

COMPLIANCE AUDIT

Honesdale Borough Police Pension Plan Wayne County, Pennsylvania For the Period January 1, 2019 to December 31, 2022

October 2023



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 Borough Council
Honesdale Borough
Wayne County
Honesdale, PA 18431

We have conducted a compliance audit of the Honesdale Borough Police Pension Plan for the period January 1, 2019 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)), which requires the Auditor General, as deemed necessary, to audit every municipality which receives general municipal pension system state aid and every municipal pension plan and fund in which general municipal pension system state aid is deposited. The audit was not conducted, nor was it required to be, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We planned and performed the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

The objectives of the audit were:

1. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior report; and
2. To determine if the pension plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies.

Our audit was limited to the areas related to the objectives identified above. To determine if municipal officials took appropriate corrective action to address the finding contained in our prior 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 the plan member 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 individual and comparing these amounts to supporting documentation evidencing amounts determined and actually paid to the recipient.
- 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.

Honesdale Borough contracted with an independent certified public accounting firm for annual audits of its basic financial statements for the years ended December 31, 2019, 2020 and 2021, which are available at the borough's offices. Those financial statements were not audited by us and, accordingly, we express no opinion or other form of assurance on them.

Borough officials are responsible for establishing and maintaining effective internal controls to provide reasonable assurance that the Honesdale Borough Police Pension Plan is administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies. As previously described, we tested transactions, interviewed selected officials, and performed procedures to the extent necessary to provide reasonable assurance of detecting instances of noncompliance with legal and regulatory requirements or noncompliance with provisions of contracts, administrative procedures, and local ordinances and policies that are significant within the context of the audit objectives.

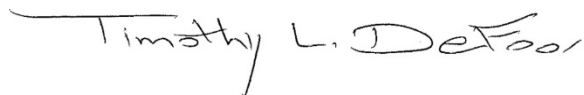
The results of our procedures indicated that, in all significant respects, the Honesdale Borough Police Pension Plan was administered in compliance with applicable state laws, regulations, contracts, administrative procedures, and local ordinances and policies, except as noted in the following finding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

Finding – Noncompliance With Prior Recommendation – Pension Benefit In
Excess Of Act 600

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

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 the report. We would like to thank borough officials for the cooperation extended to us during the conduct of the audit.



Timothy L. DeFoor
Auditor General
September 15, 2023

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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 Honesdale Borough 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 600 - Police Pension Fund Act, Act of May 29, 1956 (P.L. 1804, No. 600), as amended, 53 P.S. § 767 et seq.

The Honesdale Borough Police Pension Plan is a single-employer defined benefit pension plan locally controlled by the provisions of Ordinance No. 657, adopted pursuant to Act 600. The plan is also affected by the provisions of collective bargaining agreements between the borough and its police officers. The plan was established September 1, 1960. Active members are required to contribute five percent of compensation to the plan. As of December 31, 2022, the plan had four active members, two terminated members eligible for vested benefits in the future, and nine retirees receiving pension benefits.

HONESDALE BOROUGH POLICE PENSION PLAN
STATUS OF PRIOR FINDING

Noncompliance With Prior Recommendation

Honesdale Borough has not complied with the prior recommendation concerning the following as further discussed in the Finding and Recommendation section of this report:

- Pension Benefit In Excess Of Act 600

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – Noncompliance With Prior Recommendation – Pension Benefit In Excess Of Act 600

Condition: As previously disclosed in the prior released report, 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 which was not authorized by Act 600 or the plan’s governing document. In addition, there was no prior cost estimate provided calculating the financial impact on the borough and/or pension plan before the early retirement was awarded and the benefit began being paid from the borough’s general fund. It was recommended that the borough comply with Act 600 at its earliest opportunity to do so or to the extent that the borough is not in compliance with Act 600 and/or contractually obligated to pay benefits to the existing retiree in excess of those authorized by Act 600, the excess benefits be paid from the pension fund, reflected in the Act 205 actuarial valuation reports for the plan and funded in accordance with Act 205 funding standards. Additionally, it was also recommended the borough prepare a cost estimate of the benefit already granted, which includes a comparison of current and future contribution rates and present the cost estimate to the governing body of the municipality for its review. However, no such action was taken by the borough and the benefit continues to be paid from the borough’s general fund.

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...

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.

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

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.

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 previously indicated that they 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. The borough is aware of the non-compliance as disclosed in the prior audit report but was advised by its counsel not to take any action at this time.

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

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 \$1,842 per month, which totaled approximately \$154,590, inclusive of 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, 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 state aid attributable to the excess pension benefits provided. However, the increased costs to the pension plan from 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.

Recommendation: We again 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 the existing retiree in excess of those authorized by Act 600, the excess benefits must be paid from the pension fund, 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 be required to contact the department to verify the overpayment of state aid received and the borough reimburse such overpayments to the Commonwealth.

We also again recommend that the chief administrative officer (CAO) of the pension plan have a qualified person prepare a cost estimate for 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, it is recommended that all future benefit modifications be preceded by a cost estimate which has been prepared by a qualified person.

HONESDALE BOROUGH POLICE PENSION PLAN
FINDING AND RECOMMENDATION

Finding – (Continued)

Management's Response: Municipal officials indicated that they are aware that there would be a finding each year but were advised by counsel not to take any action.

Auditor's Conclusion: As disclosed in the prior released report, although the department acknowledged the borough's position and did not take exception with the borough's negotiating and entering into a separation settlement agreement with its former employee, the department maintains its position that under Act 205, whether statutorily authorized or not, all pension benefits, 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. Therefore, the finding remains as stated. Compliance will be evaluated during our next audit of the plan.

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, 2017, 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)
01-01-17	\$ 3,041,005	\$ 4,101,271	\$ 1,060,266	74.1%
01-01-19	3,324,577	4,184,246	859,669	79.5%
01-01-21	4,120,854	4,384,225	263,371	94.0%

Note: The market values of the plan's assets at 01-01-17, 01-01-19, and 01-01-21 have been adjusted to reflect the smoothing of gains and/or losses over a 4-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
2017	\$ 207,279	104.8%
2018	217,214	100.0%
2019	201,806	100.0%
2020	247,098	100.3%
2021	233,187	120.0%
2022	212,341	123.5%

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, 2021
Actuarial cost method	Entry age normal
Amortization method	Level dollar
Remaining amortization period	3 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	7.0%
Projected salary increases	5.0%
Cost-of-living adjustments	2.5% per year

HONESDALE BOROUGH 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 Derek Williams
Mayor

Mr. Michael Augello
Council President

Ms. Danielle Simoneaux
Borough Treasurer

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.