

LIMITED PROCEDURES ENGAGEMENT

Honesdale Borough Police Pension Plan Wayne County, Pennsylvania For the Period January 1, 2015 to December 31, 2018

October 2019



Commonwealth of Pennsylvania
Department of the Auditor General

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EUGENE A. DePASQUALE
AUDITOR GENERAL

The Honorable Mayor and Borough Council
Honesdale Borough
Wayne County
Honesdale, PA 18431

We conducted a Limited Procedures Engagement (LPE) of the Honesdale Borough Police Pension Plan for the period January 1, 2015 to December 31, 2018 to determine its compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. We also evaluated compliance with some requirements subsequent to that period when possible. The LPE was conducted pursuant to authority derived from Section 402(j) of the Municipal Pension Plan Funding Standard and Recovery Act (P.L. 1005, No. 205, as amended, 53 P.S. § 895.101 et seq.) but was not conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. 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. We believe that the evidence obtained provides a reasonable basis to support our LPE results.

Our LPE was limited to determining the following:

- 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 engagement period.
- 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.
- Whether annual employee contributions were required during the engagement period and, if so, 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 engagement period and examining documents evidencing the deposit of these employee contributions into the pension plan.

- Whether retirement benefits calculated for plan members who retired during the engagement 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.
- 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.

Based on the results of our procedures performed during our LPE, nothing came to our attention indicating that the Honesdale Borough Police Pension Plan was not being administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding further discussed later in this report:

Finding – Pension Benefit In Excess Of Act 600.

Our determination to perform a LPE for this engagement period does not preclude the Department from conducting an audit in accordance with *Government Auditing Standards* of the pension plan in subsequent periods. The borough should continue to maintain documentation related to this pension plan.

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.

The contents of this report were discussed with officials of Honesdale Borough and, where appropriate, their responses have been included in this report. We would like to thank borough officials for the cooperation extended to us during the conduct of this LPE.

September 26, 2019



EUGENE A. DEPASQUALE
Auditor General

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HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Pension Benefit In Excess Of Act 600

Condition: The borough calculated an early retirement benefit for an employee who had only worked 15 years and attained 41 years of age, based on a settlement agreement signed between the member and the borough. The early retirement pension benefit being paid to the police officer is in excess of Act 600 and the plan’s governing document. In addition, there was no cost estimate provided for determining the financial impact on the borough and/or pension plan before the early retirement benefit was awarded.

Provision 1 of the early retirement agreement states, the following:

The BOROUGH will pay a retirement payout that is consistent with the retirement he would receive at the 25 year anniversary given an early resignation. This pay will be provided monthly from September 2015 to September 2025 when he will receive his pension from the Police Pension Plan.

Moreover, the early retirement benefit provided pursuant to the separate agreement between the borough and the member is being funded and paid by the borough’s general fund, which is also not in accordance with Act 600 and Act 205 funding standards.

Criteria: Section 5(i) of Act 600 states, in part:

The ordinance or resolution establishing the police pension fund may provide for an early retirement benefit. The early retirement benefit shall be provided to a member of the police force with twenty or more years of service who terminates employment prior to the completion of superannuation retirement age and service requirements and who files a written application for an early retirement benefit with the governing body of the municipality or regional police department. The early retirement benefit shall become effective as of the date the application is filed with the actuarial equivalent of a partial superannuation retirement benefit calculated as follows:

- (1) A partial superannuation retirement benefit shall be determined by applying the percentage that the member’s years of service bear to the years of service that the member would have rendered had the member continued to be employed until his superannuation retirement date to the gross pension amount calculated using the monthly average salary during the appropriate period prior to his termination of employment.

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

- (2) The actuarial equivalent of the partial superannuation retirement benefit shall be determined by actuarially reducing the partial superannuation retirement benefit to reflect that it will commence on the effective date of the early retirement rather than on the date on which the member would have completed superannuation age and service requirements. The actuarial reduction shall be calculated using the actuarial assumptions reported in the last actuarial valuation report filed with the Public Employee Retirement Commission under the act of December 18, 1984 (P.L. 1005, No. 205), known as the “Municipal Pension Plan Funding Standard and Recovery Act.”

In addition, Section 1.17 of Ordinance No. 657 states, in part:

“Early Retirement Age” shall mean the date on which the Participant has completed twenty (20) years of Aggregate Service with the Employer.

Furthermore, Section 4.05 of Ordinance No. 657 states, in part:

Early Retirement Benefit – The early retirement benefit shall become effective as of the date the application is filed with Council or the date designed on the application, whichever is later. The benefit shall be in an amount equal to the actuarial equivalent of the Participant’s Accrued Benefit. The actuarial equivalent of the Participant’s Accrued Benefit shall be determined by actuarially reducing the Accrued Benefit to reflect that it will commence on the Participant’s Early Retirement Date rather than on the date which would have been the Participant’s Normal Retirement Date if the Participant continued in Employment to such date. The actuarial assumptions reported in the last actuarial valuation report filed with the Public Employee Retirement Commission under the Act shall be the actuarial assumptions used to calculate the actuarial equivalent of the Participant’s Accrued Benefit.

Section 305(a) of Act 205 states:

Prior to the adoption of any benefit plan modification by the governing body of the municipality, the chief administrative officer of each pension plan shall provide to the governing body of the municipality a cost estimate of the effect of the proposed benefit plan modification.

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Furthermore, Section 305(b) of Act 205 states, in part:

If the pension plan is a defined benefit plan which is self-insured in whole or in part, the cost estimate shall be prepared by an approved actuary....

Section 5(a) of Act 600 states:

Payments made under the provisions of this act shall not be a charge on any other fund in the treasury of any borough, town, township or regional police department, or under its control, save the police pension fund herein provided for.

Under Act 205, all pension benefits, whether statutorily authorized or not, must be paid from the appropriate pension fund, reflected in the plan's actuarial valuation reports, and funded in accordance with the act's standards.

Cause: Municipal officials believed that the unauthorized benefits granted would be allowable because the borough would pay the benefits from outside the plan until the normal retirement date.

Effect: The borough is paying pension benefits to a retiree in excess of those authorized by Act 600 and the plan's governing document. The retiree is currently receiving excess monthly benefits in the amount of \$1,498, which totaled approximately \$73,139, which included annual COLA increases, from the date of the initial monthly excess benefit payment through the date of this report.

Additionally, providing unauthorized pension benefits from the borough's general fund circumvents the provisions promulgated by Act 600 and Act 205 for the establishment and required funding standards for municipal pension plans and reduces the amount of funds available to pay other general operating expenses of the borough for the benefit of its taxpayers and understates the plan's total pension costs and required funding requirements stipulated within the provisions of Act 205. Since the borough received state aid based on unit value during the current audit period, it did not receive allocations attributable to the excess pension benefits provided. However, the increased costs to the pension plan as a result of the proper inclusion of all pension benefits (including excess benefits) in the actuarial valuation reporting process for funding purposes in accordance with Act 205 funding standards, could result in the receipt of excess state aid in the future and increase the municipal contributions necessary to fund the plan in accordance with Act 205.

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Recommendation: We recommend that the borough comply with Act 600 at its earliest opportunity to do so. To the extent that the borough is not in compliance with Act 600 and/or is contractually obligated to pay benefits to existing retirees in excess of those authorized by Act 600, 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 excess benefits on the borough’s future state aid allocations and submit this information to the department. If it is determined the excess benefits had an impact on the borough’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.

We also recommend that the chief administrative officer (CAO) of the pension plan have a qualified person prepare a cost estimate of the benefit already granted, which includes a comparison of current and future contribution rates. Furthermore, the CAO should present the cost estimate to the governing body of the municipality for its review. Finally, all future benefit modifications should be preceded by a cost estimate which has been prepared by a qualified person.

Management’s Response: Municipal officials disagreed with the recommendation. The retirement of the officer was based on a settlement negotiated exclusively between a former councilman and the retiree, and approved by borough council. The agreement followed a grievance filed by the officer and rather than subject the borough to potential on-going litigation, the former councilman negotiated the resolution and the officer left the police department. The settlement monies are being paid from the Borough’s general fund, not the pension plan.

Auditor’s Conclusion: The department acknowledges the borough’s position and does not take exception with the borough’s negotiating and entering into a separation settlement agreement with its former employee; but instead, despite the borough’s efforts to characterize the payment of these monthly benefits “from the borough’s general fund, not the pension plan” as something other than “pension benefits,” they are paid as pension benefits as they are regularly occurring monthly payments attributable to the retirement of the pension plan member and are no different than any other pension payment in terms of their regularity or schedule of payment. Therefore, based on the criteria cited above, the finding remains as stated and compliance will be subject to verification during the next plan engagement.

HONESDALE BOROUGH 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	\$ 2,475,376	\$ 3,663,958	\$ 1,188,582	67.6%
01-01-15	2,715,208	3,759,470	1,044,262	72.2%
01-01-17	3,041,005	4,101,271	1,060,266	74.1%

Note: The market values of the plan’s assets at 01-01-13, 01-01-15, and 01-01-17 have been adjusted to reflect the smoothing of gains and/or losses over a four-year averaging period, which will also be limited to a maximum of 120 percent and a minimum of 80 percent of the fair market value of assets. This method will lower contributions in years of less than expected returns and increase contributions in years of greater than expected returns. The net effect over long periods of time is to have less variance in contribution levels from year to year.

HONESDALE BOROUGH 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.

HONESDALE BOROUGH POLICE PENSION PLAN
SUPPLEMENTARY INFORMATION
(UNAUDITED)

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYER
AND OTHER CONTRIBUTING ENTITIES

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2013	\$ 146,224	100.0%
2014	126,488	100.0%
2015	194,469	100.0%
2016	196,332	100.0%
2017	207,279	104.8%
2018	217,214	100.0%

HONESDALE BOROUGH 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	8 years
Asset valuation method	4-year smoothing, the actuarial value of assets will be limited to a maximum of 120% and a minimum of 80% of the fair market value of assets.
Actuarial assumptions:	
Investment rate of return	7.25%
Projected salary increases	5.0%
Cost-of-living adjustments	2.75% per year

HONESDALE BOROUGH POLICE PENSION PLAN
REPORT DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom W. Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Sarah Canfield
Mayor

Mr. Michael Augello
Council President

Ms. Clare Joaquin
Borough Treasurer

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