



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

**DATE:** November 22, 2017

**TO:** Audit Committee

**CC:** SDCERS Board of Administration  
Mark Hovey, Chief Executive Officer  
Marcelle Rossman, Chief Benefits Officer  
Johnny Tran, Chief Compliance Officer/General Counsel

**FROM:** Lee Parravano, Internal Auditor

**SUBJECT:** Fiscal Year 2017 Retirement Benefit Calculations

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Enclosed is the Internal Audit of Fiscal Year 2017 Retirement Benefit Calculations. Overall, it was determined SDCERS has many controls in place to correctly calculate retirement benefits.

Based on this audit, there were two recommendations to SDCERS' management. SDCERS' management agrees with both recommendations. SDCERS' management comments are attached to this report.

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



## **Internal Audit Report**

# **Fiscal Year 2017 Retirement Benefit Calculations**

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

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## **EXECUTIVE SUMMARY**

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The objective of the audit was to determine if retirement benefits are correctly calculated for Fiscal Year 2017 retirees. SDCERS provides service retirement, disability retirement, death and survivor benefits to its participants. Based on the audit work performed, I conclude SDCERS has many controls in place to correctly calculate retirement benefits. Because of the controls in place, staff correctly calculated 99.995% of the retirement benefits paid.<sup>1</sup> Additionally, 87.5% of retiring active SDCERS Members are paid their first pension check within one month of their last paycheck.<sup>2</sup>

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

### **Cost of Living (COL) Annuity, Surviving Spouse (SS) Annuity, and Disability Retirees**

The City of San Diego (City) and San Diego Unified Port District (Port) Plans do not specifically state if the COL Annuity and SS Annuity are included or excluded from disability benefits. Currently, SDCERS pays the COL Annuity and the SS Annuity, when applicable, to disability recipients. SDCERS' General Council's opinion is that disabled retirees are entitled to the COL and SS Annuity.

### **Retirement benefits for two Members were incorrectly calculated**

SDCERS pension administration system, IRIS, is programmed to automatically calculate most Member benefits. Retirement benefits that are not applicable to the vast majority of Members sometimes require staff to perform a manual calculation. Two Members' retirement benefits that were manually calculated contained errors. Member #1 has been overpaid by approximately \$29 per month since March of 2017 and Member #2 has been overpaid approximately \$10 per month since July 2017.

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This report contains two recommendations to SDCERS' management. SDCERS' management agrees with both recommendations. SDCERS' management comments are attached to this report.

Internal Audit would like to thank SDCERS' 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 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.

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<sup>1</sup> Based on audit sample.

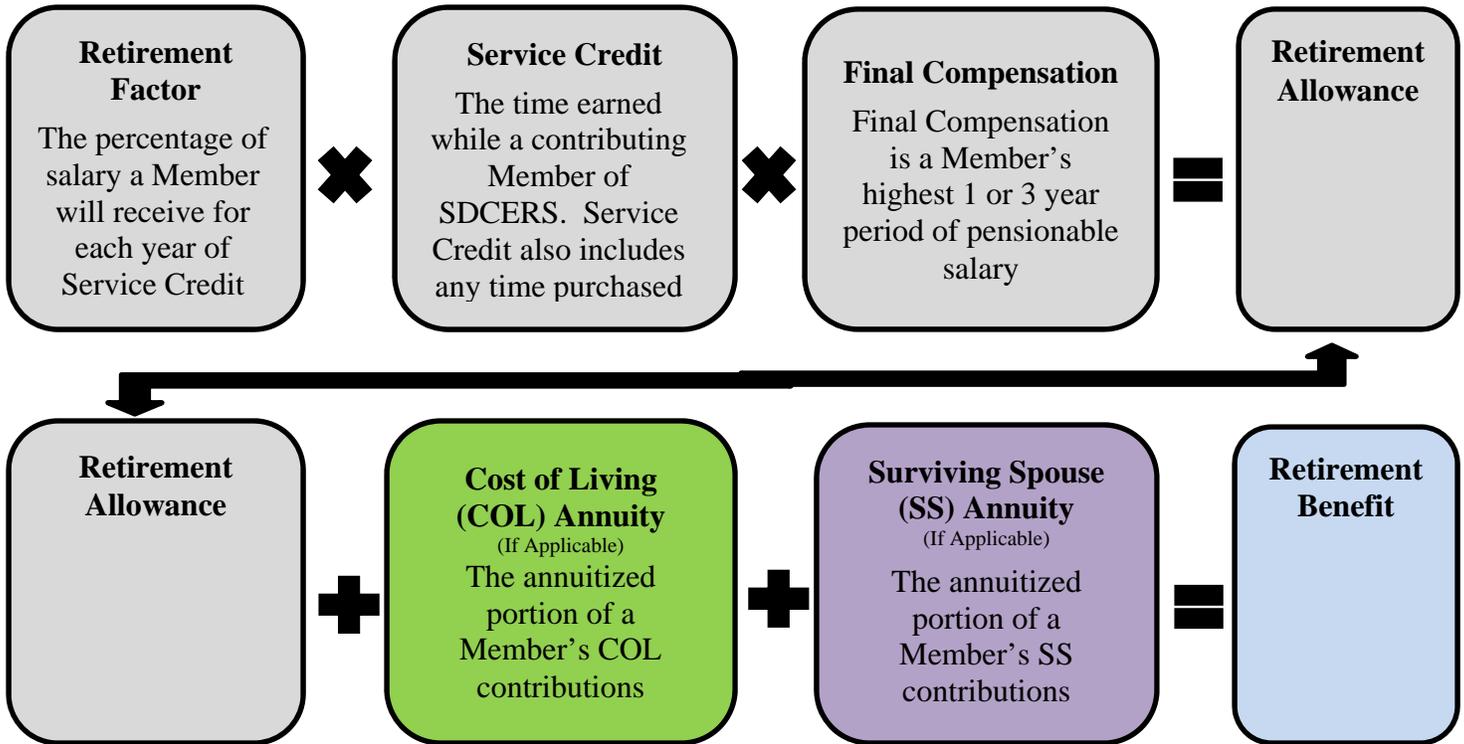
<sup>2</sup> Based on audit sample.

# INTRODUCTION

## BACKGROUND

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

In general a Member's retirement benefit is calculated as follows:



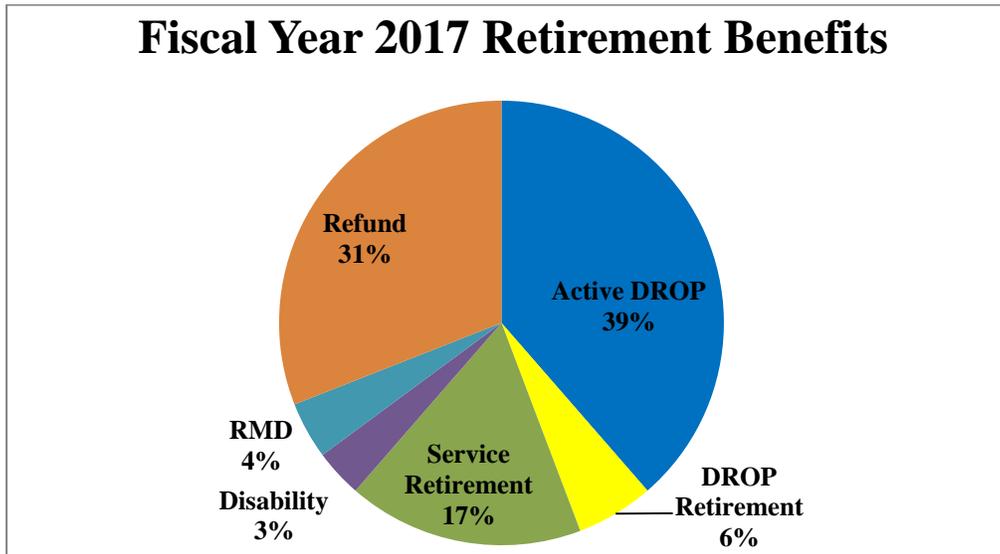
### Retirement Benefit Example

1. Frank retired when he is 55 years old. Frank's **Retirement Factor** is 2.5%.
2. At age 55, Frank has 20 years of **Service Credit**.
3. Frank's highest one-year period of pensionable salary is \$80,000. This is his **Final Compensation**.

**Frank's Base Retirement Benefit is calculated as follows:**

|  |   |
|--|---|
| <b>Retirement Factor</b>                 | = 2.5%  |
| 2.5% x 20 years of <b>Service Credit</b> | = 50%, so   |
| 50% x \$80,000 <b>Final Compensation</b> | = \$40,000 <b>Retirement Allowance</b>                |
| <b>COL Annuity</b>                       | = 2,450   |
| <b>SS Annuity (If Applicable)</b>        | = 1,250   |
| <hr/>                                    |   |
| <b>Retirement Benefit</b>                | = <b>\$43,700 Per Year, paid \$3,641.66 per month</b> |

SDCERS' Benefits Administration Division oversees the calculation and setup of all retirement benefits. There are currently 28 different tiers of retirement benefits. In Fiscal Year 2017, there were approximately 750 retirement benefits calculated by staff. The chart below provides details on the types of retirement benefits calculated.



## 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

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Based on detailed testing, strengths were identified, as well as issues that should be addressed.

### Strengths Identified

SDCERS has many controls in place to correctly calculate retirement benefits. Most of these controls have been built into IRIS. IRIS assists staff in accurately calculating Member retirement benefits in a timely manner by identifying any pensionable salary spikes, alerting staff to any breaks in service, automatically populating a Member's 13<sup>th</sup> Check eligibility, calculating a Member's Final Average Salary, and prepopulating a Member's eligible retirement factors. On average, SDCERS calculated and paid a retiring active Member their first pension check in less than 24 days after the Member's final pay check.<sup>3</sup> Additionally, 87.5% of retiring active SDCERS Members are paid their first pension check within one month of their last paycheck.<sup>4</sup> This result is exemplary, especially when compared to SDCERS' peers. A 2016 CEM Benchmarking survey<sup>5</sup> reported that only 43.3% of retiring active Members are paid their first pension check within one month of their last paycheck.

The controls imbedded in IRIS, noted above, assist SDCERS in the accuracy of the benefits provided to Members and beneficiaries. Additionally, every Member retirement benefit calculated by staff is reviewed by another individual. The table below summarizes the accuracy of the benefits tested.

| <b>Benefits Tested</b>                                   |               |
|--|---------------|
| <b>Members Tested</b>                                    |               |
| Total Members Tested                                     | 60            |
| Members Correctly Calculated                             | 58            |
| Members Incorrectly Calculated                           | 2             |
| % of Members Correctly Calculated                        | 97%           |
| % of Members Incorrectly Calculated                      | 3%            |
|  |               |
| <b>Amount of Retirement Benefits Tested</b>              |               |
| Dollar Amount of Retirement Benefits Calculated by Staff | \$ 783,445.23 |
| Dollar Amount of Retirement Benefits as Recalculated     | \$ 783,406.22 |
| Percent of Retirement Benefits Correctly Calculated      | 99.995%       |

The findings listed below should be addressed.

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<sup>3</sup> Based on Service Retirements sample tested.

<sup>4</sup> Based on Service Retirements sample tested.

<sup>5</sup> SDCERS peer group consisted of 10 similarly sized pension plans.

**Finding #1:** The City and Port Plans do not specifically state if the COL Annuity and SS Annuity are paid to disability retirees.

**Priority Rating:** Medium

The City, Port, and Airport Plans provide disability retirements for eligible Members. The disability benefits provided are spelled out in their respective Plans. However, the City and Port Plans do not specifically state if the COL Annuity and SS Annuity are included or excluded from disability benefits.<sup>6</sup>

For example, City employees granted an Industrial Disability receive the greater of 1) Monthly installments equal to 50% of the Member's Final Compensation<sup>7</sup> or 2) a Service Retirement Allowance, if the Member is eligible to service retire. The COL Annuity and SS Annuity are not included in the definition of a Member's Final Compensation and are not included in the definition of an Unmodified Service Retirement Allowance. However, the San Diego Municipal Code<sup>8</sup> (SDMC) states "each Member must pay Cost of Living Annuity Contributions" and that "upon retirement, the System will pay a Cost of Living Annuity to Members who have made Cost of Living Annuity Contributions." Additionally, the Plan states the SS Annuity will be paid to a Member at the time of retirement if the Member has selected the maximum<sup>9</sup> benefit and does not have a spouse.

The Board voted in in January 2015 that recipients of the Industrial Death Benefit are entitled to the COL Annuity. However, the decision did not include the COL Annuity and SS Annuity for Industrial and Non Industrial disability recipients. Currently, SDCERS pays the COL Annuity and the SS Annuity, when applicable, to Industrial and Non Industrial disability recipients.

SDCERS' General Council states that City and Port Members are eligible for the COL and SS Annuities, despite unclear language. The Internal Auditor agrees with this opinion.

**Recommendation 1:** SDCERS management should request the Board clarify, with a Board Rule, if industrial and non-industrial disability retirees are eligible to receive the COL Annuity and SS Annuity.

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<sup>6</sup> The Airport Plan specifically states the COL Annuity and SS Annuity, if applicable, are paid to disability retirees.

<sup>7</sup> City plan can also include an Annuity equal to the Accumulated Additional Contributions at retirement. These are post-tax contributions that Members are no longer eligible to make and do not include the COL Annuity and SS Annuity Contributions.

<sup>8</sup> The Port Plan does not contain this same language.

<sup>9</sup> Members may elect to receive a modified retirement allowance under Optional Settlements. A "retirement allowance" is not a defined term in the SDMC.

**Finding #2:** Retirement benefits for two Members were incorrectly calculated.

**Priority Rating:** Low

A Deferred Member is a Member who leaves his or her employee contributions on deposit with SDCERS after terminating employment. When a Deferred Member applies for retirement benefits, he or she is entitled, when eligible, for the retirement benefits that were in effect on the day the Deferred Member terminated employment.

Member #1 stopped contributing to SDCERS prior to 1997 and was eligible for benefits in effect at that time. IRIS is not programmed to automatically calculate a Member's benefit that terminated prior to 1997. This is because there are only 19 Members that are that are eligible to retire from SDCERS with the benefits that were in place at that time. However, SDCERS' staff does have a manual calculator to calculate these benefits. Member #1 began receiving benefits in March 2017. SDCERS' staff erred in inputting too much service credit when calculating Member #1's benefit. This resulted in an overpayment to Member #1 of approximately \$29 per month.

Member #2 ended City employment in 2000. This Member was employed subsequently by the Port from 2005 to 2017. Member #2's City and Port retirement benefits must be separately calculated. IRIS is not programmed to automatically calculate a Member's benefit that has both City and Port service and a break in service. SDCERS' staff has a manual calculator to calculate these benefits. Member #2 began receiving benefits in July 2017. SDCERS' staff incorrectly used the wrong retirement factor when calculating Member #2's City benefit. This resulted in an overpayment to Member #2 of approximately \$10 per month.

**Recommendation #2:** The Members' retirement benefits identified above should be corrected.

## **INHERENT LIMITATIONS**

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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**

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The objective of the audit was to determine if retirement benefits are correctly calculated for Fiscal Year 2017 retirees. Based on the audit work performed, I have concluded the following:

SDCERS has many controls in place to correctly calculate retirement benefits and most of these controls have been built into IRIS. Because of the controls in place, staff correctly calculated 99.995% of the retirement benefits paid<sup>10</sup> Clarity, however, could be added to the Plan by implementing Recommendation Number #1 contained in this report. Additionally, the Members identified in Recommendation #2 should be corrected.

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<sup>10</sup> Based on audit sample.

## **APPENDIX A - AUDIT OBJECTIVES, SCOPE & METHODOLOGY**

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### **AUDIT OBJECTIVES**

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The objective of the audit was to determine if retirement benefits are correctly calculated for Fiscal Year 2017 retirees.<sup>11</sup>

### **AUDIT SCOPE & METHODOLOGY**

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This audit was performed for the period from July 1, 2016 through June 30, 2017 by using the following methods:

- Reviewed the Plan, Board Rules, Legal Opinions, SDCERS 2016 Comprehensive Annual Financial Report, Actuarial Reports, and the SDCERS Participation and Administration Agreement.
- Reviewed policies and procedures utilized by staff to calculate retirement benefits.
- Interviewed staff responsible for calculating retirement benefits.
- Randomly selected 60 payees who first began receiving retirement benefits in Fiscal Year 2017. For each retirement benefit selected<sup>12</sup>:
  - Determine:
    - If the retirement benefit was accurately calculated.
    - The length of time between the Member's last paycheck and the Member's first retirement benefit payment.

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.

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<sup>11</sup> Includes continuances and beneficiaries that began receiving benefits in Fiscal Year 2017.

<sup>12</sup> Population included at least one: 1) City, Port and Airport retiree, 2) Service retirement to disability retirement, 3) Active duty to disability, and 5) one Domestic Relations Order



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

**DATE:** November 22, 2017

**TO:** Lee Parravano, SDCERS Internal Auditor

**FROM:** Marcelle Voorhies Rossman, SDCERS Chief Benefits Officer

**SUBJECT:** Management's Responses to the Findings and Recommendations in the SDCERS Internal Audit Report – Fiscal Year 2017 Retirement Benefit Calculations

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**Finding #1:** The City and Port Plans do not specifically state if the COL Annuity and SS Annuity are paid to disability retirees.

**Recommendation #1:** SDCERS management should request the Board clarify, with a Board Rule, if Industrial and Non-Industrial Retirees are eligible to receive the COL Annuity and SS Annuity.

**Response:** Management agrees and will implement the recommendation.

**Targeted Implementation Date:** June 30, 2018

**Finding #2:** Retirement benefits for two Members were incorrectly calculated.

**Recommendation #2:** The Members' retirement benefits identified above should be corrected.

**Response:** Management agrees. These benefits have been corrected prospectively with the November 2017 payments and letters requesting repayment of overpaid benefits have been sent to the members.

Additional training will be provided to staff regarding members who separated prior to 1997 including the development of a checklist for reviewers to complete.

A Problem Incident report, to update IRIS, had already been entered to correct the second issue concerning members with benefits split between more than one SDCERS plan sponsor. Staff will utilize the same checklist identified above until the issue is corrected in IRIS.

**Targeted Implementation Date:** June 30, 2018