



THE CITY OF SAN DIEGO

DATE: November 16, 2018
TO: Audit Committee Members, Honorable Mayor and Members of the City Council
FROM: Kyle Elser, Interim City Auditor
SUBJECT: Performance Audit of the City's Annual Employee Compensation Reports

Results in Brief

Due to heightened interest in public employee compensation, in 2010 the State Controller's Office created the Government Compensation in California website to enhance government transparency and to have compensation data readily available to the public. The State of California (State) further instituted reporting standards requiring cities, counties, special districts, and state government to provide public employee compensation reports, which are then published on the State Controller's website for transparency.¹

Our objectives for this audit were to:

1. Assess whether the City of San Diego's reports comply with the State of California guidance and reporting standards; and
2. Assess the overall accuracy of the reports.

We found that the City of San Diego (City) has prepared and submitted annual employee compensation reports to the State of California for recent years, and publishes the reports on the City website. However, for employees who are members in the City's pension system, the San Diego City Employees' Retirement System (SDCERS), the City has not included the City's dollar contribution towards each employee's pension in these annual reports, preventing an accurate reflection of these employees' total compensation.

We estimated the missing component of employer contributions to average about \$7,900 per pension-eligible employee. When totaled up throughout the City, the amount omitted from the report is about \$52 million for 2017.²

¹ As discussed in the Background and Finding sections, the State guidelines describe certain types of compensation to be included in the compensation reports. For the rest of this report, we refer to the aggregate of these State-designated types of pay and benefits as "total compensation."

² The defined benefit plan contribution is paid directly to the employee sponsored retirement plan. While it is not received as employee compensation for the calendar year, it is earned during that year, and the State still requires the figure as part of the standard compensation reports for public employees.



Not including the employer contribution in the reports which the City provides to the State has several effects:

- The City is not fully complying with State reporting standards;
- Total compensation for pension-eligible employees is understated, obscuring public transparency;³
- Job seekers or other stakeholders may be conducting inaccurate compensation comparisons between the City of San Diego and other jurisdictions; and
- All else equal, City employees with 401(k)-style defined contribution retirement plans have the appearance of being more highly compensated than their traditional pension-plan peers.

The City's retirement plan group—SDCERS—does not break down employer pension contributions by position, and instead calculates the City's annual contribution as a lump sum for all pensioned employees. Without that information readily available, the Department of Finance submitted the reports to the State with the amounts omitted.⁴

We also performed some testing on the overall accuracy of the reports with respect to the other compensation figures, as well as whether reports included employees who had previously left the City etc. We did not find other issues with the accuracy of the reports. Aside from omitting the pension contribution, they are a useful tool that serves their intended purpose, which is to allow the public to monitor public employee compensation.

We recommend that the Department of Finance calculate the amount of employer contributions for retirement plans for each employee in the City using the most accurate methodology feasible. This figure should be included in future annual compensation reports submitted to the State, as well as corrected in the 2017 compensation report that the City has posted on its' website and submitted to the State. The Department agreed with both of our recommendations.

In addition, the reports, along with other personnel data maintained by the City, represent a rich source of information for the City to utilize to understand and analyze compensation throughout its workforce. The Office of the City Auditor may perform further investigation into compensation patterns among different job types and employee groups and issue a follow-up memo as appropriate.

³ As discussed in more detail later in the report, we did not find that the Department of Finance's intent was to obscure transparency when omitting the City's pension contribution from the reports. SDCERS does not break down employer contributions by position. Without this information readily available, the Department of Finance submitted the reports to the State without including the City's contribution amounts to each employee's pension.

⁴ Formerly the Office of the Comptroller. In Fiscal Year 2019, Financial Management and Office of the Comptroller were consolidated and renamed Department of Finance.

We would like to thank the Departments of Finance, Personnel, and Human Resources, as well as SDCERS and the City Attorney's office for their assistance and cooperation during this audit. The Audit staff responsible for this audit are Nathan Otto, Laura Reyes-Cortez, Andy Hanau, and Danielle Knighten.

Background

The City of San Diego has more than 11,000 employees, more than half of whom are members of the San Diego City Employees Retirement System (SDCERS), the City's pension system.^{5,6} In the interest of public transparency, the California Government Code requires the City to annually prepare and provide to the State a report showing each employee's total compensation, broken into various categories for wages, benefits, and others.⁷ The State guidelines describe certain types of compensation to be reported in the respective columns. For the rest of the report, we refer to the aggregate of these State-designated types of pay and benefits as "total compensation." **Exhibit 1** demonstrates the State-designated format and required fields for these compensation reports.

Exhibit 1:

Portion of the City's 2017 Compensation Report

Department	Classification	Annual Salary Minimum	Annual Salary Maximum	Total Wages Subject to Medicare (Box 5 of W-2)				Employer Contribution				
				Total Regular Pay	Over Time	Lump Sum Pay	Other Pay and FBP	Applicable Defined Benefit	Offset/EE Share of Pension	Defined Benefit Plan	Deferred Compensation Defined Contribution Plan SPSP-ER	Health, Dental, Vision
Police	Police Officer 2	62,837	75,941	74,771	12,682	5,646	20,170	2.5@50;2.6@	0	0	0	4,847
Library	Library Clerk	32,094	38,834	15,833	5,985	1,543	-516	1.0% @ 55	0	0	0	10,779
Development Set	Combination Inspctr 2	55,141	66,581	58,124	0	0	6,203	1.0% @ 55	0	0	0	4,971
Park & Recreation	Sr Zoning Investigator	55,182	66,851	65,652	0	0	10,636	1.0% @ 55	0	0	0	4
Development Set	Combination Inspctr 2	55,141	66,581	60,448	264	0	8,648	1.0% @ 55	0	0	0	3,126
Development Set	Development Project Man	57,866	69,722	67,326	0	0	10,372	1.0% @ 55	0	0	0	239
Library	Library Aide	20,925	25,106	14,371	0	0	4,753	N/A	0	0	1,158	0
Library	Library Clerk	32,094	38,834	16,721	0	0	19	N/A	0	0	1,003	0

Source: Calendar Year 2017 Compensation Report, Department of Finance.

⁵ In June 2012, City of San Diego voters approved Proposition B, which moved most new employees except sworn police officers from the SDCERS pension system to 401(k)-style retirement plans. However, employees who were already employed with the City prior to the passage of Proposition B remained members in their SDCERS pension plans.

⁶ A Defined Benefit (DB) pension is a retirement plan whereby an employee's payouts in retirement are defined: calculated according to length of service and their salary earned. The defined benefit plan contribution is paid directly to the employee sponsored retirement plan. While it is not received as employee compensation for the calendar year, it is earned during that year, and the State still requires the figure as part of the standard compensation reports for public employees. A Defined Contribution (DC) retirement plan also involves both the employee and the City making regular contributions into a retirement account, but the future benefits paid out to the retiree can vary based on investment earnings.

⁷ California Government Code 53891–53892: The [employee compensation reports] shall state all of the following: (l) The annual compensation of a local agency's elected officials, officers, and employees in accordance with reporting instructions developed by the Controller.

"Lump Sum Pay" includes one-time cash outs such as paid excess vacation/sick leave. "Other Pay" includes, but is not limited to, car allowances, meeting stipends, incentive pay, bonus pay, retention pay, hazard pay, bilingual pay, and on-call pay.⁸ The column titled "Offset/EE" is for employees' share of retirement contributions that is paid by the employer. The City of San Diego no longer makes these offset contributions.

The "Applicable Defined Benefit Pension Formula" column contains the defined benefit pension formula for employees under a defined benefit plan. State guidance states:

"If a formula is entered in this column, enter the employer contribution amounts in the 'Defined Benefit Plan – Employer's Share' column:

- Enter 'N/A' if the position does not have a defined benefit pension formula.
- If providing a formula entry, include a percentage representation and an age. (i.e. 2% @ 55)"⁹

The City's compensation reports from 2009–2017 can be found online at:
<https://www.sandiego.gov/finance/financialrpts/compensation>

⁸ The City may not offer each of these elements of compensation described by the State in the respective fields.

⁹ "2% @ 55" would generally mean, for example, that employee's annual pension would be for 2% of their highest compensation, multiplied by how many years of service they have with the City or other eligible pension plans, and that they could collect this no sooner than age 55.

Finding 1: The City's Annual Employee Compensation Reports Should Include City Contributions towards Employee Pensions, to Maximize Transparency and Fully Comply with State Reporting Standards

The City's Annual Employee Compensation Reports Do Not Include City Contributions towards Employee Pensions

The City of San Diego (City) has prepared and submitted annual employee compensation reports to the State of California (State) for recent years and publishes the reports on the City website. However, for employees who are members in the City's pension system, San Diego City Employees' Retirement System (SDCERS), the City has not included the City's dollar contribution towards each employee's pension in these annual reports, preventing an accurate reflection of these employees' compensation.

The reports contain individualized compensation figures for every employee in the City. The amounts are broken out into different types of compensation, such as regular pay; overtime; health, dental, and vision; and others. These compensation categories and format are dictated by the State. The State Controller's Office provides guidance for completing the reports, with explanatory instructions for each column.

As shown in **Exhibit 2**, however, the column of "Defined Benefit Plans" in the "Employer Contributions" section is listed as "0" for every employee.

Exhibit 2:

Excerpt from City of San Diego 2017 Compensation Report, with missing information circled

Department	Classification	Annual Salary Minimum	Annual Salary Maximum	Total Wages Subject to Medicare (Box 5 of W-2)				Applicable Defined Benefit	Employer Contribution			
				Total Regular Pay	Over Time	Lump Sum Pay	Other Pay and FBP		Offset/EE Share of Pension	Defined Benefit Plan	Deferred Compensation Defined Contribution Plan SPSP-ER	Health, Dental, Vision
Police	Police Officer 2	62,837	75,941	74,771	12,682	5,646	20,170	2.5@50;2.6@55	0	0	0	4,847
Library	Library Clerk	32,094	38,834	15,833	5,985	1,543	-516	1.0% @ 55	0	0	0	10,779
Development Services	Combination Inspctr 2	55,141	66,581	58,124	0	0	6,203	1.0% @ 55	0	0	0	4,971
Park & Recreation	Sr Zoning Investigator	55,182	66,851	65,652	0	0	10,636	1.0% @ 55	0	0	0	4
Development Services	Combination Inspctr 2	55,141	66,581	60,448	264	0	8,648	1.0% @ 55	0	0	0	3,126
Development Services	Development Project Manager	57,866	69,722	67,326	0	0	10,372	1.0% @ 55	0	0	0	239
Library	Library Aide	20,925	25,106	14,371	0	0	4,753	N/A	0	0	1,158	0
Library	Library Clerk	32,094	38,834	16,721	0	0	19	N/A	0	0	1,003	0

Source: Calendar Year 2017 Compensation Report, Department of Finance.

The employer contribution of a defined benefit plan is the amount paid by the City of San Diego towards an employee's pension retirement plan.¹⁰ Notably, the City does report contribution figures for those employees who have newer 401(k)-style defined contribution plans instead of traditional pensions.

Most other cities in California include the employer contribution to pension systems in their reports—96% of cities include this figure; San Diego is among the 4% which do not. In 2017, the average annual amount of this figure for each pension-eligible employee in other cities throughout California was about \$11,674.

State of California Reporting Instructions Require the City to Include Additional Compensation Information in the Reports

The State Controller's Compensation Reporting Instructions specifically require the employer's share of the pension contribution to be reported, stating:

"The intent of the Government Compensation in California report is to capture pay and benefit information for every compensated employee...

In the Defined Benefit Plan – Employer's Share column, enter the required employer contribution (dollar amount) paid by the employer towards the employee's defined benefit plan. This amount may or may not include payments made toward the retirement plan's unfunded liability. Each employer can determine how to proceed based upon what is most practical....

If a dollar amount is entered in this column, then enter the corresponding formula in the 'Applicable Defined Benefit Pension Formula' column:

- Use whole dollars only.
- *Enter zero if there is no employer contribution."*

The criteria say that the employer can decide if it is practical to report the unfunded actuarial liability (UAL or UAAL) as well as the normal payment when reporting the employer contribution of a defined benefit plan. The criteria do not say that the employer can decide to report nothing at all.

Omitting Compensation Information from the Reports Reduces Transparency and Hinders Comparisons

Not including the employer contribution in the reports which the City provides to the State has several effects:

¹⁰ The defined benefit plan contribution is paid directly to the employee sponsored retirement plan. While it is not received as employee compensation for the calendar year, it is earned during that year, and the State still requires the figure as part of the standard compensation reports for public employees.

- The City is not fully complying with State compensation reporting standards;
- Total compensation for pension-eligible employees is understated, obscuring public transparency;¹¹
- Job seekers or other stakeholders may be conducting inaccurate compensation comparisons between the City of San Diego and other jurisdictions; and
- All else equal, City employees with 401(k)-style defined contribution retirement plans have the appearance of being more highly compensated than their traditional pension-plan peers.

The City is not fully complying with State compensation reporting standards

The City has a duty to comply with State requirements, including those requiring public reporting of employee compensation, and is falling short of that obligation by excluding contributions to employee pensions from its annual compensation reports. The State Controller is authorized to audit the City if the required reports are not made in the required time, form, and manner or there is reason to believe that a report is incomplete, with the City being liable for reimbursing the State for the cost of the audit.

Total compensation for pension-eligible employees is understated, obscuring public transparency

Another effect of the omission is that public transparency is obscured. The production of the annual compensation report is intended to serve transparency by providing pay and benefit information for every compensated employee. By not including the employer contribution to employee pensions, total compensation for City employees who are members of the pension system is understated in the reports.

Transparent California is a website that uses the reports to publish employee compensation figures in a publicly-searchable database. However, when looking up employees working for the City of San Diego, Transparent California includes a disclaimer that "*the City of San Diego does not provide the cost of pension benefits on an employee level and, as such, the 'total benefits' value reported is incomplete and significantly understated.*" See the peach-colored box in **Exhibit 3**.

¹¹ As discussed in more detail later in the report, we did not find that the Department of Finance's intent was to obscure transparency when omitting the City's pension contribution from the reports. SDCERS does not break down employer contributions by position. Without this information readily available, the Department of Finance submitted the reports to the State without including the City's contribution amounts to each employee's pension.

Exhibit 3:

'Total benefits value is understated' disclaimer from Transparent CA

Police Officer (2017)

Note: The City of San Diego does not provide the cost of pension benefits on an employee level and, as such, the "total benefits" value reported is incomplete and significantly understated.

Regular pay:	\$75,941.00
Overtime pay:	\$15,047.00
Other pay:	\$19,587.00
Total pay:	\$110,575.00
Benefits:	\$19,006.00
Total pay & benefits:	\$129,581.00

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Source: <http://www.TransparentCalifornia.com>

As discussed in more detail below, we estimated individualized figures for employees throughout the City, adjusting for different retirement plans for the different types of employees.¹² We calculated the missing component of employer contributions to average about \$7,900 for pension-eligible employees. When totaled up throughout the City, the amount omitted from the report is about \$52 million for 2017. This represents approximately 6.9% of total compensation for affected employees.

¹² Retirement plans vary throughout the City, based on factors such as job type and date of hire. We took these factors into consideration in our estimate. See the Objectives, Scope, and Methodology section at the end of the report for further detail.

Job seekers or other stakeholders may be conducting inaccurate compensation comparisons between the City of San Diego and other jurisdictions

Aside from reduced public transparency, it is also possible that current employees or potential recruits to the City of San Diego are comparing compensation levels among jurisdictions, without fully realizing that this omission impacts the accuracy of comparisons between positions in San Diego and other jurisdictions.

The City does already report the applicable pension formula in the reports. However, since most other cities in California also include the employer dollar contributions, job seekers who research potential jobs with San Diego will see artificially low compensation figures.

As shown in **Exhibit 4**, the State Controller's website includes a tool allowing users to compare various compensation categories across jurisdictions. For calendar year 2017, this shows that the City's average contribution towards an employee's retirement and health benefits was only \$8,668—significantly lower than peer jurisdictions. However, when including the City's dollar contribution towards employee pensions, the City's actual average contribution for retirement and health benefits is several thousand dollars higher.

Exhibit 4:

Not including retirement contributions can make San Diego appear less competitive in employer comparisons

	Long Beach	Chula Vista	San Diego
Residents	478,561	267,503	1,419,845
Employees	6,364	1,383	12,493
Residents per Employee	75	193	113
Total Wages per Resident	\$935	\$360	\$572
Total Ret. & Health Cont. per Resident	\$313	\$87	\$76
Average Wages	\$70,339	\$69,687	\$64,985
Average Retirement & Health Contribution	\$23,558	\$16,885	\$8,668
Total Wages	\$447,639,208	\$96,376,813	\$811,857,231
Total Retirement & Health Contribution	\$149,920,452	\$23,351,357	\$108,286,263
Top 5 Highest Paid Positions	1. Battalion Chief \$316,038 2. Assistant Executive	1. Director Of Recreation \$298,010 2. Fire Battalion Chief (80 Hr)	1. Fire Battalion Chief \$323,377 2. Fire Captain

Source: California State Controller, Comparison tool.

The difference is even greater for higher-salaried employees. For a Police Officer 2—the City's most common position, and a position which the City has identified as a recruiting and retention priority—the missing component averaged about \$11,892 for an employee's reported compensation.

All else equal, City employees with 401(k)-style defined contribution retirement plans have the appearance of being more highly compensated than their traditional pension-plan peers

Another effect is that if a human resources analyst or other stakeholders were to use the information for analytic purposes, they would not be able to perform accurate calculations with respect to total compensation, since it is omitted.

For example, by the reports including employer contribution figures for employees with 401(k)-style defined contribution plans but not traditional defined benefit plans, it makes it appear that—all else equal—employees with defined contribution plans are more highly compensated.

Without the Pension Contribution Amounts Readily Available, the City Submitted the Reports without this Information

The City's retirement plan group—SDCERS—does not break down employer contributions by position, and instead calculates the City's annual contribution as a lump sum for all pensioned employees. Without information on individuals' compensation readily available, the Department of Finance submitted the reports to the State with the pension contribution amounts omitted.¹³

We spoke with an analyst at the State Controller who affirmed that usually individualized amounts of employer contributions are included in a city's submission. The analyst explained that the purpose of requiring the compensation reports is transparency, particularly given the compensation scandal in the City of Bell, California in 2010.¹⁴ Although the State performs some reliability checks on the data, it primarily focuses on collecting and publishing the employee compensation reports for the sake of transparency. Thus, the reporting agency (in this case, the City of San Diego) is primarily responsible to prepare and submit accurate reports.¹⁵

¹³ Formerly the Office of the Comptroller. In fiscal year 2019, Financial Management and Office of the Comptroller were consolidated and renamed Department of Finance.

¹⁴ A 2010 investigative report by the Los Angeles Times revealed very high levels of compensation for local officials in the City of Bell, California, including nearly \$800,000 annual compensation for its city manager.

¹⁵ Given this, we also performed some testing on the overall accuracy of the reports with respect to the other compensation figures, as well as whether reports included employees who had previously left the City etc. We did not find other issues with the accuracy of the reports. See the Objectives, Scope, and Methodology section at the back of this report for more details.

We found that the City can use information in SDCERS' Annual Valuation Reports (AVRs), along with data on employees' own contributions, to generate accurate estimates of the City's pension contribution for each employee.

For example, **Exhibit 5**, is an excerpt from SDCERS' 2016 AVR. An employee in the "Safety Police Old" plan contributes just slightly less than the City of San Diego to their pension—15.38% of their pay to the City's 15.64%.

The dollar amount of the City's contribution can be determined by taking this employee's own contribution, which is known, and adjusting it slightly higher, since the City's contribution is slightly higher. For the Police Officer shown in **Exhibit 3**, this results in an estimated City pension contribution of \$12,312, which was not included in this employee's reported compensation.¹⁶

Exhibit 5:

Example Calculation Using SDCERS' Actuarial Valuation Reports

SDCERS-CITY OF SAN DIEGO ACTUARIAL VALUATION AS OF JUNE 30, 2016										
SECTION IV - CONTRIBUTIONS										
Table IV-1 (cont.) SDCERS - City of San Diego Development of the City's Contribution as of June 30, 2016 for FY 2018 (dollars in millions)										
Safety										
	Weighted Total	Police Old	Police 2009	Police 2012	Police 2012 No COL	Police Prop B	Fire Old	Fire 2012	Lifeguard Old	Lifeguard 2011
1. Total Normal Cost Rate as of June 30, 2016	30.50%	31.02%	29.76%	29.93%	27.22%	27.26%	31.27%	31.69%	32.45%	31.50%
2. Member Contribution Rate as of June 30, 2016	14.92%	15.38%	14.42%	14.50%	12.07%	12.15%	15.63%	15.23%	15.94%	15.09%
3. Employer Normal Cost Rate as of June 30, 2016 (1-2)	15.58%	15.64%	15.34%	15.43%	15.15%	15.11%	15.64%	16.46%	16.51%	16.41%

Source: SDCERS/Cheiron City of San Diego, Actuarial Valuation Report as of June 30, 2016.

Even though this method may not account for all individualized nuances, this produces a much more accurate estimate than the "\$0" currently reported for all City employees. When necessary, other cities have estimated figures for compensation reporting. See the peach-colored box on the Transparent California report for Escondido in **Exhibit 6**, for example.

¹⁶ In this case, for example, the adjustment would be multiplying the employee's own contribution by (15.64%/15.38%) to determine the corresponding employer contribution. An employee in this plan who contributed \$12,108 over the course of the year would receive an estimated employer match of \$12,108*(15.64%/15.38%) = \$12,312.

Exhibit 6:

Example of Estimates in Compensation Reporting

The screenshot displays a web interface for viewing 2017 salaries for Escondido. At the top, it reads "2017 salaries for Escondido" in bold. Below this, it states "1,245 employee records found - Page 1 of 25". There are three links: "Download records", "View cost per resident, median pay and more", and "View all agencies". A search box is present with the text "Search within these records:" above it. The search box contains a text input field with "Name or job title", a dropdown menu with "2017", and a "Search" button. Below the search box, there is a note in a light orange box: "Note: Only part of the city's retirement costs were reported on an employee basis, as CalPERS now bills the debt portion separately. This necessitated estimation to capture the full cost displayed below."

Source: <http://www.TransparentCalifornia.com>

Recommendations

In order to improve transparency, and ensure the City of San Diego's compensation reports are complete, accurate, and in full compliance with State reporting requirements, we recommend:

1. As part of its upcoming annual compensation report, the Department of Finance should calculate and/or estimate the amount of employer contributions for employees in the defined benefit retirement plans using the most accurate methodology feasible. This figure should be included in future annual compensation reports submitted to the State. (Priority 3)
2. The Department of Finance should calculate and/or estimate the amount of employer contributions for each employee's pension retirement plan for calendar year 2017, resubmit the report to the State Controller, and provide clarifying notice to the State Controller and Transparent California. In addition, the Department of Finance should analyze the feasibility and value of resubmitting prior year reports, and further consult with the State Controller to determine if reports prior to the calendar year 2017 report should be updated as well. (Priority 3)

Conclusion

Accurate and complete reporting of employee compensation is important for several reasons. By calculating and including all required fields in its annual compensation reports, the City can ensure compliance with State reporting standards, increase transparency, and provide better information for more accurate comparisons and analysis.

In addition, the reports, along with other personnel data maintained by the City, represent a rich source of information for the City to utilize to understand and analyze compensation throughout its workforce. The Office of the City Auditor may perform further investigation into compensation patterns among different job types and employee groups and issue a follow-up memo as appropriate.

Respectfully submitted,



Kyle Elser
Interim City Auditor

cc: Kris Michell, Chief Operating Officer
Rolando Charvel, Chief Financial Officer
Stacey LoMedico, Assistant Chief Operating Officer
Ron Villa, Deputy Chief Operating Officer
Tracy McCraner, Director and City Comptroller, Department of Finance
Scott Clark, Chief Accountant, Department of Finance
Andrea Tevlin, Independent Budget Analyst
Ken So, Deputy City Attorney

ATTACHMENT A: Audit Objectives, Scope, and Methodology

In accordance with the Office of the City Auditor's Fiscal Year (FY) 2019 Audit Work Plan, we conducted a performance audit of the Department of Finance's Compensation Reporting. The overall objectives of this audit were to:

1. Assess whether the City of San Diego's reports comply with the State of California guidance and reporting standards; and
2. Assess the overall accuracy of the reports.

For the first objective, we reviewed guidance from the State of California (State) for how to compile and submit the reports, and also consulted an analyst from the State Controller's Office. We consulted with others—e.g. the Office of the City Attorney and several other California cities—regarding their interpretation of the guidance. We also researched and analyzed the State database of all California cities' compensation reports for benchmarking and comparison purposes.

To test the reliability of the data and to address the second objective, we physically observed an analyst who did not compile the original reports replicate the compensation reports for calendar years 2016–2017. We compared the replicated reports with the originals, and also with information for San Diego from the State's database.

Additionally, utilizing a separate dataset on City separations provided by the Personnel Department, we reviewed the Department of Finance's 2017 compensation report to ensure employees who left City employment in calendar year 2016 were not included in the report. Utilizing a master workforce SAP report of City employees as of January 2018, we also assessed whether the 2017 compensation report included all appropriate City employees who were presently employed at the time. We also requested and reviewed a formalized Work Instruction (1097) for guidance on separation of responsibilities and promoting institutional knowledge.

Our internal control testing was limited to the steps described above, in order to evaluate the completeness and accuracy of the City's compensation reports, based on the data in SAP.¹⁷ In addition, the City prepares an Annual Report on Internal Financial Control.¹⁸ This report includes topics such as control over payroll and transactions in SAP, and describes the control environment over these functions. We did not test these payroll and transaction controls as part of the limited scope of this project.

To generate the estimates of the City's pension contribution for each employee, we requested employees' listed retirement plans and employee contribution amounts from the Department of

¹⁷ SAP is the City's financial system.

¹⁸ The March 2018 Annual Report on Internal Financial Control is available at:
https://www.sandiego.gov/sites/default/files/annual_report_on_internal_controls_march_1_2018.pdf

Finance. We then used the San Diego City Employees' Retirement System's (SDCERS) Actuarial Valuation Report (AVR) as of June 2016 to determine the necessary adjustments to make to calculate the employer contribution.

Exhibit 7, is an excerpt from SDCERS' 2016 AVR that was used to determine the employer contribution. An employee in the "Safety Police Old" plan, for example, contributes just slightly less than the City of San Diego to their pension—15.38% of their pay to the City's 15.64%.

The dollar amount of the City's contribution can be determined by taking this employee's own contribution, which is known, and adjusting it slightly higher, since the City's contribution is slightly higher. In this case, for example, the adjustment would be multiplying the employee's own contribution by (15.64%/15.38%) to determine the corresponding employer contribution.

Exhibit 7:

Example Using SDCERS' Actuarial Valuation Reports

SDCERS-CITY OF SAN DIEGO ACTUARIAL VALUATION AS OF JUNE 30, 2016										
SECTION IV - CONTRIBUTIONS										
Table IV-1 (cont.) SDCERS - City of San Diego Development of the City's Contribution as of June 30, 2016 for FY 2018 (dollars in millions)										
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3. Employer Normal Cost Rate as of June 30, 2016 (1-2)	15.58%	15.64%	15.34%	15.43%	15.15%	15.11%	15.64%	16.46%	16.51%	16.41%

Source: SDCERS'/Cheiron's City of San Diego, Actuarial Valuation Report as of June 30, 2016.

Even though this method may not account for all individualized nuances, this produces a much more accurate estimate than the "\$0" currently reported for all City employees.

Using this method, we calculated individualized employer contributions, which when totaled across the City, amounted to \$52.3 Million for calendar year 2017. This figure compares to SDCERS' projected total of \$51.7 Million for FY18, as shown in **Exhibit 8**.

Exhibit 8:

Example Using SDCERS' Actuarial Valuation Reports

**SDCERS-CITY OF SAN DIEGO
 ACTUARIAL VALUATION AS OF JUNE 30, 2016**

SECTION IV - CONTRIBUTIONS

**Table IV-1
 SDCERS - City of San Diego
 Development of the City's Contribution as of June 30, 2016 for FY 2018
 (dollars in millions)**

	WEIGHTED TOTAL CITY	Non-Safety			
		Weighted Total	General Old Plan	General 2009 Plan	Elected
1. Total Normal Cost Rate as of June 30, 2016	24.28%	20.17%	20.47%	17.99%	37.47%
2. Member Contribution Rate as of June 30, 2016	11.84%	9.80%	10.02%	8.39%	9.05%
3. Employer Normal Cost Rate as of June 30, 2016 (1-2)	12.44%	10.37%	10.45%	9.60%	28.42%
4. Actuarial Liability	\$9,013.1	\$4,684.6	\$4,641.0	\$32.1	\$11.5
5. Actuarial Assets	\$6,455.4	\$3,364.0	\$3,333.6	\$22.1	\$8.3
6. Total Unfunded Actuarial Liability (UAL) (4-5) ¹	\$2,557.8	\$1,320.6	\$1,307.4	\$10.0	\$3.2
7. Preliminary FY17 UAL amortization ¹	\$261.3	\$140.2	\$138.8	\$1.1	\$0.3
8. <u>Negative Amortization Test for FY18</u>					
a. Total UAL on 6/30/16 less FY17 UAL payment	\$2,347.2	\$1,211.8	\$1,199.8	\$9.2	\$2.9
b. Interest on 8a. To 6/30/17	\$164.3	\$84.8	\$84.0	\$0.6	\$0.2
c. Preliminary FY18 UAL amortization (line 7)	\$261.3	\$140.2	\$138.8	\$1.1	\$0.3
d. Negative interest (8b - 8c, not less than zero)	-	-	-	-	-
9. Total FY18 UAL payment on 7/01/17 (8c + 8d)	\$261.3	\$140.2	\$138.8	\$1.1	\$0.3
10. Total FY18 UAL payment throughout year	\$270.3	\$145.0	\$143.5	\$1.1	\$0.3
11. Total Expected Payroll for FY18	\$427.0	\$248.1	\$213.8	\$34.1	\$0.3
12. FY18 Normal Cost paid throughout the year	\$53.5	\$25.7	\$22.3	\$3.3	\$0.1
13. FY18 Normal Cost paid at start of year	\$51.7	\$24.8	\$21.6	\$3.2	\$0.1
14. Administrative Expenses paid throughout the year	\$11.9	\$6.3	\$6.1	\$0.2	\$0.0
15. Determination of FY18 ADC %					
a. Employer Normal Cost Rate (12 divided by 11)	12.52%	10.35%	10.45%	9.60%	28.42%
b. UAL Rate (line 10 divided by line 11)	63.29%	58.43%	67.15%	3.22%	119.39%
c. Admin Expense Rate (line 14 divided by line 11)	2.79%	2.53%	2.85%	0.47%	5.43%
d. Total employer ADC % (15a + 15b + 15c)	78.60%	71.31%	80.45%	13.29%	153.24%
16. Determination of FY18 ADC dollars					
a. FY18 ADC if paid throughout year	\$335.6	\$177.0	\$172.0	\$4.5	\$0.4
b. FY18 ADC if paid at beginning of year	\$324.5	\$171.1	\$166.3	\$4.4	\$0.4

¹ See Table IV-2 for components of these amounts.
 Note: Numbers may not add due to rounding.

Source: SDCERS'/Cheiron's City of San Diego, Actuarial Valuation Report as of June 30, 2016.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.




THE CITY OF SAN DIEGO

MEMORANDUM

DATE: November 16, 2018

TO: Kyle Elser, Interim City Auditor

FROM: Scott Clark, Chief Accountant, Department of Finance
via Rolando Charvel, Chief Financial Officer 

SUBJECT: Management's Response to the Performance Audit of the City's Annual Employee Compensation Reports

The purpose of this memorandum is to provide Management's responses to the recommendations contained in the Office of the City Auditor's Performance Audit of the City's Annual Employee Compensation Reports. In addition, we would like to provide clarifying information regarding how defined benefit pension plans are funded.

The City Auditor's Report states that by omitting employer contribution amounts, the City is not reporting the full compensation **to the employee**. We disagree. City contributions to a defined benefit plan are not compensation to the employee. Under a defined benefit plan, the employee receives a defined amount at a future date based on a benefit formula (i.e. 2.5% per year of service at age 55). This deferred compensation is contingent on the employee vesting and reaching retirement age. The annual contributions to the City's defined benefit pension plan represent **the City's cost to fund the City's pension system (SDCERS)**.

Moreover, the amount of the annual pension contribution can vary significantly between agencies depending on the actuarial assumptions used to calculate the annual Actuarially Determined Contribution. Even when two employees from different agencies have the same defined benefit formula, more conservative actuarial assumptions result in higher contributions by the employer compared to those with less conservative actuarial assumptions. SDCERS has some of the most conservative assumptions in the State, resulting in higher contributions to the pension system by the City compared to other agencies. Conservative assumptions protect the City from financial risk and potential actuarial losses on assumptions. Therefore, comparing the employer contributions to a defined benefit plan between different Agencies can be misleading without understanding the underlying assumptions.

In the report, there are references to potential job seekers comparing employer contributions into defined benefit plans between agencies in order to evaluate total employee compensation. The City's contribution amount for each employee under a defined benefit pension plan varies due to age and time of entry into the pension system. For this reason and for the reasons explained above, we believe such comparisons would be misleading.

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What is most relevant when comparing defined benefit pension benefits provided by different agencies is the benefit formula and the pension eligibility requirements. The defined benefit formula for each employee has been consistently included in the City's Annual Compensation Report.

In contrast to defined benefit pension plans, comparing defined contribution plans, such as 401(k) style plans, between various agencies is appropriate because benefits typically vest immediately and the contributions themselves represent direct compensation to the employee. For example, an employee receiving a 9% contribution as a percent of their salary can easily be compared to a different agency providing a 6% benefit.

The City of San Diego is committed to compliance and public transparency in its financial reporting. The City is a national model for its financial practices and disclosure processes. Strong internal controls, process documentation, and accuracy in reporting have been the standard for over 15 years and will continue to be the top priority in financial reporting. The Department of Finance will note that the Employee Compensation Reports have been filed with the State Controller each year on time and without exception since the inception of the program.

The following summarizes the recommendations contained in this report and the Department's responses to these recommendations.

Recommendation 1: As part of its upcoming annual compensation report, the Department of Finance should calculate and/or estimate the amount of employer contributions for employees in the defined benefit retirement plans using the most accurate methodology feasible. This figure should be included in future annual compensation reports submitted to the State by the respective April 30 deadlines.

Target Implementation Date: April 30, 2019

Management Response: Management agrees with the recommendation. Department of Finance Staff will determine the most accurate and appropriate methodology to calculate and/or estimate the amount of employer contributions for defined benefit eligible employees for inclusion in the calendar year 2018 and future annual compensation reports submitted to the State Controller's Office.

Recommendation 2: The Department of Finance should calculate and/or estimate the amount of employer contributions for each employee's pension retirement plan for calendar year 2017, resubmit the report to the State Controller, and provide clarifying notice to the State Controller and Transparent California. In addition, the Department of Finance should analyze the feasibility and value of resubmitting prior year reports, and further consult with the State Controller to determine if reports prior the calendar year 2017 report should be updated as well.

Management Response: Management agrees with the recommendation. Department of Finance Staff will determine the most accurate and appropriate methodology to calculate and/or estimate the amount of employer contributions for defined benefit eligible employees for calendar year 2017 and resubmit the report with clarifying notice to the State Controller

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and Transparent California. In addition, the Department of Finance will consult with the State Controller's Office regarding resubmission of reports prior to calendar year 2017.

Target Implementation Date: June 30, 2019

We would like to thank the City Auditor for their work and cooperation during this audit. If you have any questions or comments, please contact myself or Sally Rubi, Financial Operations Manager, Department of Finance

Sincerely,



Scott Clark
Chief Accountant, Department of Finance

cc: Kris Michell, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Stacey LoMedico, Assistant Chief Operating Officer
Ronald H. Villa, Acting Assistant Chief Operating Officer
Rolando Charvel, Chief Financial Officer
Ken So, Deputy City Attorney
Tracy McCraner, Director and City Comptroller, Department of Finance
Sarah Mayen, Assistant Director, Department of Finance
Sally Rubi, Financial Operations Manager, Department of Finance