



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

DATE: June 26, 2017

TO: SDCERS Audit Committee

CC: SDCERS Board of Administration
Mark Hovey, SDCERS Chief Executive Officer
Marcelle Rossman, SDCERS Chief Benefits Officer
Johnny Tran, SDCERS Chief Compliance Officer/General Counsel
Rolando Charvel, City of San Diego Comptroller
Elena Perez, City of San Diego Deputy Director
Lillian Garcia, Payroll Manager

FROM: Lee Parravano, SDCERS Internal Auditor

SUBJECT: Plan Sponsor Contribution & Reporting Audit – City of San Diego for the Period July 1, 2015 through June 30, 2016

Enclosed is the Plan Sponsor Contribution & Reporting Audit for the period July 1, 2015 through June 30, 2016. 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.

Based on this audit, there were three total recommendations: two recommendations pertained to SDCERS, and one pertained to the City and SDCERS. SDCERS and City management agree with all recommendations made. Responses from SDCERS and the City are attached to the report.

Details can be found in the Audit Results section of the report.

I would like to thank both SDCERS and City management for all of their 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 are greatly appreciated.



Internal Audit Report

Plan Sponsor Contribution & Reporting Audit

**City of San Diego for the Period
July 1, 2015 through June 30, 2016**

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

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EXECUTIVE SUMMARY

Every two weeks the City of San Diego (City) sends the San Diego City Employees' Retirement System (SDCERS) a transmittal file that contains over 200,000 pieces of information on approximately 8,000 Members. The information includes 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, IRIS. 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. The objective of the audit was to evaluate the accuracy and completeness of the census data submitted by the City and to verify the accuracy and adequacy of that information.¹

The City has procedures in place for the census data reported to SDCERS. Control strengths identified during the audit period from July 1, 2015 through June 30, 2016 include:

- 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, date of termination, plan code, service period, member entry age, and member contributions.
- Pensionable compensation cap for tested members was in place.
- SDCERS Membership dates were correct for all randomly tested police recruits.
- SDCERS Membership was correctly established for all tested employees who were not eligible for Membership prior to Proposition B and subsequently became eligible.

However, the following issues were identified that should be addressed.

“Unknown” Service Records

IRIS has been programmed to create an “Unknown” service record (i.e., IRIS does not know how to classify the record) in a Member's account if certain criteria are met. This includes, but is not limited to: 1) A Member who is reported in the transmittal file with Pensionable Salary, zero hours, zero service credit and a status of Active, or 2) a Member who was reported as Active on the previous pay period, but there is no record for that Member in the current pay period transmittal file. “Unknown” service records must be investigated and reclassified by SDCERS staff.

SDCERS' staff spends approximately 15 hours per week investigating and reclassifying the “Unknown” service records. As of March 2017, there were approximately 10,000 “Unknown” service records in 1,854 Member accounts.

¹ See Appendix A for complete Audit Objectives, Scope and Methodology

EXECUTIVE SUMMARY (Continued)

Proof of Age

The contribution rate of each Member is dependent on the age of a Member at time of entry into SDCERS. New Members must submit acceptable evidence of age within six months of the date of their Membership. If the Member fails to submit acceptable evidence of age to SDCERS within six months the Board Rules require SDCERS to set the Member's retirement contributions to the highest percentage rates until the required evidence is submitted.

For two Members tested, proof of age has not been received and their retirement contributions have not been set at the highest rate. Additionally, as of January 2017, 120 active Members did not have proof of age on file. None of these Members retirement contributions were adjusted to the maximum amount as required. A Member's age, however, is only one of piece of information that is needed to correctly calculate Member contributions or retirement benefits. SDCERS does not require proof from Members on these elements. Requiring evidence for proof of age, but not on other elements that could impact a Member's retirement contribution or retirement benefits, should be reconsidered.

Based on this audit, there were three total recommendations: two recommendations pertained to SDCERS, and one pertained to the City and SDCERS. SDCERS and City management agree with all recommendations made. Responses from SDCERS and the City are attached to this report.

Internal Audit would like to thank SDCERS staff and City management and staff for their assistance and numerous courtesies extended during the completion of this audit.

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.

INTRODUCTION

BACKGROUND

SDCERS administers three separate defined benefit pension plans for the City, 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, IRIS. 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 City's employer and member contribution rates, and other information required for the Comprehensive Annual Financial Report.

City of San Diego – Membership Total		
Valuation as of:	June 30, 2016	June 30, 2015
Active Counts	6,748	7,038
Terminated Vested	2,865	2,907
Disabled	1,180	1,190
Retirees	6,961	6,648
Beneficiaries	1,313	1,265
Total City Members	19,067	19,048
Active Member Payroll	\$ 465,100,254	\$ 480,662,378
Average Pay Per Active Member	\$ 68,924	\$ 68,295
Benefits in Pay Status	\$ 443,788,677	\$ 419,209,660
Average Annual Benefit	\$ 46,942	\$ 46,052

Source: SDCERS – City of San Diego Actuarial Valuation as of June 30, 2016

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.

Informational – Represents a finding to educate the Board or management.

AUDIT RESULTS

Based on detailed testing, strengths were identified, as well as issues that should be addressed to further strengthen the accuracy and completeness of member records and payroll data submitted by the City.

Strengths Identified

Listed below are the strengths identified:

- 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, date of termination, plan code, service period, member entry age, and member contributions.
- Pensionable compensation cap for tested members in place.
- SDCERS Membership dates were correct for all randomly tested police recruits.
- SDCERS Membership was correctly established for all tested employees who were not eligible for Membership prior to Proposition B and subsequently became eligible.

Below are issues that were identified that should be addressed.

Finding #1: As of March 2017, there were approximately 10,000 “Unknown” service records that will require SDCERS’ staff to investigate and resolve.

Priority Rating: Medium

Each pay period, the City provides SDCERS a transmittal file that contains information such as member name, pensionable salary, member contributions, status, 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.

IRIS requires the City to classify the status of all employees on the transmittal file. The status and description are listed below:

Status	Description
Active	Member is actively working or on leave with pay and making contributions to SDCERS.
Purchasable Leave Without Pay	Member is on a Leave of Absence under Family and Medical Leave Act (FMLA), on Job Saved, or Long Term Disability. Member can purchase this time.
Non-Purchasable Leave Without Pay	Member is on a Leave of Absence that is other than FMLA, Job Saved, Long Term Disability or Uniformed Services Employment and Reemployment Rights Act (USERRA). Member cannot purchase this time.
Military	Member is on USERRA Military Leave. Member can purchase this time.

Finding #1 (Continued): As of March 2017, there were approximately 10,000 “Unknown” service records that will require SDCERS’ staff to investigate and resolve.

Priority Rating: Medium

IRIS has been programmed to create an “Unknown” service record in a Member’s account if certain criteria are met (i.e., IRIS does not know how to classify the record).² This includes, but is not limited to: 1) A Member who is reported in the transmittal file with Pensionable Salary, zero hours, zero service credit and a status of Active, or 2) a Member who was reported as Active on the previous pay period, but there is no record for that Member in the current pay period transmittal file. These “Unknown” records require SDCERS’ staff to investigate to determine if this time is Active, Purchasable Leave Without Pay, Non-Purchasable Leave Without Pay or Military Time.³

On two pay periods examined, there were approximately 180 “Unknown” service records that were generated from the transmittal files because the Members were reported with Pensionable Salary, zero hours, zero service credit and a status of Active.⁴ Currently SDCERS’ staff spends approximately 15 hours per week performing investigations on “Unknown” service records.

Even though SDCERS’ staff spends approximately 15 hours per week investigating and reclassifying the “Unknown” service records, there are still 1,854 Members with at least one “Unknown” service record. Those 1,854 Members have 10,060 total “Unknown” service records.⁵ During an approximately seven week time period between February 8, 2017 and March 31, 2017, the number of “Unknown” service records increased by 595 and the number of Members with an “Unknown” service record increased by 59.

Both SDCERS’ management and the City are aware of this issue and are actively working to address the issue identified. Changes to City and/or SDCERS computer systems could be made that would automatically eliminate some “Unknown” service records. Alternatively, when the City begins uploading the transmittal file to IRIS in Fiscal Year 2018⁶, City staff could manually clear diagnostics created during the transmittal processes prior to final submission into IRIS.⁷

Recommendation #1a: The City and SDCERS should continue to work together and determine the most efficient and effective way to eliminate new “Unknown” service records.

Recommendation #1b: SDCERS should continue to reclassify any “Unknown” service periods.

² Pension Gold, SDCERS’ prior pension administration system, did not have the ability to automatically generate “Unknown” service records. In Pension Gold, upon a Member’s retirement or when a purchase of service credit was requested staff would manually review a Member’s account to identify if there were any periods meeting these criteria. IRIS immediately identifies these periods without manual staff time, greatly improving the process.

³ All “Unknown” records are investigated by SDCERS staff prior to setting up a Member’s retirement benefit.

⁴ Based on an April 2017 transmittal file, approximately 45 additional “Unknown” records are generated each pay period due to Members being reported as Active on the previous pay period, but there are no records for those Members in the current pay period transmittal file.

⁵ Based on IRIS data as of March 31, 2017.

⁶ Currently the transmittal file is uploaded by SDCERS personnel.

⁷ SDCERS staff is investigating the feasibility of modifying IRIS so that “Unknown” service records will generate a diagnostic during the transmittal process.

Finding #2: SDCERS is not adjusting a Member's age-rate contribution to the highest percentage when the Member fails to submit evidence of age to SDCERS within the stated time allowed.

Priority Rating: Medium

The Board, based upon the advice of the Actuary, adopts the rate of contribution of each Member according to the age at time of entry into SDCERS.⁸

SDCERS Board Rule 5.10 states "New Members must submit acceptable evidence of age within six months of the date of their Membership. If the Member fails to submit acceptable evidence of age within the stated time, the Board will assess retirement contributions at the highest percentage rates indicated by the SDCERS actuary until the required evidence is submitted. Once submitted, an adjustment to the Member's contribution age-rate will be made at the beginning of the next payroll period. Any excess contributions paid will be retained by SDCERS in the Member contribution account."

For two of the 25 Members selected for testing, proof of age has not been received from the Members. Proof of age was requested from Member #1 three times from 2004 to 2005. No proof of age has ever been received from Member #1. Member #1's retirement contributions were never adjusted to the maximum amount as required by Board Rule 5.10.

There is no documentation showing SDCERS requested proof of age from Member #2.⁹ SDCERS' staff however, verified the Member's age¹⁰ using a computer database called Lexis Nexis. Member #2's retirement contributions were never adjusted to the maximum as required by Board Rule 5.10.¹¹

SDCERS pension administration system, IRIS, contains a field indicating if a Member's proof of age has been certified. IRIS incorrectly shows that Member #1's proof of age has been certified and correctly shows Member #2's proof of age has been certified.

As of January 2017, IRIS reports 120 active Members did not have proof of age on file. None of these Members retirement contributions were adjusted to the maximum amount as required in Board Rule 5.10. Based on an estimate by the Internal Auditor, approximately \$90,000 in contributions will not be collected in Fiscal Year 2017 from Members who are reported in IRIS as not having proof of age on file.¹²

⁸ SDMC 24.0202 and SDMC 24.0302

⁹ Member's File contained a proof of age letter that was never sent to the Member.

¹⁰ SDCERS is charged a nominal amount when performing these inquiries. Amount depends on the type of inquiry performed. Inquiry for Member 2 cost \$.50 per inquiry. A total of two inquiries were performed.

¹¹ Board Rule does not allow SDCERS' staff to perform age rate verification on a Member's behalf.

¹² Setting the Member's contribution rate to the highest percentage is intended to promote compliance with the Board Rule requiring submission to SDCERS for proof of date of birth. Because the Plan Sponsors are required to verify proof of identify upon hire, which would presumably include date of birth, the \$90,000 most likely represents the amounts above the Member's correct age rate contribution amount.

Finding #2 (Continued): SDCERS is not adjusting a Member's age-rate contribution to the highest percentage when the Member fails to submit evidence of age to SDCERS within the stated time allowed.

Priority Rating: Medium

While not required by the Internal Revenue Service or the Plans,¹³ obtaining proof of age from each Member can provide additional assurances that SDCERS is administering the Plan correctly¹⁴ (e.g., collecting contributions from Members based on their entry age, making Required Minimum Distributions timely, and permitting Service Retirements when a Member is age eligible). A Member's age, however, is only one of piece of information that is needed to correctly calculate Member contributions or retirement benefits. For example, a Member's retirement contribution or retirement benefit is impacted by: 1) General or Safety Member status, 2) Pensionable Salary, 3) Date of Hire, and 4) Date of Membership. SDCERS does not require proof from the Member on these elements.¹⁵

During discussions with SDCERS' Benefits Administration personnel, it was recommended by SDCERS' staff to send each new Member a "Welcome Letter" requesting the Member to verify their date of birth and designate a beneficiary for their retirement benefits. Implementing staff's recommendation would confirm the Member's date of birth,¹⁶ eliminate possible errors made by staff when verifying a Member's age using a computer database like Lexis Nexis, and eliminate the cost of using a computer database to verify a Member's date of birth.

Recommendation 2: SDCERS should adjust all impacted Member's age rate contributions to the highest percentage allowed until proof of age has been received from the Member. Alternatively, SDCERS could implement staff's recommendation to send a "Welcome Letter" requesting the Member verify their date of birth and designate a beneficiary for their retirement benefits. This would require a revision to Board Rule 5.10 removing the requirement for new Members to submit proof of age to SDCERS.

¹³ As written by the City, Port and Airport.

¹⁴ The City of San Diego requires employees to present proof of identify upon hire which likely contains proof of a Member's age. The Port and Airport have similar requirements.

¹⁵ The Internal Auditor verifies these elements, including date of birth, when conducting audits of the census data.

¹⁶ If the Member is unresponsive to the Welcome Letter and the Member's date of birth is incorrect, SDCERS would correct the impacted Member's account when that information becomes available.

INHERENT LIMITATIONS

Because of the inherent limitations of internal controls and because samples were selected, 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

The objective of this audit was to evaluate the accuracy and completeness of member records and payroll data submitted by the City and to verify the accuracy and adequacy of that information. Based on the audit work performed, I have concluded the following:

The City accurately transmitted to SDCERS the census data for the Members on the pay periods selected.¹⁷ The transmittal file, however, also generates “Unknown” service records (i.e., IRIS does not know how to classify the record) when certain criteria are met. These “Unknown” service records must be investigated and reclassified by SDCERS staff.

The City and SDCERS should continue to work together and determine the most efficient and effective way to eliminate new “Unknown” service records. This will increase the adequacy of the information received from the City. Additionally, SDCERS should continue to research and reclassify the “Unknown” service records contained within IRIS.

Finding #2 is not directly related to the objective of this audit, which was an evaluation of the accuracy and completeness of member records and payroll data submitted by the City. The Internal Auditor however, did want to bring this matter to the attention of SDCERS’ management and the Audit Committee.

¹⁷ Based on the randomly selected 25 employee records, covering the two pay periods – November 21, 2015 to December 4, 2015 and April 23, 2016 to May 6, 2016.

APPENDIX A - AUDIT OBJECTIVES, SCOPE & METHODOLOGY

AUDIT OBJECTIVES

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

AUDIT SCOPE & METHODOLOGY

This audit was performed for the period from July 1, 2015 through June 30, 2016 by using the following methods:

- Reviewed the Plan, Memorandum of Understandings (MOUs) between the City and the employee Unions, Salary Ordinance, Personnel Rules & Regulations and the SDCERS 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.
- Randomly selected 25 employee records, covering two pay periods – November 21, 2015 to December 4, 2015 and April 23, 2016 to May 6, 2016. For each employee selected:
 - Traced Base Compensation from the transmittal file to the payroll register.
 - Traced pay rates from the payroll register to employee 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, and code section 401(a)(17) limits.
- For payroll periods November 21, 2015 to December 4, 2015 and April 23, 2016 to May 6, 2016, determine if Members are correctly transmitted to SDCERS with the following statuses: non-purchasable leave without pay, purchasable leave without pay, or active status with pensionable salary and no hours reported.
- Selected 25 police recruits from July 20, 2012 to June 3, 2016 and determine if the employee's date of Membership was properly established with SDCERS.
- Selected 25 employees who were not eligible, for SDCERS Membership prior to Proposition B and subsequently became eligible and determine whether or not those employees correctly established Membership with SDCERS.
- Reviewed felony forfeiture controls.

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.

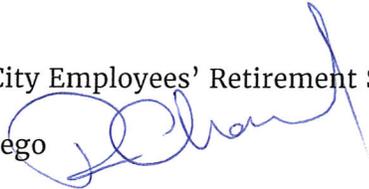


THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: June 16, 2017

TO: Lee Parravano, Internal Auditor, San Diego City Employees' Retirement System

FROM: Rolando Charvel, Comptroller, City of San Diego 

SUBJECT: Management Response to the audit of Plan Sponsor Contribution and Reporting

This memorandum is in response to your audit of plan sponsor contribution and reporting.

Recommendation #1a: The City and the San Diego City Employees' Retirement System (SDCERS) should continue to work together and determine the most efficient and effective way to eliminate new "Unknown" service records.

Management Response:

City Management agrees. The City will evaluate configuration changes to the City's transmittal file to eliminate any new "Unknown" service records. Based on a preliminary evaluation of configuration requirements, the City anticipates completing these changes by June 30, 2018. The City will continue to work with SDCERS to correct any existing employee status for "Unknown" service records.

Target Implementation Date: June 30, 2018

RC/mg

cc: Scott Chadwick, Chief Operating Officer, City of San Diego
Mary Lewis, Chief Financial Officer, City of San Diego
Ronald H. Villa, Deputy Chief Operating Officer, City of San Diego
Mark Hovey, Chief Executive Officer, SDCERS
Marcelle Rossman, Chief Benefits Officer, SDCERS
Jonathan Behnke, Chief Information Officer, City of San Diego
Elena Perez, Deputy Director, City of San Diego
Michelle Villa, Deputy Director, City of San Diego



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

DATE: June 16, 2017

TO: Lee Parravano, SDCERS Internal Auditor

FROM: Marcelle Rossman, SDCERS Chief Benefits Officer

SUBJECT: Management's responses to the findings and recommendations in the SDCERS Internal Audit Report – Plan Sponsor Contribution & Reporting, City of San Diego for the Period July 1, 2015 through June 30, 2016

Finding #1: As of March 2017, there were approximately 10,000 “Unknown” service records that will require SDCERS’ staff to investigate and resolve.

Recommendation #1a: The City and SDCERS should continue to work together and determine the most efficient and effective way to eliminate new “Unknown” service records.

Response: Management agrees. SDCERS’ staff will continue to work with the City to determine the most efficient and effective way to eliminate new “Unknown” service records.

Targeted Implementation Date: June 30, 2018

Recommendation #1b: SDCERS should continue to reclassify any “Unknown” service periods.

Response: Management agrees. Included on the Fiscal Year 2018 Action Plan is an item titled “Update Non-Financial Membership Data”. This Action Plan item includes the reclassification of the “Unknown” service periods.

Targeted Implementation Date: June 30, 2018

Finding #2: SDCERS is not adjusting a Member’s age-rate contribution to the highest percentage when the Member fails to submit evidence of age to SDCERS within the stated time allowed.

Recommendation 2: SDCERS should adjust all impacted Member’s age rate contributions to the highest percentage allowed until proof of age has been received from the Member. Alternatively, SDCERS could implement staff’s recommendation to send a “Welcome Letter” requesting the Member verify their Date of Birth and designate a beneficiary for their retirement benefits. This would require a revision to Board Rule 5.10 removing the requirement for new Members to submit proof of age to SDCERS.

Response: Management agrees. Management intends to incorporate a “Welcome Letter” into the communication process for new Members. Additionally, all non-retired members receive an annual statement with their birthdate listed and a request to inform their plan sponsor of any discrepancies. Management will also review and modify Board Rule 5.10, if required.

Targeted Implementation Date: June 30, 2018