To: Honorable Mayor and Members of the City Council  
From: Ann-Marie Hogan, City Auditor  
Subject: Employee Benefits: Tough Decisions Ahead (Audit Report)  

RECOMMENDATION  
Request the City Manager to report back on or before September 27, 2011 on the adoption status of the City Auditor’s recommendations. Report back no later than September 2012 on the full implementation status.  

SUMMARY  
Government employee benefits represent a rapidly increasing cost to the City. This report addresses three of the City’s significant employee-benefit costs and their associated underfunded liabilities. The City of Berkeley must:  
  • Reduce today’s expenses and tomorrow’s liabilities.  
  • Ensure that significant changes to employee benefits are subject to an actuarial review.  
  • Make it a policy to take into consideration the costs to administer new and existing benefits.  
  • Increase transparency and reduce administrative costs by working to implement previous audit recommendations to simplify and standardize existing employee pay and benefits.  
  • Clearly communicate costs and liabilities to Council and the public.  

Council should adopt formal policies for negotiating, awarding, and monitoring employee benefits and benefit funding levels. Council should also adopt policies aimed at increasing the transparency of City benefits and compensation, to the extent consistent with existing law.  

FISCAL IMPACTS OF RECOMMENDATION  
The City’s employer-share of CalPERS is estimated to total $40.9 million by fiscal year 2016, which is an increase of $15.12 million over actual fiscal year 2010 payments. By fiscal year 2016, the cost to fully pay the annual required contribution for the Police Retiree Medical plan is estimated at $3.3 million.  

RATIONALE FOR RECOMMENDATION  
Implementing our recommendations will help reduce costs and increase transparency.  

CONTACT PERSON  
Ann-Marie Hogan, City Auditor (510) 981-6750  

Attachments:  
1: Employee Benefits: Tough Decisions Ahead (Audit Report)
Employee Benefits: Tough Decisions Ahead

Prepared by:

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Claudette Biemeret, Auditor II

Presented to Council November 16, 2010
## Employee Benefits: Tough Decisions Ahead

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Introduction

California taxpayers are increasingly concerned about the rising cost of doing business. Government employee benefits represent a rapidly increasing cost that is not well understood by the public. The City of Berkeley must:

- Reduce today’s expenses and tomorrow’s liabilities.
- Ensure that significant changes to employee benefits are subject to an actuarial review.
- Make it a policy to take into consideration the costs to administer new and existing benefits.
- Increase transparency and reduce administrative costs by working to implement previous audit recommendations to simplify and standardize existing employee pay and benefits.
- Clearly communicate costs and liabilities to Council and the public.

This report addresses three of the City’s significant employee-benefit costs and their associated underfunded liabilities.

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Funds Available</th>
<th>Future Liability</th>
<th>Shortfall</th>
<th>Amount Funded</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CalPERS</td>
<td>$843.76</td>
<td>$990.32</td>
<td>$146.56</td>
<td>85%</td>
</tr>
<tr>
<td>2. Police Retiree Medical</td>
<td>$4.73</td>
<td>$37.24</td>
<td>$32.51</td>
<td>13%</td>
</tr>
<tr>
<td>3. Sick Leave and Vacation Payout</td>
<td>$0.40</td>
<td>$17.12*</td>
<td>$16.72</td>
<td>2%</td>
</tr>
</tbody>
</table>

*$8.22 for public-safety personnel and $8.90 for all other employees.

Employee Compensation Costs: Salaries and Benefits

As with most service organizations, the City’s largest expense is labor costs. Over $123 million is budgeted for fiscal year 2011 salaries. Total employee compensation for the year, however, is budgeted at over $212 million. The difference? Workers’ compensation and employee benefit costs, including health insurance and retirement costs. (See also Appendix B)

Benefit costs are expected to increase sharply over the next five years. This means that if the City reduced salaries, total compensation costs could still rise. Even worse, compared to salaries, benefit costs are less predictable, less controllable, and less likely to be fully funded.
The complexity of the City’s pay and benefit structure has economic costs that have been discussed in previous audits and Council reports, such as the Citywide Payroll Audit and Fiscal Responsibility and Outstanding Audits: Policies, Problems, and Solutions report. On October 26, 2010, Council Members Gordon Wozniak, Linda Maio, and Darryl Moore recommended that City Council adopt a Resolution to include in the Council Labor Negotiation Policy a policy to standardize and simplify pay and benefits.

Complex pay and benefit rules make it difficult for decision makers to understand and explain the cost and value of total compensation. This prevents stakeholders from knowing how their money is spent and erodes trust in government. Decisions made on compensation should be informed, deliberate, and transparent.

Employee-Benefit-Related Liabilities

The City has nine benefit-related liabilities totaling more than $1.1 billion.¹ Overall, these liabilities are 77% funded ($869.13) and 23% unfunded ($252.81).

The City needs to closely monitor all of its benefit-related obligations, but three were chosen for this report because of size, unpredictable and uncontrollable future costs, or both.

1) CalPERS – The California Public Retirement System pension plan is by far the largest benefit cost and future costs are growing rapidly (see chart).

2) Police Retiree Medical – Payments are tied to increases in healthcare costs, which are difficult to predict and rising rapidly. There is no cap on this benefit and payments are not reduced when employees reach Medicare age.

3) Sick Leave and Vacation Payouts – Total costs are much smaller than CalPERS. The City uses a variation of a modified pay-as-you-go approach. Paying employees for unused leave at the end of their tenure may make salaries appear higher than they actually are.

¹ According to the “unfunded liabilities” section of the 2011 Budget Update (see page 19).
CalPERS: The California Public Retirement System pension plan (85% funded)

Berkeley’s employer-share contributions to the statewide pension fund, CalPERS, ranged from 16% of salary for most employees to 35.7% for police in fiscal year 2010. Required contributions totaled over $25 million.

<table>
<thead>
<tr>
<th>Classification</th>
<th>2010 Actual Rates</th>
<th>2016 Estimated Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Police (Sworn)</td>
<td>35.7%</td>
<td>50.8%</td>
</tr>
<tr>
<td>Fire (Sworn)</td>
<td>23.5%</td>
<td>43.5%</td>
</tr>
<tr>
<td>All Other Staff</td>
<td>16.0%</td>
<td>25.8%</td>
</tr>
</tbody>
</table>

Currently, the City is 85% funded. CalPERS is using a smoothing method to prevent sharp rate increases. This method will erode Berkeley’s 85% funded level unless the City sets aside additional funds to prevent the liability from increasing.

CalPERS sets the pension rates. Rapid rate increases are primarily caused by CalPERS investment losses. Recent changes in CalPERS demographic assumptions are also expected to increase the rates beyond current projections.

In September 2010, CalPERS reported that annual fund growth was better than they expected in fiscal year 2010. According to CalPERS, pension rates will still rise, but not as high as they would have without the investment gains. However, the City’s contracted actuary has expressed concerns over optimistic projections. It does not appear that one year’s investment results should change our analysis.

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2 According to experts, pension funding levels should not fall below 80%. “The Trillion Dollar Gap” by the Pew Center on the States discusses pension funding, explains typical funding practices, and discusses how most states are not adequately funding other benefits (post-retirement health).

3 Member contributions (whether paid by the employer or the employee) are in addition to the employer-share rates. Sworn Fire and Police assume responsibility for payment of the normal employee retirement contribution to CalPERS (9%).

4 As estimated by City staff with input from outside actuary.

5 CalPERS has instituted a “smoothing mechanism” to delay the impact of stock-market losses. Rather than hit members with significant spikes, CalPERS is gradually increasing retirement rates. This helps with current costs, but increases the unfunded liability. This strategy is typical in most states. See p. 27 of the PEW report: http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf
Estimated CalPERS Employer-Share Costs in Excess of Actual 2010 Payments\(^6\)
(in millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>All Funds</th>
<th>General Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$3.00</td>
<td>$1.72</td>
</tr>
<tr>
<td>2013</td>
<td>$6.92</td>
<td>$4.01</td>
</tr>
<tr>
<td>2014</td>
<td>$12.67</td>
<td>$7.43</td>
</tr>
<tr>
<td>2015</td>
<td>$14.01</td>
<td>$8.22</td>
</tr>
<tr>
<td>2016</td>
<td>$15.12</td>
<td>$8.88</td>
</tr>
</tbody>
</table>

In fiscal year 2010, the City’s employer-share CalPERS payments totaled $25.8 million. The chart identifies how much payments are estimated to increase over that amount based on the City’s projected CalPERS rates and fiscal year 2010 wages (salary changes were not taken into consideration). See scope and methodology.

Estimated Total Employer-Share CalPERS Payments Next Five Fiscal Years
(Based on 2010 Wages\(^7\))
(in millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Miscellaneous</th>
<th>Police</th>
<th>Fire</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$28.7</td>
<td></td>
<td>$4.2</td>
<td>$5.0</td>
</tr>
<tr>
<td>2013</td>
<td>$32.7</td>
<td></td>
<td>$9.2</td>
<td>$5.0</td>
</tr>
<tr>
<td>2014</td>
<td>$38.4</td>
<td></td>
<td>$10.5</td>
<td>$6.1</td>
</tr>
<tr>
<td>2015</td>
<td>$39.8</td>
<td></td>
<td>$10.8</td>
<td>$6.4</td>
</tr>
<tr>
<td>2016</td>
<td>$40.9</td>
<td></td>
<td>$11.0</td>
<td>$6.7</td>
</tr>
</tbody>
</table>

The chart identifies the estimated total payments based on the City’s projected CalPERS rates and fiscal year 2010 wages (salary changes were not taken into consideration). See scope and methodology.
To offset the costs of rising CalPERS rates, the City will need to make significant compensation reductions to future and/or current employees. With such high pension rates, in fiscal year 2016 salary reductions would have to range from 9% for police and 11.5% for fire, to 7% for all other employees just to absorb the CalPERS increases. The City may also have to reduce staff, but this may result in higher pension rates.

Options to consider for reducing the CalPERS employer-share costs:

1. Reduce salaries for future and/or current employees.
2. Require employees to contribute more for their benefits.
3. Move to a two-tiered pension system with a different benefit structure for new hires:
   a. Change the retirement formula by either increasing the eligible age, decreasing the percentage of salary paid in retirement, or both.
   b. Cap the amount of final salary used in the retirement calculation. This would help address the concern of spiking final salaries to increase pension benefits.
4. Reduce the number of employees. However, according to the Director of Human Resources, this may result in higher rates because of fewer active employees contributing to the plan.

The City can reduce the growing CalPERS unfunded liability by paying more than required.

Police Retiree Medical – 13% Funded
Future costs of the Police Retiree Medical plan are difficult to predict. The plan was negotiated in 1989 without first obtaining an actuarial valuation to identify the long-term effects. The benefit’s high costs make it unsustainable in its current form.

Retired police officers receive payments equal to the cost of Kaiser coverage at the two-party rate. This benefit continues for the life of the retiree and spouse. Unlike other post-retirement health benefits, payments continue at the full-coverage cost even after the retiree becomes Medicare-eligible. The benefit is paid as cash (taxable income), which is a disadvantage to the retiree. There is no limit to the City’s contribution for police retirees’ healthcare costs, which is a disadvantage to the City. Similar plans for other retirees cap the City’s contribution.

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According to the Director of Human Resources, one contributing factor to the City’s high CalPERS rates is the length of time the City of Berkeley has been in the program (non-sworn employees joined in March 1942 and sworn employees joined in January 1973). This has resulted in a high number of retirees receiving pensions. Each public agency participating in CalPERS receives its own CalPERS rates based on the assumptions and factors specific to that agency. One factor is the number of retirees receiving payments.

The Comprehensive Annual Financial Report refers to this benefit as the “Berkeley Police Retirement Income Benefit Plan.” This is because benefits are paid directly to the retiree and benefits are taxable.

According to the Director of Human Resources, since 1998, the City has performed an actuarial study prior to approving a significant new benefit.
The unfunded portion of this liability is growing. Budget constraints prevent the City from paying the annual required contribution.\textsuperscript{11} In fiscal year 2010, the City paid only $1.16 million of the $2.75 million contribution. Rapidly rising healthcare rates are also driving up the City’s costs.

Options to consider for reducing both the \textit{expense} and the \textit{liability}:

1. Reduce the number of police officers.
2. Restructure the plan to match other retiree plans: cap the City’s contribution and reduce the contribution when retirees reach Medicare age.

\textbf{Sick Leave and Vacation Payouts for all City Employees – 2\% funded}

The costs and liability for sick leave and vacation payouts are related to salary rates and to whether or not an employee uses all their earned leave during employment. Most employees may accrue 320 hours of vacation time and 1,600 hours of sick leave. Public safety personnel may accrue up to 360\textsuperscript{12} hours vacation time and have no cap on accrued sick leave hours. All unused vacation time is paid in full when an employee retires or resigns, but sick leave is not. For most employees, the maximum allowable sick leave payout is 50\% of time accrued.\textsuperscript{13}

Last year the City paid over $1.47 million to employees leaving the City for sick leave, vacation, and other related benefits. This is the smallest of the three liabilities discussed in this report in terms of dollars and its costs are more predictable and controllable than the others. At 2\%, it was one of the most underfunded liabilities in 2009.

Options: To decrease both \textit{expense} and \textit{liabilities} the City could:

1. Reduce the number of hours an employee may accrue.
2. Reduce percentage of sick leave hours that employees may receive in payouts.
3. Go to “use-it or lose-it.”

\textsuperscript{11} The annual required contribution is the amount the City is required to contribute for the year, calculated in accordance with certain parameters, in order to fund the liability over time.

\textsuperscript{12} Police may accrue up to 320 vacation hours and Fire may accrue up to 360 hours.

\textsuperscript{13} Actual payout of sick-leave time is a percentage of accrued time (from 38\% to 50\%), is based on years of service and/or number of hours accrued, and is dependent on whether the employee is retiring or resigning. In some cases, an employee’s entire sick leave balance is forfeited upon leaving the City.
Employee Benefits: Tough Decisions Ahead

Closing the Benefits-Liability Gap: General Fund and All Funds

In developing the fiscal year 2011 Budget Update, the City began with a $6.5 million deficit in the General Fund and a $16.2 million deficit in all funds. As a result, the City proposed cutting 77 positions to help close the budget gap. The use of some temporary measures, such as voluntary reductions in hours worked by some employees and voluntary early retirement by others, has helped some existing employees maintain their jobs until Spring 2011.

The ongoing pressure of increased costs was not eliminated. Without additional revenue, there will be more staffing and service reductions. CalPERS and Police Retiree Medical alone could increase the General Fund costs by $10.88 million by 2016:

**CalPERS Estimated Additional General Fund Expenditures**

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditures (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$1.72</td>
</tr>
<tr>
<td>2013</td>
<td>$4.01</td>
</tr>
<tr>
<td>2014</td>
<td>$7.43</td>
</tr>
<tr>
<td>2015</td>
<td>$8.22</td>
</tr>
<tr>
<td>2016</td>
<td>$8.88</td>
</tr>
</tbody>
</table>

**Police Retiree Medical Estimated Additional General Fund Expenditures**

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditures (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$1.75</td>
</tr>
<tr>
<td>2013</td>
<td>$1.84</td>
</tr>
<tr>
<td>2014</td>
<td>$1.84</td>
</tr>
<tr>
<td>2015</td>
<td>$1.94</td>
</tr>
<tr>
<td>2016</td>
<td>$2.00</td>
</tr>
</tbody>
</table>

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14 The chart identifies the estimated additional General Fund expenditures based on the projected CalPERS rates and fiscal year 2010 wages (salary changes were not taken into consideration). See scope and methodology.
15 The chart identifies the estimated additional General Fund expenditures, if the City paid the full annual required contribution for the Police Retiree Medical plan. See scope and methodology.
The two charts above identify only the projected CalPERS (all plans) and Police Retiree Medical expenditure increases. Combined, these benefits would increase General Fund costs an estimated $10.88 by fiscal year 2016. The majority of the General Fund Budget is for Police and Fire.

The table below illustrates that at least 63 full-time positions may have to be eliminated in fiscal year 2016 to address only the impact to the General Fund based on just these two benefits:

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City Auditor Recommendations

1. Council should adopt formal policies for negotiating, awarding, and monitoring employee benefits and benefit funding levels. This should include a policy to take into consideration the costs to administer new and existing benefits.

2. Council should adopt policies aimed at increasing the transparency of City benefits and compensation, to the extent consistent with existing law. This should include a policy to attempt to simplify pay and benefits rules, which could also reduce costs and complexity.

3. Budget reports should include some additional information on the analysis of funding levels for each employee-benefit. This includes detail and explanation for target funding ranges. For CalPERS, provide information on the possible need for additional funding. Changes in CalPERS demographic assumptions, as well as the smoothing mechanism used by CalPERS, are expected to result in a higher unfunded liability percentage. Incorporate this information into standard reports prepared for Council.

4. Formalize the policy to perform an actuarial study prior to approving a significant new benefit, as Human Resources states has been done since 1998. The City Manager should document exceptions.
5. Determine which employee benefits are the highest risk to the City and, if appropriate, perform actuarial valuations annually, rather than biennially.

*The City Manager agrees with the report and the recommendations. The recommendations will be adopted in principle by September 2011 and fully implemented by September 2012.*

Implementing these changes will require the courage and cooperation of elected and appointed officials, and City employees and their representatives.

We wish to thank the Director of Human Resources, the now former Budget Manager, the City Manager, and their staff for their time, cooperation, and responsiveness.
# Appendix A

## The City's Employee-Benefit-Related Liabilities (in millions)

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Funds Available</th>
<th>Amount Owed</th>
<th>Shortfall</th>
<th>% Funded</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. CalPERS (all plans) (as of 6/30/08)</td>
<td>$843.76</td>
<td>$990.32</td>
<td>$146.56</td>
<td>85%</td>
</tr>
<tr>
<td>2. Police Retiree Medical (as of 6/30/08)</td>
<td>4.73</td>
<td>37.24</td>
<td>32.51</td>
<td>13%</td>
</tr>
<tr>
<td>3. Sick Leave and Vacation Payout (as of 6/30/09)</td>
<td>0.40</td>
<td>17.12</td>
<td>16.72</td>
<td>2%</td>
</tr>
<tr>
<td>4. Workers' Compensation (as of 6/30/09)</td>
<td>8.28</td>
<td>21.19</td>
<td>12.91</td>
<td>39%</td>
</tr>
<tr>
<td>5. Non-Sworn Retiree Medical (as of 6/30/08)</td>
<td>5.45</td>
<td>22.13</td>
<td>16.68</td>
<td>25%</td>
</tr>
<tr>
<td>6. Fire Retiree Medical (as of 6/30/08)</td>
<td>3.46</td>
<td>9.34</td>
<td>5.88</td>
<td>37%</td>
</tr>
<tr>
<td>7. Safety Members Pension Fund (as of 6/30/09)</td>
<td>3.04</td>
<td>7.61</td>
<td>4.57</td>
<td>40%</td>
</tr>
<tr>
<td>8. SRIP I Disability (as of 6/30/08)</td>
<td>-</td>
<td>13.05</td>
<td>13.05</td>
<td>0%</td>
</tr>
<tr>
<td>9. Police Sick Leave Entitlement (as of 6/30/09)</td>
<td>-</td>
<td>3.92</td>
<td>3.92</td>
<td>0%</td>
</tr>
</tbody>
</table>

| Total                                | $869.12 | $1,121.92 | $252.80 | 77%     |

(a) CalPERS, Police Retiree Medical, and Sick Leave and Vacation Payout are discussed in this report.

(b) Workers’ Compensation is a significant expense and a significant liability for the City. Our recommendations for reducing these costs can be found in our audits. Consideration of a robust employee wellness program is one recommendation that could be more fully explored. Workers’ compensation costs are affected by the same steep increases in healthcare costs in general that are impacting the Police Retiree Medical costs.

(c) Non-Sworn and Fire Retiree Medical costs are capped. This makes it easier to predict and control future costs. Payments are also reduced when retirees reach 65.

(d) SMPF and SRIP I plans are closed to new members. According to the City Manager, the City’s position is not worsening and there are no actions the City may take to reduce costs. These are “sunk costs.”

(e) Police Sick Leave Entitlement is the smallest dollar amount of the nine but the cost is growing rapidly due to rising healthcare costs.

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16 CalPERS issues actuarial reports approximately one and a quarter (1 ¼) years after the valuation date. For example, CalPERS will issue of the City’s actuarial valuations as of June 30, 2009 in Fall 2010.

17 Although included in the unfunded liability (employee benefits) table, workers’ compensation is not a true employee benefit. It is state mandated insurance that all employers must have to address on-the-job injuries.
### Appendix B

**Salary vs. Compensation – The Total Benefit Package**

The following illustrates the estimated difference between average annual mid-range salaries and average annual compensation (salary plus benefits) for various City employees in fiscal year 2011. *The salaries do not include overtime, which can significantly increase costs for public-safety personnel and solid-waste workers.*

<table>
<thead>
<tr>
<th>Position</th>
<th>Salary</th>
<th>Benefits (% of Salary)</th>
<th>Total Compensation</th>
<th>Workers’ Comp (% of Salary)</th>
<th>Total Labor Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Police Officer</strong></td>
<td>$105,941</td>
<td>60.64%</td>
<td>$170,184</td>
<td>8.46%</td>
<td>$179,147</td>
</tr>
<tr>
<td><strong>Solid Waste Truck Driver</strong></td>
<td>$66,336</td>
<td>55.25%</td>
<td>$102,985</td>
<td>17.43%</td>
<td>$114,547</td>
</tr>
<tr>
<td><strong>Community Services Officer</strong></td>
<td>$62,172</td>
<td>55.25%</td>
<td>$96,521</td>
<td>8.32%</td>
<td>$101,693</td>
</tr>
<tr>
<td><strong>Firefighter/Transport Paramedic</strong></td>
<td>$100,849</td>
<td>48.73%</td>
<td>$149,993</td>
<td>8.68%</td>
<td>$158,747</td>
</tr>
<tr>
<td><strong>Office Specialist II</strong></td>
<td>$53,688</td>
<td>55.25%</td>
<td>$83,349</td>
<td>2.21%</td>
<td>$84,536</td>
</tr>
<tr>
<td><strong>Registered Nurse</strong></td>
<td>$88,956</td>
<td>55.25%</td>
<td>$138,102</td>
<td>2.21%</td>
<td>$140,068</td>
</tr>
</tbody>
</table>

18 In fiscal year 2010, citywide overtime pay totaled $6,947,722 (salary only) of which $4,772,503 (69%) was directly attributable to public-safety personnel. Another $1,031,097 (15%) was for solid-waste workers.

19 Sworn Police and Fire take-home pay is reduced by 9% because they assume responsibility for payment of the normal employee retirement contribution to CalPERS. Total labor costs include only what the City pays.
The City benefit costs included in the average labor costs above include CalPERS and Workers’ Compensation:

<table>
<thead>
<tr>
<th>Projected CalPERS Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Misc</td>
</tr>
<tr>
<td>Police</td>
</tr>
<tr>
<td>Fire</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Budgeted Fiscal Year 2011 Workers’ Compensation Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Staff</td>
</tr>
<tr>
<td>----------------</td>
</tr>
<tr>
<td>2.21%</td>
</tr>
</tbody>
</table>

Some other benefit costs include retiree medical, sick leave and vacation payouts, healthcare, and dental.

The question of whether compensation in local government is comparable to private sector continues to be explored and debated, since various studies have reached very different conclusions. Any lack of transparency in the true cost of benefits can only exacerbate these differences of opinion.

Employees of state and local government earn an average of 11 and 12 percent less, respectively, than comparable private-sector employees, according to a report commissioned by the Center for State and Local Government Excellence and the National Institute on Retirement Security. This April 2010 study concludes that this is true even when benefits are included and when data is standardized for known determinants, such as education and job location. A competing web post on the Reason Foundation website suggests that, even though government workers may be more highly educated, government might simply be hiring overqualified workers.

On October 19, 2010, the San Francisco Chronicle reported that a study conducted by economists at UC Berkeley and Rutgers University found similar total compensation levels for private- and public-sector employees in California. Public-sector employees were paid 7% less, but the value of their benefits was 6% more. The study also concluded that professionals were paid more in California private-sector than public sector, and non-professionals were paid more in public- than in private-sector.

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20 Office staff would be, for example, an Accountant or an Office Specialist.
21 A field worker would be, for example, a Building Inspector or a Community Service Officer.
22 A laborer would be, for example, a Solid Waste Worker or an Electrician.
23 [Report](http://www.slge.org/vertical/Sites/%7BA260E1DF-5AEE-459D-84C4-876EFE1E4032%7D/uploads/%7B03E820E8-F0F9-472F-98E2-F0AE1166D116%7D.PDF)
25 [Article](http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2010/10/19/MNUJ1FUAOH.DTL&tsp=1)
Appendix C

The General Fund

The General Fund is the City’s primary operating fund. It is not connected to any one revenue source and may be used at the City’s discretion.

In fiscal year 2011, the City budgeted over $319 million for expenditures, which included $146 million in General Fund expenditures. Labor costs are the primary General Fund expenditure ($110 million). The majority of General Fund expense is for Public Safety, since other operating departments (such as Public Works and Parks) are primarily, or partially, funded by grants or by dedicated revenue that may only be used for specified purposes.

Total City Budgeted Expenditures – $319 Million
Fiscal Year 2011

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26 This budgeted figure is adjusted for dual appropriations, which are revenues generated by one fund and transferred to another fund. Budgeted expenditures, per the Budget Update, totaled $370 million and included these fund transfers.
Appendix D

Scope and Methodology

Our initial objective was to prepare an easy-to-read informational report addressing the City’s top three underfunded liabilities (employee benefits). After completing some survey work, we decided to expand our objective and illustrate the impact these liabilities have on budgeting and staffing due to the annual benefit costs, and provide possible solutions to address the cost pressures.

We reviewed financial, budget, and actuarial-valuation reports and budget summary source documents for reasonableness and consistency. We researched data that needed additional explanation but we did not audit the accuracy of these reports or source documents. We did not thoroughly analyze the assumptions used in the actuarial valuations. Our reviews were not intended to provide absolute assurance that all data are free from error. Rather, our intent was to provide reasonable assurance that the reported information presented a fair picture of the City’s underfunded liabilities and annual costs (employee benefits). The numbers presented in this report are rounded for ease of use and reporting.

Specifically, we used the following sources and met with the following personnel to meet our objective:

- Fiscal Year 2011 Mid-Biennial Proposed Budget Update
- Fiscal Year 2011 Average Fringe Benefit Rates
- Fiscal Year 2009 Comprehensive Annual Financial Report
- June 30, 2008 Actuarial Valuations for CalPERS (Misc, Police, and Fire)
- June 30, 2008 Actuarial Valuations for Retiree Medical Plans (Misc, Police, and Fire)
- Union Agreements
- Budget Manager
- Human Resources Director
- Finance Director

We also communicated with Payroll, Human Resources, and Budget staff; reviewed articles and reports related to salaries and pension; performed SunGard HTE\(^{27}\) payroll inquires; and obtained the following: workers’ compensation code classifications; actual fiscal year 2010 CalPERS payments; actual fiscal year 2010 CalPERS rates; fiscal year 2010 sick leave and vacation summary schedule.

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\(^{27}\) The City’s financial and work management system.
To illustrate the impact of CalPERS increases and paying the full Police Retiree Medical contribution we assumed 1) no changes to actuarial assumptions; 2) no salary changes; and 3) no changes in staffing levels. The calculations are as follows:

**CalPERS General Fund Costs** – fiscal year 2010 PERS-able\(^{28}\) wages were multiplied by the City’s projected CalPERS rates from 2012 to 2016 to estimate future costs. The actual fiscal year 2010 CalPERS payments were subtracted from these estimates. The difference was multiplied by an estimated percentage of salaries paid through the General Fund.

**Police Retiree Medical** – the actual Police Retiree Medical Plan contribution paid by the City in fiscal year 2010 was subtracted from the annual recommended contribution, per the actuarial valuation, for fiscal years 2012 to 2016. The difference was multiplied by an estimated percentage of salaries paid through the General Fund.

We also performed the following calculations to support the values and figures used in our report:

**Employee Count** – To estimate the number of full-time employee positions (63) that $10.88 million could pay for, we first estimated the average labor costs for miscellaneous, police, and fire employees. We based average labor costs on the fiscal year 2011 average salaries and average fringe benefit rates provided by the Budget Office. We used those three averages to estimate the overall City average of $172,365. We took that number and divided it into the fiscal year 2016 estimated impact of CalPERS increases (General Fund only) and paying the full Police Retiree Medical contribution (General Fund only).

**CalPERS Total Costs** and **Cost Growth** – To estimate the total costs, we multiplied fiscal year 2010 PERS-able wages by the City’s projected rates from 2012 to 2016. To estimate the cost growth, we took the actual fiscal year 2010 CalPERS payments and subtracted them from these estimates.

**Salary Reductions** – To estimate the percentage of salary reduction necessary to offset CalPERS rate increases, we first estimated the average monthly labor costs for police, fire, and miscellaneous employee groups. We based the average labor costs on the fiscal year 2011 average salaries and average fringe benefit rates provided by the Budget Office. We then took the average monthly labor costs and made adjustments for CalPERS increases (based on projected rates). We made no changes to other fringe benefit rates (e.g., retiree medical and workers’ compensation). We then calculated the amount of decrease necessary to offset increased CalPERS rates.

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\(^{28}\) The following is excluded from the CalPERS calculations: overtime pay and any related add pay attached to overtime; lump-sum payment, such as termination payout of unused leave and excess sick leave; cash in lieu of benefits and tool and shoe allowances; SDI and non-public safety workers’ compensation payments (except the leave coordinated portions); and military leave.
Average Mid-Range Salaries and Labor Costs by Classification – We obtained average monthly salaries for specific job classifications from Union agreements and calculated annual salaries. We multiplied the salaries by the fringe benefit rates provided by the Budget Office to estimate labor costs. For police, we obtained the average “add” pay of 5% from a Payroll representative and included that percentage increase in the average salary calculation.

Prior to issuance of this report, the Audit Manager, Teresa Berkeley-Simmons assumed the position of Budget Manager. All Budget Office information was provided by the now former Budget Manager, Tracy Vesely, or her staff.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform our audit to obtain sufficient and appropriate evidence that provides a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides reasonable basis for our findings and conclusions, based on our audit objectives.

This report was initiated by the Auditor’s Office and scheduled as part of the fiscal year 2011 Audit Plan presented to Council on June 29, 2010.