COMPLIANCE AUDIT

City of Chester Officers and Employees Pension Plan

Delaware County, Pennsylvania

For the Period

January 1, 2016 to December 31, 2017

April 2019

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

The Honorable Mayor and City Council
City of Chester
Delaware County
Chester, PA 19013

We have conducted a compliance audit of the City of Chester Officers and Employees Pension Plan for the period January 1, 2016 to December 31, 2017. We also evaluated compliance with some requirements subsequent to that period when possible. The audit was conducted pursuant to authority derived from Section 402(j) of Act 205 and in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior audit report; and

2. To determine if the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

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

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

- We determined whether annual employer contributions were calculated and deposited in accordance with the plan's governing document and applicable laws and regulations by examining the municipality's calculation of the plan's annual financial requirements and minimum municipal obligation (MMO) and comparing these calculated amounts to amounts actually budgeted and deposited into the pension plan as evidenced by supporting documentation.

- We determined whether annual employee contributions were calculated, deducted, and deposited into the pension plan in accordance with the plan's governing document and applicable laws and regulations by testing total members' contributions on an annual basis using the rates obtained from the plan's governing document in effect for all years within the period under audit and examining documents evidencing the deposit of these employee contributions into the pension plan.

- We determined whether retirement benefits calculated for all 5 of the 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 benefit due to retired individuals and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to recipients.

- We determined whether the January 1, 2015 and January 1, 2017 actuarial valuation reports were prepared and submitted by March 31, 2016 and 2018, respectively, in accordance with Act 205 and whether selected information provided on these reports is accurate, complete, and in accordance with plan provisions to ensure compliance for participation in the state aid program by comparing selected information to supporting source documentation.

- We determined whether the 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.

City officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the City of Chester Officers and Employees 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 and as previously described, we tested transactions, assessed official actions, performed analytical procedures, and interviewed selected officials to provide reasonable assurance of detecting instances of noncompliance with legal and regulatory requirements or noncompliance with provisions of contracts, administrative procedures, and local ordinances and policies that are significant within the context of the audit objectives.

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

Finding – Noncompliance With Prior Audit Recommendation – Provision Of Benefits Inconsistent With The Third Class City Code

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

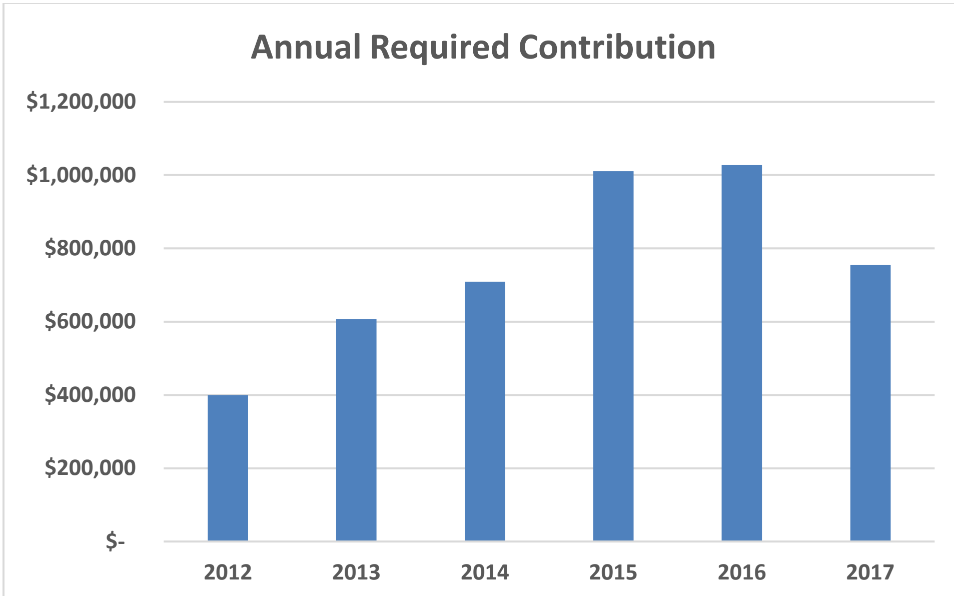
As previously noted, one of the objectives of our audit of the City of Chester Officers and Employees Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through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

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, 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 24.2% as of January 1, 2017, 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 with city currently in Level III severe distress status.**

The decline in the plan's funded ratio occurred despite the increase in the city's annual required contribution to the Officers and Employees plan from $399,962 in 2012 to $754,857 in 2017, an increase of 88.7%. During that period, the annual required contribution spiked to over $1 million in 2015 and 2016. In addition, the city determined the plan's 2018 minimum municipal obligation (MMO) to be $638,153.

A graphic illustration of the increase in the city's annual required contribution to the Officers and Employees plan since 2012 is presented below:



Pursuant to Act 205 regulations, the actuarial assumption as to interest or investment earnings that may be utilized by municipalities is not less than 5% or more than 9%. As illustrated in the Supplementary Information contained in this report, using the city's current 7.5% investment return assumption, the city's reported Net Pension Liability for the Officers and Employees plan as of December 31, 2017 is $6,011,525. Using a more conservative 6.5% assumption, the city's Net Pension Liability for the Officers and Employees plan would be $6,846,382, an increase of $834,857. Therefore, the city's reported Net Pension Liability is dependent on investment earnings at the high-end of the allowable assumptions, which could be difficult to sustain in this current economic environment.

Based on the annual benefit payments owed to beneficiaries as reported in the plan's January 1, 2017 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 Officers and Employees plan has assets to fund just over 3 years of benefit payments as illustrated below:

Plan	Actuarial Valuation of Assets 1-1-17	Annual Benefit Payments Owed To Beneficiaries 1-1-17	Years of Benefit Payments That Can Be Funded By Assets Available 1-1-17
Officers and Employees	$ 2,019,149	$ 642,526	3.14

While we note that the city has and will continue to contribute more to the plan, we encourage city officials to develop a long-term strategic plan to address its Officers and Employee Pension Plan funding crisis. The city should 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 non-uniformed employees. 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. We would like to thank city officials for the cooperation extended to us during the conduct of the audit.

January 2, 2019

EUGENE A. DEPASQUALE
Auditor General

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BACKGROUND

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

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

In addition to Act 205, the City of Chester Officers and Employees Pension Plan is also governed by implementing regulations adopted by the former Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

Act 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 362 - The Third Class City Code, Act of May 23, 1945 (P.L. 903, No. 362), Article XLIII-A, Optional Retirement System for Officers and Employees, as amended, 53 P.S. § 39371 et seq.

The City of Chester Officers and Employees Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Article 145, adopted pursuant to Act 362. The plan is also affected by the provisions of collective bargaining agreements between the city and its non-uniformed employees. The plan was established January 1, 1941. Active members are required to contribute 6 percent of compensation to the plan if hired prior to January 1, 1988, 1 percent of compensation if hired after December 31, 1987, and 3.5% if hired after March 1, 2017. As of December 31, 2017, the plan had 116 active members and 58 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2017, selected plan benefit provisions are as follows.

<u>Eligibility Requirements</u>:

Normal Retirement	If hired before January 1, 1988: Age 60 and 20 years of service. If hired after December 31, 1987: Age 65 and 25 years of service.
Early Retirement	If hired before January 1, 1988: Age 60 and 12 years of service. If hired after December 31, 1987: Age 65 and 12 years of service.
Vesting	A member is 100% vested after 12 years of service.

<u>Retirement Benefit</u>:

If hired before January 1, 1988: 50% of final rate of compensation.

If hired after December 31, 1987: 0.75% of average monthly compensation based on final 5 years of compensation times full years of service.

<u>Survivor Benefit</u>:

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.

<u>Disability Benefit</u>:

After 15 years of service and before age 55 - normal retirement benefit.

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Audit Recommendation

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

- Provision Of Benefits Inconsistent With The Third Class City Code

Finding – Noncompliance With Prior Audit Recommendation – Provision Of Benefits Inconsistent With 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 our prior audit reports since the audit report for the years ended December 31, 2000, 1999 and 1998, the plan's governing document contains a benefit provision that is inconsistent with the Third Class City Code (Act 362), as noted below:

Benefit	Governing Document	Third Class City Code
Definition of salary	Salary includes regular wages, 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.

Criteria: As disclosed in prior audit reports, the Commonwealth Court of Pennsylvania issued its opinion on January 24, 2001, 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.

Finding – (Continued)

Recommendation: The Department acknowledges 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.

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.

Management's Response: The city provided the following response:

> The Solicitor's office has begun to update City Ordinances to comply with the Third Class City Code and has committed to having all pension related ordinances updated to comply with state legislation and audit recommendations by December 31, 2020. To insure compliance, the City has and will continue to have our consultants at Thomas J. Anderson and Associates review the updated ordinances prior to implementation.

Auditor's Conclusion: Based on the management response, it appears that municipal officials are striving to comply with the recommendation. Compliance will be evaluated during our next audit of the plan.

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

The supplementary information contained on Pages 6 through 8 reflects the implementation of GASB Statement No. 67, *Financial Reporting for Pension Plans*. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2015

	2014	2015
Total Pension Liability		
Service cost	$ 158,100	$ 156,071
Interest	682,217	667,156
Difference between expected and actual experience	-	(580,791)
Changes of assumptions	-	258,129
Benefit payments, including refunds of member contributions	(731,987)	(700,880)
Net Change in Total Pension Liability	108,330	(200,315)
Total Pension Liability – Beginning	9,304,115	9,412,445
Total Pension Liability – Ending (a)	$ 9,412,445	$ 9,212,130
Plan Fiduciary Net Position		
Contributions – state aid	$ 709,116	$ 1,010,694
Contributions – member	53,174	60,504
Net investment income	78,796	77,924
Benefit payments, including refunds of member contributions	(731,987)	(700,880)
Administrative expense	(9,500)	(18,927)
Net Change in Plan Fiduciary Net Position	99,599	429,315
Plan Fiduciary Net Position – Beginning	733,431	833,030
Plan Fiduciary Net Position – Ending (b)	$ 833,030	$ 1,262,345
Net Pension Liability – Ending (a-b)	$ 8,579,415	$ 7,949,785
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	8.9%	13.7%
Estimated Covered Employee Payroll	$ 4,493,142	$ 4,800,000
Net Pension Liability as a Percentage of Covered Employee Payroll	190.9%	165.6%

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CHANGES IN THE NET PENSION
LIABILITY AND RELATED RATIOS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2017

	2016	2017
Total Pension Liability		
Service cost	$ 163,875	$ 161,572
Interest	677,595	613,073
Difference between expected and actual experience	-	(1,050,985)
Changes of assumptions	-	30,724
Benefit payments, including refunds of member contributions	(682,804)	(675,613)
Net Change in Total Pension Liability	158,666	(921,229)
Total Pension Liability – Beginning	9,212,130	9,370,796
Total Pension Liability – Ending (a)	$ 9,370,796	$ 8,449,567
Plan Fiduciary Net Position		
Contributions – state aid	$ 1,027,873	$ 754,857
Contributions – member	157,965	182,859
Net investment income	147,391	293,169
Benefit payments, including refunds of member contributions	(682,804)	(675,613)
Administrative expense	(10,500)	(19,500)
Net Change in Plan Fiduciary Net Position	639,925	535,772
Plan Fiduciary Net Position – Beginning	1,262,345	1,902,270
Plan Fiduciary Net Position – Ending (b)	$ 1,902,270	$ 2,438,042
Net Pension Liability – Ending (a-b)	$ 7,468,526	$ 6,011,525
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	20.3%	28.9%
Estimated Covered Employee Payroll	$ 4,836,136	$ 4,920,000
Net Pension Liability as a Percentage of Covered Employee Payroll	154.4%	122.2%

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the city as of December 31, 2014, 2015, 2016, and 2017, calculated using the discount rate of 7.5%, as well as what the city's net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Net Pension Liability - 12/31/14	$ 9,529,319	$ 8,579,415	$ 7,765,062
Net Pension Liability - 12/31/15	$ 8,875,173	$ 7,949,785	$ 7,156,438
Net Pension Liability - 12/31/16	$ 8,410,333	$ 7,468,526	$ 6,661,471
Net Pension Liability - 12/31/17	$ 6,846,382	$ 6,011,525	$ 5,294,532

SCHEDULE OF INVESTMENT RETURNS

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

2017	15.41%
2016	11.68%
2015	(5.02%)
2014	6.19%

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF FUNDING PROGRESS

Historical trend information about the plan is presented herewith as supplementary information. It is intended to help users assess the plan's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other state and local government retirement systems.

The actuarial information is required by Act 205 biennially. The historical information, beginning as of January 1, 2013, is as follows:

	(1)	(2)	(3)	(4)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Accrued Liability (b) - (a)	Funded Ratio (a)/(b)
01-01-13	$ 882,488	$ 9,160,992	$ 8,278,504	9.6%
01-01-15	990,525	9,089,783	8,099,258	10.9%
01-01-17	2,019,149	8,350,535	6,331,386	24.2%

Note: The market values of the plan's assets at 01-01-13 have been adjusted to reflect the smoothing of gains and/or losses subject to a maximum corridor of 130 percent of the market value of assets. The market values of the plan's assets at 01-01-15 and 01-01-17 have been adjusted to reflect the smoothing of gains and/or losses subject to a maximum corridor of 120 percent of the market value of assets. These methods will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

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 OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2012	$ 399,962	100.0%
2013	606,847	100.0%
2014	709,116	100.0%
2015	1,010,694	100.0%
2016	1,027,873	100.0%
2017	754,857	100.0%

Note: The actuarially determined contributions for the years 2012 through 2014, and 2017 reflect the 25 percent reduction of the amortization contributions the city was permitted to defer pursuant to Act 44 of 2009.

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
SUPPLEMENTARY INFORMATION
NOTES TO SUPPLEMENTARY SCHEDULES
(UNAUDITED)

The information presented in the supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation date follows:

Actuarial valuation date	January 1, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	8 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

CITY OF CHESTER OFFICERS AND EMPLOYEES PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

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