGSTON 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, 2015
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	18 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a corridor between 80-120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.75%
Projected salary increases	5.0%
Cost-of-living adjustments	1.0% per year postretirement

MUNICIPALITY OF KINGSTON POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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