



SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

MEMORANDUM

DATE: September 25, 2023

TO: SDCERS Audit Committee

FROM: Sarah Dickson, SDCERS Chief Internal Auditor

SUBJECT: City of San Diego Pension Payroll Audit for the period July 1, 2021 through June 30, 2022

Enclosed is the Pension Payroll Audit for the period July 1, 2021 through June 30, 2022. 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.

I would like to thank the 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.

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Internal Audit Report

City of San Diego Pension

Payroll Audit

for the Period July 1, 2021 through June 30, 2022

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 about 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 determine whether the City complied with applicable sections of their Plan Document and SDCERS' Board Policies, and to validate completeness and accuracy of census data.¹

The City has procedures in place for the census data reported to SDCERS. Control strengths identified during the audit period from July 1, 2021 through June 30, 2022² include:

- Accurately and completely reporting all elements to SDCERS for all 25 randomly tested Members.
- Correctly establishing Membership for all 25 randomly tested employees.
- Ensuring provisional employees worked no more than 720 hours per fiscal year.

The following observations, however, were identified and should be addressed.

Misstatement of Pensionable Salary - High

Focused testing on City employees on Military Leave, salaried City employees on Industrial Leave, and City employees on out-of-class assignments found misstatements in pensionable salary reported to SDCERS.

Lack of Supporting Documentation for Provisional Employee - Low

Provisional retiree testing found one out of nine retirees did not have Appointing Authority pre-approval evidence that the retiree was required to be rehired due to special skills or knowledge.

Transmittal File Processing - Low

Based on review of multiple City transmittal files and based on interviews with City Payroll, the amount of time it takes to process transmittal files has increased. Although the influx of Proposition B Employees has definitely contributed, City Payroll indicated three key areas that continue to contribute: terminations mid-pay-period, transmittal file informational error 2042, and Police Recruit promotions to Police Officer mid-pay-period. These three areas require manual intervention/calculations, which lead to time delays in processing the transmittal file.

¹ See Appendix A for completed Audit Objectives, Scope and Methodology.

² Additional pay-periods were selected outside of this scope period for analytical purposes but most of the audit is covered by this scope period.

Based on this audit, there were five total recommendations all of which pertained to the City. The City agrees with all of the respective recommendations. Their responses, including anticipated completion dates, are included within each of the findings.

Internal Audit would like to thank the City and SDCERS Staff for their patience, 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 San Diego 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, 2022	June 30, 2021
Active Counts	5,555	5,068
Terminated Vested	2,935	2,847
Disabled	1,053	1,076
Retirees	8,420	8,265
Beneficiaries	1,556	1,517
Total City Members	19,519	18,773
Active Member Payroll	\$ 525,994,656	\$ 466,863,508
Average Pay Per Active	\$ 94,689	\$ 92,120
Benefits in Pay Status	\$ 595,762,444	\$ 574,870,826
Average Benefit	\$ 54,018	\$ 52,944

Source: SDCERS – City of San Diego Actuarial Valuation as of June 30, 2022

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 observations that should be addressed below and on the following pages.

Finding #1: Misstatements of Pensionable Salary

- A. Focused testing over City employees on USERRA Military Leave found two of four employees tested had their pensionable add-on pay excluded while on USERRA Military Leave. Also, when compensation cannot be determined with reasonable certainty (e.g. the Member consistently works variable hours or earns variable rates of pay), the City has not been reporting to SDCERS the average rate of compensation the employee received during the twelve months preceding USERRA Military Leave. Therefore, the City is not reporting what the Member would have been paid if the Member had continued to work for the City.
- B. **Management Identified** - Focused testing on salaried employees on Industrial Leave found that SAP is not correctly reporting pensionable salary when a salaried employee is on a partial period of Industrial Leave. For two out of two selections tested, pensionable salary reported was understated.
- C. **Management Identified** - Focused testing over City employees on OCA-time found that SAP is not consistently reporting percentage-based add-on pay. Two out of seven selections tested who received 80 hours of OCA pay had their associated percentage-based add-on pay calculated and reported at their non-OCA rate.

Priority Rating: High

BACKGROUND

Payroll Specialists within City Departments are responsible for completing Personnel Change Request (PCR) Forms to notify the Personnel Department (“Personnel”) of changes to their employee’s status (e.g. new hires, merit increases, terminations, etc.). Personnel is then responsible for inputting PCR information into SAP, the City’s system of record. All SAP inputs are reviewed to ensure completeness and accuracy by an independent Personnel Employee. Payroll Specialists enter most add-on pays into SAP, while Personnel is responsible for entering only a few add-on pays (e.g. *Bilingual pay*). SAP is programed to pull source data, such as salary and add-on pay, from tables in order to calculate and report pensionable salary and contributions to SDCERS via a transmittal file.

Uniformed Services Employment Reemployment Rights Act (USERRA) Military Leave

Rule 4.30 Cost of Service Credit in SDCERS’ Board Policies indicates the cost of service credit for USERRA covered military leave is the amount of employee contributions the Member would have paid if the Member had continued to work for the City, Port or Airport throughout their military leave. Employee contributions are based off pensionable salary.

USERRA regulations indicate the Plan Sponsor must determine the rate or rates of compensation the Member would have received but for the military-related absence. In order to determine the rate of compensation a Member would have received, a Plan Sponsor must analyze how many hours the

Member likely would have worked and how much the Member would have earned based on the Member's work history leading up to the military-related absence. If the compensation cannot be determined with reasonable certainty (e.g. the Member consistently works variable hours or earns variable rates of pay under a commission scheme), the Plan Sponsor is required to look at the average rate of compensation the Member received during the preceding 12 months. If the service member was employed less than 12 months prior to leaving for military service, the employer is required to determine the average rate of compensation during the period of employment immediately preceding the military service.

Advanced Post and *Two-Wheel* add-on pays are all considered pensionable wage types as is USERRA Military Leave.

Industrial Leave

Industrial leave is compensated leave while an employee is on a leave of absence. Industrial leave is an alternate to Workers' Compensation and details are included in the City's Administrative Regulation 63.00. Industrial leave is considered a pensionable wage type.

Out-Of-Class Assignments (OCA)

Out-of-class assignment means the temporary transfer of an employee to a vacant position or to a position where the incumbent of the position is unable to perform the duties thereof by reason of absence or disability. An eligible employee in an OCA position shall receive an increase equal to that which would be given if the employee were promoted to the same class (job) from an eligible list established by a promotional examination. OCA pay begins about one month after the employee has been in the OCA position. OCA pay is considered a pensionable wage type.

FINDINGS & RISK STATEMENT:

A. USERRA Military Leave related testing found:

- i. Two of four employees tested³ had their pensionable add-on pay excluded while on USERRA Military Leave. These two employees received *Advanced Post* and *Two-Wheel* add-on pays just before and just after their USERRA Military Leave.
- ii. When compensation cannot be determined with reasonable certainty (e.g. the Member consistently works variable hours or earns variable rates of pay), the City has not been reporting to SDCERS the average rate of compensation the employee received during the twelve months preceding USERRA Military Leave.

Consequently, the City is not reporting to SDCERS what the Member would have been paid if the Member had continued to work for the City.

- #### B. **Management Identified** - Focused testing on salaried employees on Industrial Leave found that SAP is not correctly reporting pensionable salary when a salaried employee is on a partial period of Industrial Leave. For two out of two selections tested, pensionable salary reported was

³ This was focused testing over City employees on USERRA Military Leave.

understated. Management asserted a system correction is in process, which will fix errors prospectively and retrospectively.

- C. **Management Identified** - Focused testing over City employees on OCA-time found that SAP is not consistently reporting percentage-based add-on pay. Two out of seven selections tested who received 80 hours of OCA pay had their associated percentage-based add-on pay calculated and reported to SDCERS at their non-OCA rate.

Misstated pensionable salary increases the risk of misstating the Member's high one-year salary calculation, the Member's calculated contributions and the Member's purchase service contracts.

RECOMMENDATIONS:

- A. City Personnel and City Payroll should work together to:
- i. Investigate the USERRA Military Leave error's root cause and rectify to ensure the rate or rates of compensation reported to SDCERS represents what the Member would have received but for the military-related absence. Ensure that in cases where compensation cannot be determined with reasonable certainty, the average rate of compensation the Member received during the twelve months preceding USERRA Military Leave is reported to SDCERS.
 - ii. Determine which employee data was incorrectly reported to SDCERS and communicate to SDCERS the Member accounts requiring correction.
- B. City Payroll should investigate the industrial leave error's root cause and rectify. Then Payroll should determine which employee data was incorrectly report to SDCERS and communicate to SDCERS the Member accounts requiring correction.
- C. City Payroll should investigate the out-of-class assignment error's root cause and rectify. Then Payroll should determine which employee data was incorrectly report to SDCERS and communicate to SDCERS the Member accounts requiring correction.

MANAGEMENT OWNER 1A: Personnel and Department of Finance

MANAGEMENT'S RESPONSE 1Ai: The City agrees with Recommendation 1Ai. The City will identify the USERRA Military Leave error's root cause and rectify to ensure employees' salaries are reported to SDCERS as if the employee was working and not on USERRA Military Leave. City employees that are participating members of SDCERS have work schedules such that the City can say with reasonable certainty what an employee's bi-weekly pensionable salary would have been but for the military-related absence.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1Ai: December 2023

MANAGEMENT'S RESPONSE 1Aii: The City agrees with Recommendation 1Aii. The City will determine which employee data was incorrectly reported to SDCERS and communicate to SDCERS the member accounts requiring correction.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1Aii: June 2024

MANAGEMENT OWNER 1B: Department of Finance and Risk Management

MANAGEMENT'S RESPONSE 1B: The City agrees with Recommendation 1B. The City previously identified the industrial leave error prior to the audit finding by SDCERS. The root cause has been identified and the correction is currently being tested to ensure that the City will transmit the correct pensionable salary information to SDCERS and to collect the correct retirement contributions from employees in the period of industrial leave. The City will determine which employee data was incorrectly reported to SDCERS and communicate to SDCERS the Member accounts requiring correction.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1B: December 2023

MANAGEMENT OWNER 1C: Personnel and Department of Finance

MANAGEMENT'S RESPONSE 1C: The City agrees with Recommendation 1C. While the City agrees there is an inconsistency of reported pensionable salary among employees' pensionable hours worked while in an OCA-position with percentage-based add-on pay, the City is uncertain whether the inconsistency is the result of a programming error or if there is a valid reason for the differences in reported pensionable salary in these cases. The City will investigate the root cause of the inconsistencies regarding transmitted salaries to SDCERS and rectify the reporting by applying consistent methodology between "pensionable wages" and "standard pension wage base". Due to large number of employees working OCAs (1,147 in 2022) and the de minimis delta of originally reported and corrected pensionable salary and employee contributions, it is not administratively feasible for the City to identify all potential inconsistencies with pensionable salaries related to OCAs. As a result, the City will apply any corrections when reporting pensionable salary for hours worked while in an OCA-position on a prospective basis only. Once implemented, the City will communicate/provide SDCERS with conforming pensionable salaries.

MANAGEMENT'S ESTIMATED COMPLETION DATE 1C: December 2023

Finding #2: Lack of Supporting Documentation for Provisional Employee

Provisional retiree testing found one out of nine retirees did not have Appointing Authority pre-approval evidence that the retiree was required to be rehired due to special skills or knowledge. Note that this provisional retiree was a renewal; he was a provisional employee in FY2021 as well as FY2022.

Priority Rating: Low

BACKGROUND

The City of San Diego’s Municipal Code Section 24.1001 indicates the following:

- (a) The City will not pay any person who has retired from City service under this Article for any services rendered as an officer or employee of the City, except as provided below:
 - (1) Reinstatement from Disability Retirement. A former City officer or employee who was granted a disability retirement under Division 5 of this Article, but is ordered back to work under section 24.0510, may return to paid City employment after his or her retirement benefits are terminated.
 - (2) Elected Officers. A retired City officer or employee may return to paid City service as an officer elected by the City’s electors.
 - (3) Provisional Employees. A retired City officer or employee may be employed for pay in a position that requires special skills or knowledge, as determined by the appropriate appointing authority, for no more than 720 hours per fiscal year. During this employment, the retired officer or employee will continue to receive his or her retirement benefits under this Article, but will not be an active Member of the System, will not accrue annual leave, and will not be eligible to participate in either of the City’s Supplemental Pension Savings Plans.
- (b) The City will not employ any retired person as a provisional employee under section 24.1001(a)(3) if the retired person received unemployment insurance compensation arising out of prior employment as a provisional employee under section 24.1001 (a)(3).

SDCERS’ Returning to Work After Retirement Policy mirrors the municipal code verbiage above.

To help facilitate compliance with (a)(3) above, the City requires Appointing Authorities to authorize rehiring provisional employees at a minimum before the start of the provisional employee’s position and in some cases requires annual renewals.

FINDING & RISK STATEMENT:

Provisional retiree testing found one out of nine retirees did not have Appointing Authority pre-approval evidence that the retiree was required to be rehired due to special skills or knowledge. Note that this provisional retiree was a renewal; he was a provisional employee in FY2021 as well as FY2022. Missing approval evidence increases the risk of non-compliance with the Municipal Code and the SDCERS’ Board Policy.

RECOMMENDATION:

City Personnel should implement a monitoring process to ensure retirees hired provisionally have pre-authorization documentation included within their personnel file prior to service initiation or continuance.

MANAGEMENT OWNER 2: City Personnel

MANAGEMENT'S RESPONSE 2: Agree. City Personnel will implement a monitoring process to ensure retirees hired provisionally have pre-authorization documentation included within their personnel file prior to service initiation or continuance.

MANAGEMENT'S ESTIMATED COMPLETION DATE 2: November 2023

Finding #3: Transmittal File Processing

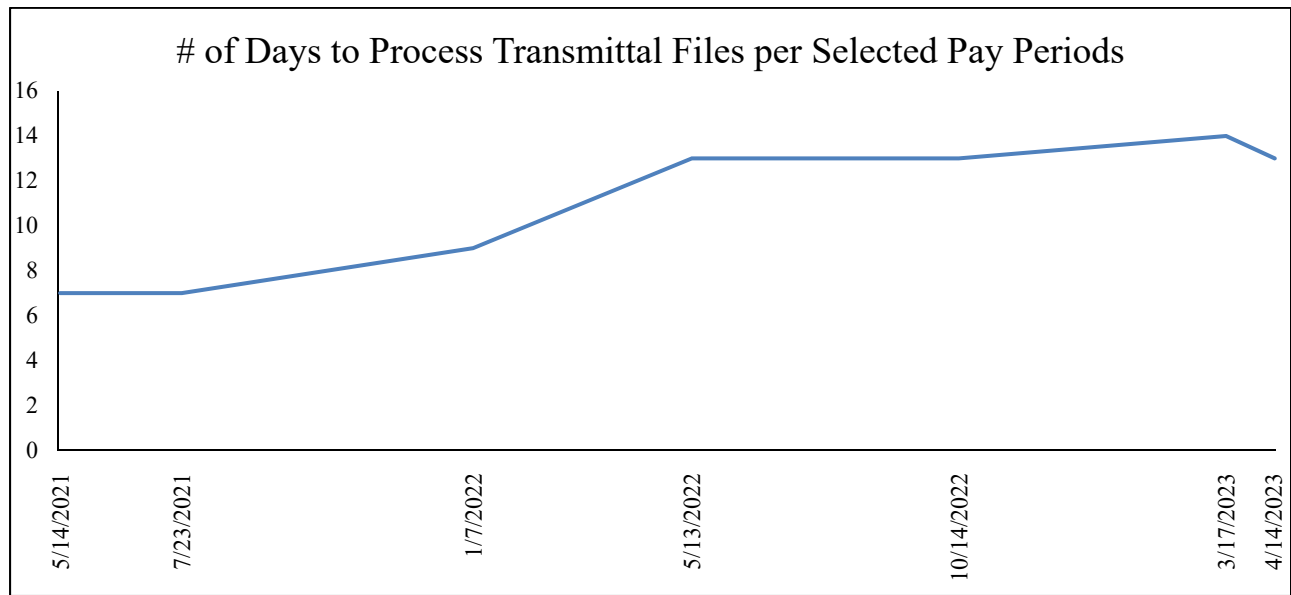
Based on review of multiple City transmittal files and based on interviews with City Payroll, the amount of time it takes to process transmittal files has increased. Although the influx of Proposition B Employees has definitely contributed, City Payroll indicated three key areas that continue to contribute: terminations mid-pay-period, transmittal file informational error 2042, and Police Recruit promotions to Police Officer mid-pay-period. These three areas require manual intervention/calculations, which lead to time delays in processing the transmittal file.

Priority Rating: Low

BACKGROUND

Every two weeks the City sends SDCERS a transmittal file containing information such as the 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 benefit.

Seven pay periods were reviewed to determine the amount of days it took to process and post the City's transmittal files. See the chart below.



The chart shows that the number of days it takes to process and post the transmittal file has nearly doubled.

FINDING & RISK STATEMENT:

Based on review of multiple City transmittal files and based on interviews with City Payroll, the amount of time it takes to process transmittal files has increased. Although the influx of Proposition B Employees has definitely contributed, City Payroll indicated three key areas that continue to

contribute: terminations mid-pay-period, transmittal file informational error 2042⁴, and Police Recruit promotions to Police Officer mid-pay-period. These three areas require manual intervention/calculations, which lead to time delays in processing the transmittal file. Manual intervention ultimately increases the risk of errors.

RECOMMENDATION:

City Payroll should determine if SAP can be programmed to pro-rate mid-pay-period terminations as well as mid-pay-period promotions from a Police Recruit to a Police Officer. City Payroll should work with other City Departments to determine if 2042 informational errors can be reduced.

MANAGEMENT OWNER 3: Personnel, Risk Management, and Department of Finance

MANAGEMENT'S RESPONSE 3: The City agrees with Recommendation 3. The City will investigate options for submitted salaries to consistently pro-rate mid-pay-period terminations and mid-pay-period promotions for which an employee becomes SDCERS membership eligible/ineligible. City will also research and, if feasible, rectify other nonautomatic reporting statuses (aka SDCERS IRIS informational error code 2042), such as: LTD, SLWOP – Job Saved and Name on List, Workers' Compensation, etc. so that manual work is reduced, and the risk of errors are diminished. It is the City's goal to automate processes where possible.

MANAGEMENT'S ESTIMATED COMPLETION DATE 3: July 2024

⁴ Informational error 2042 occurs when payroll details are missing for a non-terminated member; IRIS is expecting data for the Member, but information was not transmitted.

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 Payroll Audit. Based on the audit work performed, I have determined the following:

The City is meeting objectives in the following areas:

- Census data, including Membership dates
- Provisional employees working no more than 720 hours per fiscal year

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

APPENDIX A - AUDIT OBJECTIVES, SCOPE & METHODOLOGY

AUDIT OBJECTIVES

To determine whether the City complied with applicable sections of their Plan Document and SDCERS' Board Policies and to validate completeness and accuracy of census data.

AUDIT SCOPE & METHODOLOGY

This audit was performed mainly for the period from July 1, 2021 through June 30, 2022⁵ 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 10, 2021 to July 23, 2021, and December 25, 2021 to January 7, 2022. For each employee selected:
 - Compared the payroll records of the plan sponsor to data reported to SDCERS to determine whether the Plan Sponsor correctly reported compensation and earnings to SDCERS.
 - Reviewed pay rates reported to SDCERS and reconcile to plan sponsor salary records.
 - Reviewed records to determine if the following payroll elements were reported correctly: member date of birth, gender, date of hire, eligible date of membership, class of employee (misc., safety), plan code (2009 safety), date of termination, employment status, service period, member entry age, member contributions, employer contributions (for member offset only), and Code section 401(a)(17) limits (\$290K = Calendar 2021 & \$305K = Calendar 2022).
- For the pay period ending (PPE) July 23, 2021 and January 7, 2022, identified all DROP Members from each pay period that have partial hours reported (i.e., hours are less than 80) that were not hired or terminated during the pay period. Selected a sample and determined if the Member's Base Compensation and associated contribution was appropriate.
- Judgmentally selected employees on military or industrial leave (salaried employees only), employees that are firefighters who are at the end of their cycles, employees using COVID time

⁵ Additional pay-periods were selected outside of this scope period for analytical purposes but most of the audit is covered by this scope period. See the last bullet herein.

or employees on OCA and determined if the City is accurately and completely reporting pensionable salary.

- For the PPE July 23, 2021 and January 7, 2022, 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 categorized time as purchasable or non-purchasable, where applicable.
- Obtained the FY22 actuary payee file and queried SAP as of June 30, 2022, which shows active City employees as of that date. Conducted a match to determine who is on the actuary file in addition to the active payroll file and selected a sample. Tested to ensure compliance with IRS regulations, the Municipal Code and SDCERS' policies.
- Obtained a report of 1099's to individuals (not corporations) as of December 31, 2021 and joined to the FY22 actuary payee file. Determined if a Retiree is also working for the City of San Diego as a contractor and tested to ensure compliance with IRS regulations, the Municipal Code and SDCERS' policies.
- Selected various PPE's during FY2022 and also included PPE's ending pre and post Prop B Unwinding (for Phase I and Phase II employees) to determine how long it took to post a transmittal file. Interviewed City Payroll Department employees to determine which types of transmittal file issues required investigation. Analyzed for potential efficiencies.

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.