

COMPLIANCE AUDIT

City of Chester Police Pension Plan Delaware County, Pennsylvania For the Period January 1, 2020 to December 31, 2022

February 2024



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General



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**TIMOTHY L. DEFOOR
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, 2020 to December 31, 2022. 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)). The Act 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, 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, local ordinances and policies, our methodology included the following:

- We determined whether state aid was properly 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 obligation¹ (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 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 calculated and actually paid to the recipients.
- We determined whether the January 1, 2019, and January 1, 2021, actuarial valuation reports were prepared and submitted by March 31, 2020, and 2022, 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.

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. 53 P.S. §895.302.

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, 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, 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, local ordinances and policies, except as noted in the following finding 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 Nos. 1, 2, and 3 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.

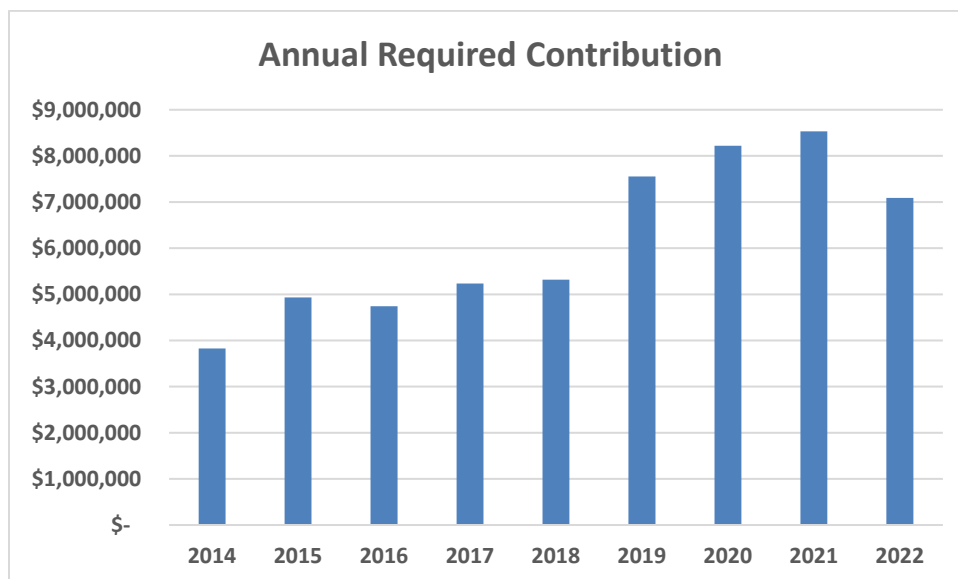
As previously noted, one of the objectives of our audit of the City of Chester Police Pension Plan was to determine compliance with applicable state laws, regulations, contracts, administrative procedures, local ordinances and policies. Among several provisions relating to municipal pension plans, Act 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:

<u>Level</u>	<u>Indication</u>	<u>Funding Criteria</u>
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 34.5% as of January 1, 2021, 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.**²

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 \$7,088,632 in 2022, an increase of 85.3%, 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 2020, 2021 and 2022. The city only recently deposited the remainder of its 2017 Police Pension Plan required obligation during 2022. In addition, the city calculated the plan's 2023 required municipal obligation, \$10,631,820.

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



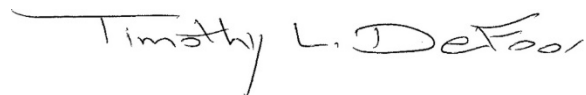
Based on the annual benefit payments owed to beneficiaries as reported in the plan's January 1, 2021, actuarial valuation report, at current funding levels, based on the plan's current benefit obligations and actuarial assumptions (which include 6.5 percent long-term investment return projections), the police pension plan does not have assets to fund five years of benefit payments as illustrated below:

² It should be noted that the City of Chester filed for Chapter 9 Bankruptcy relief in November of 2022 during this audit period and proceedings are ongoing. The outcome of this filing on the City's pension plans is unknown at this time.

Plan	Actuarial Valuation of Assets ³ 1-1-21	Annual Benefit Payments Owed To Beneficiaries 1-1-21	Years of Benefit Payments That Can Be Funded By Assets Available 1-1-21
Police	\$ 33,929,867	\$ 6,817,815	4.98

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. 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 City of Chester and, where appropriate, their responses have been included in the report.



Timothy L. DeFoor
Auditor General
November 21, 2023

³ The police pension plan funding levels are more dire than shown in the table above because the actuarial value of assets reflected above includes pension contribution receivables of approximately \$32.4 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.

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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 two 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 are required to contribute eight percent of compensation to the plan. As of December 31, 2021, the plan had 70 active members, no terminated members eligible for vested benefits in the future, and 147 retirees receiving pension benefits.

CITY OF CHESTER POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Compliance With Prior Recommendation

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

- Untimely Deposit Of State Aid

During the current audit period, the city 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. Additionally, the city deposited the state aid received during 2020, 2021 and 2022 into the plan in accordance with Act 205.

- Deficiencies Relative To The City's Enactment Of The Special Taxing Provisions Of Act 205

During the current audit period, the city developed and implemented procedures to account for the receipt and distribution of tax revenues collected under the special taxing authority afforded by Act 205 and maintained 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. City officials also implemented procedures to ensure that the city did 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 the years 2021 and 2022.

Partial Compliance With Prior Recommendation

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

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

The city made periodic general fund contributions totaling \$2,500,000 in 2020 to the plan towards the outstanding 2015 MMO, and the remaining balance of \$476,683, including interest in accordance with Act 205, was paid in January 2021. The city also made payments in 2021 totaling \$6,391,640 towards the outstanding 2016 MMO, and the remaining balance of \$84,994, including interest in accordance with Act 205, was paid in January 2022. Further, the 2017 MMO, including interest in accordance with Act 205, in the amount of \$7,108,948 was paid by the city during 2022. Moreover, the city continues to regularly deposit funds into the plan towards the outstanding MMOs in arrears, and the city made payments in 2022 totaling \$915,700 towards the outstanding 2018 MMO. However, as of the completion of our audit work, the balance of the 2018 MMO and the full amount of the plan's 2019 MMO remain outstanding. In addition, a similar condition occurred during the current audit period as further discussed in Finding No. 3 of this report.

CITY OF CHESTER POLICE PENSION PLAN
STATUS OF PRIOR FINDINGS

Noncompliance With Prior Recommendations

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

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: As previously disclosed in the ten most recent 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:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Third Class City Code</u>
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. ⁴
Normal retirement/ service-related disability benefit	<p>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.</p> <p>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.</p>	<p>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.</p> <p>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.</p>

⁴ 11 Pa. C.S.A. §14300(b).

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Third Class City Code</u>
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.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 1 – (Continued)

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

Criteria: 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: The city again failed to take appropriate corrective action to comply with the prior audit recommendation.

Effect: Inconsistent benefits may 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 benefits provided; however, the provision of inconsistent 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 these benefits on the city’s future state aid allocations and submit this information to the department. If it is determined these excess benefits had an impact on the city’s future state aid allocations after the submission of this information, the plan’s actuary would be required to contact the department to verify the overpayment of state aid received and the city reimburse the overpayment to the Commonwealth.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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 city is working with its legal team and the state provided receivership team to update the governing document to comply with the findings as stated.

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

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

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

Condition: As previously disclosed in the seven most recent 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:

<u>Benefit Provision</u>	<u>Governing Document</u>	<u>Collective Bargaining Agreement</u>
Normal retirement criteria	If hired before 1/1/88 – age 50 and 20 years 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).	50% of earnings reportable on IRS Form W-2 in the twelve (12) month period prior to retirement.
	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).	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.

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.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 2 – (Continued)

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: The city provided the following response:

The city is working with its legal team and the state provided receivership team to update the governing document to comply with the findings as stated.

Auditor’s Conclusion: 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. 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 2015, 2016, and 2017 MMOs and a portion of the 2018 MMO due to the police pension plan along with applicable interest in accordance with Act 205. However, the city again did not fully pay the minimum municipal obligation (MMO) of the police pension plan for the years 2018, 2019 and 2020, as required by Act 205 and the prior recommendation.

The total MMO for 2018 for the police pension plan calculated by the city was \$5,315,716; and in the prior audit period, the city deposited \$626,813 towards the 2018 MMO. In addition, as disclosed in the Status of Prior Findings section of this report, the city made an additional payment towards the 2018 MMO in the amount of \$915,700 in 2022. As of the date of this report, the balance of the 2018 MMO remains outstanding.

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.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

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.

A similar condition occurred during the current audit period. The total MMO for 2021 for the police pension plan calculated by the city was \$8,533,497; and in 2021, the city deposited 2021 state aid in the amount of \$1,352,834 towards the 2021 MMO; however, as of the date of this report, the balance of the 2021 MMO remains outstanding.

The total MMO for 2022 for the police pension plan calculated by the city was \$7,088,632; and in 2022, the city deposited 2022 state aid in the amount of \$1,296,451 towards the 2022 MMO; however, as of the date of this report, the balance of the 2022 MMO remains outstanding.

The city provided the following MMO balances, including interest, as determined by the city, due the police pension plan:

	<u>MMO Balance (as of 9/1/23 including interest)</u>
2018 MMO	\$1,238,389
2019 MMO	\$7,815,553
2020 MMO	\$8,151,939
2021 MMO	\$8,581,935
2022 MMO	\$6,487,984

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.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

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.

Cause: 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.

Effect: The continued failure to fully pay the MMOs in accordance with Act 205 has resulted in the city accruing additional interest on the 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 2018, 2019, 2020, 2021 and 2022 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.

Recommendation: We recommend that the city pay the outstanding MMOs due to the police pension plan for the years 2018, 2019, 2020, 2021 and 2022 with interest, in accordance with Section 302(e) of Act 205. A copy of the interest calculation must be maintained by the city for examination during our next audit of the plan.

Furthermore, we recommend that in the future, the city determine and pay the full MMO due to the plan in accordance with Act 205 requirements.

CITY OF CHESTER POLICE PENSION PLAN
FINDINGS AND RECOMMENDATIONS

Finding No. 3 – (Continued)

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

The city is continuing to fund the pension plans in a timely manner to bring the MMO payments up to date.

Auditor's Conclusion: 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.

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, 2017, is as follows:

	(1)	(2)	(3)	(4)
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) - Entry Age (b)	Unfunded (Assets in Excess of) Actuarial Liability (b) - (a)	Funded Ratio (a)/(b)
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%
01-01-21	33,929,867	98,405,971	64,476,104	34.5%

Note: The market values of the plan’s assets at 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.

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

<u>Year Ended December 31</u>	<u>Actuarially Determined Contribution</u>	<u>Actual Contributions</u>	<u>Contribution Deficiency</u>	<u>Covered- Employee Payroll</u>	<u>Contributions as a Percentage of Covered- Employee Payroll</u>
2014	\$ 3,824,942	\$ 3,824,942	\$ -	\$7,802,522	49.02%
2015	4,931,999	4,931,999	-	7,800,000	63.23%
2016	4,741,872	4,741,872	-	7,466,696	63.51%
2017	5,235,369	5,235,369	-	5,680,410	92.17%
2018	5,315,716	(446,749)	5,762,465	7,985,224	N/A
2019	7,554,343	109,861	7,444,662	7,985,224	1.37%
2020	8,220,254	455,169	7,765,085	7,800,000	5.84%
2021	8,533,497	358,822	8,174,675	7,800,000	4.60%
2022	7,088,632	908,358	6,180,094	6,220,000	14.61%

Note: The City's 12/31/2022 outstanding MMO balance including interest for 2018-2022 was \$35,326,981 (see Finding No. 3 contained in this report).

The 2018 negative contributions made reflect the net imputed interest penalty applied under Act 205, which is the reason the contributions made are negative for 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, 2021
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	11 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	6.5%
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.⁵

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.⁶

The city’s practice has been to calculate the police officers’ pension benefits based on the amount of the individual’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, 24 police officers retired between January 1, 2013, and December 31, 2020, 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, the city recalculated the pension benefits of the 24 police officers using the retiree’s final 36 months of pay in accordance with the plan’s governing document, however, the wages used still included additional hours over and above their regular hours in the determination of their final 36-months’ earnings used in the determination of their monthly pension benefits.⁷

⁵ 11 Pa.C.S. § 14303(a), (b).

⁶ 11 Pa.C.S. § 14300(b).

⁷ It should be noted that there is pending litigation regarding the recalculation of these benefits. The impact of such litigation on the pension plan was not known as of the date of this report.

CITY OF CHESTER POLICE PENSION PLAN COMMENTS

In addition, six additional police officers retired with non-disability normal retirement pensions during the current audit period and had an average of \$77,643 in additional earnings for hours over and above their regular hours earned during their last 36-months' employment, included in their pension determinations. The city's practice of including these additional hours for the 30 police officers since 2013 had a significant impact on not only the individual pension calculations but ultimately the pension plan as a whole, and the resources needed to fund it. The excess payments for these retired officers increased the amount needed to fund the plan by approximately \$81,723 per month or \$980,676 annually at the time of this audit.

Through the inclusion of large amounts of additional compensation in the police officers' final 36 months of earnings, the six aforementioned retirees are receiving pension benefits that approximate on average 65.8 percent of the amount of their average annual wages excluding additional earnings (*For one employee, monthly benefit payments exceed 100% of the employee's base salary*) during their final 36 months of employment with the city.

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 36 months of employment and including that compensation in the calculation of pension benefits has resulted in significantly increased pension benefit payments to the retirees, as well as significantly increased municipal contributions to the pension plan, incorrect actuarial projections, and risk to the fiscal soundness of the city's police pension plan. Determining benefits based on this method also creates a situation where it is difficult, if not impossible, to make accurate actuarial calculations for the plan's future liabilities.

The city's practice of including all overtime and other forms of compensation accumulated in the final 36 months of employment is not, per se, in excess of the provisions stipulated in the city's governing document, however, it is important to consider the funding standard for municipal pension plans. The overarching principle of Act 205 is undermined when a plan is funded based on an established plan benefit structure and an important piece of the overall underlying accrued liability (*i.e., the final monthly earnings containing large amounts of overtime hours worked and other forms of compensation in the final 36 months of employment which cannot be reasonably estimated until separation from employment*) is unknown and, therefore, cannot be funded over time in accordance with Act 205. This methodology has adverse ramifications on the funded status of the plan and also results in increased annual contributions required which, when the city's annual state aid allocation is not sufficient to cover the annual minimum municipal obligation, shall be borne by the taxpayer in the form of increased resources needed from the city's general-purpose funds.

CITY OF CHESTER POLICE PENSION PLAN
COMMENTS

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 discussed 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 36 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 Joshua D. Shapiro
Governor
Commonwealth of Pennsylvania

The Honorable Stefan Roots
Mayor

Ms. Portia West
Councilwoman

Ms. Tameka Gibson
Councilwoman

Mr. Fred Green
Councilman

Mr. Shy'Quan Davis
Councilman

Ms. Joy Taylor
City Controller

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.