

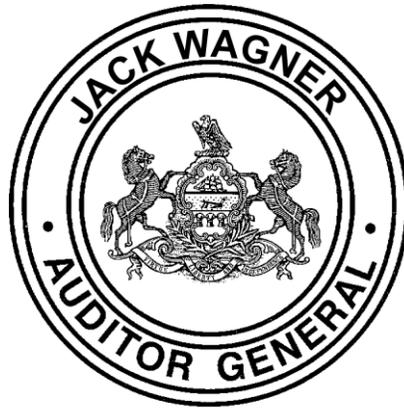
CITY OF CHESTER POLICE PENSION PLAN

DELAWARE COUNTY

COMPLIANCE AUDIT REPORT

FOR THE PERIOD

JANUARY 1, 2009, TO DECEMBER 31, 2010



CITY OF CHESTER POLICE PENSION PLAN

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BACKGROUND

On December 18, 1984, the Pennsylvania Legislature adopted the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.). The act established mandatory actuarial reporting and funding requirements and a uniform basis for the distribution of state aid to Pennsylvania's public pension plans. Section 402(j) of Act 205 specifically requires the Auditor General, as deemed necessary, to make an audit of every municipality which receives general municipal pension system State aid and of every municipal pension plan and fund in which general municipal pension system State aid is deposited.

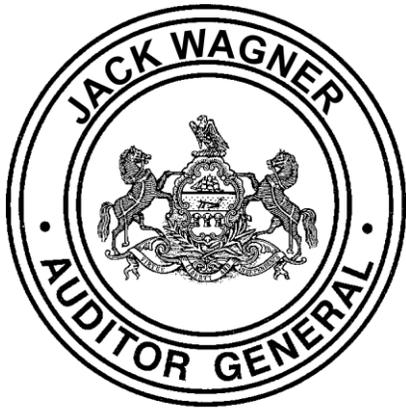
Pension plan aid is provided from a 2 percent foreign casualty insurance premium tax, a portion of the foreign fire insurance tax designated for paid firefighters and any investment income earned on the collection of these taxes. Generally, municipal pension plans established prior to December 18, 1984,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

In addition to Act 205, the City of Chester 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 177 - General Local Government Code, Act of December 19, 1996 (P.L. 1178, 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 Chester Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 143 of the city's codified ordinances, 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 Honorable Mayor and City Council
City of Chester
Delaware County
Chester, PA 19013

We have conducted a compliance audit of the City of Chester Police Pension Plan for the period January 1, 2009, to December 31, 2010. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with *Government Auditing Standards* applicable to performance audits 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings 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. The City of Chester 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 Chester 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 the extent necessary to satisfy the audit objectives.

The results of our tests indicated that, in all significant respects, the City of Chester Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following findings further discussed later in this report:

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Provision Of Benefits Inconsistent With The Third Class City Code

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Inconsistent Pension Benefits

Finding No. 3 – 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 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 the plan's funded ratio is 55.2% as of January 1, 2009, which is the most recent date available. We encourage city 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 City of Chester and, where appropriate, their responses have been included in the report.

December 22, 2011

JACK WAGNER
Auditor General

CITY OF CHESTER POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendation

The City of Chester has complied with the prior audit recommendation concerning the following:

- Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

The city deposited \$986,159 into the police plan representing the outstanding 2006 minimum municipal obligation balance due to the plan plus applicable interest; and

- Incorrect Data On Certification Form AG 64 Resulting In An Excess Reimbursement For Special 2002 Ad Hoc Postretirement Adjustment

The city reimbursed \$1,083 to the Commonwealth for the overpayment of the special 2002 ad hoc postretirement adjustment reimbursement.

Noncompliance With Prior Audit Recommendations

The City of Chester has not complied with the prior audit recommendations concerning the following as further discussed in the Findings and Recommendations section of this report:

- Provision Of Benefits Inconsistent With Third Class City Code; and

- Inconsistent Pension Benefits

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – Noncompliance With Prior Audit Recommendation – Provision Of Benefits
Inconsistent With The Third Class City Code

Condition: The city adopted a home rule charter pursuant to the Home Rule Charter and Optional Plans Law, 53 Pa. C.S. § 2901 et seq. (previously 53 P.S. § 1-101 et seq.). As disclosed in the prior audit report, the city has provided pension benefits to its police officers which are inconsistent with the Third Class City Code. The specific inconsistencies are as follows:

Benefit Provision	Governing Document	Third Class City Code
Definition of salary	Salary includes regular wages (including personal, sick and vacation pay), overtime wages, longevity wages, holiday pay, education benefits and any payments for reimbursement of health premiums.	Salary is the fixed amount of compensation paid at regular, periodic intervals by the city to the member and from which pension contributions have been deducted.
Normal retirement/ service-related disability benefit	Disability pension calculations are to be based on an amount equal to one hundred percent (100%) of such police officer’s average monthly earnings reportable or reported on the police officer’s W-2 form in the twelve month period prior to his or her retirement. In addition, normal retirement pension calculations for officers hired prior to 1/1/88, are equal to one-half of such police officer’s yearly salary. Post 1/1/88 employees have pensions calculated on the last three years of service.	Notwithstanding any provision of this act, any police officer who becomes totally disabled due to injuries sustained in the line of duty shall be deemed to be fully vested in the police pension fund, regardless of the actual number of years of credited service, and shall be eligible for immediate retirement benefits. 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 or retirement, or the highest average annual salary which the member received during any five years of service preceding injury, death, honorable discharge, vesting or retirement, whichever is the higher, and except as to service increments, 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.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Benefit Provision	Governing Document	Third Class City Code
Benefit at age 60	At age 60, a benefit equal to 2% for each year of service with a 50% maximum, regardless of years of service.	Not provided
Survivor benefit	The widow of a member of the police force, or a member who retires on pension who dies on or after January 1, 1960, or if no widow survives, or if she survives and subsequently dies or remarries, the child or children under the age of eighteen years of a member of the police force, or a member who retires on pension who dies on or after January 1, 1960, shall, during her lifetime, or so long as she does not remarry, in the case of a widow, or until reaching the age of eighteen years, in the case of a child or children, be entitled to receive a pension calculated at the rate of fifty percent (50%) of the pension the member was receiving or would have received had he been retired at the time of his death.	The spouse of a member of the police force or a member who retires on pension who dies or if no spouse survives or if such person survives and subsequently dies or remarries, then the child or children under the age of eighteen years of a member of the police force or a member who retires on pension who dies on or after the effective date of this amendment, shall, during the lifetime of the surviving spouse, even if the surviving spouse remarries, or until reaching the age of eighteen years in the case of a child or children, be entitled to receive a pension calculated at the rate of fifty per centum of the pension the member was receiving or would have been receiving had he been retired at the time of his death and may receive the pension the member was receiving or would have been receiving had he been retired at the time of his death.
Vesting	Employees hired before 1/1/88 – after 20 years of service; Employees hired on or after 1/1/88 – after 25 years of service. Benefit is 50% of salary.	Provides for members with a minimum of 12 years of service to vest. Benefit is determined by applying the member's years of service to the years the member would have rendered by his minimum retirement date.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Third Class City Code</u>
Non-service related disability	0-5 years of service – 2.5% per year of service; Greater than 5 years – 2.5% per year of service with a 25% minimum and a 50% maximum.	Less than 10 years of service – 25% of annual compensation; More than 10 years of service - 50% of annual compensation.

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.

Cause: City officials were unable to implement compliance with the prior audit recommendation through the collective bargaining process.

Effect: The provision of unauthorized benefits could increase the plan’s pension costs and reduce the amount of funds available for investment purposes or the payment of authorized benefits or administrative expenses. Since the city received its state aid allocations based on unit value during the current audit period, it did not receive excess state aid allocations attributable to the unauthorized benefits provided; however, the provision of unauthorized benefits could result in the receipt of excess state aid in the future, or increase required municipal contributions to the plan.

Recommendation: As disclosed in the prior audit report, 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 a home rule municipality for granting benefits not authorized by the Third Class City Code to existing retirees or to individuals who began full-time employment before January 24, 2001 (the date *Monroeville* was issued). However, the department expects the city to restrict pension benefits to those authorized by the Third Class City Code for all employees who began full-time employment on or after that date.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

Special note should be taken that the department’s application of *Monroeville* only to employees hired on or after January 24, 2001, does not sanction (1) a municipality’s granting excess benefits to existing or future employees when none had been granted as of January 24, 2001, or (2) a municipality’s increasing excess benefits for existing or future employees beyond those that had been granted as of that date.

In those instances where the city has failed to provide benefits mandated by the Third Class City Code, we again recommend that city officials consult with their solicitor to determine their obligation to provide these benefits, given the city’s distressed designation under Act 205.

Management’s Response: In conjunction with the negotiation of the next collective bargaining agreement between the Police Department and the City, if through the negotiating process, the City is able to restrict pension benefits to those authorized by the Third Class City Code, it will then be the intent of the City to amend the governing document as recommended by the Department.

Auditor’s Conclusion: Compliance with the finding recommendation will be evaluated during the next audit of the plan.

Finding No. 2 – Noncompliance With Prior Audit Recommendation – Inconsistent Pension Benefits

Condition: As disclosed in the prior audit report, the pension plan’s governing document, Article 143 of the city’s codified ordinances, contains benefit provisions that conflict with the collective bargaining agreement between the police officers and the city, as follows:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>
Normal retirement criteria	If hired before 1/1/88 – age 50 and 20 years service; if hired after 1/1/88 – age 53 and 25 years of service	After 20 years of service
Retirement service increment	Maximum of \$100 per month	Maximum of \$150 per month

Criteria: The plan’s governing document and the collective bargaining agreement should contain consistent benefit provisions to ensure the sound administration of retirement benefits.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

Cause: City officials were unable to implement compliance with the prior audit recommendation through the collective bargaining process.

Effect: Inconsistent plan documents could result in inconsistent or improper benefit calculations and incorrect benefit payments from the pension plan.

Recommendation: We again recommend that city officials ensure the plan's governing document and the collective bargaining agreement contain consistent benefit provisions at their earliest opportunity to do so.

Management's Response: In conjunction with the negotiation of the next collective bargaining agreement between the Police Department and the City, if through the negotiating process, the City is able to restrict pension benefits to those authorized by the Third Class City Code, it will then be the intent of the City to amend the governing documents as recommended by the Department.

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

Finding No. 3 – Incorrect Data On Certification Form AG 385 Resulting In An Overpayment Of State Aid

Condition: The city certified two ineligible police officers (4 units) in 2008, three ineligible police officers (6 units) in 2009 and two ineligible police officers (4 units) in 2010 on Certification Form AG 385.

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: In April 2010, the city granted service-related disability pensions to three police officers retroactive to December 11, 2006, February 15, 2007 and August 30, 2007, respectively. These officers had previously been certified on Certification Forms AG 385 in 2008, 2009 and 2010.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

Effect: The data submitted on these certification forms is used, in part, to calculate the state aid due to the city for distribution to its pension plans. Since the city received its 2008, 2009 and 2010 state aid allocations based on unit value, the effect of the incorrect certification of pension data on the city’s state aid allocations is identified in the following table:

<u>Year</u>	<u>Units Overstated</u>	<u>Unit Value</u>	<u>State Aid Overpayment</u>
2008	4	\$ 3,186	\$ 12,744
2009	6	\$ 3,128	18,768
2010	4	\$ 3,235	<u>12,940</u>
Total Overpayment of State Aid			<u><u>\$ 44,452</u></u>

In addition, since the city used the overpayments of state aid to pay the minimum municipal obligations (MMOs) due to the police pension plan, if the reimbursement to the Commonwealth is made from the pension plan, the plan’s MMOs will not be fully paid.

Recommendation: We recommend that the total excess state aid, in the amount of \$44,452, 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, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222. A copy of the interest calculation must be submitted along with the check.

We also recommend that plan officials establish adequate internal control procedures 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 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: City officials agreed with the finding without exception.

CITY OF CHESTER POLICE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

Finding No. 3 contained in this audit report cites an overpayment of state aid to the city in the amount of \$44,452. A condition 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, 11 Stanwix Street, Suite 1450, Pittsburgh, PA 15222.

CITY OF CHESTER 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, 2005, 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)]
01-01-05	\$ 23,580,756	\$ 36,969,067	\$ 13,388,311	63.8%	\$ 5,276,075	253.8%
01-01-07	26,668,786	42,761,177	16,092,391	62.4%	5,379,321	299.2%
01-01-09	25,877,310	46,837,236	20,959,926	55.2%	6,176,704	339.3%

Note: The market value of the plan's assets at 01-01-09 has been adjusted to reflect the smoothing of gains and/or losses at 130 percent of market value. 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.

CITY OF CHESTER POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the actuarial accrued liability as a factor.

Analysis of the dollar amount of the actuarial value of assets, actuarial accrued liability, and unfunded (assets in excess of) actuarial accrued liability in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the actuarial accrued liability (Column 4) provides one indication of the plan's funding status on a going-concern basis. Analysis of this percentage, over time, indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the plan.

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

CITY OF CHESTER POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2005	\$ 1,884,898	100.0%
2006	2,097,262	100.0%
2007	1,414,455	100.0%
2008	1,447,528	100.0%
2009	1,957,189	100.0%
2010	1,648,447	100.0%

CITY OF CHESTER 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, 2009
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	16 years
Asset valuation method	Plan assets are valued using the method described in Section 210 of Act 205, as amended, subject to a ceiling of 130% of the market value of assets.

Actuarial assumptions:

Investment rate of return *	7.5%
Projected salary increases *	5.0%
* Includes inflation at	Not disclosed
Cost-of-living adjustments	None assumed

CITY OF CHESTER POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Corbett
Governor
Commonwealth of Pennsylvania

City of Chester Police Pension Plan
Delaware County
1 West 4th Street
Chester, PA 19013

The Honorable John Linder	Mayor
Ms. Edith Blackwell	Controller
Ms. Sara I. Bingnear	City Clerk
Mr. Kenneth R. Schuster	Solicitor

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, Room 318 Finance Building, Harrisburg, PA 17120. If you have any questions regarding this report or any other matter, you may contact the Department of the Auditor General by accessing our website at www.auditorgen.state.pa.us.