COMPLIANCE AUDIT

City of Chester
Police 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 Police 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 findings 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. To determine if municipal officials took appropriate corrective action to address the findings 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 6 of the plan members who retired during the current audit period 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 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.

- 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. 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 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

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

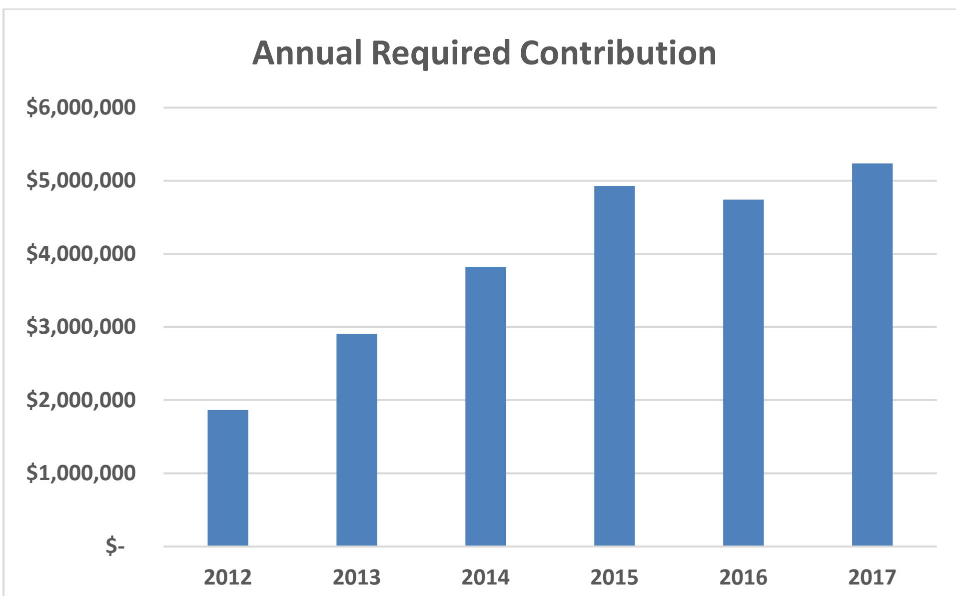
As previously noted, one of the objectives of our audit of the City of Chester Police Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. Act 205 was amended on September 18, 2009, through the adoption 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 30.6% 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 the city currently in Level III severe distress status.**

The continued decline in the plan's funded ratio occurred despite the increase in the city's annual required contribution to the Police Pension Plan from $1,865,056 in 2012, to $5,235,369 in 2017, an increase of 180.7% 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 additionally, for 2016 and 2017. The city only recently deposited the remainder of its 2014 Police Pension Plan MMO during 2018. In addition, the city determined the plan's 2018 minimum municipal obligation (MMO) to be $5,315,716.

A graphic illustration of the increase in the city's annual required contribution to the Police Pension 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 Police plan as of December 31, 2017 is $60,854,314. Using a more conservative 6.5% assumption, the city's Net Pension Liability for the Police plan would be $70,045,446, an increase of $9,191,132. 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 police pension plan does not have assets to fund five 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
Police	$ 25,498,629	$ 6,221,147	4.10

Moreover, the police pension plan funding levels are actually more severe than shown in the table above because the actuarial value of assets reflected above includes pension contribution receivables of approximately $14.3 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, since the issuance of our last audit report, it was noted that the city has implemented certain corrective actions to stabilize its general fund and address its pension crisis including increasing its earned income tax rate from 2.10% to 2.75%, 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. The city also made general fund contributions (not just originating with state aid) into the pension plan during 2017 for the first time since 2013 and also began making $500,000 monthly contributions into the police pension plan beginning January 2018. Although the impact of these actions on the city's police pension plan has not yet been determined by the plan's actuary given their timing, the city anticipates the long-term position of the pension fund to improve over time, and we encourage city officials to continue developing its long-term strategic plan to address its Police Pension Plan funding crisis and continue making 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 that are determined in accordance with the provisions and the intent of the Third Class City Code and will 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 4, 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 Police Pension Plan is also governed by implementing regulations adopted by the former Public Employee Retirement Commission published at Title 16, Part IV of the Pennsylvania Code and applicable provisions of various other state statutes including, but not limited to, the following:

Act 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% per January 1 until reaching 8%, and members hired on or after February 1, 2017 are required to contribute 8% of compensation to the plan. As of December 31, 2017, the plan had 81 active members, no terminated members eligible for vested benefits in the future, and 138 retirees receiving pension benefits from the plan.

BACKGROUND – (Continued)

As of December 31, 2017, selected plan benefit provisions are as follows *(refer to Finding No. 2 noting inconsistencies between the plan governing document and collective bargaining agreement (CBA))*:

Eligibility Requirements:

Normal Retirement	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. 20 years of service, no minimum age. (CBA) If hired after 2/1/17 – age 50 and 25 years of service.
Early Retirement	None
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. Pensions shall vest at 12 years of service with receipt of pension benefits at age 50. (CBA) Employees hired after 2/1/17 – None, must have 25 years of service and reach age 50.

Retirement Benefit:

Hired pre January 1, 1988: Benefit equals 50% of final pay plus 1.25% of pay times years of service over 20 years (Maximum service increment $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 service increment $100 per month).

50% of earnings reportable on IRS Form W-2 in the twelve (12) month period prior to retirement. Monthly service increment of $500 for retirees with 21 or more years of service. (CBA)

Hired after 2/1/17: Benefit equals 50% of the higher of final monthly salary or the highest average annual salary during any 5 preceding years plus a service increment of 1.25% of pay times years of service in excess of 20 years but not including service after age 65. (Maximum service increment is $100 per month and salary is defined as base pay plus longevity.

Survivor Benefit:

If retired or eligible for retirement – Benefit equals 50% of benefit to surviving spouse or children under the age of 18.

Service Related Disability Benefit:

Benefit equals 50% of the higher of final monthly salary or the highest average annual salary during any of the 5 preceding years (70% if "heroic" disability event), offset by 100% of worker's compensation, social security disability, and any earning from employment after retirement and excess earning above the average at time of retirement. The offset for earning is reduced by the annual cost of health insurance benefits paid by the retiree.

Non-Service Related Disability Benefit:

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

If hired after 2/1/17 – None

CITY OF CHESTER POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Audit Recommendations

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

- Incorrect Data On Certification Form AG 385 Resulting In An Underpayment Of State Aid

  Plan officials complied with the instructions that accompany Certification Form AG 385 to assist them in accurately reporting the required pension data during the audit period.

- Pension Benefits Modified Without Prior Cost Estimate

  Benefit modifications during the audit period were preceded by a cost estimate in accordance with Act 205 provisions.

Partial Compliance With Prior Audit Recommendation

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

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

  During the current audit period, the city paid the outstanding 2014 MMO due the police pension plan and included interest in accordance with Act 205; however, the city again failed to pay the full MMO due the plan for 2015 as also previously recommended. In addition, a similar condition occurred during the current audit period. The city again failed to fully pay the annual MMOs for the police pension plan in accordance with Act 205 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 audit 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 eight audit reports, the city operates pursuant to 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	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 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. 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.

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." The court's holding was in accord with the position taken by this Department since at least January 1995.

Cause: City officials were again 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: 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 date *Monroeville* was issued) 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 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.

Finding No. 1 – (Continued)

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: 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. The City conducted a "State of the Pension" address where Police participants were provided with actuarial data relating to their respective pension fund. This communication lead to the police willingly discussing pension benefits and contractual changes outside of their contract. The Controller's office, FOP members and the city's CFO met in 2018 to discuss the pension plan and how to improve the plan's financial standing. In addition, the CFO has met and discussed the importance of updating the language from the Third Class City Code in both the FOP contract and City ordinance.

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

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

Condition: As disclosed in our prior five 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 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: The city provided the following response:

> Our Solicitor's department has committed to work to correct this issue with inconsistent pension benefits.

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

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 2014 MMO due the police pension plan along with applicable interest in accordance with Act 205. However, the city again failed to pay the full MMO due the plan for 2015. The total MMO for 2015 for the police pension plan calculated by the city was $4,931,999; however, the city did not deposit any payments towards the 2015 MMO during 2015. In 2016, the city deposited 2015 state aid in the amount of $375,273 towards the 2015 MMO, and in 2018 made general fund contributions totaling $1,018,908 towards the 2015 MMO. As of the date of this report, the balance of the 2015 MMO remains outstanding.

Finding No. 3 – (Continued)

In addition, a similar condition occurred during the current audit period. The city again failed to fully pay the annual MMOs for the police pension plan for 2016 and 2017 in accordance with Act 205, as follows:

The total MMO 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. As of the date of this report, the balance of the 2016 MMO remains outstanding.

The total MMO 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, the city did not make any additional payments towards the 2017 MMO. As of the date of this report, the balance of the 2017 MMO remains outstanding.

Furthermore, subsequent to the current audit period, the total MMO for 2018 for the police pension plan calculated by the city was $5,315,716 and the city deposited 2018 state aid in the amount of $626,813 towards the 2018 MMO; however, the city did not make any additional payments towards the 2018 MMO. As of the date of this report, the balance of the 2018 MMO remains outstanding.

Although the full amounts of the MMOs due have been recorded as accounts receivable and are therefore considered plan assets, the city has an unpaid 2015 MMO balance for the police pension plan of $5,121,202 (including interest), an unpaid 2016 MMO balance for the police pension plan of $5,384,581 (including interest), an unpaid 2017 MMO balance for the police pension plan of $5,556,817 (including interest), and an unpaid 2018 MMO balance for the police pension plan of $5,052,914 (including interest). All interest calculations were provided by the city as of December 31, 2018.

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 2015, 2016, 2017, and 2018 MMOs by the annual December 31, deadlines, the city must add the outstanding 2015, 2016, 2017, and 2018 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 recommend that the city pay the outstanding MMOs due to the police pension plan for the years 2015, 2016, 2017, and 2018 with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculations 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 determine and pay the full MMO due to the plan in accordance with Act 205 requirements.

Finding No. 3 – (Continued)

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

> The City of Chester, which has been under Act 47 since 1995 recently entered into more severe financial hardships. The City was unable to budget for the drastic increases in its minimum municipal obligations, in addition to being unable to submit the projected bi-weekly payments, as suggested by the Act 47 team due to insufficient cash flows. The City recently adopted a recovery plan, with the help of the Act 47 team, in hopes to help the City become financially stable in 2019. We look to deposit over $7 Million into the Police Pension Plan based on the 2019 cash projections. This amount is significantly more than the City has been able to deposit in the past few years and we are working to be able to increase the amount deposited into the plans each year.
>
> The City has increased a majority of its fees to generate additional revenues and has the cooperation of all three of its labor unions who are willing to decrease pension benefits to progress the growth of the City's underfunded pension liability.
>
> In preparation for 2019, the City has instituted a new pay-for-parking plan to increase revenues. As well as increased its non-resident earned income tax, the City will be use this revenue specifically for the pension plans.

Auditor's Conclusion: It appears that the city has initiated the implementation of a comprehensive strategic plan to not only pay the past due MMOs owed to the plan, but also to ensure that future MMOs can be paid timely in accordance with Act 205 requirements to avoid long-term interest accruals. 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 prior audit report, 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 and after the current audit period. The city again failed to timely deposit its 2016 and 2018 state aid allocations into the police pension plan within the 30 day grace period allowed by Act 205. The city received its 2016 state aid allocation in the amount of $1,622,994 on September 27, 2016 but did not deposit the $476,149 allocated to the police pension plan until January 31, 2017. In addition, the city received its 2018 state aid allocation in the amount of $1,812,858 on September 30, 2018 but did not deposit the $626,183 allocated to the police pension plan until November 15, 2018. Although this represents significant improvement over the timing of previous deposits of state aid, the timing of the 2018 deposit of state aid into the pension plan still exceeded the 30 days allowed by Act 205.

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: Plan officials failed to establish adequate internal control procedures to ensure the timely deposit of the 2016 state aid allocation in accordance with Act 205 requirements.

Effect: Although the state aid was eventually deposited into the plan, the interest earned beyond the 30 day grace period was not deposited into the plan. When state aid is not deposited into a pension plan account in a timely manner, the funds are not available to pay operating expenses or for investment and the risk of misapplication is increased.

Recommendation: We again recommend that the city pay the police pension plan the interest earned during the period beyond the 30 day grace period allowed by Act 205. A copy of the interest calculation must be maintained by the city for examination during our next audit of the plan.

We also again recommend that plan officials develop and implement adequate internal control procedures to ensure that future state aid allocations are deposited timely in accordance with Act 205 requirements.

Finding No. 4 – (Continued)

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

> Given the City's distressed financial status, we have been working with the Act 47 team to deposit the state aid in a timely manner. The City had outstanding checks and/or payments when the state aid was deposited into the City's general fund account. The City agrees to pay any interest payments due. Although this mishap was unintentional, the City does not want to create the idea or thought that the state relief funds were misappropriated.

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

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)

The supplementary information contained on Pages 17 through 19 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	$ 1,243,265	$ 1,236,135
Interest	4,481,692	5,549,595
Change of benefit terms	-	1,150,972
Difference between expected and actual experience	-	11,188,833
Changes of assumptions	-	1,623,158
Benefit payments, including refunds of member contributions	(5,090,966)	(5,793,191)
Net Change in Total Pension Liability	633,991	14,955,502
Total Pension Liability – Beginning	61,058,110	61,692,101
Total Pension Liability – Ending (a)	$ 61,692,101	$ 76,647,603
Plan Fiduciary Net Position		
Contributions – employer	$ 3,180,671	$ 4,556,726
Contributions – state aid	644,271	375,273
Contributions – member	398,035	425,108
Net investment income	1,615,921	488,902
Benefit payments, including refunds of member contributions	(5,090,966)	(5,793,191)
Administrative expense	(32,540)	(30,640)
Net Change in Plan Fiduciary Net Position	715,392	22,178
Plan Fiduciary Net Position – Beginning	20,101,245	20,816,637
Plan Fiduciary Net Position – Ending (b)	$ 20,816,637	$ 20,838,815
Net Pension Liability – Ending (a-b)	$ 40,875,464	$ 55,808,788
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	33.7%	27.2%
Estimated Covered Employee Payroll	$ 7,802,522	$ 7,800,000
Net Pension Liability as a Percentage of Covered Employee Payroll	523.9%	715.5%

CITY OF CHESTER POLICE 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	$ 1,297,942	$ 1,310,381
Interest	5,620,818	6,118,275
Change of benefit terms	-	31,342
Difference between expected and actual experience	-	5,560,939
Changes of assumptions	-	224,829
Benefit payments, including refunds of member contributions	(6,002,620)	(6,228,465)
Net Change in Total Pension Liability	916,140	7,017,301
Total Pension Liability – Beginning	76,647,603	77,563,743
Total Pension Liability – Ending (a)	$ 77,563,743	$ 84,581,044
Plan Fiduciary Net Position		
Contributions – employer	$ 4,265,723	$ 4,785,029
Contributions – state aid	476,149	450,340
Contributions – member	377,404	420,331
Net investment income	1,958,427	2,471,847
Benefit payments, including refunds of member contributions	(6,002,620)	(6,228,465)
Administrative expense	(41,320)	(44,930)
Net Change in Plan Fiduciary Net Position	1,033,763	1,854,152
Plan Fiduciary Net Position – Beginning	20,838,815	21,872,578
Plan Fiduciary Net Position – Ending (b)	$ 21,872,578	$ 23,726,730
Net Pension Liability – Ending (a-b)	$ 55,691,165	$ 60,854,314
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	28.2%	28.1%
Estimated Covered Employee Payroll	$ 7,466,696	$ 8,200,000
Net Pension Liability as a Percentage of Covered Employee Payroll	745.9%	742.1%

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	$ 47,515,341	$ 40,875,464	$ 35,250,938
Net Pension Liability - 12/31/15	$ 64,119,160	$ 55,808,788	$ 48,812,740
Net Pension Liability - 12/31/16	$ 64,127,850	$ 55,691,165	$ 48,582,792
Net Pension Liability - 12/31/17	$ 70,045,446	$ 60,854,314	$ 53,114,061

SCHEDULE OF INVESTMENT RETURNS

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

2017	14.38%
2016	6.28%
2015	(0.26%)
2014	7.58%

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, 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	$ 22,684,586	$ 59,723,152	$ 37,038,566	38.0%
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%

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 at 130 percent of the market value of assets. The market value of the plan's assets at 01-01-15 and 01-01-17 has been adjusted to reflect the smoothing of gains and/or losses subject to maximum of 120 percent of the market value of assets. These methods 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.

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.

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
2012	$ 1,865,056	100.0%
2013	2,906,548	100.0%
2014	3,824,942	100.0%
2015	4,931,999	28.3%*
2016	4,741,872	10.0%*
2017	5,235,369	8.6%*

Note: The actuarially determined contributions for the years 2010 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.

* Although the full amounts of the annual required contributions for the years 2015, 2016, and 2017 were recorded as receivables, the city did not pay the full amount of the police pension plan's annual required contributions for the years those years, as disclosed in Finding No. 3 contained in this report.

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, 2017
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	15 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 POLICE PENSION PLAN
COMMENTS

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 the prior audit report, 14 police officers previously retired 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. The city’s practice of including these additional hours 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 in the amount of approximately $51,780 per month or $621,360 annually.

During the current audit period, 2 additional police officers retired with non-disability normal retirement pensions and had additional hours included in their pension determinations and were not previously included in our analysis. During the final 12 months of these 2 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:

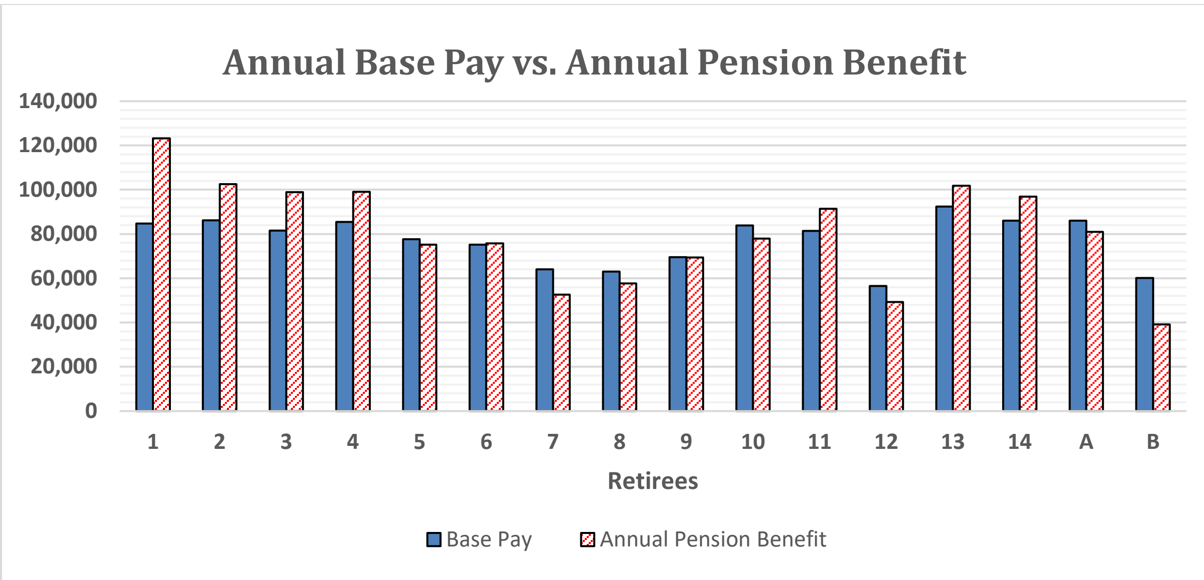
Retiree	Total Additional Hours	Overtime Hours	Vacation Hours	Sick Hours	Personal Hours
A	1,353.0	915.0	258.0	116.0	64.0
B	545.5	107.5	204.0	144.0	90.0

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.

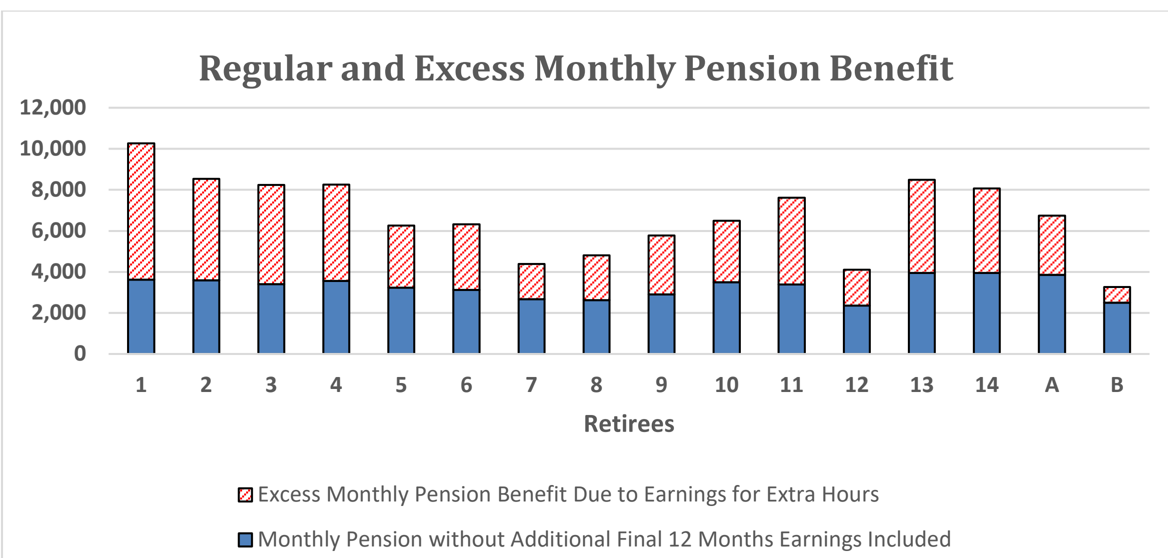
Retiree – Full Years of Service	Additional Final 12 Month Earnings for extra hours	Annual Base Pay per contract (including longevity)	Annual Pension Benefit	Monthly Pension Benefit	Monthly Pension w/o Additional Final 12 Months Earnings Included	Excess Monthly Pension Benefit due to earnings for extra hours
A – 21*	$ 64,554	$ 86,022	$ 80,940	$ 6,745	$ 3,853	$ 2,892
B – 20	18,153	60,099	39,120	3,260	2,504	756

* 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.

Through the inclusion of large amounts of additional compensation in the police officers' final 12 months of earnings, plan members who retired during the current and prior audit periods are receiving pension benefits that approximate on average 104.7 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. Retirees 1 through 14 were reported in the prior audit report, and retirees A and B retired during the current audit period:



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.

During the current period, it was noted that 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 detailed 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
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
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Ms. Elizabeth Williams
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Councilwoman

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Councilman

Mr. William Morgan
Councilman

Mr. Nafis J. Nichols
Chief Financial Officer

Ms. Edith M. Blackwell
City Controller

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