



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

DATE: February 24, 2021
TO: SDCERS Audit Committee
FROM: Sarah Dickson, Chief Internal Auditor
SUBJECT: Retirement Benefit Estimates and Calculations Audit

Enclosed is the Retirement Benefit Estimates and Calculations Audit Report. I would like to thank SDCERS staff for all of the assistance and cooperation provided during this audit. Their patience, valuable time and efforts spent is greatly appreciated, especially during these pandemic times.

CC: Gregg Rademacher, Chief Executive Officer
Marcelle Voorhies Rossman, Deputy Chief Executive Officer
Johnny Tran, Chief Compliance Officer/General Counsel
Cynthia Queen, Member Services Director
Phuong Nguyen, Benefits Administration Supervisor



Internal Audit Report

Retirement Benefit Estimates and Calculations

**Prepared by:
Sarah Dickson, Chief Internal Auditor**

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EXECUTIVE SUMMARY

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 a comprehensive range of member services to its nearly 20,000 active, retired and deferred members, including the administration of retirement, health, disability and death benefits. This audit focused on the administration of *retirement* benefits, including estimates provided to Members as they plan for retirement. SDCERS contains 28 tiers of benefits and each tier has unique eligibility rules and/or retirement benefit formulas which impact SDCERS administration of retirement benefits.

The audit objectives were to determine the effectiveness and efficiency of the retirement benefit estimates process, the reliability and integrity of retirement benefit calculations and whether retirement benefit calculations are compliant with plan documents for retirements occurring from July 1, 2019 through August 31, 2020. Based on the audit work performed, I conclude SDCERS has many controls in place to correctly calculate estimates and retirement benefits. Because of the controls in place, staff correctly calculated 100% of the retirement benefits paid.¹

However, we did identify the following areas where the process could be improved and/or the system of controls could be strengthened ultimately resulting in operational efficiencies:

- The review and approval process for retirement benefit estimates is manual rather than automated as it is for final benefit calculations and manual processes are more prone to error.
- IRIS' estimate warning flags are not complete and accurate.
- The Benefits Administration Division is creating an additional, unnecessary estimate just prior to calculating a Member's final retirement benefit, which potentially impacts IRIS' estimate warning flags.
- IRIS access to modify estimates is not appropriately restricted.
- Duplicate estimate records are included within Documentum.

Based on this audit, there were 5 recommendations and SDCERS Management agrees with all of them, except one which they partially agree with. Their responses, including anticipated completion dates, are included within the finding.

Internal Audit would like to thank all who participated in the audit for their time.

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.

¹ Based on audit sample. Only DROP entries and service retirements were tested. Refunds, required minimum distributions, and DROP exits were excluded from testing.

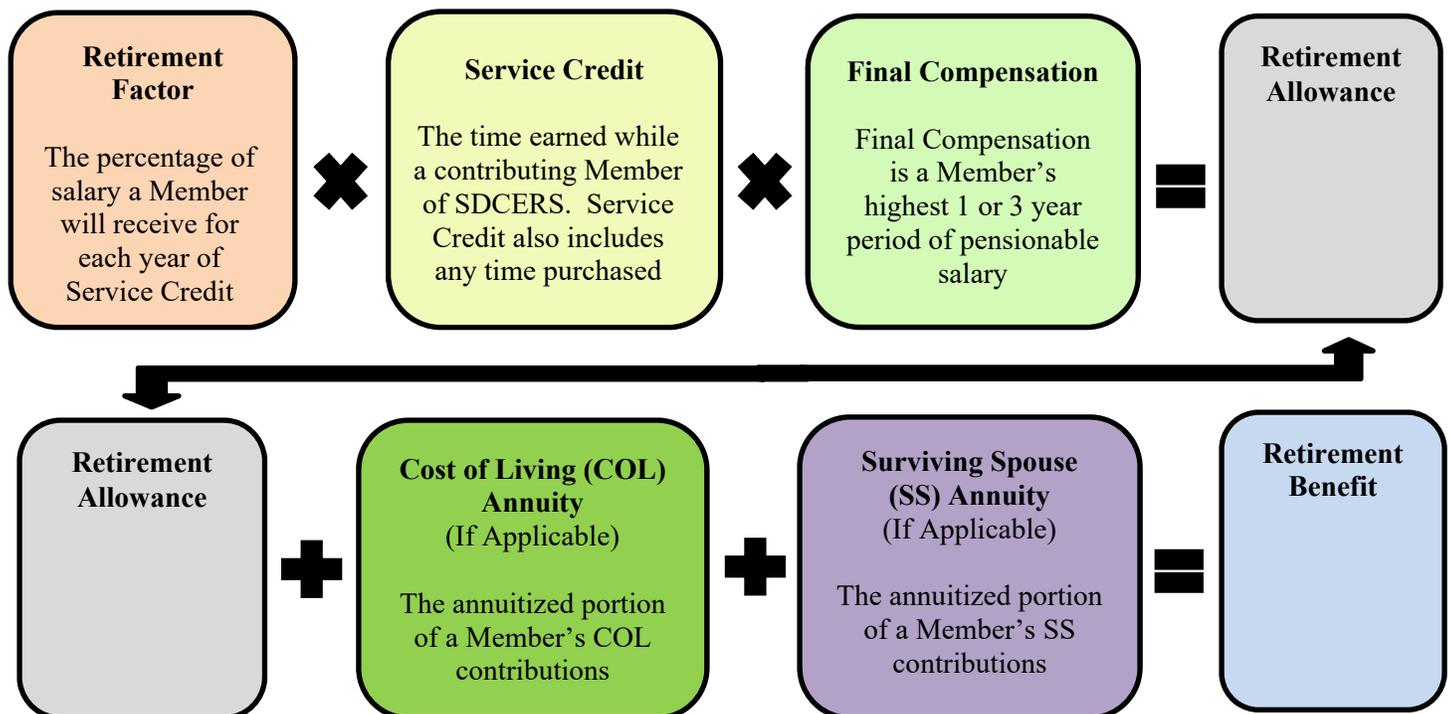
INTRODUCTION

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 a comprehensive range of member services to its nearly 20,000 active, retired and deferred members, including the administration of retirement, health, disability and death benefits. SDCERS contains 28 tiers of benefits and each tier has unique eligibility rules and/or retirement benefit formulas which impact SDCERS administration of retirement benefits. For the period from July 1, 2019 through August 31, 2020, there were approximately 850 retirement benefits calculated by staff.

SDCERS' Members Services (MS) Division oversees the retirement counseling process, where Members are counseled about his or her retirement options. During these counseling sessions, MS relies on estimated retirement benefit calculations produced by the Benefits Administration (BA) Division. However, the Counselors are allowed to change about five inputs in estimates without reaching out to BA for revisions. BA oversees the calculation and setup of all retirement benefits. SDCERS' pension administration system, IRIS, has several built-in controls which aid BA staff in estimating and calculating retirement benefits. For example, IRIS has the ability to alert staff of breaks in service and potentially incomplete contributions.

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:

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

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, strengths were identified, as well as issues that should be addressed.

Strengths Identified

SDCERS has many controls in place to correctly estimate and calculate retirement benefits. Most of these controls have been built into IRIS. IRIS assists staff in accurately calculating estimates by identifying breaks in service, pre-1997 Members, and potentially incomplete contributions. IRIS assists staff in accurately calculating retirement benefits by identifying any pensionable salary spikes, alerting staff to any breaks in service, calculating a Member's Final Average Salary, and repopulating a Member's eligible retirement factors. Additionally, every retirement benefit calculated by staff is reviewed by another individual. All of this combined contributed to the 100% accuracy rate as determined during testing.

The finding listed below should be addressed.

FINDING #1: RETIREMENT ESTIMATES

SDCERS' process for calculating retirement benefit estimates can be improved.

Priority Rating: Medium

BACKGROUND

When a Member is ready to retire, he or she calls SDCERS to set up a counseling appointment. This triggers a workflow within IRIS for the Benefits Administration (BA) Division to calculate a retirement estimate for the Member. Unlike final benefit calculations, IRIS does not require an independent approval of retirement estimates prior to finalization. Once BA completes the estimate, BA will complete the workflow within IRIS and a record of the estimate is included in IRIS. A Member Services' Counselor tasked with meeting the Member will review BA's estimate for reasonableness prior to the appointment. Once deemed reasonable, the Counselor will generate a copy of the estimate. IRIS will systematically create a paper copy of the estimate and also simultaneously creates a record of the same paper copy within Documentum under the Member's name. Estimates are then provided to Members prior to their counseling session. Management asserted the estimates provided to the Member are considered records.

During the counseling session, the Member sometimes wishes to change inputs into their estimates such as the retirement date, beneficiaries, lifetime options, and option percentage caps. Counselors are allowed and have access to change this information and provide the Member with a new estimate. These changes do not create a new record of the estimate within IRIS, rather, it modifies the existing estimate created by BA. If the Counselor creates a new paper copy of the estimate, a record will be included in Documentum. Any other input change requests must be performed by BA and then a revised estimate is provided to the Counselor during the counseling session.

BA's process narrative surrounding estimates require estimates relating to employees who terminated prior to 1997 to be reviewed prior to finalization. This review is a manual process documented via email. BA verbally asserted other types of estimates are reviewed if deemed more complicated, such as Members with blended benefits or benefit caps. Management also asserted that often judgement is used when determining whether to involve a supervisor.

Once a Member is ready to retire or enter DROP, BA calculates the Member's benefit. IRIS has been programmed to flag benefits that are greater than 5% different than the latest estimate within IRIS. This comparison excludes estimates if more than one was provided to the Member during his or her Counseling session. Furthermore, this comparison includes estimates created for actuarial purposes. This "5%" warning, in addition to other warning flags set up in IRIS, are reviewed by the benefit calculation creator to aid in ensuring the final calculation is correct.

FINDINGS & RISK STATEMENTS

- A. BA's process for independently² reviewing estimates is manual, via email, rather than automated as it is for final benefit calculations. Therefore, it is more difficult to determine who performed the review and when the review was performed. Furthermore, other than "employees terminated prior to 1997," management has not documented what other types of estimates are considered *complicated* and therefore require review. Therefore, it is more difficult to determine whether *all complicated* estimates were appropriately routed for review.

Manual processes versus automated processes increase the risk of error since manual processes are more prone to error. Furthermore, unclear expectations as to which estimates are *complicated* increase the risk that calculations are not elevated appropriately and are erroneous. Ultimately, providing erroneous estimates to Members increases the risk of reputational damage to SDCERS.

- B. IRIS' warning when a final benefit calculation is greater than 5% of the last estimate is incomplete and inaccurate. IRIS erroneously flagged two (2) out of 33 estimates tested; these estimates were NOT greater than 5% different than the benefit calculation but were flagged because an 'actuarial estimate' was compared to the final benefit calculation. One (1) out of 33 estimates tested were greater than 5% different, yet was not flagged by IRIS. Finally, IRIS does not have the ability to compare more than one estimate to the final benefit calculation to determine if the difference is greater than 5%. Often, more than one estimate is created by BA, more than one estimate is provided to a Member by the Counselors, or sometimes verbal estimates are provided by Counselors to a Member, but since IRIS can only calculate the difference between the 'latest' estimate, the flags are potentially misstated.

Incomplete and inaccurate warnings increase the risk that errors in benefit calculations will be missed and that necessary communications to a Member regarding his/her misstated estimate will not occur.

² 'Independently' reviewed means someone other than the preparer reviewed the transaction.

- C. Nineteen (19) out of 33 Members tested showed that a BA employee created an estimate just before calculating the Member's final benefit calculation. These estimates were typically created *after* the Member's counseling session yet just *before* the final benefit calculation.

Creating another estimate in IRIS just before creating the final benefit calculation increases the risk extra records will be maintained that are not necessary and that ">5%" warning flags are misstated.

- D. Testing of 33 Members showed estimates calculated by BA were not necessarily provided to the Member during his/her counseling session thus indicating potential inappropriate IRIS access. Two (2) out of 53 estimates were prepared by the Counselors themselves.³ One (1) out of 53 estimates had a difference that was caused by changes management asserted are not allowed to be made by Counselors (again, indicating potential inappropriate access). Additionally, through conducting fieldwork for this audit, the Internal Auditor has access to modify estimates within IRIS.

Inappropriate access increases the risk erroneous estimates will be created, communicated and retained.

- E. Documentum included Member estimates that were duplicative. Testing found 13 out of 33 Members had duplicative estimates or the same estimates with the exception of the estimate's date within his/her Documentum repository.

Retaining duplicates increases confusion as to which estimates were actually provided to the Member. Furthermore, retaining non-records takes up space on the network.

RECOMMENDATIONS

- A. i) BA should determine and document which estimate-types are "complicated," such as Members who were terminated before 1997, are subject to a cap, and/or are blended, and then re-configure IRIS to require a senior and/or supervisory review of these estimates prior to providing them to Members. Reviewers should not be at a level lower than the preparer.
- ii) The re-configuration should ensure IRIS retains evidence of who performed the review and when the review was performed.
- iii) As needed training should be provided to reviewers to ensure they understand the nuances of unique eligibility rules and retirement benefit formulas.

³ These two estimates, prepared by two different Counselors, were Counselors formerly in BA meant to be shared between BA and Member Services (MS). That said their BA-associated access was retained during this transition period. Management was aware of the associated access.

- B. BA should reconfigure IRIS so that all estimates provided to the Member and only estimates provided to the Member (e.g. the estimate records) are retained and compared to the final benefit calculation to determine if the difference is greater than 5%.
- C. Unless operationally necessary, BA should cease creating estimates just prior to the final benefit calculation.
- D. i) MS should define which estimate inputs can be changed by Counselors and then restrict all other inputs via IRIS access restrictions.
 - ii) Management should review user access to IRIS and ensure inappropriate access to modify benefit estimates is revoked.
- E. MS should revise the Counselor's process to ensure all and only estimates provided to the Member are included in Documentum (e.g. the estimate record or records). Accidentally created estimates should be deleted or flagged as such.

MANAGEMENT OWNER 1Ai, 1Aii, and 1Aiii: Benefits Administration

MANAGEMENT'S RESPONSE 1Ai: Management agrees with the recommendations. BA will update staff's procedure to document the uncommon benefit situations such as but not limited to; City members terminating before July 2000, Safety Unified Port Members terminating before January 2001, benefits exceeding the cap, or final average salary exceeding the IRC limit. A PIR will be logged to display validations in IRIS when these uncommon benefits arise instructing staff to escalate to a reviewer. Sending to a reviewer will remain at the discretion of the staff until the re-configuration in Aii is carried out.

MANAGEMENT'S RESPONSE 1Aii: IRIS will be reconfigured to display a validation when estimates for defined, uncommon benefit situations are created. The validation will require staff to submit estimates for approval, and IRIS will also be reconfigured to record which staff member submitted the estimate for approval, and the staff member who approved the estimate.

MANAGEMENT'S RESPONSE 1Aiii: Training will be provided on an as needed basis to help staff stay knowledgeable of uncommon benefits and how they are handled.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1Ai: August 31, 2021

MANAGEMENT'S ESTIMATED COMPLETION DATE 1Aii: June 30, 2022

MANAGEMENT'S ESTIMATED COMPLETION DATE 1Aiii: As needed

MANAGEMENT OWNER 1B: Benefits Administration

MANAGEMENT'S RESPONSE 1B: Management partially agrees with the recommendation. A PIR will be logged to stop system generated estimates used in the actuarial process from being used in the 5% comparison. However, IRIS is unable to compare multiple estimates generated and given to the member and this is not a feasible change. IRIS will continue to compare the latest estimate created by staff.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1B: December 31, 2021

MANAGEMENT OWNER 1C: Benefits Administration

MANAGEMENT'S RESPONSE 1C: Management agrees with the recommendation. Staff will stop creating estimates after the counseling appointment.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1C: January 31, 2021

MANAGEMENT OWNER 1Di and 1Dii: Benefits Administration and Member Services

MANAGEMENT'S RESPONSE 1Di and 1Dii: Management agrees with the recommendation. Benefits Administration and Member Services have identified six fields the Counselors can change on the benefit calculation screen. BA will log a PIR to create security resources for these six fields and assign them to the appropriate users. BA roles will be removed from two counselors and, in the interim, it has been communicated to the Counselors to only modify these six fields until the fix is completed.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1Di and 1Dii: August 31, 2021

MANAGEMENT OWNER 1E: Member Services

MANAGEMENT'S RESPONSE 1E: Management agrees with the recommendation. Member Services will create a procedure that will require the counselors to confirm after each appointment if any extraneous estimates are in the member file that were not provided to the member, and track any files to be purged. The current plan is to purge files weekly in one batch, but this may be modified once the procedure is finalized. This requires training for the counselors and the scanners.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1E: June 30, 2021

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 audit objectives were to determine the effectiveness and efficiency of the retirement benefit estimates process, the reliability and integrity of retirement benefit calculations and whether retirement benefit calculations are compliant with plan documents for retirements occurring from July 1, 2019 through August 31, 2020. Based on the audit work performed, I have concluded the following:

SDCERS has many controls in place to correctly estimate and calculate retirement benefits and most of these controls have been built into IRIS. Because of the controls in place, staff correctly calculated 100% of the retirement benefits paid for the selections tested.⁴ Process improvements to enhance the estimate process or strengthen estimate controls were identified and shared with management.

⁴ Only DROP entries and service retirements were tested. Refunds, required minimum distributions, and DROP exits were excluded from testing.

APPENDIX A - AUDIT OBJECTIVES, SCOPE & METHODOLOGY

AUDIT OBJECTIVES

The audit objectives were to determine the effectiveness and efficiency of the benefit estimates process, the reliability and integrity of retirement benefit calculations and whether retirement benefit calculations are compliant with plan documents.

AUDIT SCOPE & METHODOLOGY

This audit was performed for the period from July 1, 2019 through August 31, 2020 by using the following methods:

- Obtaining general background information (number of documents handled, dollars and source of funding, number of employees, etc.) regarding the process being audited.
- Obtaining Board Policies/Plan Documents over the process being audited.
- Obtaining any written policies and procedures utilized by staff to process transactions in the area being audited. 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 process transactions.
- Obtaining other documentation, such as brochures, financial statements, Actuary Reports, that may be helpful to gain a better understanding of the processes.
- Walking through transactions subject to auditing. This included interviewing staff responsible for processing transactions within scope to ascertain what job duties they perform, records they have access to, and authorization they have in order to determine if there are any issues that should be addressed.
- Haphazardly selecting 33 payees who first began receiving retirement benefits in Fiscal Year 2020 and July and August of 2020. For each selection determined⁵:
 - Estimates in IRIS prior to the counseling session agree with the estimate given to the Member (Support).
 - Estimates that are >5% different than the final benefit calculation are appropriately flagged by IRIS (Completeness/Accuracy)
 - Estimates, in general, appear reasonable.
 - Estimates are within 5% of actual benefits and for those that are not, investigate reasonableness (Accuracy).
 - Estimates included in Documentum appear to be records (e.g. estimates provided to the Member) (Records)
 - Estimates relating to pre-1997 deferred vested Members are independently reviewed by someone in BA (Review/Approval)

⁵ Population included City, Port and Airport retirees.

- Member meets the eligibility requirements for service retirement/DROP entry benefits based on the Plan Document (Compliance).
- Benefits are calculated accurately (Accuracy):
 - Recalculated FAS, service Credit, retirement % factor, retirement benefit, supplemental benefit (where applicable), COL Annuity, and SS Annuity (where applicable)
- Benefits agree with the Member's supporting application (Support).
- Application is appropriately signed by Member (Authorization).
- Supervisor reviews/approves the benefit calculation (Review/Approval).

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.