



**SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM  
STAFF REPORT  
AUDIT DIVISION**

**DATE:** February 27, 2015  
**TO:** AUDIT COMMITTEE  
**FROM:** Lee Parravano, Internal Auditor, Audit  
**SUBJECT:** Plan Sponsor Contribution & Reporting Audit - City of San Diego

---

Enclosed is the Plan Sponsor Contribution & Reporting Audit for the period July 1, 2011 through June 30, 2013. Overall, the City of San Diego (City) has procedures in place for the census data and control strengths were identified during the audit. Opportunities for improvement were also identified that should be addressed to further strengthen controls.

Based on this audit, there were two findings made related to census data. Finding number 1 had three recommendations and finding number 2 had one recommendation. Recommendations 1a and 1b did not require any response from City management or SDCERS management, but should be considered by SDCERS Board. SDCERS management agrees to recommendation 1c. The City's management agrees with the recommendation in finding number 2. Management's written responses can be found after page 15 of the audit report.

I would like to thank City and SDCERS staff for all of the assistance and cooperation provided during this audit. Everyone involved was very helpful and willing to provide the information needed. Their valuable time and efforts spent on this audit is greatly appreciated.



## **Internal Audit Report**

# **Plan Sponsor Contribution & Reporting Audit**

**City of San Diego**

**Prepared by:  
Lee Parravano, Internal Auditor**

# Table of Contents

EXECUTIVE SUMMARY ..... 1

AUDIT OBJECTIVES, SCOPE & METHODOLOGY ..... 3

    Audit Objectives..... 3

    Audit Scope & Methodology ..... 3

INTRODUCTION ..... 4

    Background ..... 4

    Priority Rating Process..... 4

AUDIT RESULTS..... 5

    Finding #1: The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets..... 5

    Finding #2: The amount paid for Multiple Certification pay could not be traced to an MOU or signed supporting documentation..... 14

## **EXECUTIVE SUMMARY**

The City of San Diego (City) has procedures in place for the census data reported to San Diego City Employees' Retirement System (SDCERS). Control strengths identified during the audit period from July 1, 2011 through June 30, 2013 include:

- The City correctly reported wage types included in pensionable salary (Base Compensation) to SDCERS.
- The following elements were correctly reported to SDCERS for all tested employees; date of birth, date of hire, date of membership, classification of employee, gender, date of termination, employment status, Plan code, service period, member entry age, and member contributions.
- Pensionable compensation cap for tested members was observed.
- Membership in the City Employees' Retirement System (Plan) was correctly not established for temporary employees tested.
- Membership in the Plan was correctly not established for independent contractors tested.

However, the following issues were identified that should be addressed to further strengthen controls over the census data.

### Discounted Employee Offsets

Annually, SDCERS actuary performs an actuarial valuation. The actuarial valuation determines, as of a valuation date, the Normal Cost, Actuarial Accrued Liability, Actuarial Value of Assets, and related Actuarial Present Value for a pension plan.

The City's annual retirement costs is made up of two parts; the Normal Cost and the contribution related to the Unfunded Actuarial Liability (UAL). The Normal Cost is the cost of the benefit that is attributed to the current year of service. The City's Normal Cost is split into substantially equal employee and employer rates. All or part of the employee's Normal Cost rate is subject to potential offset by the City. The offset is determined through the meet and confer negotiations between the City and the employee bargaining groups. Such offsets are not to be refunded to employees at termination.

Beginning July 1, 1976 the City of San Diego began offsetting a portion of the employee's Normal Cost rate. Based on the advice of the actuary, the City contributed less than the full amount of the offset to SDCERS for fiscal years 1978 to 1993 based on anticipated savings from employees terminating employment and not receiving a retirement allowance from SDCERS. The discount rates applied to employee offsets were based on the actuary's recommendation.

The actuarial firm, performing the actuarial valuations for fiscal year contributions in 1994 to 2006, recommended the City contribute the entire offset rate to SDCERS without any discount applied. The actuary recommended the anticipated savings from employees terminating employment be calculated at the system level so as to be consistent with the manner in which all other liabilities are calculated.

## **EXECUTIVE SUMMARY (Continued)**

### Discounted Employee Offsets (Continued)

The actuarial firm, performing the actuarial valuations for fiscal year contributions in 2007 to 2013, was unaware the City was discounting employee offsets. Their actuarial models did not assume any discount on employee offsets.

The City continued to discount employee offsets from July 1, 1994 to June 30, 2013. The discount rates applied to employee offsets were not based on actuarial amounts from July 1, 1994 to June 30, 2013. Additionally, the discounts for employee offsets were calculated outside of the actuarial process since July 1, 1994. The total gross dollar amount of discounted employee offsets that were never remitted to SDCERS is estimated to be \$49,000,000.00 at June 30, 2014. A portion of the \$49,000,000.00 has been paid down each year as part of the payment on the UAL. The estimated net discounted employee offsets that were never remitted to SDCERS is estimated to be \$23,000,000.00 at June 30, 2014. The \$23,000,000.00 does not account for interest or the years when the City's contribution to SDCERS was less than the Annual Required Contribution/Actuarially Determined Contribution.

### Multiple Certification Pay

The amount paid for Multiple Certification pay could not be traced to a Memorandum of Understanding (MOU) or signed supporting documentation. The MOU does not state if the second certification is paid at a set rate or if the second certification should be paid in an amount equal to the certificate obtained. Based on a unsigned memorandum dated June 25, 2001 the amount paid for Multiple Certification pay was \$.75. This wage type is included in, and reported to SDCERS, as Base Compensation. This employee received \$3,120.00 for the audit period July 1, 2011 to June 30, 2013 related to this wage type.

\*\*\*\*\*

Based on this audit, there were two findings made related to the census data. Finding number 1 had three recommendations and finding number 2 had one recommendation. Recommendations 1a and 1b did not require any response from City management or SDCERS management, but should be considered by SDCERS Board. SDCERS management agrees to recommendation 1c. The City's management agrees with the recommendation in finding number 2. Details can be found in the Audit Results section of this report.

The information in this report is intended solely for the use of the City and SDCERS' Audit Committee, Board of Administration, and management and is not intended to be, and should not be, used by anyone other than these specified parties.

## **AUDIT OBJECTIVES, SCOPE & METHODOLOGY**

### **Audit Objectives**

The objective of the audit was to evaluate the controls over member records and payroll data submitted by the City to SDCERS and to verify the accuracy and adequacy of that information.

### **Audit Scope & Methodology**

This audit was performed for the period from July 1, 2011 through June 30, 2013 by using the following methods:

- Reviewed the Plan, Memorandum of Understandings between the City and the employee Unions, City Salary Ordinances, and the San Diego City Employees' Retirement System Participation and Administration Agreement.
- Reviewed policies and procedures utilized by staff to process the City's retirement transmittal file to SDCERS.
- Interviewed staff responsible for processing payroll, member enrollment, and transmitting the retirement file to SDCERS to determine if there is appropriate segregation of duties.
- Randomly selected twenty-five employee records, covering two pay periods – December 10, 2011 to December 23, 2011 and April 27, 2013 to May 10, 2013. For each employee selected:
  - Traced pensionable salary (Base Compensation) from the transmittal file to the payroll remittance.
  - Traced pay rates from the payroll remittance to the personnel files.
  - Reviewed various documents as necessary to determine if the following elements were reported correctly; member date of birth, date of hire, eligible date of membership, class of employee, gender, date of termination, employment status, Plan code, service period, member entry age, member contributions, employer offset contributions, and code section 401(a)(17) limits.
- Reviewed the City's enrollment practices for temporary and part-time employees to determine if employees met the City's membership criteria.
- Reviewed the City's enrollment practices pertaining to independent contractors to determine if individuals met the City's membership criteria.

This audit was planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions. Internal Audit believes the evidence obtained provides a reasonable basis for the findings and recommendations.

Internal Audit would like to thank SDCERS and the City of San Diego management and staff for their cooperation with the performance of this audit.

## INTRODUCTION

### Background

SDCERS administers three separate defined benefit pension plans for the City of San Diego, the San Diego Unified Port District, and the San Diego County Regional Airport Authority. SDCERS provides service retirement, disability retirement, death and survivor benefits to its participants.

Each pay period the City provides SDCERS a transmittal file that contains information such as member name, pensionable salary, member contributions, class of employee, and member date of birth. The transmittal file is used by SDCERS to update each member's data contained within SDCERS' pension administration system. Member data is used by SDCERS to determine items such as service retirement eligibility, monthly base salary for benefits, benefit formula, and death benefits. Collectively, the underlying member data is referred to as census data. On a yearly basis SDCERS sends the census data to the Plan actuary to provide an actuarial valuation. The actuarial valuation provides the financial condition of the City Plan, the past and expected trends in the financial condition of the City Plan, the City's employer and member contribution rates, and other information required by the Governmental Accounting Standards Board.

<b>City of San Diego – Membership Total</b>		
<b>Valuation as of:</b>	<b>June 30, 2013</b>	<b>June 30, 2012</b>
Active Counts	7,566	7,724
Terminated Vested	2,971	2,892
Disabled	1,212	1,221
Retirees	6,042	5,796
Beneficiaries	1,200	1,188
<b>Total City Members</b>	<b>18,991</b>	<b>18,821</b>
Active Member Payroll	\$ 499,463,072	\$ 511,090,601
Average Pay Per Active	\$ 66,014	\$ 66,169
Benefits in Pay Status	\$ 371,628,344	\$ 350,163,967
Average Benefit	\$ 43,959	\$ 42,677

*Source: SDCERS – City of San Diego Actuarial Valuation as of June 30, 2013*

### Priority Rating Process

To assist management in its evaluation, the findings have been assigned a qualitative assessment of the need for corrective action. Each item is assessed a high, medium, or low priority as follows:

High - Represents a finding requiring immediate action by management to mitigate risks associated with the process being audited.

Medium - Represents a finding requiring timely action by management to mitigate risks associated with the process being audited.

Low - Represents a finding for corrective action by management to mitigate risks with the process being audited.

## AUDIT RESULTS

Based on detailed testing of twenty-five individuals from two pay periods, control strengths were identified, as well as issues that should be addressed to further strengthen controls.

### Control Strengths Identified

Listed below are the control strengths identified:

- The City correctly reported wage types included in Base Compensation to SDCERS.
- The following elements were correctly reported to SDCERS for all tested employees; date of birth, date of hire, date of membership, classification of employee, gender, date of termination, employment status, Plan code, service period, member entry age, and member contributions.
- Pensionable compensation cap for tested members was observed.
- Membership in the City Employees' Retirement System (Plan) was correctly not established for temporary employees tested.
- Membership in the Plan was correctly not established for independent contractors tested.

Below are issues that were identified and should be addressed to further strengthen controls over the City's census data.

**Finding #1:** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

Annually, SDCERS actuary performs an actuarial valuation. The actuarial valuation determines, as of a valuation date, the Normal Cost, Actuarial Accrued Liability, Actuarial Value of Assets, and related Actuarial Present Value for a pension plan. The Actuary makes assumptions as to the occurrence of future events affecting pension costs, such as: mortality, withdrawal, disablement and retirement; changes in compensation and pension benefits; rates of investment earnings and asset appreciation or depreciation and other relevant items.

Per San Diego Municipal Code Sections 24.0201 and 24.0202 the normal rate of contribution for General and Safety Members is based upon the Member's age at his or her birthday nearest to the date the Member joined the Retirement System. SDCERS Board (Board), based upon advice of the Actuary, shall periodically adopt the rate of contribution of each General and Safety Members according to age at the time of entry into the Retirement System. These rates will be contained in the Operating Tables furnished to the Board by the System's Actuary. The Normal Cost rate is multiplied by the Member's current Base Compensation to determine each Member's normal dollar cost.

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

Normal Cost, as defined by the Actuarial Standards Board, is the portion of the Actuarial Present Value of pension plan benefits and expenses which is allocated to a valuation year by the Actuarial Cost Method. Normal Cost is computed as the annual percent of pay required to fund the retirement benefit for all Members between their dates of hire and assumed dates of retirement. Normal Cost does not include any Unfunded Actuarial Accrued Liability. For pension plan benefits which are provided in part by employee contributions, Normal Cost refers to the total of employee contributions and employer Normal Cost.

All or part of the employee's Normal Cost rate is subject to potential "offset" by the employer. The offset is determined through the meet and confer negotiations between the City and the employee bargaining groups. The rates provided by SDCERS actuary are prior to any applicable offset. Such offsets and related accumulated interest are not to be refunded to employees at termination.

Beginning July 1, 1976 the City of San Diego began offsetting a portion of the employee's Normal Cost rate. The actuarial valuation performed by Towers, Perrin, Forster & Crosby as of June 30, 1976, for fiscal year contributions in 1978, stated "the recommendations are predicated on members continuing to contribute on the basis of "full" rates. We have been informed that, through the meet and confer process, members will not be required to contribute on the basis of "full" rates for a limited period of time. Accordingly the City should contribute on the basis of the recommendations set forth plus 76% of the General Member contributions that the City subsidizes and 87% of the Safety Member contributions that the City subsidizes." Towers, Perrin, Forester & Crosby's opinion stated, "If the above recommendations are adopted, the Retirement System will be maintained on a sound basis in accordance with the actuarial assumptions and methods underlying the calculations."

The actuarial valuations from June 30, 1976 to June 30, 1991, for fiscal year contributions in 1978 to 1993, contained various funding rates for discounting employee offsets ranging from 22% to 27% for General Members and 7% to 13% for Safety Members.

The June 30, 1992 actuarial valuation, for fiscal year employee and employer contribution rates effective beginning July 1, 1993, performed by Gabriel, Roeder, Smith & Company (GRS) stated, "Such offsets and related accumulated interest are not to be refunded to employees at termination. In the valuation, the City's liability for potential refunds is reduced to reflect this. Therefore, the City's contribution is 1% for each 1% of pay pick up. The rate does not get netted for future refund savings, as this is already reflected in the system liabilities." Additionally GRS stated, "Overall, the contribution decreased slightly from 5.91% to 5.62% of payroll. Such change is primarily attributable to a difference in methodology that more accurately reflects the plan's reduction in liabilities due to the reduction in employee refunds caused by City pick up of a portion of employee contributions. Previously, such refund savings was applied to the pick up rate. Our approach is consistent with the savings occurring at the plan level where they ultimately occur. Thus, the City pick up for the fiscal year to which such recommended rates apply should NOT be reduced by anticipated savings since we are recognizing such savings at the plan level."

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

The July 16, 1993 SDCERS Board was presented a motion to approve the Business and Procedures Committee's recommendation to approve Scenario I as it related to the 1992 valuation. Scenario I contained different employer contribution rates than recommended by the Actuary and contained an understanding that an agreement between the City and Board regarding the issue of the discount of the offset be resolved in the 1994 actuarial valuation. The minutes included a letter from GRS stating "As long as your funded ratio of assets to liabilities remains close to 100%, we have no problem with a rate structure that differs somewhat from our recommended rates." A Board motion to approve Scenario I, as recommended by the Business and Procedures Committee, passed 9 to 2.

The June 30, 1993 actuarial valuation contained a memo from GRS stating, "At the request of the Retirement Board, this valuation changes the methodology with respect to the potential member refund savings caused by City "pick up" of member contributions." The Comments and Recommendations of that report contained two comments related to the City offsetting employee contributions.

Comment B states:

"At the request of the Retirement Board, this valuation changes the methodology in regard to the contribution calculation for employee refunds back to the manner in which the calculation was performed two years ago in the June 30, 1991 valuation. The portion of the employee contribution, picked up by the City, is not subject to refund upon termination of employment. The valuation last year reflected this savings within the retirement system by reducing the system contribution rate. The rationale for this approach was to calculate the refund in the same manner as every other system benefit and to more accurately reflect the accrued liability. Previously, the City pick up, contributed to the System, was reduced by anticipated savings for employee refunds prior to being contributed."

However, there was a transition issue, as well as another issue relating to the amount of monies being contributed to the retiree medical trust that were raised by various parties. Accordingly, we have shifted back to the former method at the request of the Board. We do not believe that this change in methodology will have a significant impact on the overall financial condition of the System. Last year, for example the added pension contribution due to the revision was roughly \$700,000.

Last year the overall contribution rate would have been increased from 5.62% to 6.31% if we had kept the former method. In this valuation, the impact of this return to the former methodology is to raise the overall contribution rate from 6.42% to 7.13%.

Currently, the "refund savings" assumption reduces the City's pick up by 22% for General employees and 7% for Safety employees. We will analyze actual experience of this, as well as all other assumptions, in the upcoming triennial experience study."

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

Comment C states:

“As was done in last year’s valuation, we are reflecting the employee refund savings, due to the City’s partial pickup of employee contributions, ENTIRELY at the system level so as to be consistent with the manner in which all other liabilities are calculated. Thus, the City should not reduce the existing pickups as has been done in the past.”

Included in the 1993 GRS actuarial valuation in the Section Titled *Actuarial Assumptions Used for the June 30, 1993 Valuation* was a description of member refunds. It states, “Member refunds - All or part of the employee contribution rate is subject to potential pick up by the employer. Such pick up and related accumulated interest are not to be refunded at termination. The City’s liability for potential refunds is reduced to reflect this.”

On April 15, 1994 the Board approved the June 30, 1993 actuarial valuation using the “Before Changes” rates on page i of the GRS valuation. The “Before Changes” rate adopted was 6.42%. The “Before Changes” rate of 6.42% is already reduced by anticipated savings for employee refunds prior to being contributed as noted above in Comment B of the 1993 GRS actuarial valuation. The City continued the practice of discounting the employee offsets for General Members at 22% and 7% for Safety Members.

On May 26, 1994 the Board approved the continuation of the fiscal year 1994 employer contribution rates in fiscal year 1995 with the discount applied. A letter for GRS included in the Board minutes stated, “Such rates are lower than our recommended rates in the actuarial report. However, if such rates are adopted for one year, we do not believe that the long-term financial integrity of the Trust will be impaired.”

On April 21, 1995, at the Business and Procedures meeting, Mr. Roeder of GRS stated, “Both the revised valuation for last year and the current valuation assume the corridor methods of handling the discount with the 7% and 22% discount that was implemented. If the Board is uncomfortable with this, the Board can look at the levels.” Mr. Roeder continued to state that in his opinion, “those numbers are somewhat high” and “the Board should review the numbers.” He additionally stated that, “the discount is being handled outside the actuarial system at this point.”

On June 16, 1995, at the Board meeting, a letter from GRS was included in the materials that stated, “If the refund savings continue to be applied outside the plan, we would recommend a change to a 6% credit for General employees and 3% credit for Safety employees. Since we do not normally recommend annual fine tuning of assumptions, we would recommend that no further change be made until the next time that assumptions, in their entirety, are reviewed. At such point we would like the Board to consider our initial recommendation that such potential refund be reflected by lowering the actuarial contribution rate, instead of adjusting for saved refunds outside the plan.” The Board adopted the discounting of employee offsets at 22% for General Member and 7% for Safety Members.

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

The June 30, 1995 actuarial valuation was approved at the September 20, 1996 Board meeting with no discussion of the discount of employee offsets.

On June 9, 1999 Milliman & Robertson, Inc. issued a letter resulting from a detailed review the actuarial services performed by GRS. Included in their letter is a discussion of major issues identified. Major issues are categorized in one of three levels of significance to the overall funding status of SDCERS. A level 1 finding is defined as areas of changes needed which will result in a financial impact on actuarial findings. The letter included a level 1 finding on the discount of employee offsets. The letter stated, "There is one other modification between what the actuarially determined rate would expect as income from employee contributions and what is actually received each year. The actuarial process assumes a given set of employee contribution rates is to be used to compute the expected future value of employee contributions. However, a portion of the employee contributions are picked up by the City and are not subject to future refund upon termination of employment. Due to the nonforfeiture aspect of the picked up contributions, the City is making reduced dollar contributions in place of the expected dollar amount of the employee contributions. However, the amount of the reduction is not based on an actuarial computation, but has been fixed at 22% for General employees, and 7% for Safety employees." The letter further stated, "Based on our computations of the Normal Cost rate by decrement, including contribution refunds, these reductions to recognize the non-forfeitures of the picked up contribution should be around 4.3% for General Members and 1.6% for Safety Members. Since the assumed reduction and the actuarially computed rates of the refundability factors are so far apart, we recommend a review of this practice." Lastly the letter stated, "In summary, we found no potential financial impact in the computation of the actuarially computed rates; but to the extent the current funding policy is not contributing on an actuarially computed basis, gains or losses will occur."

At the July 16, 1999 Business and Procedures Committee meeting Karen Steffen of Milliman & Robertson, Inc. presented the Actuarial Audit Report. She stated the discount of employee offsets was "extremely out of alignment and would recommend the Board look at this."

At the October 15, 1999 Business and Procedures Committee meeting Mr. Roeder of GRS recommended the Board adopt new discounted offset rates of 5% for General Members and 1% for Safety Members. No action was taken on this issue by the Business and Procedures Committee at this meeting.

At the December 17, 1999 Business and Procedures Committee meeting staff brought a recommendation to the Committee to adopt discount offset rates of 5% for General Members and 1% for Safety Members implemented over a four year period beginning July 1, 2000. No action was taken on this issue by the Business and Procedures Committee at this meeting.

The October 20, 2000 Business and Procedures Committee meeting approved a motion to adopt discounting General Member offset rates at 5% and Safety Member offset rates at 3%, to be phased in over a four year period. The Board did not take any action on this issue at the October 20, 2000 Board meeting.

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

At the Business and Procedures meeting on March 16, 2001 Mr. Roeder at GRS stated, in regard to the discounting of the offset, “From the first time I made my recommendation, the System has been cumulatively underfunded by approximately \$50 million which is significant.” At the March 16, 2001 Board meeting the Board adopted the actuary’s recommendation to change the discount on the offset, modified to be phased in beginning 2003, over a four-year period (from 22% and 7% to 5% and 1%).

The June 30, 2005 actuarial valuation, for contributions in fiscal year 2007, was performed by Cheiron. Cheiron was never aware the City was discounting employee offsets. Cheiron’s models did not assume any discount for employee offset contributions. Included in the June 30, 2005 actuarial valuation under the section titled *Actuarial Assumptions and Methods* included the statement, “All or part of the employee contribution rate is subject to potential “pick up” by the employer. That “pick up” and the related accumulated interest are not to be refunded to employees at termination. The liability for potential refunds is reduced to reflect this.” The City continued to discount the employee offsets at 5% for General Members and 1% for Safety Members for the fiscal years 2007 to 2013.

Beginning in fiscal year 2014 the City no longer had any provisions for City paid employee contributions.

The City of San Diego Charter Section 143 titled *Contributions* effective January 1, 1955 states, “employees shall contribute according to the actuarial tables adopted by the Board of Administration for normal retirement allowances.” It also states, “The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under retirement plan or revised retirement plan because of past service of employees. The mortality, service, experience or other table calculated by the actuary and the valuation determined by him and approved by the Board shall be conclusive and final, and any retirement system established under this article shall be based thereon.” Section 143 was amended November 2, 2004; effective January 21, 2005 to include, “Funding obligations of the City shall be determined by the Board on an annual basis and in no circumstances, except for a court approved settlement agreement, shall the City and the Board enter into multi-year contracts or agreements delaying full funding of City obligations to the system.”

The discounts for employee offsets were not based on actuarial amounts from July 1, 1994 to June 30, 2013. The discounts for employee offsets were calculated outside of the actuarial process since July 1, 1994. In fiscal year 2006 the discount of employee offsets matched amounts recommended by the actuary. However, these amounts were based on a recommendation from GRS as of December 17, 1999, six and a half years prior. The actuary did not make any recommendations for discounting employee offsets for fiscal years 2007 to 2013.

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

In order for SDCERS to administer the Plan in accordance with its terms, benefits payments should only be made when appropriate contributions have been made. The payment of benefits when appropriate contributions have not been made reduces Plan assets available to pay other members and beneficiaries. Collecting the discounted employee offsets as a component of the UAL over an extended period of time is in violation of the Plan's terms and would place the Plan's financial ability to pay participants and beneficiaries at risk. Failing to administer the Plan with its terms could risk the Plan's qualified status.

Article XVI of the California Constitution, Section 17 states "The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility for investment of moneys and administration of the system, including:

- a. To discharge their duties solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedent over any other duty.
- b. To discharge their duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use.
- c. To diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.
- d. To have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system.

Based on a legal opinion obtained by SDCERS, the Board is required to undertake reasonable efforts to seek payment from the City for the discounted employee offsets in order to fulfill its exclusive benefit obligations, its fiduciary obligations, its obligations of prudence and its obligation to assure the competency of the system. Allowing the discounted employee offsets to be rolled into the UAL would violate Article XVI, § 17 by the Board failing to place its duties to members above all other duties. Additionally, failing to undertake reasonable efforts to seek payment from the City for the discounted employee offset contributions artificially increases the UAL and, therefore, the assets of SDCERS are diminished in violation of Article XVI, § 17. The adequacy of SDCERS' assets are jeopardized, even if only incrementally and temporarily and such action would be a violation of the Board's obligation.

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

Because the normal rate of contribution for General and Safety Members is based upon the Member's age at his or her birthday nearest to the date the Member joined the Retirement System an exact calculation of the discounted employee offsets was not able to be performed. SDCERS staff does not reconcile the dollar amount the City remits for employee offsets on a biweekly basis. The detailed records to determine the employee offset amount actually contributed per employee are not kept at SDCERS. In addition, the various offsets in effect during the period July 1, 1994 to June 30, 2013 would make this calculation near impossible. However, based on estimated average General Member rates ranging from 8.36% to 10.57% and estimated Safety Member rates ranging from 11.54% to 15.45% and City offsets ranging from 0% to 7% for General Members and 0% to 10% for Safety Members the total gross dollar amount of discounted employee offsets that were never remitted to SDCERS is estimated to be \$49,000,000.00 at June 30, 2014.

Since SDCERS actuaries assume full funding of the employee actuarial rates when actual experience of the system does not coincide exactly with assumed experience an experience gain or loss is calculated. The resulting experience gain or loss is added to or subtracted from the UAL. One of the experiences is employee contributions more/less than expected. The gross discounted employee offsets of \$49,000,000.00 calculated above would have been included in the experience gains and losses. Prior to June 30, 2007 the gains or losses related to experience were amortized over a 30 year, closed amortization period that began July 1, 1991. In 2007 all experience gains and losses that occurred subsequent to 1991 were combined into the 2007 UAL. The UAL for 2007 is amortized over a closed 20 year period. Gains and losses occurring after June 30, 2007 are amortized over a 15 year period. Therefor any experience gains or losses related to employee contributions have been partially paid down each year. The estimated net discounted employee offsets that were never remitted to SDCERS are estimated to be \$23,000,000.00 at June 30, 2014. The \$23,000,000.00 does not account for interest or the years when the City's contribution to SDCERS was less than the Annual Required Contribution/Actuarially Determined Contribution.

For the fiscal years ended June 30, 1995 to June 30, 2002 SDCERS Comprehensive Annual Financial Report (CAFR) stated in the Notes Financial Statements, "Employer and member contributions are recognized as revenue in the period in which the employee services are performed and expenses are recorded when the corresponding liabilities are incurred." For the fiscal years ended June 30, 2003 to June 30, 2013 SDCERS CAFR stated in the Notes to Financial Statements, Plan Sponsor and member contributions are recognized in the period in which the contributions are due. SDCERS CAFR for fiscal years ended June 30, 1995 to June 30, 2013 disclosed the discounted percentage applied to employee offsets.

**Finding #1 (Continued):** The City of San Diego has not been contributing annually the amount necessary to fund a normal retirement allowance during the period July 1, 1994 to June 30, 2013 due to discounting employee offsets.

**Priority Rating:** High

**Recommendation #1a:** SDCERS should administer the Plan in accordance with its terms. Additionally, SDCERS should require the Normal Cost of funding a retirement allowance be paid annually from the City. Furthermore, the Normal Cost of funding the retirement allowance should be certified by the Board appointed actuary.

**Recommendation #1b:** SDCERS should determine the feasibility of calculating the exact amount due from the City for the discounted employee offsets from July 1, 1994 to June 30, 2013 and SDCERS Board should determine how this amount will be paid.

**Recommendation #1c:** As of fiscal year 2014 the City of San Diego no longer offsets any portion of employee contributions, however, should the City offset any portion of employee contributions in the future, SDCERS should reconcile all employee offsets to determine the correct amount has been remitted. Any variances should be followed up on in a timely manner.

**Finding #2:** The amount paid for Multiple Certification pay could not be traced to an MOU or signed supporting documentation.

**Priority Rating:** Low

One employee selected for testing received multiple certification pay that is included in Base Compensation. This employee obtained two certifications that were specified in the Memorandum of Understanding between the City and the San Diego Municipal Employees' Association (MEA). The multiple certification pay was approved effective January 1, 2001.

When the multiple certification pay was approved Article 86 of the MOU stated, "Employees in the classification listed at the end of this Article (and excluding those listed in Sections II and III below) who obtain and maintain a Grade II certification in a job-related specialty from either the California Water Environment Association (CWEA) or the American Water Works Association (AWWA) will be eligible for an additional compensation of 25 cents per hour. Employees who obtain and maintain a Grade III certification will be eligible for 50 cents per hour maximum compensation. Employees who obtain and maintain a Grade IV certification will be eligible for 75 cents per hour maximum compensation." Both of the certifications were calculated at \$.75 per hour when the multiple certification pay was approved.

Article 86 of the MOU between the City and the San Diego Municipal Employees' Association (MEA) during the pay period tested stated, "Compensation may be provided for multiple certifications subject to the following: 1) The employee must request approval for multiple certifications to the Human Resources Director via his/her Deputy Director; 2) The request must describe the responsibilities and duties of his/her position that would be directly related to the additional certification and significantly enhanced by multiple certifications; 3) The Human Resources Director will respond with an approval or denial. The decision of the Human Resources Director will be final."

Additionally, the MOU in effect during the pay period tested stated, "Employees in the classifications listed in Appendix F (and excluding those listed in Section IV and V below) who obtain and maintain a Grade II certification in a job related specialty from the California Water Environment Association (CWEA) will be eligible for an additional compensation of thirty cents (\$.30) per hour. Employees who obtain and maintain a Grade III certification will be eligible for an additional compensation of thirty cents (\$.30) per hour. Employees who maintain a Grade IV certification will be eligible for eighty cents (\$.80) per hour maximum compensation. The compensation for these certifications shall increase by ten cents (\$.10) per hour effective December 20, 2003, and by fifteen cents (\$.15) an hour effective December 18, 2004."

Per an unsigned memorandum dated June 25, 2001 titled, *Changes to Salary/Classification Tables and Add-on pay for FY 2001-2002* the amount paid for multiple certification pay was \$.75. The MOU does not state if the second certification is paid at a set rate or if the second certification should be paid in an amount equal to the certificate obtained.

**Finding #2 (Continued):** The amount paid for Multiple Certification pay could not be traced to an MOU or signed supporting documentation.

**Priority Rating:** Low

The amount paid to this employee, for the initial certification, has increased from \$0.75 per hour to \$1.05 per hour. The amount paid for the second certification, however, has not increased and has remained at \$.75 since the multiple certification pay was approved. This employee received \$3,120.00 for the time period July 1, 2001 to June 30, 2013 related to the second certification. This was included in Base Compensation reported to SDCERS.

**Recommendation #2:** City management should ensure proper supporting documentation is retained for all employee pay. Any adjustments to employee Base Compensation should be communicated to SDCERS.

CITY OF SAN DIEGO  
M E M O R A N D U M

DATE: February 27, 2015  
TO: Lee Parravano, SDCERS Internal Auditor  
FROM: Donna Wallace, Assistant Personnel Director *DW*  
SUBJECT: Response to the Plan Sponsor Contribution Reporting Audit – Recommendation 2

---

The Personnel Department will ensure proper supporting documentation is retained for the creation and maintenance of salary and add-on pay tables for all employee pay.



**DATE:** February 23, 2015

**TO:** Lee Parravano, Internal Auditor

**FROM:** Ted Lasalvia, Controller

**SUBJECT:** Management's Response to the Plan Sponsor Contribution and Reporting Audit – Recommendation 1C

---

***Recommendation 1C:***

***As of fiscal year 2014, the City of San Diego no longer offsets any portion of employee contributions; however, should the City offset any portion of employee contributions in the future, SDCERS should reconcile all employee offsets to determine the correct amount has been remitted. Any variances should be followed up on in a timely manner.***

Management's Response: Agree

Finance is responsible for ensuring the receipt of contributions for active members. As part of the IRIS system, a receivable transaction is generated upon the successful processing of a transmittal file. Should the City implement offset rates in the future, the Finance group is ready to monitor the receipt of the calculated offset amounts.

If the Plan Sponsor has an offset rate for employee contributions, that offset rate is uploaded within IRIS and becomes a calculation within the processing of the transmittal file. The output of the transmittal file is a receivable from the Plan Sponsor for employee contributions made and the calculated amount of the offset. Finance then applies the actual payment received against the receivable and notes any significant differences. Offset rates can change over time due to collective bargaining agreements or legislative action.

The Benefits Administration division works with the Plan Sponsors to clear any discrepancies within the transmittal file. Finance receives, applies and reports all contribution amounts received.