

# COMPLIANCE AUDIT

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## City of Coatesville Police Pension Plan Chester County, Pennsylvania For the Period January 1, 2012 to December 31, 2013

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March 2015



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General



**Commonwealth of Pennsylvania  
Department of the Auditor General  
Harrisburg, PA 17120-0018  
Facebook: Pennsylvania Auditor General  
Twitter: @PAAuditorGen**

**EUGENE A. DePASQUALE  
AUDITOR GENERAL**

City Council  
City of Coatesville  
Chester County  
Coatesville, PA 19320

We have conducted a compliance audit of the City of Coatesville Police Pension Plan for the period January 1, 2012 to December 31, 2013. 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 findings 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. 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 special ad hoc postretirement adjustment granted to eligible pensioners is in accordance with applicable laws and regulations and whether the ad hoc reimbursement received by the municipality was treated in accordance with applicable laws and regulations.

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

City officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the City of Coatesville 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 city's internal controls as they relate to the city'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, 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 tests indicated that, in all significant respects, the City of Coatesville 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 – Pension Benefits In Excess Of Third Class City Code

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, are extremely concerned about the decline in the plan's funded status contained in the schedule of funding progress included in this report. **The plan's funded ratio went from 100.1% as of January 1, 2011, to 79.1% as of as of January 1, 2013**, which is the most recent data available. **As noted in the finding contained in this audit report, this decline is due, in part, to the excess benefits provided by the city in 2012. These benefits were provided without a required cost study which would have disclosed the costs of these benefits prior to their adoption. We encourage city officials to make fiscally responsible decisions as plan fiduciaries that will benefit the City of Coatesville and its taxpayers to ensure the police pension plan has adequate resources to meet current and future benefit obligations to the city's hard working police officers.**

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

February 26, 2015



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 City of Coatesville 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 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 317 - The Third Class City Code, Act of June 23, 1931 (P.L. 932, No. 317), as amended, 53 P.S. § 35101 et seq.

The City of Coatesville Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 1382-2012, adopted pursuant to Act 317. The plan is also affected by the provisions of collective bargaining agreements between the city and its police officers. The plan was established January 1, 1961. Active members are required to contribute 5 percent of salary plus \$3 per month to the plan. As of December 31, 2013, the plan had 27 active members, no terminated members eligible for vested benefits in the future, and 30 retirees receiving pension benefits from the plan.

## **BACKGROUND – (Continued)**

As of December 31, 2013, selected plan benefit provisions are as follows:

### Eligibility Requirements:

Normal Retirement	20 years of service.
Early Retirement	None
Vesting	A member is 100% vested after 12 years of service.

### Retirement Benefit:

Benefit is 50% of average monthly compensation, plus a monthly service increment of 1/40<sup>th</sup> of such pension (maximum of \$300) for each year of service in excess of 20 years but not including service after age 65. Compensation based on final monthly rate of pay or highest 5 years if greater.

### 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 average monthly compensation.

### Non-Service Related Disability Benefit:

Benefit equals 25% of average monthly pension if less than 10 years of service and 50% of average monthly compensation if 10 or more years of service.

CITY OF COATESVILLE POLICE PENSION PLAN  
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

The City of Coatesville has complied with the prior audit recommendations concerning the following:

- Pension Benefit Not In Compliance With Third Class City Code

The city adopted Ordinance No. 1382-2012 which provides for a non-service related disability benefit provision in accordance with the Third Class City Code; and

- Ordinance Improperly Amended By Resolution

The city adopted Ordinance No. 1382-2012 which amends the prior plan document with a properly executed ordinance.

CITY OF COATESVILLE POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – Pension Benefits In Excess Of Third Class City Code**

Condition: During the current audit period, the city granted pension benefits that are not authorized by the Third Class City Code. Section 38-8.3 of Ordinance No. 1383-2012 provides for an “early retirement window for the period May 1, 2012 to May 31, 2012”, and states, in part:

a. Early Retirement Pension Eligibility

The city will offer an early retirement window period May 1, 2012 to May 31, 2012 with terms as follows:

- i. Members at Superannuation: Active Members who have reached superannuation requirements as of May 1, 2012 will be permitted to retire immediately at 70% of their Final Average Salary.
- ii. Members with 15 Years of Service: Active Members with at least 15 years of pensionable service time as of May 1, 2012 will be permitted to retire immediately at 50% of their Final Average Salary and will thereafter be eligible for annual COLA adjustments at amounts specified in the CBA.

In addition, the city increased these pension benefits for its police pension plan members without a cost estimate of the effect of the increase on the plan, as required by Act 205.

Criteria: Section 4302 of the Third Class City Code states, in part:

Such ordinance shall prescribe a minimum period of continuous service, not less than twenty years, and, when any minimum age is prescribed, a minimum age of fifty years, after which members of the force may retire from active duty...(Emphasis added)

Section 4303 of the Third Class City Code states, in part:

...The basis of the apportionment of the pension shall be determined by the rate of the monthly pay of the member at the date of injury, death, honorable discharge, vesting under section 4302.1 or retirement, or the highest average annual salary which the member received during any five years of service preceding injury, death, honorable discharge, vesting under section 4302.1 or retirement, whichever is the higher, and except as to service increments provided for in subsection (b) of this section, shall not in any case exceed in any year one-half the annual pay of such member computed at such monthly or average annual rate, whichever is the higher...(Emphasis added)

CITY OF COATESVILLE POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Section 305(a) of Act 205 states:

Prior to the adoption of any benefit plan modification by the governing body of the municipality, the chief administrative officer of each pension plan shall provide to the governing body of the municipality a cost estimate of the effect of the proposed benefit plan modification.

Furthermore, Section 305(b) of Act 205 states, in part:

If the pension plan is a defined benefit plan which is self-insured in whole or in part, the cost estimate shall be prepared by an approved actuary. . . .

Cause: Municipal officials failed to establish adequate internal control procedures to ensure that the early retirement window was in accordance with the Third Class City Code and was adopted after a cost study was prepared in accordance with Act 205 requirements.

Effect: The plan paid pension benefits to 8 retirees in excess of those authorized by the Third Class City Code. Through the date of this audit report, the retirees have received excess benefits which have totaled approximately \$570,871.

In addition, due in part to the effect of the benefit increases, the funding status of the plan decreased from 100.1% as of January 1, 2011, to 79.1% as of January 1, 2013. Furthermore, the city's minimum municipal obligation determination increased from \$271,871 in 2014 to \$686,820 in 2015, the first year that was based on data from the January 1, 2013, actuarial valuation report which includes the benefit increases.

Providing unauthorized pension benefits increases the plan's pension costs and reduces the amount of funds available for investment purposes or for the payment of authorized benefits or administrative expenses. In addition, the increased costs to the pension plan as a result of the excess pension benefits could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205 funding standards.

In addition, the failure to obtain a cost estimate of the benefit increases prohibited city officials from assessing the financial impact on the pension plan prior to their adoption.

CITY OF COATESVILLE POLICE PENSION PLAN  
FINDING AND RECOMMENDATION

**Finding – (Continued)**

Recommendation: We recommend that to the extent the city is not in compliance with the Third Class City Code and/or is contractually obligated to pay benefits to existing retirees in excess of those authorized by the Third Class City Code, the excess benefits must be reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Furthermore, such benefits will be deemed ineligible for funding with state pension aid. In such case, the plan's actuary may be required to determine the impact, if any, of the excess benefits on the city's future state aid allocations and submit this information to the department. If it is determined the excess benefits had an impact on the city's future state aid allocations after the submission of this information, the plan's actuary would then be required to contact the department to verify the overpayment of state aid received. Plan officials would then be required to reimburse the overpayment to the Commonwealth.

We also recommend that all future benefit modifications be in accordance with the Third Class City Code and be preceded by a cost estimate in accordance with Act 205 provisions.

Management's Response: After the audit exit conference held on December 10, 2014, management provided a response to the initial draft finding presented. During the review process, the finding and recommendation were revised and were presented to management on February 3, 2015, for an amended response; however, as of February 26, 2015, no response has been provided.

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

CITY OF COATESVILLE 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, 2009, 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)]
01-01-09	\$ 7,810,524	\$ 8,258,265	\$ 447,741	94.6%	\$ 1,487,807	30.1%
01-01-11	9,661,468	9,651,210	(10,258)	100.1%	2,329,846	(0.4%)
01-01-13	11,316,129	14,309,943	2,993,814	79.1%	1,967,062	152.2%

CITY OF COATESVILLE 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. When assets are in excess of the actuarial accrued liability, the higher the bracketed percentage, the stronger the plan.

CITY OF COATESVILLE POLICE PENSION PLAN  
SUPPLEMENTARY INFORMATION  
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER  
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2008	\$ 533,632	100.0%
2009	171,695	100.0%
2010	235,182	100.0%
2011	388,442	101.1%
2012	270,257	100.0%
2013	234,323	100.0%

CITY OF COATESVILLE 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, 2013
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	12 years
Asset valuation method	Fair value
Actuarial assumptions:	
Investment rate of return	7.0%
Projected salary increases	5.0%
Cost-of-living adjustments	For members retired after 1/1/1999 and hired before 1/1/2002 an annual cost-of-living increase of 6%, maximum 70% of compensation at retirement. For members hired on or after 1/1/2002, increase is equal to change in the Consumer Price Index (CPI-W), no maximum.

CITY OF COATESVILLE POLICE PENSION PLAN  
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf  
Governor  
Commonwealth of Pennsylvania

City of Coatesville Police Pension Plan  
Chester County  
One City Hall Place  
Coatesville, PA 19320

Mr. Joseph Hamrick      Council President

Mr. Kirby Hudson      City Manager

Mr. John Marcarelli      Finance Director

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