



COUNCILMEMBER DONNA FRYE
City of San Diego
Sixth District

MEMORANDUM

DATE: April 20, 2007
TO: Jay Goldstone, CFO
FROM: Councilmember Donna Frye
SUBJECT: June 30, 2006 Actuarial Valuation

Donna Frye

This memorandum is in regard to the April 16, 2007 Cheiron Report to the San Diego City Council Concerning the City's June 30, 2006 Actuarial Valuation (**See attached page 6 - Why the Unfunded Actuarial Liability Decreased**). Specifically, it states that there was a \$22.8 million reduction in the unfunded liability due to the "*Proper treatment of IRS benefit limitations.*"

During the April 16 City Council meeting, I asked what happened to that liability and you stated that the liability was being transferred from SDCERS to the City. Please respond in writing to the following:

1. Please provide a copy of the relevant IRS Code Section(s) and an explanation for the intent of that/those code section(s).
2. Please describe this "Compliance Strategy" in detail. Please specifically address the following questions in your description:
 - a. It appears that this "Compliance Strategy" assumes the \$22.8 million unfunded liability no longer exists as a SDCERS pension benefit and therefore removes it from the SDCERS financial and actuarial statements, but at the same time the City intends to continue to recognize it as a pension benefit and pay for it. Is that a correct description? If not, please explain why not.
 - b. Currently the City and some of its employees are making pension contributions for future pension payments that apparently exceed IRS 415 legal limits. Those contributions are being invested in SDCERS which is a tax deferred 401(a) trust account. Does this "IRS Compliance Strategy" include the use of another tax deferred account?
 - c. Will this other account also be a 401(a) Trust?
 - d. Are the contributions for pension benefits that exceed the IRS 415 limits going to be deposited into this other tax deferred account?
 - e. Has the IRS agreed that the City and its employees may continue to make contributions to pay for benefits that exceed the 415 limits by simply depositing

those assets into this other tax deferred account thereby just shifting the assets and liability from the SDCERS pension account to this additional tax deferred account?

- f. How many defined benefit employee pension plans may the City of San Diego legally have?
 - g. Will we receive an Annual Actuarial Valuation for this additional pension plan? Who will prepare that valuation? Please provide the supporting actuarial schedule that forecasts the growth of this estimated \$22.8 million unfunded liability and corresponding annual required contributions over the 20 year fixed amortization period using the EAN methodology and please disclose the other actuarial assumptions used in the schedule (i.e. 8% discount rate, 4.25% salary inflation, etc.)
 - h. Will SDCERS administer this plan?
 - i. Will the annual required contributions to fund this \$22.8 million unfunded liability be subject to GASB disclosure requirements? If so, which GASB Statements?
3. Who made the decision to use this "Compliance Strategy"? Please provide any and all documentation related to it.
 4. Has the IRS approved of this "Compliance Strategy"? If so, please provide documentation from the IRS that states they have approved of this "Compliance Strategy."
 5. When did you first become aware of these IRS 415 violations?
 6. Did you make KPMG aware of this issue? If so, when?
 7. Has this issue, the corresponding unfunded liability and annual required contributions been properly disclosed in the 2003 CAFR? If so, on what page?
 8. Has this issue, the corresponding unfunded liability and annual required contributions been properly disclosed in the SDCERS 2003 and 2004 CAFRs?
 9. Who calculated the \$22.8 million unfunded liability number? Have you confirmed that number with the City's actuary? If not, do you intend to?
 10. Since this \$22.8 million unfunded liability results from defined benefit pension promises that are outside of the proper treatment of IRS 415 limitations how is it legal for the City of San Diego to simply assume that unfunded liability from SDCERS?
 11. Is this IRS 415 limit violation strictly created by the defined benefit pension payments or do the payments from the DROP accounts also contribute to the IRS 415 limit violation?
 12. How many employees are currently receiving pension benefits above what the IRS considers legal and/or are outside of benefit limitations? What is the average amount of benefits that are received per employee above the IRS limitations?
 13. Will this liability grow as more employees are added or have corrective actions been taken to prevent this from continuing? Is there any action (s) that the City Council should take to correct this?
 14. What is the dollar amount the City proposes to pay towards this unfunded liability in the 2008 budget? Where is the Annual Actuarial Valuation that supports that annual contribution amount?
 15. On what page of the proposed 2008 budget is the annual required contribution for this unfunded liability shown? (I believe that you referred me to page 133 of Volume II, but I cannot locate it.) Is the \$22.8 million unfunded liability shown in the budget or just the annual payment?

16. Is there any other information of which you are aware that is material that I have not asked you?

Thank you for your prompt response to the above concerns.

Cc: Honorable City Councilmembers
Honorable Mayor Jerry Sanders
City Attorney Michael Aguirre
Independent Budget Analyst, Andrea Tevlin
Greg Levin, Deputy Comptroller

DF/ks



Why the Unfunded Actuarial Liability Decreased

(\$ in millions)

1)	Investment performance.....	\$ 158.9
2)	Asset smoothing method.....	183.8
3)	Contributions greater than expected.....	105.6
4)	Liabilities growing less than expected.....	46.3
5)	Proper treatment of disability benefits.....	9.9
6)	Proper treatment of IRS benefit limitations.....	22.8
7)	Addition of "contingent" liabilities.....	(112.7)
8)	Expected growth in the UAL.....	(21.4)
	Total decrease in UAL	\$ 393.2