



SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

MEMORANDUM

DATE: January 31, 2019

TO: SDCERS Audit Committee

FROM: Sarah Dickson, *SDCERS Chief Internal Auditor*

SUBJECT: Health Insurance Cost Recovery Audit

Enclosed is the Health Insurance Cost Recovery Audit Report. Overall, SDCERS has controls in place to correctly calculate costs associated with the City of San Diego's health insurance program; however, one issue was identified that should be addressed. SDCERS' management agrees with the recommendation and their response is attached to the report.

I would like to thank SDCERS for all of their assistance. Everyone involved was very helpful and valuable time and efforts spent on this audit are greatly appreciated.

Attachment: Health Insurance Cost Recovery Audit Report

cc: Gregg Rademacher, *SDCERS Chief Executive Officer*
Marcelle Voorhies Rossman, *SDCERS Deputy Chief Executive Officer*
Johnny Tran, *SDCERS Chief Compliance Officer/General Counsel*
Ted LaSalvia, *SDCERS Controller*



Internal Audit Report

Health Insurance Cost Recovery

Prepared by:
Sarah Dickson, Chief Internal Auditor

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EXECUTIVE SUMMARY

The objective of the audit was to determine if the City of San Diego (The City) was billed completely and accurately for health insurance program activities performed by SDCERS. The City administers health insurance plans for their active employees and for City retirees that are members of SDCERS. SDCERS provides health insurance services on the City's behalf and subsequently bills the City for these services. Based on the audit work performed, I conclude SDCERS has many controls in place to correctly calculate health insurance costs. However, the following issue was identified that should be addressed.

SDCERS bills for substantially all *direct* costs and some *indirect* costs associated with the City of San Diego's health insurance program; however, SDCERS does not bill for a share of certain *indirect* costs associated with the program such as rent, depreciation, and labor.

This report contains one recommendation to SDCERS' management. SDCERS' management agrees with the recommendation and their comments are attached to this report.

Internal Audit would like to thank management for their assistance during the audit.

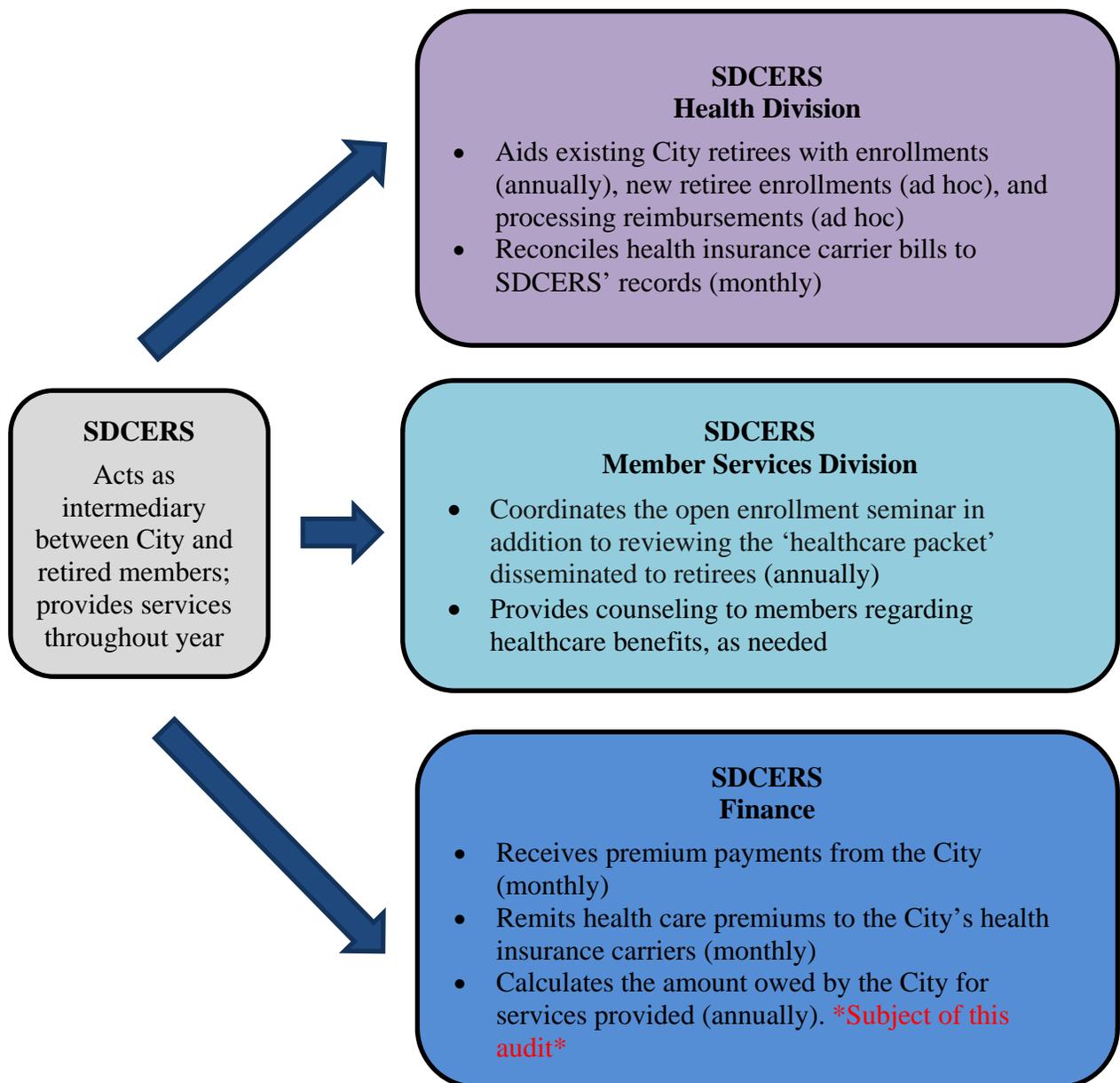
The information in this report is intended solely for the use of SDCERS' Audit Committee, Board of Administration, and management and is not intended to be, and should not be, used by anyone other than these specified parties.

INTRODUCTION

BACKGROUND

The City of San Diego (The City) administers health insurance plans for their retirees via a pay-go system. SDCERS acts as an intermediary between the City and their retired members by providing healthcare insurance services such as enrollments and reimbursements. Enrollments generally occur annually and reimbursements are ad-hoc. SDCERS bills the City monthly for premium payments they need to remit to the City’s health insurance carriers and then subsequently pays the health insurance carriers. Annually, SDCERS calculates and bills the City for their healthcare insurance services after the fiscal year ends (see Appendix C for the FY18 bill).

Below is a snapshot of services SDCERS provides and when they occur:



PRIORITY RATING PROCESS

To assist management in its evaluation, the finding has been assigned a qualitative assessment of the need for corrective action 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. SDCERS improved the billing process in FY18 by including direct parking and call center labor costs and by relying on payroll information from the system of record SAP; however, the finding below should be addressed.

Finding #1: SDCERS bills for substantially all *direct* costs associated with the City of San Diego's health insurance program; however, SDCERS does not bill for a share of certain *indirect* costs associated with the program such as rent, depreciation, and labor.

Priority Rating: Medium

A Memorandum of Understanding (MOU) effective May 13, 2014 between SDCERS and the City of San Diego (The City) indicates the following:

Compensation: The City agrees to advance sufficient funds to compensate and reimburse SDCERS directly for all expenses of any nature, including staff time, administrative expenses, consultant fees, attorneys' fees and defense costs, if applicable, or any other expenses incurred by SDCERS at its sole discretion as a result of its performance under this Agreement. SDCERS agrees to obtain City approval before incurring expenses for outside consultants or outside attorneys. SDCERS will invoice the City for all such fees and expenses. The City will pay the invoiced fees within 30 days of its receipt of the invoice.

The Scope of Services under the MOU are:

- A. Responsibility of Enrollment of New Retirees: SDCERS is responsible for counseling and enrolling Health Eligible Retirees....
- B. Responsibility for Processing Reimbursements for the Limited Retiree Health Benefit: SDCERS is responsible for counseling and processing reimbursement claims for retirees who are eligible for the Limited Retiree Health Benefit.
- C. Responsibility for Enrollment of Surviving Spouses and Dependent of SDCERS Members Killed in the Line of Duty: SDCERS is responsible for counseling and enrolling eligible Surviving Spouses and Dependents of SDCERS Members Killed in the Line of Duty.
- D. Responsibility for Annual Open Enrollment: SDCERS is responsible for preparing, distributing and processing the annual Open Enrollment materials for existing retirees, their eligible dependents and survivors, and eligible Surviving Spouses and Dependents of SDCERS Members Killed in the Line of Duty.
- E. City's Responsibility to Provide Data: The City agrees to compile and provide SDCERS with any data in its possession that SDCERS requires to perform its responsibilities under this MOU.
- F. SDCERS' Responsibility to Provide Data Relating to the Implementation of Retiree Health Benefits: SDCERS agrees to compile and provide the City with any data in SDCERS' possession that the City requires regarding SDCERS' implementation of the City retiree health benefits.
- G. Responsibility for Payment of Monthly Premiums to the Health Insurance Carriers: SDCERS is responsible for transmitting the monthly premiums on behalf of retirees to the City's health insurance carriers.

Finding #1 (continued): SDCERS bills for substantially all *direct* costs associated with the City of San Diego’s health insurance program; however, SDCERS does not bill for a share of certain *indirect* costs associated with the program such as rent, depreciation, and labor.

Priority Rating: Medium

The MOU also indicates: Pursuant to instructions from the Internal Revenue Service (IRS) the Board has determined that it cannot incur any expenses out of the trust fund for purposes of managing health insurance benefits for the City retirees.

SDCERS has a devoted Health Division, including four employees and a part-time manager¹, who are all responsible for Scope of Services A through D and F above. The Health Division also aids in Scope of Service G above by reconciling bills from the City’s health insurance providers to SDCERS records. In addition, two to three SDCERS’ Finance Division employees work on paying the monthly premiums to the health care insurance carriers (Scope of Services item G above). The SDCERS’ Communications Manager coordinates the annual open enrollment seminar in addition to reviewing the ‘packet’ disseminated to retirees (Scope of Services item D above). Together, SDCERS’ Controller and the Deputy CEO calculate the City’s annual bill for the program.

SDCERS bills for substantially all *direct* costs and a portion of *indirect information technology* costs associated with the City’s health insurance program; however, SDCERS does not bill for a share of other *indirect* program costs such as office operations expense, rent, depreciation, and labor. Billing for a portion of indirect program costs decreases the risk trust funds are spent on health insurance benefits.

Costs that apply either *directly* or *indirectly* to the health insurance program and should be billed to the City are included in the table below (per Internal Audit); all other costs were believed to be “not applicable” and excluded (*e.g.* Actuary Services). For a complete list of costs reviewed, see Appendix B, “Schedule of Administrative Expenses,” which was included within SDCERS’ FY18 Consolidated Annual Financial Report and which is the source for the contextual total amounts included in the last column below (in thousands and where applicable).

Labor/ Non-Labor (“Non”)	Direct/ Indirect Cost ²	Fixed or Variable ³	Cost Types	Appropriately Included in FY18 Bill?	FY18 TOTAL CAFR Amount
Non	Direct	Variable	Parking	Yes	N/A
Non	Direct	Variable	Printing/Stationary	Yes	N/A
Non	Direct	Variable	Postage/Mailing	Yes	N/A
Non	Direct	Variable	Care Counsel Services	Yes	N/A
Non	Direct	Variable	Travel & Training	Yes	N/A

¹ The part-time manager splits her time between the Disability Division and the Health Division and codes her health insurance time worked to a specific charge code.

² Direct costs are those that can be easily identified and measurably attributed to the health insurance program whereas indirect costs benefit more than one program.

³ Fixed costs represent those that SDCERS would continue to pay regardless of whether the City’s health insurance program resides with SDCERS.

Labor/ Non- Labor ("Non")	Direct/ Indirect Cost ²	Fixed or Variable ³	Cost Types	Appropriately Included in FY18 Bill?	FY18 TOTAL CAFR Amount
Non	Indirect	Both	Information & Technology Services (SDCERS billed for a portion of IRIS licensing and Sagitec services but did not bill for any server and desktop support, telephone usage and services, or scanning machine licensing & maintenance for example)	Partially	\$1,822
Non	Indirect	Both	Office Operations Expense (SDCERS billed for office operations expenses above, but did not bill for any office supplies, temporary Member Services staffing, or shredding for example)	No	\$416 ⁴
Non	Indirect	Fixed	Depreciation	No	\$817
Non	Indirect	Fixed	Rent	No	\$1,019
Labor	Direct	Variable	Labor (4 FTE's and 1 PT); includes non-health employees working on health insurance projects	Yes	N/A
Labor	Direct	Fixed	Member Services Call Center; calls associated with the health insurance program	Yes	N/A
Labor	Indirect	Fixed	Labor that benefits more than just the health insurance program (e.g. IT/Finance/HR)	No	\$5,693 ⁵

Recommendation 1: SDCERS' management should develop and document a process to ensure a portion of *all indirect costs associated with the program*, such as rent, depreciation and labor, are billed to the City. Where estimates are used, management should include a process that ensures the rates are reasonable, equitable, and justifiable and where expenses are excluded (e.g. those expenses clearly "not applicable" such as Actuary Services), management should justify the reason for the exclusion. Finally, the process should include a formal, independent review and approval by SDCERS management.

⁴ Represents total Office Operations Expense costs per the FY18 CAFR, which includes parking expenses and postage/ mailing expenses that are itemized above.

⁵ Represents total Salaries and Personnel costs per the FY18 CAFR, which excludes \$1M related to the Investments Division and excludes all costs related to the Health Division. The figure includes Member Services Call Center Salaries and Personnel costs which are itemized above.

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 the audit was to determine if the City was billed completely and accurately for health insurance program activities performed by SDCERS. Based on the audit work performed, I have concluded SDCERS has many controls in place to correctly calculate health insurance bills to the City; however, SDCERS should improve the process by billing for more indirect costs.

APPENDIX A - AUDIT OBJECTIVES, SCOPE & METHODOLOGY

AUDIT OBJECTIVE

Determine if the cost recovery of the City of San Diego's retiree health insurance is complete and accurate.

AUDIT SCOPE & METHODOLOGY

The scope of the audit will include the health insurance cost recovery billing for FY18 by using the following methods:

- Obtained the health insurance MOU between SDCERS and the City of San Diego, lease documents and other perm-file related documents.
- Obtained any written policies and procedures utilized by staff to complete health insurance billings. If available, review the policies and procedures to determine if they are adequate, and to determine if they accurately reflect the current procedures used to prepare billings.
- Selected the FY18 billing for testing since management modified the billing process for FY18 (e.g. included direct parking and call center costs). Performed the following:
 - Created a labor and a non-labor "leadsheet" of all costs *directly* and *indirectly* associated with the Health Insurance Cost Recovery process
 - Ensured completeness of costs by reviewing expense items in the FY18 draft financial statements
 - Determined if SDCERS bills the City for the cost based on review of the FY18 billing
 - For each cost already included in the bill:
 - Validated completeness and accuracy
 - Assessed reasonableness of overhead/allocation percentage used, where applicable
 - For each cost excluded from the bill:
 - Analyzed costs and determine whether they should be billed

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 finding and recommendation.

APPENDIX B - SCHEDULE OF ADMINISTRATIVE EXPENSES

San Diego City Employees' Retirement System Other Supplemental Information

Schedule of Administrative Expenses For the Fiscal Year Ended June 30, 2018

(Dollars in Thousands)

Salaries and Personnel ¹	\$5,693
Information and Technology Services	
Data Processing and Computer Services	952
Contracted Services	870
Total Information and Technology Services	<u>1,822</u>
Legal/External	
Litigation/Fiduciary/Tax/General	632
Disability	15
Total Legal/External	<u>647</u>
General Operations	
Rent	1,019
Depreciation Expense	817
Actuary Services	628
Office Operations Expense	416
Fiduciary Insurance	260
Audit Services	104
Travel and Training	101
Disability Processing	72
Total General Operations	<u>3,417</u>
Grand Total	<u>\$11,579</u>

¹ Personnel expense of \$1.0 million can be readily identified as investment related costs and are reported as investment expenses in the Statement of Changes in Plan Net Position.

APPENDIX C – FY18 CITY OF SAN DIEGO BILL



401 West A Street, Suite 400
 San Diego, CA 92101
 619.525.3600

INVOICE

Date: November 2, 2018
 Invoice #: HI 110218

To:
 City of San Diego
 Tracy McCraner
 202 C Street, MS-8A
 San Diego, CA 92101

FOR: FY18/FY19 HEALTHCARE EXPENSES

DESCRIPTION	AMOUNT DUE
FY18 Health Expenses:	
Labor Support	\$552,000
Information Systems Support	38,000
Other Operating Costs	144,000
Total FY18 Health Expenses	<u>734,000</u>
Estimated FY18 Health Expenses	
Paid by City on 09/11/17	(581,220)
Less FY17 Balance Due	68,174
Net FY18 Prepaid Health Expenses	<u>(513,046)</u>
FY18 Health Expenses Balance Due	<u>\$220,954</u>
FY 19 Estimated Health Expenses:	
Labor Support	\$538,000
Information Systems Support	38,000
Other Operating Costs	137,000
Total FY19 Estimated Health Expenses	<u>\$713,000</u>
Total Amount Due	<u><u>\$933,954</u></u>
\$933,954	
Wiring Instructions:	
Wells Fargo Bank	
ABA: 121000248	
SDCERS Concentration Account	
Acct #: 4121856587	
Contact: Peggy McPherson	
(619) 699-3074	
TOTAL	\$933,954



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

DATE: January 30, 2019

TO: Sarah Dickson, SDCERS Internal Auditor

FROM: Marcelle Voorhies Rossman, SDCERS Deputy Chief Executive Officer 

SUBJECT: Management's responses to the Findings and Recommendations in the SDCERS Internal Audit Report – Health Insurance Cost Recovery

Finding #1: SDCERS bills for substantially all *direct* costs associated with the City of San Diego's health insurance program; however, SDCERS does not bill for a share of certain *indirect* costs associated with the program such as rent, depreciation, and labor.

Recommendation #1: SDCERS' management should develop and document a process to ensure a portion of *all indirect costs associated with the program*, such as rent, depreciation and labor, are billed to the City. Where estimates are used, management should include a process that ensures the rates are reasonable, equitable, and justifiable and where expenses are excluded (*e.g.* those expenses clearly "not applicable" such as Actuary Services), management should justify the reason for the exclusion. Finally, the process should include a formal, independent review and approval by SDCERS management.

Response: Management agrees and will implement the recommendation.

Targeted Implementation Date: June 30, 2019