SDCERS
San Diego City Employees' Retirement System

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

MEMORANDUM

DATE: January 31, 2020

TO: SDCERS Audit Committee

FROM: Sarah Dickson, SDCERS Chief Internal Auditor

SUBJECT: City of San Diego Contribution & Reporting Audit for the period July 1, 2018 through June 30, 2019

Enclosed is the Plan Sponsor Contribution & Reporting Audit for the period July 1, 2018 through June 30, 2019. Overall, the City of San Diego has procedures in place for the transmittal of census data and many control strengths were identified during the audit. One informational finding was included as a status update. Although a management response is not required for informational findings, SDCERS management agrees and their response can be found subsequent to the audit report.

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

CC: Tracy McCraner, City of San Diego Director & City Comptroller, Department of Finance
Sarah Mayen, City of San Diego Assistant Director & City Comptroller, Department of Finance
Sally Rubi, City of San Diego Financial Operations Manager
Lillian Garcia, City of San Diego Payroll Manager
Douglas Edwards, City of San Diego Personnel Director
Julio Canizal, City of San Diego Risk Management Director
Kyle Elser, City of San Diego Interim City Auditor
Gregg Rademacher, SDCERS Chief Executive Officer
Marcelle Voorhies Rossman, SDCERS Deputy Chief Executive Officer
Johnny Tran, SDCERS Chief Compliance Officer/General Counsel

SDCERS

San Diego City Employees' Retirement System

Internal Audit Report

City of San Diego

Contribution & Reporting Audit

for the Period July 1, 2018 through June 30, 2019

Prepared by:
Sarah Dickson, Chief 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 7,000 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 accuracy and completeness controls over Member records and payroll 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, 2018 through June 30, 2019 include:
- Accurately and completely reporting all elements to SDCERS for all randomly tested Members. Census data was correctly transmitted to SDCERS with 100% accuracy.[2]
- Correctly establishing Membership for all tested employees.
- Correctly reporting Membership dates for all tested police department employees.
- Ensuring provisional employees work no more than 720 hours per fiscal year.
- Ensuring provisional employees are either 59 and one-half when rehired or have a Bona Fide Separation from City service.

The following observation, however, was included to further educate and inform management and the Audit Committee.

Status Update on "Unknown" Service Records
The previous City of San Diego Contribution & Reporting Audit issued June 16, 2017 had an unknown service records ("Unknowns") finding with two associated recommendations. Both recommendations associated with the "Unknowns" finding were outstanding during all or part of the audit scope period of fiscal year of 2019 ("FY19"). However, since SDCERS showed progress in reducing existing and newly created "Unknowns," the recommendations were closed in August of 2018 and 2019, respectively. This item has been included to provide a status update.

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Although no official response is required, SDCERS agrees with the informational finding. Their response is attached to the report.

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[1] See Appendix A for completed Audit Objectives, Scope and Methodology
[2] Percentage based on 25 randomly selected employee records covering the two pay periods – July 14, 2018 through July 27, 2018 and December 29, 2018 through January 11, 2019.

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 Unified Port District, the City of San Diego, 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 by the Governmental Accounting Standards Board.

City of San Diego – Membership Total		
Valuation as of:	**June 30, 2018**	**June 30, 2017**
Active Counts	5,967	6,388
Terminated Vested	2,921	2,851
Disabled	1,150	1,161
Retirees	7,522	7,272
Beneficiaries	1,352	1,335
Total City Members	18,912	19,007
Active Member Payroll	$ 455,753,399	$ 448,889,789
Average Pay Per Active	$ 76,379	$ 70,271
Benefits in Pay Status	$ 493,806,455	$ 470,812,001
Average Benefit	$ 49,262	$ 48,199

Source: SDCERS – City of San Diego Actuarial Valuation as of June 30, 2018

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/inform the Audit Committee or management.

AUDIT RESULTS

Based on detailed testing, many strengths were identified and one informational finding was included to provide a status update.

> **Finding #1:** Both recommendations associated with the "Unknowns" finding correlating with the previously issued City of San Diego Contribution and Reporting Audit were outstanding during all or part of this audit's scope period of FY19. However, since SDCERS showed progress in reducing existing and newly created "Unknowns," the recommendations were closed in August of 2018 and 2019, respectively. This item has been included to provide a status update.
>
> **Priority Rating:** Informational

The previous City of San Diego Contribution & Reporting Audit issued June 16, 2017 had an unknown service records ("Unknowns") finding with two associated recommendations. "Unknowns" are created by IRIS if certain criteria are met (i.e., IRIS does not know how to classify the record). Some examples of their causes are:

1. When pensionable salary is greater than zero, no contributions are reported and the Member's status is "Active"
2. When a Member was reported as "Active" in the previous PPE but is not reported at all in the current PPE
3. When the Member's termination date or DROP termination date are on the first day of the PPE

Once an "Unknown" is created, SDCERS must make a correction within the system that then needs to be reviewed and approved by another party, increasing investigation time.

The approximate count of new "Unknowns" created (per the previous audit workpapers) for the pay period ending April 7, 2017 was 165. In addition, the number of hours used to investigate new "Unknowns" was 15 hours per week per the previous audit.

Both recommendations associated with the "Unknowns" finding were outstanding during all or part of the audit scope period of fiscal year of 2019 ("FY19"). However, since SDCERS showed progress in reducing existing and newly created "Unknowns," the recommendations were closed in August of 2018 and 2019, respectively. This informational item has been included to provide a status update.

Status Update
Soon after issuance of the City of San Diego Contribution & Reporting Audit Report, SDCERS implemented a consistent, pro-active, manual approach to avoiding the creation of new "Unknowns."

This pro-active approach included investigating the root cause of new "Unknowns" (if the root cause was not already identified), and correcting those types of errors in the transmittal file prior to submittal by the City. As a result, we noted a decrease in the count of new "Unknowns" created each pay period at the time of closing one of the outstanding recommendations:

Approximate Count of New "Unknowns" for PPE Ending		
April 7, 2017 (Prior Audit)	July 12, 2019 (Current Experience)	% Decrease
165	65	61%

We also noted a significant decrease in the hours spent preventing and investigating "Unknowns:"

Approximate Hours Spent Investigating and Preventing "Unknowns"		
Prior Audit	Current Experience	% Decrease
15 hours per week	2 hours per week	87%

In addition to the pro-active, manual approach above, SDCERS created four computer system changes within IRIS to either eliminate creation of new "Unknowns" or pass investigation of transactions likely to create new "Unknowns" to the City. Creation dates for the computer system changes ranged from February 2018 through August 2019, with the bulk created in February or March 2019. SDCERS completed one of the system changes in July 2019, which passed some of the manual investigative responsibilities to the City, and two in December 2019, which either passed manual investigative responsibilities to the City or eliminated creation of new "Unknowns." One more system change is scheduled for completion in January 2020, which will eliminate creation of new "Unknowns."

Recommendation 1: As SDCERS completes computer system changes and passes transactional investigations to the City, SDCERS should share with the City the processes they have used to investigate these types of transactions.

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

I have concluded work on the City Contribution & Reporting Audit. Based on the audit work performed, I have determined the following:

The City is meeting objectives in the following areas:
- Census data
- Membership status and dates
- IRS compliance for retirees hired provisionally

Implementation of the recommendation contained in this Audit Report should assist SDCERS and the City in improving the transmittal file process.

APPENDIX A - AUDIT OBJECTIVES, SCOPE & METHODOLOGY

AUDIT OBJECTIVES

The objective of the audit was to evaluate accuracy and completeness controls over Member records and payroll data submitted by the City of San Diego and to verify the accuracy and adequacy of that information.

AUDIT SCOPE & METHODOLOGY

This audit was performed for the period from July 1, 2018 through June 30, 2019 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 – July 14, 2018 to July 27, 2018, and December 29, 2018 to January 11, 2019. For each employee selected:

- Traced pensionable 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, employer offset contributions, and code section 401(a)(17) limits.

➢ For the PPE July 27, 2018 and January 11, 2019, determined if SDCERS is receiving adequate information from the City to determine a Member's employment status (e.g. active or on leave) and whether SDCERS appropriately categorizes time as purchasable or non-purchasable, where applicable.

➢ Judgmentally selected 25 employees who were paid as of the PPE July 27, 2018 and January 11, 2019, but were not included on the associated transmittal file and determined if the employees were correctly classified as a Member or not.

➢ Judgmentally selected 25 employees who were paid as of the PPE July 27, 2018 and January 11, 2019 who had differing original versus rehire dates and determined if the employees were enrolled in the correct tier of the plan.

➢ Judgmentally selected 25 police employees who were paid as of the PPE July 27, 2018 and January 11, 2019 and who were hired after July 1, 2012 and determined if the employees were enrolled in the correct tier of the plan with the correct membership date.

➢ As of the last day of the audit period (June 30, 2019), matched the list of "Active" City employees to retired members per SDCERS. In addition, asked for a list of contracted employees (if available) and matched the list of contracted employees to the retired members per SDCERS. Ensure tax & policy compliance for retirees hired provisionally, where applicable.

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.

SDCERS
San Diego City Employees' Retirement System

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
MEMORANDUM

DATE: January 30, 2020

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 – City of San Diego Contribution and Reporting Audit for the Period July 1, 2018 – June 30, 2019

Finding #1: Both recommendations associated with the "Unknowns" finding correlating with the previously issued City of San Diego Contribution and Reporting Audit were outstanding during all or part of this audit's scope period of FY19. However, since SDCERS showed progress in reducing existing and newly created "Unknowns," the recommendations were closed in August of 2018 and 2019, respectively. This item has been included to provide a status update.

Recommendation #1: As SDCERS completes computer system changes and passes transactional investigations to the City, SDCERS should share with the City the processes they have used to investigate these types of transactions.

Response: Management agrees. A meeting with Department of Finance Payroll Division staff was held January 16, 2020 to discuss changes that have already been made and planned changes. As computer system changes are implemented SDCERS will schedule additional meetings with City staff.

Targeted Implementation Date: June 30, 2020