COMPLIANCE AUDIT

City of Chester Police Pension Plan

Delaware County, Pennsylvania

For the Period
January 1, 2018 to December 31, 2019

May 2021

TIMOTHY L. DeFOOR • AUDITOR GENERAL •

Commonwealth of Pennsylvania
Department of the Auditor General

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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, 2018 to December 31, 2019. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from the Municipal Pension Plan Funding Standard and Recovery Act (Act 205 of 1984, as amended, 53 P.S. § 895.402 (j)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the 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 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 findings contained in our prior 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[1] (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 plan members who retired during the current 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 benefits due to the retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipients.

- We determined whether the January 1, 2017 and January 1, 2019 actuarial valuation reports were prepared and submitted by March 31, 2018 and 2020, 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 pension plan is in compliance with Act 205 for distressed municipalities through inquiry of plan officials and evaluation of the recovery remedies implemented during the audit period.

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[1] The minimum municipal obligation (MMO) is an annual calculation of the municipality's annual required contribution to the pension plan, prepared by the municipality pursuant to Act 205 provisions. The annual MMO is due by December 31 and is payable to the pension plan from the revenue of the municipality, which may include general fund contributions or general municipal pension system state aid received by the municipality.

- 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.

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. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary 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 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 – Partial Compliance With Prior Audit Recommendation – Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Finding No. 4 – Noncompliance With Prior Audit Recommendation – Untimely Deposit Of State Aid

Finding No. 5 – Deficiencies Relative To The City's Enactment Of The Special Taxing Provisions Of Act 205

Finding Nos. 1, 2, 3, and 4 contained in this audit report repeat conditions that were cited in our previous report that have not been corrected by city officials. We are concerned by the city's failure to correct those previously reported findings and strongly encourage timely implementation of the recommendations noted in this audit report.

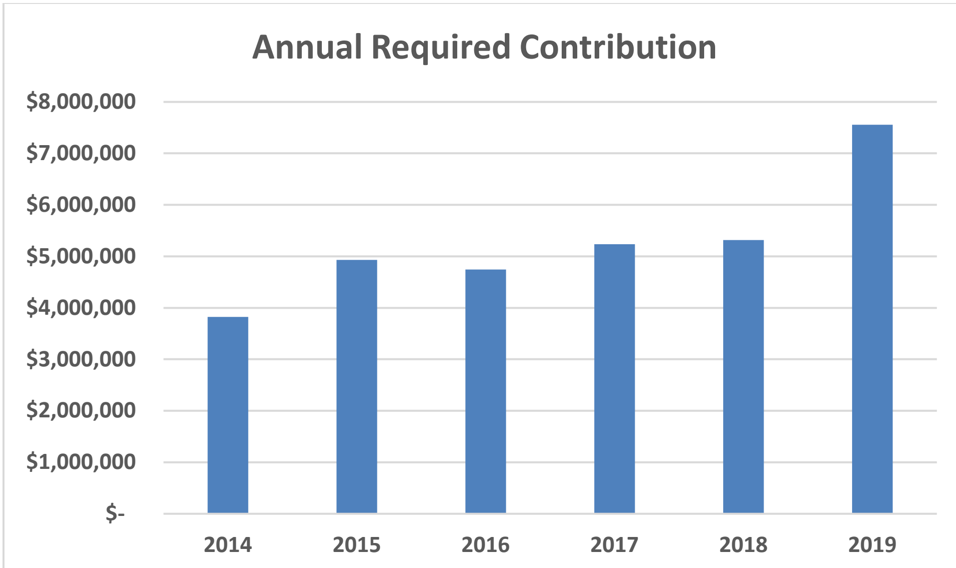
As previously noted, one of the objectives of our audit of the City of Chester Police Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Among several provisions relating to municipal pension plans,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

Level	Indication	Funding Criteria
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, we 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 33.6% as of January 1, 2019, which is the most recent data available. Based in part on this information and when combined with the funded status of the city's other pension plans, the Municipal Pension Reporting Program issued a notification that the aggregate funded status of the city's plans places the city currently in Level III Severe Distress Status.**

The plan's funded ratio continues to remain a concern despite the increase in the city's annual required contribution to the Police Pension Plan from $3,824,942 in 2014 to $7,554,343 in 2019, an increase of 97.5%, and due in large part to the fact that, as disclosed later in the Findings and Recommendations section of this report, the city has been unable to make its annual required contributions for not only prior years, but similarly, during 2018, 2019, and 2020. The city only recently deposited the remainder of its 2015 Police Pension Plan required obligation during 2021. In addition, the city determined the plan's 2021 required municipal obligation to be $8,533,497.

A graphic illustration of the increase in the city's annual required contribution to the Police Pension Plan since 2014 is presented below:



Based on the annual benefit payments owed to beneficiaries as reported in the plan's January 1, 2019 actuarial valuation report, at current funding levels, based on the plan's current benefit obligations and actuarial assumptions (which include 7.5 percent long-term investment return projections), the police pension plan does not have assets to fund five years of benefit payments as illustrated below:

Plan	Actuarial Valuation of Assets[2] 1-1-19	Annual Benefit Payments Owed To Beneficiaries 1-1-19	Years of Benefit Payments That Can Be Funded By Assets Available 1-1-19
Police	$ 27,992,553	$ 5,991,106	4.67

[2] The police pension plan funding levels are actually more dire than shown in the table above because the actuarial value of assets reflected above includes pension contribution receivables of approximately $21.2 million and has been adjusted to reflect the smoothing of gains and/or losses subject to maximum of 120 percent of the actual market value of assets as permitted pursuant to Act 205.

The deterioration of the plan's funded status has been exacerbated over time by conditions noted in the Comments section of this audit report as well as the city's continued inability to meet its minimum funding requirements under Act 205 as mentioned earlier in this report. However, in recent years the city has implemented certain corrective actions to stabilize its general fund and address its pension crisis including increasing its earned income tax rate, renegotiating agreements with its collective bargaining units (limiting pension benefits and/or revising pension provisions to those authorized by Third Class City Code), increasing member contribution rates (immediate for new hires and over time for existing members), redefining DROP eligibility and participation requirements for new hires, and reducing overtime expenses and other compensation components which factor into the determination of pension benefit calculations. In addition, utilizing a special tax provision provided in Act 44 of 2009, the city modified its earned income tax rate to 3.75 percent for residents and 2.0 percent for non-residents of the city, effective January 1, 2021, for the sole purpose of defraying the additional costs required to be paid pursuant to Act 205 directly related to the city's pension plans. The city anticipates the long-term position of the pension fund to improve over time and we encourage city officials to continue developing and implementing its long-term strategic plan to address its Police Pension Plan funding crisis. The city must continue to make fiscally responsible decisions as plan fiduciaries that will benefit the City of Chester and its taxpayers to ensure that the pension plan has adequate resources to meet current and future benefit obligations to the city's hard working police officers. Doing so will help to ensure the plan's 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.

Timothy L. DeFoor

April 12, 2021

Timothy L. DeFoor
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.

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 Chester Police Pension Plan is also governed by implementing regulations 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 67 - The Third Class City Code, Act of November 24, 2015 (P.L. 242, No. 67), as amended, 11 Pa. C.S. § 10101 et seq.

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.

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 67 (formerly 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, 1930. Active members hired prior to February 1, 2017 are required to contribute 5 percent of compensation to the pension fund increased by 1 percent per January 1 until reaching 8 percent, and members hired on or after February 1, 2017 are required to contribute 8 percent of compensation to the plan. As of December 31, 2019, the plan had 78 active members, no terminated members eligible for vested benefits in the future, and 141 retirees receiving pension benefits from the plan.

Partial Compliance With Prior Audit Recommendation

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

- Failure To Fully Pay The Minimum Municipal Obligation (MMO) Of The Plan

  The city made periodic general fund contributions totaling $2,500,000 in 2019 and $2,500,000 in 2020 to the plan towards the outstanding 2015 MMO, and the remaining balance of $475,023, including interest in accordance with Act 205, was paid in January 2021. In addition, the city continues to regularly deposit funds into the plan towards the outstanding MMOs for the years in arrears, and as of the date of our fieldwork completion, the city had made payments in 2021 totaling $1,523,062 towards the outstanding 2016 MMO. However, the balance of the 2016 MMO and the full amount of the plan's 2017 MMO remain outstanding. In addition, a similar condition occurred during the current audit period as further discussed in Finding No. 3 of this report.

Noncompliance With Prior Audit Recommendations

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

- Provision Of Benefits Inconsistent With The Third Class City Code

- Inconsistent Pension Benefits

- Untimely Deposit Of State Aid

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

Condition: As previously disclosed in our prior nine audit reports, the city operates as 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.) and the plan's governing ordinance provides pension benefits to its police officers which are inconsistent with the Third Class City Code, 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	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. 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.	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 14302.1 (relating to limited vested benefit) or retirement, or the highest average annual salary that the member received during any five years of service preceding injury, death, honorable discharge, vesting under section 14302.1 or retirement, whichever is higher, and except as to service increments provided for in subsection (d), shall not in any case exceed in any year one-half the annual pay of the member computed at the monthly or average annual rate, whichever is higher. Notwithstanding any provision of this chapter, a police officer who becomes totally disabled due to an injury 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.

Finding No. 1 – (Continued)

Benefit Provision	Governing Document	Third Class City Code
Early retirement 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 the spouse survives and subsequently dies or remarries, the child or children under 18 years of age of a member of the police force or a member who retires on pension who dies on or after August 1, 1963, <u>shall, during the lifetime of the surviving spouse, even if the surviving spouse remarries</u>, or until reaching 18 years of age in the case of a child or children, be entitled to receive a pension calculated at the rate of 50% of the pension the member was receiving or would have been receiving if the member was retired at the time of the member's death and may receive the pension the member was receiving or would have been receiving had the member been retired at the time of the member's death. [Emphasis added.]
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 the member's minimum retirement date.

Finding No. 1 – (Continued)

Benefit Provision	Governing Document	Third Class City Code
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: As previously cited in prior reports, the Commonwealth Court of Pennsylvania issued its opinion in *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee* on January 24, 2001. 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." *Municipality of Monroeville v. Monroeville Police Department Wage Policy Committee*, 767 A.2d 596, 598 (Cmmw. Ct. 2001). The court's holding was in accord with the position taken by this Department since at least January 1995.

Cause: Municipal officials again failed to take appropriate corrective action to comply with the prior audit recommendation.

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: We again recommend that the city restrict pension benefits to those authorized by the Third Class City Code for all employees who began full-time employment on or after January 24, 2001 (the effective date *Monroeville* was decided) upon the renewal, extension, or renegotiation of the collective bargaining agreement. To the extent that the city is not in compliance with the Third Class City Code and/or is contractually obligated to provide benefits in excess of those authorized by the Third Class City Code to employees who began employment on or after January 24, 2001, 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 unauthorized benefits on the city's future state aid allocations and submit this information to the department. If it is determined the unauthorized benefits had an impact on the city's future state aid allocations after the submission

Finding No. 1 – (Continued)

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.

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: At our exit conference held on March 23, 2021, municipal officials indicated that a written response to this finding would be provided within 10 days; however, as of May 20, 2021, no such response has been provided.

Auditor's Conclusion: This finding repeats a condition that was cited in our previous nine audit reports that has not been corrected by city officials. We are concerned by the city's continued failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation noted in this audit report. Any response to the finding provided by officials subsequent to report issuance will be given due consideration upon receipt and compliance will be evaluated during our next audit of the plan, accordingly.

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

Condition: As previously disclosed in our prior six audit reports, 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:

Benefit Provision	Governing Document	Collective Bargaining Agreement
Normal retirement criteria	If hired before 1/1/88 – age 50 and 20 years of service. If hired after 1/1/88 – age 53 and 25 years of service.	After 20 years of service. Employees hired after February 1, 2017 must have 25 years of service and reach 50 years of age.
	Hired pre January 1, 1988: Benefit equals 50% of final pay plus 1.25% of pay times years of service over 20 years (Maximum $100 per month). Hired after December 31, 1987: Benefit equals 50% of final 3 years average pay plus 1.25% of pay times years of service over 25 years (Maximum $100 per month).	50% of earnings reportable on IRS Form W-2 in the twelve (12) month period prior to retirement. For all employees hired on or after January 1, 2017 the term "salary" will be defined as "base pay plus longevity". No other forms of compensation will be included.
Retirement service increment	Maximum of $100 per month	Maximum of $500 per month
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.	Pensions shall vest at 12 years of service with receipt of pension benefits at age 50. The vesting provision of the current pension plan shall be changed to be consistent with the Third Class City Code.

Finding No. 2 – (Continued)

Criteria: As disclosed in prior reports, the plan's governing document and the collective bargaining agreement should contain consistent benefit provisions to ensure the sound administration of retirement benefits.

Cause: City officials were again 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: At our exit conference held on March 23, 2021, municipal officials indicated that a written response to this finding would be provided within 10 days; however, as of May 20, 2021, no such response has been provided.

Auditor's Conclusion: This finding repeats a condition that was cited in our previous six audit reports that has not been corrected by city officials. We are concerned by the city's continued failure to correct this previously reported audit finding and strongly encourage timely implementation of the recommendation noted in this audit report. Any response to the finding provided by officials subsequent to report issuance will be given due consideration upon receipt and compliance will be evaluated during our next audit of the plan, accordingly.

Finding No. 3 – Partial Compliance With Prior Audit Recommendation - Failure To Fully Pay The Minimum Municipal Obligation Of The Plan

Condition: As disclosed in the Status of Prior Findings section of this report, the city partially complied with the prior audit recommendation by paying the outstanding 2015 minimum municipal obligation (MMO) and a portion of the outstanding 2016 MMO due to the police pension plan, along with applicable interest in accordance with Act 205. However, the city did not fully pay the balance of the plan's 2016 MMO or the 2017 MMO. In addition, a similar condition occurred during the current audit period. The city again failed to fully pay the MMOs due the police pension plan for the years 2018, 2019, and, subsequent to the audit period, 2020, as required by Act 205.

The total MMO due for 2016 for the police pension plan calculated by the city was $4,741,872; and in 2017, the city deposited 2016 state aid in the amount of $476,149 towards the 2016 MMO; however, the city did not make any additional payments towards the 2016 MMO until 2021. As of the date of our fieldwork completion, the city made payments totaling $1,523,062 in 2021 towards the 2016 MMO. As of the date of this report, the balance of the 2016 MMO remains outstanding.

The total MMO due for 2017 for the police pension plan calculated by the city was $5,235,369; and in 2017, the city deposited 2017 state aid in the amount of $450,340 towards the 2017 MMO; however, as of the date of this report, the balance of the 2017 MMO remains outstanding.

In addition, the total MMO for 2018 for the police pension plan calculated by the city was $5,315,716; and in 2018, the city deposited 2018 state aid in the amount of $626,813 towards the 2018 MMO; however, as of the date of this report, the balance of the 2018 MMO remains outstanding.

Furthermore, the total MMO for 2019 for the police pension plan calculated by the city was $7,554,343; and in 2019 and 2020, the city deposited 2019 state aid in the amount of $1,976,513 towards the 2019 MMO; however, as of the date of this report, the balance of the 2019 MMO remains outstanding.

Finally, subsequent to the current audit period, the total MMO for 2020 for the police pension plan calculated by the city was $8,220,254; and in 2020, the city deposited 2020 state aid in the amount of $1,890,752 towards the 2020 MMO; however, as of the date of this report, the balance of the 2020 MMO remains outstanding.

Finding No. 3 – (Continued)

As of December 31, 2020 the city has the following MMO balances due (including interest):

	Balance due as of 12/31/20, including interest
2016 MMO	$6,253,071
2017 MMO	$6,453,087
2018 MMO	$5,867,909
2019 MMO	$6,539,417
2020 MMO	$6,820,878

All interest calculations were provided by the city as of December 31, 2020. As noted previously, as of the date of our fieldwork completion, the city has made payments in 2021 towards the 2016 MMO.

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

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

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

> Annually the municipality shall provide for the full amount of the minimum obligation of the municipality in the budget of the municipality. The minimum obligation of the municipality shall be payable to the pension plan from the revenue of the municipality.

<u>Finding No. 3 – (Continued)</u>

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

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

<u>Cause</u>: The city could not properly budget for the drastic annual increases in its pension liability and allocate the necessary financial resources to meet its annual municipal pension obligation.

<u>Effect</u>: The continued failure to fully pay the MMOs in accordance with Act 205 has resulted in the city accruing additional interest on these outstanding MMO balances, further increasing the city's financial obligation to its pension plan, which could result in the plan not having adequate resources to meet current and future benefit obligations to its members.

Due to the city's failure to fully pay the 2016, 2017, 2018, 2019, and 2020 MMOs by the annual December 31, deadlines, the city must add the outstanding MMO balances to the current year's MMO and include interest, as required by Act 205.

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

<u>Recommendation</u>: We again recommend that the city pay the outstanding MMOs due to the police pension plan for the years 2016, 2017, 2018, 2019, and 2020 with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be submitted to this Department along with evidence of the payments to the pension plan.

Furthermore, we recommend that in the future, city officials pay the full annual MMOs due to the plan in accordance with Act 205 requirements.

<u>Management's Response</u>: At our exit conference held on March 23, 2021, municipal officials indicated that a written response to this finding would be provided within 10 days; however, as of May 20, 2021, no such response has been provided.

Finding No. 3 – (Continued)

Auditor's Conclusion: Although the municipality did not provide a written response as of the issuance of this report, any response to the finding provided by officials subsequent to report issuance will be given due consideration upon receipt. Due to the potential withhold of state aid, the city's compliance with the finding recommendation will be evaluated subsequent to the release of the audit report and during our next audit of the plan.

Finding No. 4 – Noncompliance With Prior Audit Recommendation – Untimely Deposit Of State Aid

Condition: As disclosed in the two most recent prior audit reports, the city failed to deposit its state aid allocations into the police pension plan within the 30 day grace period allowed by Act 205. A similar condition occurred during the current audit period. The city did not deposit its 2018 state aid allocation into the police pension plan within the 30 day grace period allowed by Act 205. The city received its 2018 state aid allocation in the amount of $1,812,858 on September 20, 2018, but did not deposit the $626,813 allocated to the police pension plan until November 15, 2018. In addition, the city received its 2019 state aid allocation in the amount of $1,976,513 on September 18, 2019, but only deposited $500,000 to the police pension plan in accordance with Act 205 on October 9, 2019. The city subsequently deposited the remainder of its 2019 state aid through deposits of $250,000 each, on November 6, 2019, November 18, 2019, and December 19, 2019, and an additional $726,513 on January 8, 2020. Subsequent to the audit period, the city timely deposited its 2020 state aid into the police pension plan in the amount of $1,890,752 on September 28, 2020.

Criteria: Section 402(g) of Act 205 states, in part:

> . . . the total amount of the general municipal pension system State aid received by the municipality shall, within 30 days of receipt by the treasurer of the municipality, be deposited in the pension fund or the alternate funding mechanism applicable to the pension plan.

Cause: City officials indicated that given the city's distressed financial status, the city has been working with the Act 47 team to deposit the state aid in a timely manner; however, the city was unable to deposit funds received during 2018 and 2019 in accordance with Act 205.

Effect: When state aid is not deposited into a pension plan account in a timely manner, the funds are not available to assist in funding the city's annual pension obligation, pay operating expenses or for investment, the risk of misapplication is increased, and additional costs associated with the interest on the late deposits further exacerbates the impact on the city's already strained financial resources.

Finding No. 4 – (Continued)

Recommendation: We again recommend that the city ensure that future state aid allocations are deposited timely in accordance with Act 205 requirements.

Management's Response: At our exit conference held on March 23, 2021, municipal officials indicated that a written response to this finding would be provided within 10 days; however, as of May 20, 2021, no such response has been provided.

Auditor's Conclusion: Although the municipality did not provide a written response as of the issuance of this report, any response to the finding provided by officials subsequent to report issuance will be given due consideration upon receipt and compliance will be evaluated during our next audit of the plan, accordingly.

Finding No. 5 – Deficiencies Relative To The City's Enactment Of The Special Taxing Provisions Of Act 205

Condition: The City of Chester's pension plans were determined to be Level III Distressed by the former Pennsylvania Employee Retirement Commission (PERC). Act 44 of 2009 provides short-term fiscal relief to local governments operating public pension plans and includes discretionary remedies available for distressed municipalities to assist with the funding of their pension plans. Utilizing a special tax provision provided in Act 44, the city adopted Ordinance No. 8-2018 *(effective January 1, 2019)* increasing its Earned Income Tax rate for non-residents of the city for the sole purpose of defraying the additional costs required to be paid pursuant to Act 205 directly related to the city's pension plans. In addition, the city's recovery coordinator prepared the calculation necessary to determine the appropriate funding levels mandated by Act 205 after enacting the special taxing legislation. The city subsequently modified its tax rate by enacting Ordinance No. 5-2020 which effectively re-established its Earned Income Tax rates for both residents (3.75 percent of earnings) and non-residents (2.0 percent of earnings) of the city *(effective January 1, 2021)*. However, this department identified the following deficiencies relative to the city's enactment of the special taxing provisions of Act 205:

- Ordinance No. 8-2018 enacted special taxing authority for non-residents of the city; however, such enactment was contrary to provisions of Act 199.

Finding No. 5 – (Continued)

- Although it appears that the city attempted to rectify the aforementioned inconsistency through the passage of Ordinance No. 5-2020 by re-establishing the city's earned income tax rates for residents and non-residents effective 2021, the ordinance does not specify the amount of tax imposed specifically for the sole purpose of defraying the additional costs required to be paid pursuant to Act 205 directly related to the city's pension plans.

- The city did not establish procedures to adequately account for tax revenues received under the special taxing provisions of Act 205 or to differentiate the amount of tax collected and received from the taxing agent generated pursuant to Act 205 for its distressed pension plans, as opposed to tax revenue generated under Act 511 which can be used for general government purposes during 2019 and 2020.

- The city did not maintain adequate supporting documentation evidencing that amounts received under the special taxing authority of Act 205 and designated for its distressed pension plans were appropriately deposited into the pension plans during 2019 and 2020.

- The city failed to implement procedures to effectively monitor and evidence that required contributions under the special taxing provisions of Act 205 were made by the city to its pension plans during the years 2019 and 2020 from funds in existence prior to implementation of the special tax, in amounts determined by the coordinator.

Additionally, it was further noted that based on records provided during the audit by the taxing entity responsible for collecting local taxes, the city reportedly received tax revenues amounting to $7 million and $3.5 million during 2019 and 2020, respectively. However, the department was unable to determine whether the amounts received under the special taxing provisions of Act 205 were deposited into the city's pension plans and, accordingly, whether the city continued to meet the special tax provisions under Act 205 for the years 2019 and 2020.

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

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

Finding No. 5 – (Continued)

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

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

Furthermore, relative to the additional remedies available to distressed municipalities to assist with the funding of their pension plans, Section 607(f) of Act 205 further states:

> **(f) Special municipal taxing authority.**
>
> (1) If the tax rates set by the municipality on earned income or on real property are at the maximum provided by applicable law, the municipality may increase its tax on either earned income or real property above those maximum rates. The proceeds of this special municipal tax increase shall be used solely to defray the additional costs required to be paid pursuant to this act, which are directly related to the pension plans of the municipality. The municipality utilizing this special municipal taxing authority shall not reduce the level of municipal contributions to the pension plans prior to the implementation of the special municipal taxing authority. [Emphasis added.]
>
> (2) The average level of municipal contributions to the pension plans from all revenue sources for the three years immediately prior to the implementation of the special municipal taxing authority shall be expressed as a percentage of the average covered payroll for that same three-year period: Provided, however, that any supplemental contributions made to the plans pursuant to any pension recovery legislation enacted by the municipalities shall be excluded for purposes of determining the level of municipal contribution to the pension plans prior to the implementation of the special municipal taxing authority. In each year subsequent to the implementation of the special municipal taxing authority, the municipal contributions to the pension plan from all revenue sources existing prior to the implementation of the special existing municipal taxing authority, reduced by any supplemental pension recovery contributions, shall equal or exceed this average percentage of the current covered payroll. [Emphasis added.] A municipality utilizing the provisions of section 404 may levy or continue to levy the special municipal tax increase under this subsection provided that the municipality does not reduce the level of municipal contributions to the pension plans prior to the implementation of the special municipal taxing authority. In executing the procedure prescribed in this subsection to determine the level of municipal contributions, the debt service payments for bonds or notes issued under section 404 shall be considered municipal contributions.

Finding No. 5 – (Continued)

Moreover, Section 34 of Act 199 of 2014 pertaining to distressed municipalities, states:

> For tax years beginning after the effective date of this section, a financially distressed municipality shall be prohibited from using the special taxing authority in section 607(f) of the act of December 18, 1984 (P.L. 1005, No. 205), known as the Municipal Pension Plan Funding Standard and Recovery Act, to impose an increase in the rate, over the rate imposed as of June 30, 2014, of taxation on nonresident income unless an equal or greater increase in the rate of taxation on resident income, over the highest rate levied in the previous fiscal year, is imposed in the same tax year. [Emphasis added.]

Cause: Although the city's recovery coordinator prepared the calculation necessary to determine the appropriate funding levels mandated by Section 607(f) of Act 205 after enacting the special taxing legislation, the city lacked adequate internal control procedures to ensure that the city did not reduce its level of contributions to its pension plans and from funding sources in effect prior to the implementation of the special municipal tax. Nor did the city maintain appropriate substantive evidence to ensure that funds received under distress provisions of Act 205 were used for their intended purpose.

Effect: The failure to properly apply the provisions of Section 607(f) of Act 205 and fund the pension plans accordingly resulted in less annual funding towards the city's distressed pension plans than afforded under the provisions of Act 205 during 2019 and 2020 and could result in the plans not having the necessary resources to meet current and future benefit obligations to its members. In addition, the failure to maintain the levels of contribution prior to enacting the additional special tax reduced the net overall contributions to the plan, potentially negating benefits of the additional tax. Furthermore, since the city failed to maintain a separate accounting for the tax designated for distressed pension payments, it could not be determined how much was actually received by the city and deposited into its pension plans pursuant to Act 205 for the sole purpose of defraying the additional costs directly related to the city's pension plans during 2019 and 2020.

Recommendation: We recommend that the city develop and implement adequate procedures to account for the receipt and distribution of tax revenues collected under the special taxing authority afforded by Act 205 and maintain adequate, substantive documentation evidencing that funds collected under the special tax are used solely to defray the additional costs related to its pension plans in accordance with Act 205.

Finding No. 5 – (Continued)

We also recommend that city officials implement adequate internal control procedures to ensure that the city does not reduce its level of contributions to its pension plans from funding sources prior to the implementation of the special municipal tax in accordance with Act 205 for periods subsequent to this report. Such procedures should include maintaining appropriate supporting documentation identifying the sources of its annual contributions to its pension plans as well as an annual reconciliation evidencing that funding requirements were properly met in accordance with Section 607(f) of Act 205.

Furthermore, we recommend that the city, along with its solicitor, review the ordinance enacting the special taxing authority by the city and ensure compliance with provisions of Act 205 and Act 199.

Finally, we recommend that the city provide documentation that funds previously collected under provisions of Section 607(f) of Act 205 during 2019 and 2020 were used for their intended purpose under the act.

Management's Response: At our exit conference held on March 23, 2021, municipal officials indicated that a written response to this finding would be provided within 10 days; however, as of May 20, 2021, no such response has been provided.

Auditor's Conclusion: Although the municipality did not provide a written response as of the issuance of this report, any response to the finding provided by officials subsequent to report issuance will be given due consideration upon receipt and compliance will be evaluated during our next audit of the plan, accordingly.

CITY OF CHESTER POLICE PENSION PLAN
POTENTIAL WITHHOLD OF STATE AID

A condition such as that reported by Finding No. 3 contained in this audit report may lead to a total withholding of state aid in the future unless that finding is corrected. However, such action will not be considered if sufficient written documentation is provided to verify compliance with this department's recommendation. Such documentation should be submitted to: Department of the Auditor General, Bureau of Municipal Pension & Liquor Control Audits, 314 Finance Building, Harrisburg, PA 17120.

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, 2015, 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)
01-01-15	$ 23,770,657	$ 75,655,064	$ 51,884,407	31.4%
01-01-17	25,498,629	83,380,853	57,882,224	30.6%
01-01-19	27,992,553	83,195,607	55,203,054	33.6%

Note: The market values of the plan's assets at 01-01-15, 01-01-17, and 01-01-19 have been adjusted to reflect the smoothing of gains and/or losses subject to maximum of 120 percent of the market value of assets. This method will lower contributions in years of less than expected returns and increase contribution 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.

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.

CITY OF CHESTER 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
2014	$ 3,824,942	$ 3,824,942	$ -	$7,802,522	49.02%
2015	4,931,999	2,054,645	2,877,354	7,800,000	26.34%
2016	4,741,872	(1,060,728)	5,802,600	7,466,696	N/A
2017	5,235,369	(752,838)	5,988,207	5,680,410	N/A
2018	5,315,716	(129,469)	5,445,185	7,985,224	N/A
2019	7,554,343	760,577	6,793,766	7,985,224	9.52%

Note: The City's 12/31/19 outstanding MMO balance including interest for 2015-2019 was $26,907,112. See Finding No. 3 contained in the Findings and Recommendations section of this report.

The 2016-2018 negative contributions made reflect the net imputed interest penalty applied under Act 205, which is the reason the contributions made are negative for 2016-2018.

N/A – Not applicable

CITY OF CHESTER 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, 2019
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	13 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 120% of the market value of assets.
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases	5.0%
Cost-of-living adjustments	None assumed

As previously noted in this audit report, the City of Chester Police Pension Plan is governed by local ordinances adopted pursuant to Act 177 and Act 67 (formerly Act 317), the Third Class City Code. With regard to the determination of pension benefits for police officers, Section 14303 of the Third Class City Code states:

> **Allowance and service increments.**
> **(a) Allowance.--**A payment for an allowance shall only be a charge on the police pension fund and may not be a charge on another fund under the control of or in the city treasury.
> **(b) Apportionment of the pension.--**The basis of the apportionment of the pension:
> (1) Shall be determined by the rate of the monthly pay of the member at the date of injury, death, honorable discharge, vesting under section 14302.1 (relating to limited vested benefit) or retirement, or the highest average annual salary that the member received during any five years of service preceding injury, death, honorable discharge, vesting under section 14302.1 or retirement, whichever is higher.
> (2) Except as to service increments provided for in subsection (d), may not exceed in a year one-half the annual pay of the member computed at the monthly or average annual rate, whichever is higher.

Although the Code does not contain a definition for the term "pay", the Code defines the term salary at Section 14300(b) as follows:

> "Salary." The fixed amount of compensation paid at regular, periodic intervals by the city to the member and from which pension contributions have been deducted.

The city's practice has been to calculate the police officers' pension benefits based on the amount of the retiree's final 12 months of pay. This includes regular monthly pay plus overtime, vacation, sick and personal pay that a police officer accumulates in his or her final 12 months of employment. As disclosed in prior audit reports, 16 police officers retired between January 1, 2013 and December 31, 2017 with non-disability normal retirement pensions which included additional hours over and above their regular hours in the determination of their final 12 month earnings used in the determination of their monthly pension benefits.

During the current audit period, 8 additional police officers retired with non-disability normal retirement pensions and had additional hours included in their pension determinations. The city's practice of including these additional hours for these 24 police officers since 2013 had a significant impact on not only the individual pension calculations but ultimately the pension plan and the amount of money needed to fund it. The excess payments for these retired officers increased the amount needed to fund the plan by approximately $75,122 per month or $901,464 annually, at the time of this audit.

For the 8 aforementioned police officers who retired during the current audit period, during the final 12 months of these 8 police officers' respective employments, in addition to their regular hours, the police officers accumulated the following number of additional hours that were included in their final 12 month earnings. The additional hours included overtime, and unused vacation, sick, and personal pay, as illustrated below:

Retiree	Overtime Hours	Vacation Hours	Sick Hours	Personal Hours	Total Additional Hours
1	821.0	96.0	116.0	42.0	1,075.0
2	211.5	352.0	296.0	80.0	939.5
3	1,260.0	216.0	180.0	48.0	1,704.0
4	1,204.0	136.0	44.0	24.0	1,408.0
5	1,218.5	-	195.5	71.0	1,485.0
6	1,697.5	78.5	16.5	32.0	1,824.5
7	2,024.5	9.5	-	24.0	2,058.0
8	890.5	80.0	8.0	48.0	1,026.5

CITY OF CHESTER POLICE PENSION PLAN
COMMENTS

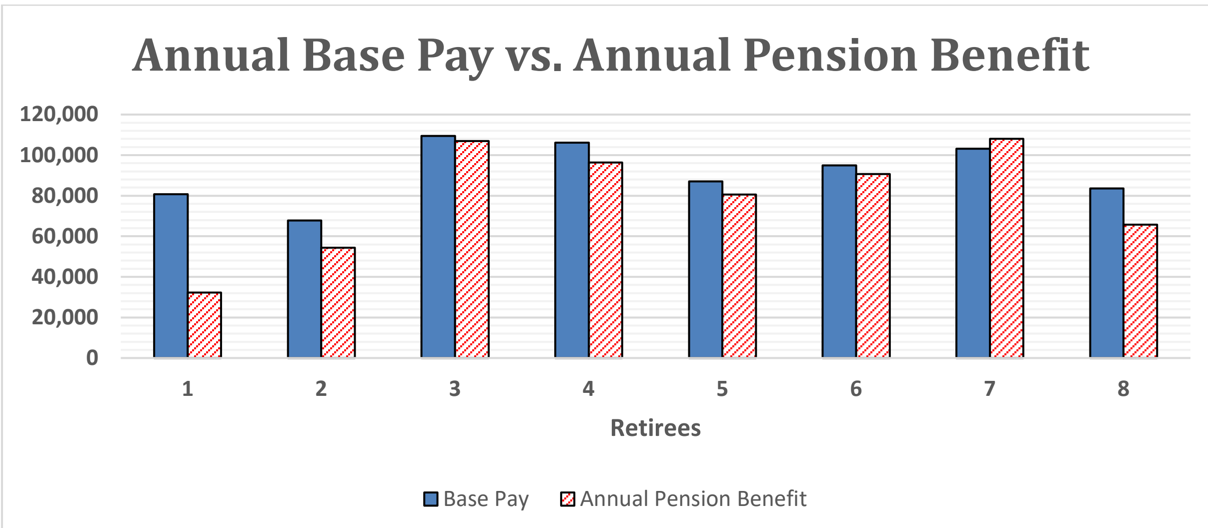
The following chart illustrates the effect that using the retiree's final 12 months accumulated earnings to determine the retiree's pension benefits instead of using the retiree's regular monthly base pay to determine the retiree's monthly pension benefit has on the pension calculation and ultimately the pension plan and the amount of money needed to fund it.

Retiree – Full Years of Service	Additional Final 12 Month Earnings for extra hours	Annual Base Pay per contract (including longevity)	Annual Pension Benefit	Monthly Pension Benefit	Monthly Pension w/o Additional Final 12 Months Earnings Included	Excess Monthly Pension Benefit due to earnings for extra hours
1 – 20**	$ 48,232	$ 80,722	$ 32,256	$ 2,688	$ 1,682	$ 1,006
2 – 20	40,839	67,813	54,324	4,527	2,825	1,702
3 – 30*	92,495	109,419	106,956	8,913	5,059	3,854
4 – 21*	82,010	106,156	96,432	8,036	4,534	3,502
5 – 20	74,097	87,033	80,556	6,713	3,626	3,087
6 – 20	86,355	94,957	90,660	7,555	3,957	3,598
7 – 21*	107,762	103,112	108,072	9,006	4,404	4,602
8 – 20	47,788	83,558	65,676	5,473	3,482	1,991

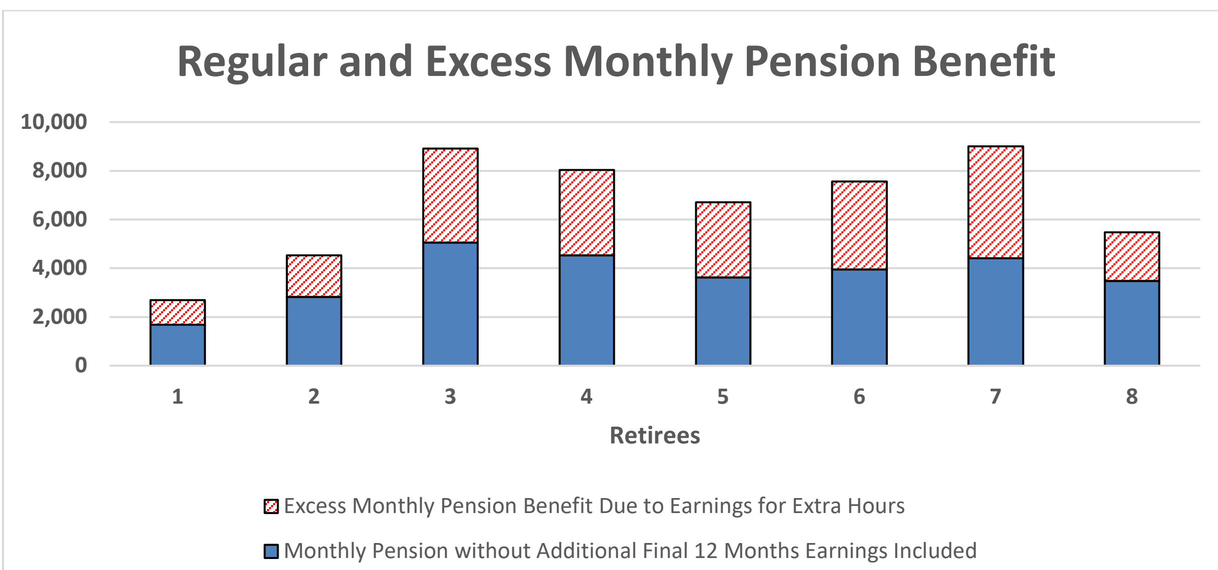
* The final monthly pension benefit for this retiree include a service increment determined pursuant to the Third Class City Code, which authorizes additional pension benefits based upon completed years of service in excess of 20 years, not to exceed $500 per month.

** Survivor of a deceased police officer.

Through the inclusion of large amounts of additional compensation in the police officers' final 12 months of earnings, the 8 aforementioned plan members who retired during the current audit period are receiving pension benefits that approximate on average 86.7 percent of the amount of their total base pay earned during their final year of employment with the city. The annual pension benefits compared to the base pay for individual retirees is illustrated below:



The effect of the inclusion of additional earnings on the monthly pension benefits for individual retirees is illustrated below:



CITY OF CHESTER POLICE PENSION PLAN
COMMENTS

As previously noted in this audit report, the City of Chester is a home rule municipality, and until the *Monroeville* decision, there was no definitive decision as to whether home rule municipalities were obliged to comply with applicable pension law. Consequently, 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.

Given the funded status of the police pension plan and the ever increasing financial burden of prior, current, and future contributions that will be necessary to adequately fund the plan, we encourage city officials to review the methodology used to calculate pension benefits for its police officers. The city's practice of allowing police officers the opportunity to accumulate large amounts of overtime and other forms of compensation during their last 12 months of employment and including that compensation in the calculation of pension benefits has created apparent windfalls for retirees, significantly increased the required municipal contributions to the pension funds, thwarted actuarial projections, and jeopardized the fiscal soundness of the city's police pension plan.

The city has taken preliminary steps to attempt to limit "salary" as used in pension benefit calculations to include "base pay plus longevity" for employees hired after January 1, 2017 through collective bargaining, as noted earlier in this report; however, as noted above, the city's continued practice of allowing police officers hired prior to January 1, 2017 the opportunity to accumulate large amounts of overtime and other forms of compensation during their last 12 months of employment and including that compensation in the calculation of pension benefits will continue to impact the city's funding and fiscal soundness of the police pension plan.

CITY OF CHESTER POLICE PENSION PLAN
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