



Highlights

Highlights of OCA-12-002

Why OCA Did This Study

In accordance with the City Auditor's Fiscal Year 2011 Audit Work Plan, we conducted a performance audit of San Diego City Employees' Retirement System (SDCERS). The main objectives of the audit were: 1) determine whether SDCERS' expenses are comparable to other retirement systems and identify reasons for anomalies; 2) identify potential reductions to administrative costs and investment management fees; 3) determine whether SDCERS allocates its administrative and investment management expenses appropriately to each sponsor; 4) determine the efficiency and effectiveness of SDCERS' disability pension approval process; and 5) determine if SDCERS' actuarial assumptions are comparable to peers.

What OCA Recommends

OCA makes 12 recommendations to SDCERS and the City's Risk Management Department to strengthen operations and reduce costs. The recommendations to SDCERS include working with the City Attorney's Office to eliminate the cost of fiduciary insurance for board members; implementing business process improvements to streamline operations; reassess its mix of passive and actively managed investments. We also recommend that SDCERS ensures it adheres to its own policies and best practices and issue a Request for Proposal for actuarial services and an actuarial audit. Lastly, we recommend that the City's Department of Risk Management work with the City Attorney's Office to determine whether the City is required to reimburse high-income retirees for their Medicare Part B Income Related Monthly Adjustment Amount (IRMAA) and whether the City can offset Industrial Disability Retirement (IDR) benefits by income from outside employment and/or workers' compensation awards.

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San Diego City Employees' Retirement System

SDCERS' Unique Environment Increases Operating Expenses, but Cost-Cutting Opportunities Exist

What OCA Found

Our audit found that when compared to peers, SDCERS' administrative expenses—approximately \$15 million in fiscal year 2010—are higher, its plan funding level is lower, and actuarial assumptions are more conservative. However, the contentious history between SDCERS and the City uniquely impacts its current operating environment and leads to additional expenses for the system.

Specifically, we found that numerous, ongoing lawsuits have resulted in higher-than-peer legal and actuarial costs; efforts to maintain independence and transparent decision-making contribute to higher personnel, rent, and information technology expenses; and measures to protect its Board of Administration trustees if they are personally named in a lawsuit have resulted in a \$550,000 annual expense for fiduciary liability coverage. However, even after accounting for the uniqueness of SDCERS' operating environment, certain administrative costs still appear high compared to peers, and we noted that opportunities exist to streamline operations and reduce costs.

The City's retirement plan has the lowest funding ratio of any of its peers and its fiscal year 2010 ratio was below what many experts consider to be adequate. While the City underfunded the pension system for a number of years, it has fully paid its recommended contributions since 2006. However, the majority of the City's annual retirement cost is related to paying down the unfunded actuarial liability (UAL)—specifically the remaining balance of the June 30, 2007, UAL. SDCERS' trustees have adopted a number of actuarial methodologies and assumptions over the past five years to be more in line with peers and industry standards, and SDCERS now uses actuarial assumptions and methodologies that are more conservative than peers.

We found also that SDCERS' investment management expenses for fiscal year 2010 were higher than peers, largely because its investment portfolio was almost entirely actively-managed—as opposed to assets invested in passively managed funds, which carry significantly lower fees.

Lastly, we found that the City spent almost \$100,000 in fiscal year 2010 to reimburse high-income retirees for their Medicare Part B Income Related Monthly Adjustment Amount (IRMAA) premium even though this benefit is not explicitly defined in the Municipal Code. In addition, the City could reduce expenses if it offset Industrial Disability Retirement (IDR) benefits by income recipients receive from outside employment and/or a Workers' Compensation award.