



**SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
M E M O R A N D U M**

DATE: February 25, 2016

TO: SDCERS Audit Committee

CC: Mark Hovey, SDCERS Chief Executive Officer
Johnny Tran, SDCERS Chief Compliance Officer/General Counsel
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Scott Brickner, SDCRAA Vice President, CFO/Treasurer, Finance & Asset Management
Thella Bowens SDCRAA President/Chief Executive Officer

FROM: Lee Parravano, SDCERS Internal Auditor

SUBJECT: Plan Sponsor Contribution & Reporting Audit – SDCRAA for the period July 1, 2013 through June 30, 2014

Enclosed is the Plan Sponsor Contribution & Reporting Audit for the period July 1, 2013 through June 30, 2014. Overall, the San Diego County Regional Airport Authority (SDCRAA) 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, four recommendations have been made to improve controls related to the census data, and SDCRAA management agrees with all four of the recommendations. Management's written response can be found after page 11 of the audit report.

I would like to thank SDCRAA 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

**San Diego County Regional Airport Authority
for the Period July 1, 2013 through June 30, 2014**

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

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EXECUTIVE SUMMARY

The San Diego County Regional Airport Authority (Authority) 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, 2013 through June 30, 2014 include:

- Payroll records correctly reported compensation and pensionable pay codes to SDCERS.
- Pay rates reported to SDCERS agreed to publicly available pay schedules for PEPRAs members tested.
- The following elements were correctly reported to SDCERS for all randomly tested members; date of birth, date of hire, date of membership, classification of employees, gender, plan code, service period, member entry age, member contributions and employer contributions.
- Pensionable compensation cap for tested members was observed.
- Membership in the Authority's Plan was correctly established or not established for all tested employees.

The retirement census information was correctly transmitted to SDCERS with 99.2% accuracy¹.

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

Member Contribution & Authority Offset

Member contributions are made up of three parts; 1) Normal Contributions, 2) COL Annuity Contributions and 3) Surviving Spouse or Domestic Partner Contributions. The Authority pays, or offsets, certain required Member contributions on the Members behalf. The Amended and Restated San Diego County Regional Airport Authority Retirement Plan and Trust of 2013 (Plan) does not indicate if Member Cost of Living Annuity (COL Annuity) Contributions and Surviving Spouse or Domestic Partner Contributions are calculated based on Member Contributions before or after the offset. This ambiguity could lead to confusion whether Member COL Annuity Contributions and Surviving Spouse or Domestic Partner Contributions are calculated based on Member Contributions before or after the offset.

Reporting of Base Compensation

One employee tested had Retro Pay of \$28.19 incorrectly included in pensionable salary (Base Compensation) for the period April 18, 2014 through May 1, 2014. The \$28.19 in Retro Pay was for hours worked April 16, 2014 and April 17, 2014 that were eligible for a raise effective April 16, 2014. The \$28.19 is, in fact, Base Compensation for the pay period through April 4, 2014 through April 17, 2014. For the fiscal year 2014 \$19,779.11 was reported as pay code Retro Pay to SDCERS.

Date of Termination

One employee selected for testing had a date of termination reported to SDCERS as 3/26/2015. The documentation in the employee file indicated the employee terminated employment 3/25/2015.

¹ Percentage based on the randomly selected twenty-five employee records, covering the two pay periods – November 15, 2013 to November 28, 2013 and April 18, 2014 to May 1, 2014.

EXECUTIVE SUMMARY (Continued)

Standby Pay Adjustment

The Authority did not have supporting documentation for the rate of pay used for three employees that received a standby pay adjustment in October 2014 for work performed in previous pay periods. Three employees were paid at the hourly rate effective October 2, 2014 rather than the rate in effect when the work was performed. This resulted in the three employees being paid \$86.23 more than the formally documented and approved amounts. The \$86.23 was reported to SDCERS as Base Compensation during the correct pay periods and Member contributions were made to SDCERS on this amount.

Based on this audit, four recommendations have been made to improve internal controls related to the census data. The Authority's management agrees with all four of the recommendations made. 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 Authority 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 Authority 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, 2013 through June 30, 2014 by using the following methods:

- Reviewed the Plan, Memorandum of Agreements (MOAs) between the Authority and the employee Unions, and the SDCERS Participation and Administration Agreement.
- Reviewed policies and procedures utilized by staff to process the Authority'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 – November 15, 2013 to November 28, 2013 and April 18, 2014 to May 1, 2014. For each employee selected:
 - Traced pensionable salary (Base Compensation) from the transmittal file to the payroll register.
 - Traced pay rates from the payroll register 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, code section 401(a)(17) limits, and pensionable compensation limits for PEPPRA members.
- Selected twenty-five employees on the payroll register for the periods November 15, 2013 to November 28, 2013 and April 18, 2014 to May 1, 2014. For each employee tested determine if Membership in the Plan is correctly established or correctly not established.
- For payroll periods November 15, 2013 to November 28, 2013 and April 18, 2014 to May 1, 2014 determine if Retro Pay pay codes have been utilized and if reporting to SDCERS is consistent with the Plan.

This audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*. Those standards require that Internal Audit plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Internal Audit believes the evidence obtained provides a reasonable basis for the findings and recommendations.

Internal Audit would like to thank SDCERS and San Diego County Regional Airport Authority management and staff for their assistance and numerous courtesies extended during the completion of this audit.

INTRODUCTION

Background

SDCERS administers three separate defined benefit pension plans for the Authority, the City of San Diego, and the San Diego Unified Port District. SDCERS provides service retirement, disability retirement, death and survivor benefits to its participants. On January 1, 2003 the Authority entered into an agreement with SDCERS to administer its defined benefit pension plan.

Each pay period the Authority 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, Cheiron, to provide an actuarial valuation. The actuarial valuation provides the financial condition of the Plan, the past and expected trends in the financial condition of the Plan, the Authority's employer and member contribution rates, and other information required by the Governmental Accounting Standards Board.

San Diego County Regional Airport Authority – Membership Total		
Valuation as of:	June 30, 2014	June 30, 2013
Active Counts	362	347
Terminated Vested	90	79
Disabled	2	2
Retirees	59	45
Beneficiaries	6	4
Total Authority Members	519	477
Active Member Payroll	\$ 27,955,455	\$ 26,380,323
Average Pay Per Active Member	\$ 77,225	\$ 76,024
Benefits in Pay Status	\$ 2,668,801	\$ 2,013,899
Average Benefit	\$ 39,833	\$ 39,488

Source: SDCERS – Airport Authority Actuarial Valuation as of June 30, 2014

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, 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:

- Payroll records correctly reported compensation and pensionable pay codes to SDCERS.
- Pay rates reported to SDCERS agreed to publicly available pay schedules for PEPRAs members tested.
- The following elements were correctly reported to SDCERS for all tested members; date of birth, date of hire, date of membership, classification of employees, gender, plan code, service period, member entry age, member contributions and employer contributions.
- Pensionable compensation cap for tested members was observed.
- Membership in the Plan was correctly established or not established for employees tested.

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

Finding #1: The Plan does not indicate if Member COL Annuity Contributions and Surviving Spouse Contributions are calculated based on Member Contributions before or after the offset.

Priority Rating: High

SDCERS, based upon the advice of the Actuary, periodically adopts the rate of contribution of each Member. The contribution each Member makes is made up of three parts; 1) Normal Contributions, 2) COL Annuity Contributions and 3) Surviving Spouse or Domestic Partner Contributions.

Normal Contributions are the Normal Cost contributions made by a Member used to fund the Member's share of actuarial present value of the Plan benefits allocated to the current year.

COL Annuity Contributions are the contributions made by a Member that are used to fund the COL Annuity. COL Annuity Contributions are 20% of the sum of the Member's Normal Contributions plus the Surviving Spouse or Domestic Partner Contributions.

Surviving Spouse or Domestic Partner Contributions are defined as contributions made by a Member used to fund the Member's share of the cost of the continuance to the Member's Surviving Spouse or Domestic Partner. Surviving Spouse or Domestic Partner Contributions are 7.56% of the total of the Member's contribution.

The Authority pays certain required Member contributions to SDCERS on the Members behalf. These payments are known as offsets. Section 802 titled Crediting of Airport Authority Offsets, added September 4, 2014 by Amendment 1, states:

Finding #1 (Continued): The Plan does not indicate if Member COL Annuity Contributions and Surviving Spouse Contributions are calculated based on Member Contributions before or after the offset.

Priority Rating: High

“Contributions to the Plan which are made by Authority offsets in accordance with § 0801 of the Plan shall be considered Employer Contributions, and shall be paid and credited in accordance with § 0800 of this Plan. Authority offsets shall not be credited to the account of any employee. Authority offsets shall not be utilized for Cost of Living Annuity Contributions in accordance with § 0202.5 of this Plan or Surviving Spouse or Domestic Partner Contributions in accordance with § 0600 of this Plan. Cost of Living Contributions and Surviving Spouse or Domestic Partner Contributions must be paid by the employee; said contributions which shall be picked-up in accordance with Internal Revenue Code § 414(h)(2) and § 0204 of this Plan.”

The Plan does not indicate if Member COL Annuity Contributions and Surviving Spouse or Domestic Partner Contributions are calculated based on Member Contributions before or after the Offset.

The practice, prior to, and after Amendment 1, has been to calculate a Member’s gross contribution before any applicable offset and to separately calculate the offset. The offset is separately calculated and subtracted from the Member’s gross contribution. The resulting number is the Member’s net contribution that is deducted from his or her paycheck and remitted to SDCERS. The Member’s net contribution deducted from his or her paycheck is used to determine the amounts allocated to the Normal Contribution, the COL Annuity Contribution and Surviving Spouse or Domestic Partner Contribution. The offset reduces the Normal Contribution, COL Annuity Contribution and the Surviving Spouse or Domestic Partner Contribution. In the example below SDCERS has been using the “After Offset” column to determine Member Contributions and related allocations.

Example Calculation of Member Contributions				
Base Compensation	\$	1,860.00		
Contribution Rate		10.0%		
Offset Rate		7.0%		
Member gross contribution	\$	186.00		
Offset amount	\$	130.20		
Member net contribution	\$	55.80		
Member Contribution Allocation		Before Offset	Offset	After Offset
Normal Contribution	\$	140.94	\$ 99.66	\$ 41.28
COL Annuity Contribution		31.00	21.70	9.30
Surviving Spouse or Domestic Partner Contribution		14.06	9.84	4.22
	\$	186.00	\$ 130.20	\$ 55.80

Finding #1 (Continued): The Plan does not indicate if Member COL Annuity Contributions and Surviving Spouse Contributions are calculated based on Member Contributions before or after the offset.

Priority Rating: High

The language included in Amendment 1 that states, “Authority offsets shall not be utilized for Cost of Living Annuity Contributions in accordance with § 0202.5 of this Plan or Surviving Spouse or Domestic Partner Contributions in accordance with § 0600 of this Plan” and “Cost of Living Contributions and Surviving Spouse or Domestic Partner Contributions must be paid by the employee...” is ambiguous and could lead to confusion whether Member COL Annuity Contributions and Surviving Spouse or Domestic Partner Contributions are calculated based on Member Contributions before or after the offset.

The amount allocated to a Member’s COL Annuity Contribution account determines a Member’s COL Annuity. The COL Annuity is a lifetime payment that is calculated by computing the Actuarial Equivalent of the Member’s Accumulated COL Annuity Contributions at retirement.

The amount allocated to a Member’s Surviving Spouse or Domestic Partner Contribution account are available² to be paid to a Member in either a lump sum or turned into a lifetime payment at retirement. The lifetime payment is calculated by computing the Actuarial Equivalent of the Member’s Accumulated Surviving Spouse or Domestic Partner Contributions at retirement.

COL Annuity Contributions and Surviving Spouse or Domestic Partner Contributions are paid by the employee, however, if the offset was utilized to reduce only the Members Normal Cost the amount required to be paid by the Member for the COL Annuity Contributions and Surviving Spouse or Domestic Partner Contributions would be higher. This would lead to higher Member Contribution amounts and a higher benefit at retirement.

Recommendation #1: The Authority should revise Section 802 of the Plan to clarify if Member COL Annuity Contributions and Surviving Spouse or Domestic Partner Contributions are calculated based on Member Contributions before or after the Offset.

² This is available to Members who selected the maximum benefit and did not have a surviving spouse or Domestic Partner at time of retirement.

Finding #2: One employee selected for testing had pay code Retro Pay, which is a component of Base Compensation, reported into the incorrect pay period.

Priority Rating: Low

Base Compensation as defined in the Plan is compensation, identified by pay codes, as either included or excluded from pensionable earnings. Pay code “Retro Pay” is identified as Base Compensation.

One employee tested had Retro Pay of \$28.19 included in Base Compensation reported to SDCERS for the pay period April 18, 2014 through May 1, 2014. The \$28.19 in Retro Pay was for hours worked April 16, 2014 and April 17, 2014 that were eligible for a raise effective April 16, 2014. The salary adjustment was not set up timely which delayed the payment of the raise until the pay period April 18, 2014 through May 1, 2014. The Retro Pay of \$28.19 was reported to SDCERS as Base Compensation for the period April 18, 2014 through May 1, 2014. The \$28.19 is, in fact, Base Compensation for the pay period through April 4, 2014 through April 17, 2014.

Final Compensation for a Classic Member³ means a Member’s highest one-year period of Base Compensation while contributing to the Plan. Final Compensation is used in the calculation to determine a Member’s retirement benefit.

The \$28.19 in Retro Pay should have been reported to SDCERS as an adjustment of previously submitted salary data. Inclusion of Retro Pay, or any pay code included in Base Compensation, into an incorrect period could incorrectly increase a Member’s highest one-year period. An increase to a Member’s highest one-year period, due to inclusion of Retro Pay, would incorrectly result in an increase to a Member’s retirement benefit.

A detailed examination by Authority personnel would be required to determine if any additional corrections to the \$19,779.11 reported as pay code Retro Pay during fiscal year ended June 30, 2014 are required.

Recommendation #2: Authority management should establish procedures to ensure any pay code included in Base Compensation is reported in the correct pay period. Additionally, Authority management should determine if additional individuals are affected, for all Plan years, and communicate to SDCERS the Member accounts required to be corrected.

³ A Classic Member is a Non-PEPRA Member. In general, a PEPRA Member is a Member who first became a Member of SDCERS or a reciprocal system after January 1, 2013. Final Compensation for PEPRA Members is a Member’s highest three-year period.

Finding #3: One employee selected for testing had a date of termination reported to SDCERS that did not agree to supporting documentation.

Priority Rating: Medium

Service Credit means the years or partial years of service purchased by a Member or earned by a Member while the Member is employed by the City of San Diego, the San Diego Unified Port District or the Authority and contributing to this Plan or SDCERS, as applicable.

Service Credit is one of the factors used to determine a Member's eligibility for retirement and for calculating the retirement benefit.

One employee selected for testing had a date of termination reported to SDCERS as 3/26/2015. The documentation in the employee file indicated the employee terminated employment 3/25/2015.

Recommendation #3: Authority management should ensure employee termination dates are accurately communicated to SDCERS on a timely basis.

Finding #4: The Authority did not have supporting documentation for the rate of pay used for three employees that received a standby pay adjustment in October 2014 for work performed in previous pay periods.

Priority Rating: Low

On October 10, 2014 three employees were paid a total of 140 hours of compensation for standby duties performed in a prior pay period. These three employees were paid at the hourly rate effective October 2, 2014 rather than the rate in effect when the work was performed. The supporting documentation for the pay adjustment did not provide direction and authorization for it to be paid at a different rate than the hourly rate in effect when the work was performed. This resulted in the three employees being paid \$86.23 more than the formally documented and approved amounts. The \$86.23 was reported to SDCERS as Base Compensation during the correct pay periods and Member contributions were made to SDCERS on this amount. Authority management has represented that, in consideration of the circumstances of the specific situation, it was determined by Authority management that the employee's current rate be used for the pay adjustment rather than the rate when the work was performed.

Recommendation #4: Authority management should ensure that all authorized compensation adjustments are formally documented.

INHERENT LIMITATIONS

Because of the inherent limitations of internal controls, errors or irregularities may occur and may not be detected. Also, projections of any evaluation of the internal control structure to future periods are subject to the risk that procedures may become inadequate due to changes in conditions, or that the degree of compliance with the procedures may deteriorate.

CONCLUSION

I have concluded work on the audit objectives of the Plan Sponsor Contribution & Reporting Audit. Based on the audit work performed, I have determined the following:

The Authority is meeting the objectives in the following areas:

- Retirement census information was correctly transmitted to SDCERS with 99.2% accuracy⁴.

The Authority is not meeting the objectives in the following area:

- Changes to Member Base Compensation should be reported to SDCERS as an adjustment of previously submitted salary data.

Implementation of the recommendations contained in this Audit Report should assist the Authority in improving the retirement census information sent to SDCERS.

The Authority Plan Sponsor Contribution & Reporting Audit for the period July 1, 2011 through June 30, 2013 was issued August 27, 2014. That report contained findings and recommendations that would be relevant to the Authority Plan Sponsor Contribution & Reporting Audit for the period July 1, 2013 through June 30, 2014. However, all of the findings and related recommendations from the Plan Sponsor Contribution & Reporting Audit for the period July 1, 2011 through June 30, 2013 have been implemented as of September 2015. Those findings and recommendations are not repeated in this report. That report is available on SDCERS website at www.sdcers.org or can be obtained by contacting SDCERS, Internal Audit Department, 401 West A Street, Suite 400, San Diego, CA, 92101.

⁴ Percentage based on the randomly selected twenty-five employee records, covering the two pay periods – November 15, 2013 to November 28, 2013 and April 18, 2014 to May 1, 2014.

February 25, 2016

Lee M. Parravano, CPA, CIA, CGMA
San Diego City Employees' Retirement System
401 West A Street, Suite 400,
San Diego CA 92101

Re: San Diego County Regional Airport Authority Plan Sponsor Contribution and Reporting Audit

Dear Mr. Parravano:

In response to the San Diego County Regional Airport Authority Plan Sponsor Contribution and Reporting Audit for the period July 1, 2011 through June 30, 2013 conducted by San Diego City Employees' Retirement System (SDCERS) the San Diego County Regional Airport Authority (the Authority) submits the following:

Finding #1 Response – The Authority is currently working with SDCERS' General Counsel to prepare an amendment to the Plan to clarify and correct the Plan's language pertaining to this issue. The amendment will amend the language so it is consistent with SDCERS' long standing and consistent practice on how these contributions are treated -- a practice dating back to the inception of the Plan in 2003. The Authority intends to submit the proposed amendment to the Authority's Board at its March 17, 2016 meeting.

Finding # 2 Response – The Authority concurs with this finding and has modified its procedures to ensure that all adjustments to base compensation for a previous pay period are accurately reported to SDCERS. Staff is currently reviewing previously reported retro payment adjustments to determine if additional individuals are affected and we will communicate any necessary adjustments to SDCERS. We anticipate this will be completed by March 31, 2016.

Finding #3 Response – The Authority has, in place, checks and balances to ensure accurate maintenance and reporting of employee information. This practice is being amended to strengthen processes to ensure the accuracy of records in instances where

an employee's information changes unexpectedly (e.g., the audited employee record was for an employee who left one day earlier than their stated voluntary termination date).

Finding # 4 Response – Effective immediately, Authority staff will replace verbal communications clarifying approved compensation adjustments with written documentation to ensure that all approved compensation adjustments are accurately documented, recorded and reported.

Sincerely,



Elizabeth Stewart

Senior Manager, Accounting

cc: Kurt Gering, Director, Talent & Engagement, SDCRAA

Jeffrey Lindeman, Senior Director, Talent & Engagement, SDCRAA

Scott Brickner, Vice President/Treasurer, Finance & Asset Management, SCRAA

Kathy Kiefer, Senior Director, Accounting, SDCRAA

Breton Lobner, General Counsel, SDCRAA