



Office of the City Auditor

**Report to the City Council
City of San José**

**EMPLOYEE BENEFIT FUND
ADMINISTRATION:
OPPORTUNITIES EXIST TO
IMPROVE CONTROLS**

**Report 19-02
March 2019**

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March 14, 2019

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Employee Benefit Fund Administration: Opportunities Exist to Improve Controls

The City of San José offers various benefits to eligible full- and part-time employees and their dependents. The Human Resources Department's (HR) Employee Benefits Division administers many of these benefits, including medical, dental, vision, unemployment, life insurance, and various other benefit programs. The Benefits Division establishes and monitors contracts with benefit providers, ensures benefit payments to the providers are accurate, and that employee and dependent eligibility lists are up-to-date. The Benefits Division also works with employees, ensuring they are informed of the City's benefit offerings and coordinating long-term leaves of absence.

The costs of these benefit programs, including administrative costs, are accounted for in multiple benefit funds within the City's financial management system. The objective of this audit was to review the administration and management of the benefit funds managed by HR. We limited our audit to the administration of the funds; we did not review benefits provided or the costs of individual benefits.

Finding 1: Fund Management Can Be Improved. The Benefits Division monitors monthly activity in the benefit funds, tracks City and employee expenditures, and compares transactions in the financial management system to the Adopted Operating Budgets. However, in some instances fund balances do not always align with either formal or informal targets, and not all are monitored. The *Employee Health Fund*, which is meant primarily to pass through employee contributions, had a cash balance of about \$500,000 at the end of FY 2017-18, largely due to accumulating interest earnings. To ensure fund balances are reasonable, we recommend that HR establish policies and procedures for tracking activities in the Benefit Funds, and in coordination with the Budget Office, formalize fund balance and reserve targets. Further, the Administration should work with the City Attorney's Office to determine allowable uses of interest earnings and excess balances in the *Employee Health Fund*.

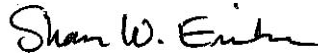
Finding 2: Staff Costs Can Be Better Aligned With Job Duties Across Benefit Funds. Benefits Division staff costs are generally budgeted to one or more of the City's benefit funds based on the level of work expected by Division staff. However, the actual distribution of work has not aligned with how staff costs have been budgeted. This misalignment between budgeted staff costs and the actual distribution of work potentially impacts employees who are enrolled in voluntary benefits and are paying associated administration fees. We recommend that HR work with the Budget Office to review and adjust allocations of work across the benefit funds. In preparation of the FY 2019-20

Proposed Operating Budget, HR has begun working with the Budget Office to reallocate staffing costs among the benefit funds to better align with actual job duties.

Finding 3: The Benefits Division Can Take Steps to More Efficiently Manage Its Changing Workload. The workload of the Benefits Division has changed in recent years because of new benefits, changes in benefit plans, and new benefit providers. Additionally, turnover and vacancies have impacted how the Division’s work is allocated among its staff. As a result, senior staff in the Benefits Division have been performing tasks normally assigned to lower level staff members. As current staff becomes more experienced in their positions, the Benefits Division should reallocate work assignments to appropriate job classifications and prioritize filling the current vacant positions. The Benefits Division can also find efficiencies by finalizing updates to the City’s leave policy, completing plans for outside administration of COBRA benefits, simplifying the process for verifying eligibility for cash in-lieu benefits, and exploring opportunities to streamline how it administers leaves of absence.

This report includes 8 recommendations to improve administration of the employee benefit funds. We plan to present this report at the March 21, 2019 Public Safety, Finance, and Strategic Support Committee. We would like to thank the Human Resources Department, the City Attorney’s Office, the Finance Department, and the Budget Office for their assistance during this audit process. The administration has reviewed this report and its response is shown on the yellow pages.

Respectfully submitted,



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Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability, and our audits provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

In accordance with the City Auditor's Fiscal Year (FY) 2018-19 Work Plan, we have completed an audit of the Human Resource Department's administration of employee benefit funds.

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. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

The Office of the City Auditor thanks the Human Resources Department, the Finance Department, the Budget Office, and the City Attorney's Office for their time and insight during the audit process.

Background

The City of San José offers various benefits to eligible full- and part-time employees and their dependents. The Human Resources Department (HR) administers many of the benefits, including medical, dental, vision, and other miscellaneous benefits.¹ HR also administers the City's Tier 3 defined contribution plan for certain City employees.² Medical benefits are the largest of the benefits administered by HR.³

Other benefits are administered by other City offices or oversight bodies. For example, retirement benefits are administered by two independent retirement

¹ Other benefits include unemployment, an employee assistance program (EAP), flexible spending accounts, life insurance, long-term disability insurance, long-term care insurance, and personal accident insurance. The City also provides health and dental in-lieu (i.e., cash payments in-lieu of coverage) for eligible employees who are covered by another eligible group health or dental plan.

² See the City Auditor's [2017 Audit of the Tier 3 Defined Contribution Plan](#).

³ In FY 2017-18, there were 10,600 active employees and dependents enrolled in City medical plans and City spending on health benefits totaled about \$50 million. This does not account for those participating in health in-lieu programs or retirees receiving benefits.

boards.⁴ Also, the City’s deferred compensation plan⁵ is overseen by the Deferred Compensation Advisory Committee (DCAC), and the newly created Voluntary Employee Beneficiary Association (VEBA) is overseen by the VEBA Advisory Committee. HR provides administrative support for both the DCAC and the VEBA Advisory Committee.

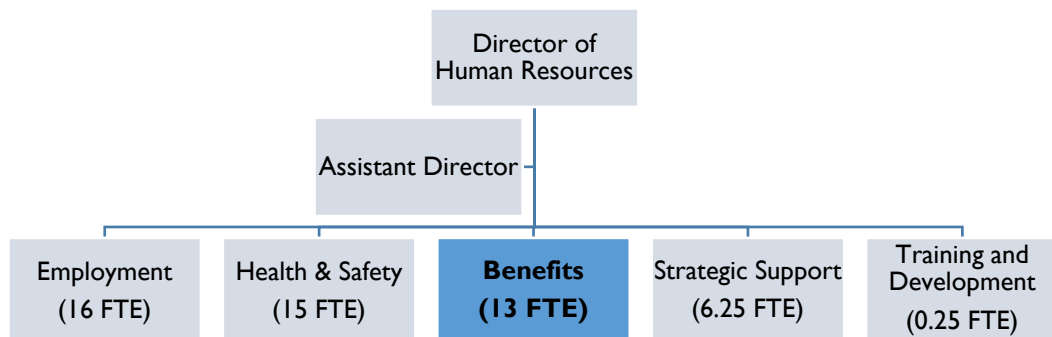
The Role of the Human Resource Department’s Benefits Division

Within HR, the Employee Benefits Division (Benefits Division) is responsible for administering the City’s benefits. The Benefits Division establishes and monitors contracts with benefit providers for active employees, retirees, and their dependents; and works with the providers to ensure benefit payments are accurate and employee and dependent eligibility lists are up-to-date.

The Benefits Division provides new employees with information about benefit offerings, manages the City’s annual open enrollment, processes long-term leaves of absence for employees, and provides ongoing customer service to employees and departments.

The City’s Adopted Operating Budget identifies employee benefits as one of HR’s five core services. The employee benefits core service is composed of 13 full-time equivalents (FTE). Of those, 10.5 FTE are in the Benefits Division, an increase of one position from FY 2017-18 due to implementation of the VEBA. An additional 2.5 FTE in the Human Resource Information Systems (HRIS) workgroup, part of the Strategic Support Division, are assigned to work on benefits. At the time of the audit, the Benefits Division had two vacant positions.

Exhibit I: FY 2018-19 Human Resources Department Staffing By Core Service



Note: Staffing in this chart is broken down by HR’s core services as defined in the City’s operating budget, which do not align directly with how staff is allocated across divisions in HR’s organizational chart. The 13 FTE in the benefits core service include 10.5 FTE within the Benefits Division, and 2.5 FTE from the HRIS workgroup which is located in the Strategic Support Division.

Source: FY 2018-19 Adopted Operating Budget.

⁴ See the City Auditor’s [2017 Audit of Retirement Services](#).

⁵ This also includes the PTC deferred compensation plan, which provides part-time, temporary, and contract employees who are not members of another City retirement plan with a retirement program by requiring them to defer a portion of their current compensation, in accordance with applicable provisions of the Internal Revenue Code. The City also provides contributions to this plan. See the City Auditor’s [2013 Audit of Deferred Compensation](#).

Benefit Administration Requires Coordination Among Employees, Human Resources, and other Departments

Although the Benefits Division is primarily responsible for managing employee benefits, other HR divisions, other departments, and employees have benefits-related responsibilities as well (see Exhibit 2).

Exhibit 2: Employees, Human Resources, and other Departments Are Responsible for Aspects of Benefits Management

	Enrollment	Separations	Leaves of Absence
Employee	<ul style="list-style-type: none"> - Selects benefit coverage in PeopleSoft (during open enrollment or upon hire or qualifying life event). - Provides documentation for dependent or health/dental in-lieu eligibility. 	<ul style="list-style-type: none"> - Submits a letter of resignation to department/City. - Can enroll in COBRA within 60 days of separation. - If enrolled in COBRA, remits payments to the City or benefit provider (as necessary). 	<ul style="list-style-type: none"> - Submits application for leave, as well as any required documentation for protected leaves.⁶ - Elects which benefits to continue during unpaid portion of leave; remits premium payments as necessary. - Coordinates with HR to reinstate lapsed benefit coverage upon return from unpaid leave.
Departments	<ul style="list-style-type: none"> - Notifies HR of new employees through a PeopleSoft transaction memo. 	<ul style="list-style-type: none"> - Remits notice of separation (NOS) to HR. 	<ul style="list-style-type: none"> - Approves unprotected leave requests.⁶ - Notifies HR of approved, extended leaves. - Forwards protected leave requests to HR. - Maintains time reporting for employees on leave. - Notifies HR of employees' return from leaves.
HR – Benefits	<ul style="list-style-type: none"> - Provides benefits information to employees at new employee orientations, the annual open enrollment, and ongoing customer service. - Verifies eligibility for dependents and health/dental in-lieu coverage. 	<ul style="list-style-type: none"> - Notifies employee of COBRA eligibility (and manages enrollment if necessary). - Ensures benefit provider lists of covered employees exclude separated employees. 	<ul style="list-style-type: none"> - Approves protected leave requests. - Monitors and coordinates leave activities: ensuring accurate benefit coverages; monitoring leave balances and return dates; and collecting monthly premium payments from employees on unpaid leaves.
HR – Information Systems	<ul style="list-style-type: none"> - Creates user profiles in PeopleSoft for new employees. - Updates benefit eligibility records to reflect coverage changes resulting from life events. 	<ul style="list-style-type: none"> - Updates PeopleSoft to reflect changes in eligibility and vendor remittance reports. 	<ul style="list-style-type: none"> - Coordinates with Benefits to update PeopleSoft to reflect changes in benefits eligibility reports.
Finance	<ul style="list-style-type: none"> - Processes payroll deductions and adjustments. 	<ul style="list-style-type: none"> - Calculates final paychecks for employees. 	<ul style="list-style-type: none"> - Reviews time reporting of employees on leave. - Assists departments with payroll adjustments resulting from leaves. - Conducts collection activities for unpaid premiums resulting from unpaid leaves.

Notes:

- Retirement also plays a role in benefit administration for City retirees. This includes verifying eligibility of retirees and remitting retiree premium payments.
- Different departments and divisions listed above are also involved in payments made to benefit providers, serving as distinct controls in the remittance of such payments.
- PeopleSoft is the City's Human Resource Management System.
- COBRA refers to the Consolidated Omnibus Budget Reconciliation Act or Cal-COBRA (California law equivalent). This act ensures that employees separating with the City have the ability to continue their health insurance coverage for a specific amount of time, as required by state and federal law.

Source: Auditor compiled through interviews, document reviews, and observations.

⁶ Employee leaves of absence are categorized as protected or unprotected. Protected leaves are governed by Federal and/or State laws and require employers to provide employees extended leaves of absence, provided certain conditions are met. Unprotected leaves are governed by the City's Administrative Policy Manual and are approved or denied at the discretion of departments.

The City Maintains Multiple Benefit Funds to Account for Costs of Administering Benefits

This audit looked at six separate benefit funds managed by HR, and created by the City for health, dental, life, unemployment, and several other miscellaneous benefits.⁷ Budgeted expenditures in the benefit funds totaled \$92 million dollars in FY 2018-19, up from about \$68 million three years ago. The increase is largely due to the introduction of a self-insured medical plan which was in full effect for all of FY 2017-18, and increasing health care costs, generally.

Of total expenditures anticipated in FY 2018-19, about \$80 million are expenses directly related to employee benefits (e.g., premium payments and benefit claims) and \$3 million accounts for administration, consulting, and stop-loss insurance expenses. About \$9 million in City expenditures related to the Federal Insurance Contributions Act (FICA)⁸ are also accounted for in the funds.

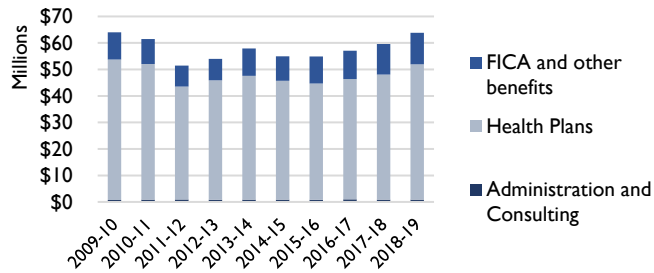
Funding to pay for benefits administration varies across the benefits funds. One particular fee that appears on employees' paychecks is a 21 cent, *benefits administration fee*. This fee covers the active benefited employees portion of the costs of benefits consultants. Separate fees are charged to the City and to retirement trust funds to cover the remaining cost of the benefits consultant (an expense paid out of the *Benefits Fund 160*). Personal and non-personal costs in this fund are paid for by the City. Following are descriptions of the six funds. See Appendix A for the sources and uses of the funds.

- The *Benefit Fund (160)* accounts for the costs associated with the City's two major health providers, Kaiser Permanente and Sutter Health Plus, as well as other miscellaneous benefits, including vision and the City's employee assistance program. This fund also accounts for the City's portion of payments under FICA. Sources of funds for this fund include contributions from the City and a benefits administration fee for employees and retirees. In FY 2017-18, expenditures in this fund totaled \$60 million.

⁷ The San José Municipal Code (§4.80.2000-4.80.2030) establishes the benefit funds to account for the costs associated with employee benefits, excluding retirement, deferred compensation, and VEBA. Two separate funds account for deferred compensation and VEBA.

⁸ FICA funds Social Security and Medicare programs, which provides benefits for retirees, the disabled, and children.

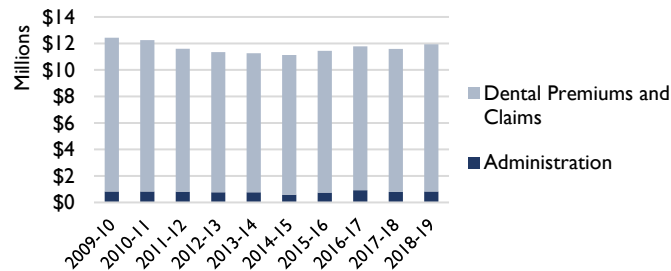
Exhibit 3: Benefit Fund 160 Expenditures



Source: Adopted Operating Budgets, FY 2009-10 through FY 2016-17 are actual figures, FY 2017-18 is estimated, and FY 2018-19 is adopted.

- The *Dental Insurance Fund* (fund 155) accounts for a self-funded PPO dental plan and a fully-insured HMO dental plan. Employee, retiree, and City contributions primarily fund the cost of this benefit, including administration. In FY 2017-18, payments of premiums and claims totaled \$10.8 million. Expenditures in this fund have remained relatively consistent over the past 10 years.

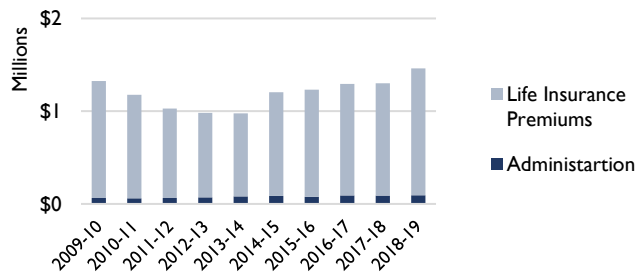
Exhibit 4: Dental Insurance Fund 155 Expenditures



Source: Adopted Operating Budgets, FY 2009-10 through FY 2016-17 are actual figures, FY 2017-18 is estimated, and FY 2018-19 is adopted.

- The *Life Insurance Fund* (fund 156) accounts for the money collected and distributed for the Citywide and retiree life insurance program. Administration of basic life insurance is paid for through a fee collected from the City each pay period. In FY 2017-18, expenditures totaled \$1.3 million. Budgeted expenditures increased to \$1.46 million in FY 2018-19.

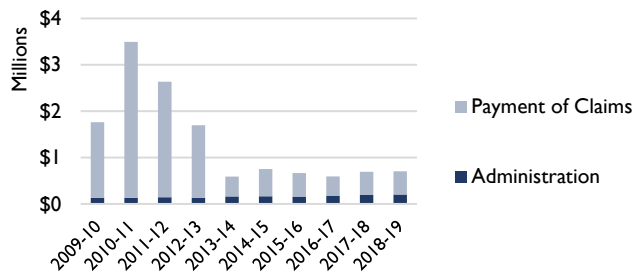
Exhibit 5: Life Insurance Fund 156 Expenditures



Source: Adopted Operating Budgets, FY 2009-10 through FY 2016-17 are actual figures, FY 2017-18 is estimated, and FY 2018-19 is adopted.

- The *Unemployment Insurance Fund* (fund 157) accounts for the cost of unemployment compensation paid to eligible terminated employees.⁹ Expenditures are funded through contributions made by the City and interest earnings on the fund balance. In 2017-18, expenditures were about \$500,000 for claims, and \$192,000 for administration costs. Payments on claims have remained fairly steady in recent years after a large spike at the beginning of this decade.

Exhibit 6: Unemployment Insurance Fund 157 Expenditures



Source: Adopted Operating Budgets, FY 2009-10 through FY 2016-17 are actual figures, FY 2017-18 is estimated and FY 2018-19 is adopted.

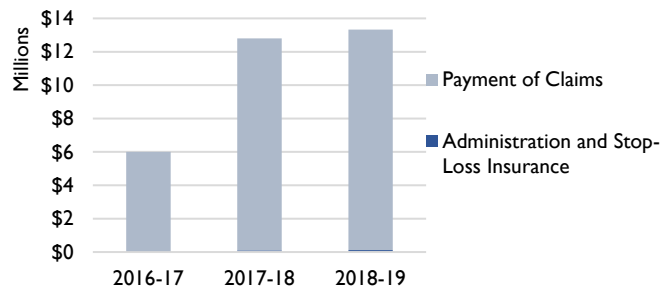
- The *Self-Insured Medical Insurance Fund* (fund 158)¹⁰ accounts for the costs for claims, stop-loss insurance,¹¹ and administration of the City’s self-insured medical plan, which are covered by the premium rates paid by participants and the City. In FYs 2017-18 and 2018-19, a total of \$4.65 million of additional moneys were transferred from the General Fund to cover fund deficits for those two years.

⁹ Unemployment insurance is self-funded and not a part of the state’s plan.

¹⁰ In FY 2016-17, the self-insured medical plan, administered through Blue Shield, was adopted by the City Council beginning January 1, 2017. This fund was established in conjunction with it.

¹¹ Stop-loss insurance protects the City from unusually large claims. The City’s has purchased both specific excess loss and aggregate stop-loss insurance.

Exhibit 7: Self-Insured Medical Fund 158 Expenditures



Source: Adopted Operating Budgets, FY 2016-17 are actual figures, FY 2017-18 is estimated, and FY 2018-19 is adopted.

- The *Employee Health Fund* (fund 161), accounts primarily for employee contributions for specific benefits, along with FICA and federal or state income taxes, that are withheld from employees' paychecks. Employee contributions are held in this fund until they are paid out to specific vendors.¹² Large amounts of moneys pass through this fund; in FY 2017-18, more than \$20 million each month was withheld and sent to benefit providers or the state or federal government. As it is meant solely as a pass-through fund, it is not a "budgeted" fund and does not appear in the City's Adopted Operating Budget.

Audit Objective, Scope, and Methodology

The objective of our audit was to review the Human Resource Department's administration and management of benefit funds, including for health, dental, life, and unemployment insurance. We limited our audit to the administration of the funds; we did not review actual benefits provided or the costs of individual benefits. To meet our audit objective and understand management controls, we did the following:

- Reviewed relevant federal and state government laws including the Health Insurance Portability Accountability Act (HIPAA), the Affordability Care Act (ACA), Family Medical Leave Act (FMLA), the California Family Rights Act (CFRA), and the Pregnancy Disability Leave (PDL).
- Reviewed policies and procedures related to benefits administration including the City municipal code, the employee handbook, and relevant City policies.
- Interviewed staff from the Human Resources Department (Benefits, HRIS, Strategic Support), the Finance Department (Payroll, Accounts Receivable, and Accounting), the Budget Office, Information Technology, and the City Attorney's Office.

¹² Employer portions of CalPERS are also included in this fund. In FY 2017-18, the employer portion of CalPERS accounted for \$175,000 in total, less than 1 percent of total fund activity.

- Observed the biweekly premium reconciliation process, and the vendor payment process for dental, life insurance, flexible spending, and commuter benefits.
- Reviewed benefits consultant reports, including actuarial estimates of reserve goals.
- Reviewed contracts with the City's dental, vision, life, flexible spending, commuter benefit, COBRA, and health providers, and benefits consultants.
- Analyzed and reviewed PeopleSoft reports related to payroll deductions for benefits, enrollment, notices of separation, staffing, and tenure.
- Sampled and reviewed notices of separation compared to PeopleSoft reports.
- Compiled information from operating budget documents from FY 2009-10 through FY 2018-19 for budgeted benefit funds, and reports from the City's Financial Management System (FMS) for all benefit funds, and for the *Employee Health Fund* (fund 161), from FYs 1999-00 through 2017-18.
- Assessed self-reported estimates of work performed by Benefits Division staff, comparing to labor distribution reports.
- Reviewed prior benefits-related performance audits conducted by the San José City Auditor and other jurisdictions, including Riverside, Palo Alto, Sacramento, Durham, Oklahoma City, and Gainesville.
- Reviewed websites, budgets, and other documents from other jurisdictions including Fresno, Long Beach, Oakland, San Diego, City and County of San Francisco, and County of Santa Cruz. Interviewed benefits staff from Los Angeles, Sacramento, and Sunnyvale.

Finding I Fund Management Can Be Improved

Summary

The Benefits Division monitors monthly activity in the benefit funds, tracks City and employee expenditures, and compares transactions in the financial management system to the Adopted Operating Budgets. However, in some instances fund balances do not always align with either formal or informal targets, and not all are monitored. The Employee Health Fund, which is meant primarily to pass through employee contributions, had a cash balance of about \$500,000 at the end of FY 2017-18, largely due to accumulating interest earnings. To ensure fund balances are reasonable, we recommend that HR establish policies and procedures for tracking activities in the Benefit Funds, and in coordination with the Budget Office, formalize fund balance and reserve targets. Further, the Administration should work with the City Attorney's Office to determine allowable uses of interest earnings and excess balances in the *Employee Health Fund*.

HR Monitors Expenditures Out of the Various Benefit Funds

The Benefits Division monitors monthly activity in the benefit funds, including tracking City and employee expenditures for benefits, and comparing transactions in the financial management system to the Adopted Operating Budgets.¹³ In the last couple of years, the benefits group has added monitoring transactions in the unbudgeted fund, the *Employee Health Fund*, to this task. In October 2018, a new analyst in HR's Strategic Support Division was hired and whose responsibilities include monitoring these funds.

Fund Balance Targets

The City has established reserve and unrestricted fund balance targets for many of the benefit funds. Reserves and fund balances are maintained to protect the City from unexpected costs or ensure funding is available as needed.

Some benefit funds have formal reserve or fund balance targets. For example, the City's Budgeted Funds Guide identifies the target for the *Unemployment Insurance Fund* reserve as one year of claims, estimated as \$500,000 for both FY 2017-18 and FY 2018-19. Other reserves are recommended by actuaries with HR's benefit consultant. For the self-insured dental program, the actuaries also incorporated excess fund balance into their rate calculations.

Some funds have informal reserve or fund balance targets that are set by HR and Budget staff during the annual budget process. Informal targets have been

¹³ The Benefits Division also track overall retiree expenditures for benefits related to this fund. Individual retiree contributions are tracked and managed by the Office of Retirement Services.

documented through comment boxes in Excel tracking worksheets, or are simply verbal targets. For example, in the Benefits Division's tracking sheet for the *Life Insurance Fund*, there is a comment box identifying a target unrestricted fund balance of \$120,000.

The *Benefits Fund* (Fund 160) does not have any formal targets for reserves or ending fund balance. HR reported that they aim to keep a reserve of \$500,000. However, this has not been documented.

Actual Ending Fund Balances Should Better Align with Formal or Informal Targets

Actual reserve and unrestricted fund balances did not align with targets in most funds. For example, as noted earlier, the *Unemployment Insurance Fund* has a reserve target of one year of claims, estimated at \$500,000. The actual fund balance was \$1.97 million at the end of FY 2017-18. This fund balance grew in FYs 2010-11 and 2011-12 when the City set aside additional funding to address expected large numbers of unemployment claims. However, the number of claims that actually occurred was far less than planned, resulting in additional ending fund balance and reserves. The City has been slowly draining the excess fund balance/reserves by using the fund balance to cover the annual costs in the fund rather than ongoing contributions from various City funds.

On the other hand, the *Self-Insured Medical Fund* has significantly less in reserve than the target recommended by HR's benefit consultants. After its establishment in FY 2016-17, the City had planned to build up the reserve in the Self-Insured Medical Fund over time. However, costs have exceeded expectations and the City determined not to fund reserves to the level recommended by actuaries with their benefits consultant. The consultant's actuaries had estimated a need for a reserve for claims and unrestricted fund balance equaling three and a half months, or about \$3.39 million. The ending fund balance in this fund was \$472,000—far less than the target.¹⁴

Some variation from targets is expected because of differences between projected and actual revenues and expenditures. When the variation becomes great, however, it can signify that too much has been collected from employees or the City, or that the City has put itself at risk if the amount set aside does not cover potential contingencies.

¹⁴ In the FY 2018-19 Adopted Operating Budget, the City Council authorized a "one-time transfer to the Self-Insured Medical Fund in the amount of \$3.0 million to address a projected negative fund balance" for the fiscal year.

Exhibit 8: Benefit Fund Balances Varied From 14 Percent to 394 Percent of Targets

Fund	Targeted Balances¹⁵	FY 2017-18 Actual Balances	Difference
Dental (Fund 155)	Dental Claims Reserve: \$2.65 million Unrestricted Fund Balance: \$500,000 Total: \$3.15 million	Dental Claims Reserve: \$2.79 million Unrestricted Fund Balance: \$802,000 Total: \$3.59 million	+\$442,000 <i>114% of target</i>
Life (Fund 156)	No Formal Reserve Unrestricted Fund Balance: \$120,000 Total: \$120,000	No Formal Reserve Unrestricted Fund Balance: \$127,000 Total: \$127,000	+\$7,000 <i>106% of target</i>
Unemployment (Fund 157)	Reserve for Claims: ¹⁶ \$500,000 Unrestricted Fund Balance: \$-0- Total: \$500,000	Reserve for Claims: \$1 million Unrestricted Fund Balance: \$970,000 Total: \$1.97 million	+\$1.47 million <i>394% of target</i>
Self-Insured Medical (Fund 158)	Self-Insured Medical Claims Reserve: \$2.39 million Unrestricted Fund Balance: \$1 million Total: \$3.39 million¹⁷	Self-Insured Medical Claims Reserve: \$-0- Unrestricted Fund Balance: \$472,000 Total: \$472,000	-\$2.92 million <i>14% of target</i>
Benefit Fund (Fund 160)	No Formal Reserve Unrestricted Fund Balance: \$500,000 Total: \$500,000	No Formal Reserve Unrestricted Fund Balance: \$708,000 Total: \$708,000	+\$208,000 <i>142% of target</i>
Employee Health Fund (Fund 161)	No Formal Reserve Unrestricted Fund Balance: \$-0- Total: \$-0-	No Formal Reserve Estimated Cash Balance: \$513,000 Total: \$513,000	+\$513,000 <i>No Target</i>

Source: Auditor analysis of the City's Budgeted Funds Guide and Adopted Operating Budget, FMS, internal HR budget tracking spreadsheets, and HR benefit consultant reports.

Unmonitored Interest Earnings Have Accumulated in the Employee Health Fund (Fund 161)

The *Employee Health Fund* historically has been treated a little differently than the other funds. This fund is intended as a pass-through fund that accounts for employee money withheld from paychecks, and then transferred to the benefit providers, such as Kaiser Permanente or Sutter Health Plus, for medical insurance

¹⁵ Per HR's prior benefits consultant, combined restricted and unrestricted reserves should equal 3.5 months of claims for the Self-Insured Medical, and 3 months of claims for Self-Insured Dental. HR's current consultant, which began in December 2018, is currently reviewing these targets.

¹⁶ As stated in the budgeted funds guide, the reserve for claims is based on one year of projected claims. Unemployment insurance claims have ranged between \$430,000 and \$586,000 since FY 2013-14.

¹⁷ These figures are based on the most recent actuarial estimates for calendar year 2019.

premiums. The fund also accounts for income tax or FICA payments due to the federal or state government.

Although meant to be primarily a pass-through fund for employee contributions and withholdings, there can be a large sum of money in this fund at any given time. This is a result of timing differences between when money is collected from employees' paychecks and when vendor payments are processed. In FY 2017-18, on average more than \$20 million flowed through this fund in any given month.

At the end of FY 2017-18, according to the City's financial management system, the *Employee Health Fund* had a cash balance of roughly \$513,000. A large portion of this amount, roughly \$270,000, is due to interest earnings and unrealized gains/losses accumulated over many years.¹⁸

Although HR has begun tracking some activity in this fund in recent years, it has not monitored the cash balance or accounted for interest earnings in its fee setting calculations. It also has not set a cash balance (or fund balance) target for the fund.

HR Can Improve Processes for Managing Benefit Funds

According to the City's Budgeted Funds Guide, HR is the lead department responsible for the benefit funds. Using reports from the City's Financial Management System, HR tracks most but not all activity in the City's benefit funds. For example, staff do not track all transfers in and expenditures out of *Employee Benefits Fund* (Fund 161). Also, for many of the funds, the unrestricted fund balance targets are not documented. As described in Exhibit 2, other departments are responsible for various pieces of benefit fund administration. For instance, bi-weekly payroll transactions, which are the source of much of the activity in the benefit funds, are managed by the Payroll Division in the Finance Department.

As new staff transitions into monitoring ongoing activity in the benefit funds, HR should develop internal procedures to ensure completeness and consistency moving forward. This would include ensuring transfers into the funds align with transfers out of the funds, and following up with Payroll or other responsible staff if issues arise. The procedures should include, in coordination with the Budget office, documenting agreed upon formal or informal fund balance and reserve targets. HR should also document proposed actions to align balances with targets when they vary significantly.

¹⁸ The City allocates interest monthly across all the City's funds based on the average daily cash balance of a fund. Because of the timing difference between withholdings from paychecks and remittances to vendors, the *Employee Health Fund* has an average daily cash balance each month that generates interest earnings.

Recommendation #1: The Human Resources Department should:

- A. Establish policies and procedures for monitoring all transfers, revenues, and expenditures in the Benefit Funds, and**
- B. In coordination with the Budget Office, formalize fund balance and reserve targets.**

Recommendation #2: The Administration should work with the City Attorney's Office to determine allowable uses of interest earnings and excess balances in the Employee Health Fund (fund 161).

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Finding 2 **Staff Costs Can Be Better Aligned With Job Duties Across Benefit Funds**

Summary

Staff costs in the Benefits Division are generally budgeted to one or more of the City's benefit funds based on the level of work expected by Division staff. However, the actual distribution of work has not aligned with how staff costs have been budgeted. This misalignment between budgeted staff costs and the actual distribution of work potentially impacts the administrative fees that employees who are enrolled in voluntary benefits pay. We recommend that HR work with the Budget Office to review and adjust allocations of work across the benefit funds. In preparation of the FY 2019-20 Proposed Operating Budget, HR has begun working with the Budget Office to reallocate staffing costs among the benefit funds to better align with actual job duties.

The Actual Distribution of Work Does Not Align With How Positions Are Budgeted

Staff costs in the Benefits Division are generally allocated to one or more of the City's benefit funds. For example, half of one Staff Technician position is budgeted to the *Dental Insurance Fund* and half to the *Self-Insured Medical Fund*. Only one position in the Benefits Division is shown as funded by the *General Fund*. These allocations are approved each year during the annual budget process.¹⁹

However, the allocation of staff costs to the City's various benefit funds does not align with how work is actually distributed across the Benefits Division. The misalignment between budgeted staff costs and the actual distribution of work potentially impacts the administrative fees that employees who are enrolled in voluntary benefits pay. For instance, three Benefit Division staff positions are currently budgeted to the *Deferred Compensation Benefit Fund*, however, at the time of the audit, staff estimated that the current level of work performed on behalf of the fund equates to approximately one position.²⁰

In other instances, work related to a specific benefit is done by staff members that are funded by different benefit funds. For example, two staff positions are funded through a combination of the *Dental* (155), *Life* (156), *Unemployment* (157), and *Self-Insured Medical* (158) funds, but staff estimates indicate that these positions spend more than 90 percent of time performing work related to the *Benefits Fund* (160).

¹⁹ There are 2.5 staff members from the Human Resources Information Systems (HRIS) work group funded through the benefit funds. Their role is more focused on the human resource management system, PeopleSoft, including opening events for new enrollments, and running eligibility reports.

²⁰ There are additional positions in the Finance Department funded through deferred compensation that are not included in this analysis. The *Deferred Compensation Fund* budget is approved each year by the Deferred Compensation Advisory Committee (DCAC).

Employee Benefit Fund Administration

Finally, much of the work that staff reports can best be categorized as “general benefits administration”, or activities that potentially cross over all types of benefits. Examples include managing employee leaves, conducting new employee orientations, open enrollments, attending meetings, or providing customer service.

Exhibit 9: FY 2018-19 Budget Allocations and Job Duties

	Budget Allocation	Job Duties ²¹
Deferred Comp (Fund 153)	3 FTE 1 – senior/manager 1 – analyst 1 – staff tech/office specialist	<ul style="list-style-type: none"> - Coordinating with other departments/divisions, conducting meetings, preparing reports, processing paperwork, wire transfers, reconciliation, and providing customer service. - Providing contract, fund, and vendor management. - Preparing materials for and participating in Deferred Compensation Advisory Committee (DCAC) meetings.
Dental (Fund 155)	1.2 FTE 0.5 – senior/manager 0.1 – analyst 0.6 – staff tech/office specialist (0.1 vacant)	<ul style="list-style-type: none"> - Preparing rate recommendations and claims projections in conjunction with an outside actuary. - Coordinating with other departments/divisions, conducting meetings, and providing customer service. - Providing contract, fund, and vendor management.
Life (Fund 156)	0.3 FTE 0.1 – senior/manager 0.1 – analyst 0.1 – staff tech/office specialist (vacant)	<ul style="list-style-type: none"> - Coordinating with other departments/divisions, conducting meetings, preparing reports, and providing customer service. - Providing contract, fund, and vendor management.
Unemployment (Fund 157)	0.9 FTE 0.5 – senior/manager 0.2 – analyst 0.2 – staff technician (vacant)	<ul style="list-style-type: none"> - Processing claims, providing customer service, and conducting meetings. - Providing fund and vendor management.
Self-Insured Medical (Fund 158)	1 FTE 1 – staff tech/office specialist	<ul style="list-style-type: none"> - Preparing rate recommendations and claims projections in conjunction with and outside actuary. - Coordinating with other stakeholders, conducting meetings, and providing customer service. - Providing contract, fund, and vendor management. - Monitoring stop-loss insurance and processing claim payments.
Benefits Fund,²² (Funds 160)	2.1 FTE 0.9 – senior/manager 0.6 – analyst 0.6 – staff tech/office specialist (vacant)	<ul style="list-style-type: none"> - Coordinating with other departments/divisions, conducting meetings, preparing reports, processing paperwork, and providing customer service. - Providing contract, fund, and vendor management.
VEBA (Fund 253)	1 FTE 1 – analyst (vacant)	<ul style="list-style-type: none"> - Coordinating with other departments/divisions, conducting meetings, preparing materials, wire transfers, reconciliation, and providing customer service. - Providing contract and fund management. - Preparing materials for and participating in VEBA Advisory meetings.
General Fund (Fund 001)	1 FTE²³ 1 – senior/manager	<ul style="list-style-type: none"> - Overseeing the administration of leaves of absence. - Providing customer service and attending meetings. - Providing Citywide training.
Total	10.5 FTE (2 vacant positions)	

Source: Auditor Analysis of budgeted time of currently filled positions in the Benefits Division compared to job duties. This does not include the 2.5 FTE in the HRIS workgroup.

²¹ The Benefits Division also more broadly manages open enrollment periods and participates in new employee orientations. Some benefits require more involvement in the enrollment period than others.

²² The *Benefit Fund* (160) accounts for costs associated with a variety of City benefits, including medical and vision.

²³ This position was added in FY 2016-17 for extended absence management for employee leaves, including coordinating compliance with federal and state laws, as well as City policy. This position was to be the City’s FMLA coordinator and work with City departments to ensure employees are aware of their rights and train timekeepers to on proper time recording.

In preparation of the FY 2019-20 Proposed Operating Budget, HR has begun working with the Budget Office to reallocate staffing costs among the benefit funds to better align with actual job duties. According to HR, this includes reducing the number of staff allocated to deferred compensation, and increasing the staff allocated to the *Benefits Fund*, as well as to the *General Fund* for leave management.

Recommendation #3: The Human Resources Department should work with the Budget Office to review and adjust allocations of staffing costs across the benefit funds.

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Finding 3 The Benefits Division Can Take Steps to Manage Its Changing Workload More Efficiently

Summary

The workload of the Benefits Division has changed in recent years because of new benefits, changes in benefit plans and new benefit providers. Additionally, turnover and vacancies have impacted how the Division's work is allocated among staff. As a result, senior staff in the Benefits Division have been performing tasks normally assigned to lower level staff members. As current staff becomes more experienced in their positions, the Division should reallocate work assignments to appropriate job classifications and prioritize filling the current vacant positions. The Benefits Division can also find efficiencies by finalizing updates to the City's leave policy, completing plans for outside administration of COBRA benefits, simplifying the process for verifying eligibility for cash in-lieu benefits, and exploring opportunities to streamline how it administers leaves of absence.

The Benefit Division Has Been Impacted by Changes in Workload and Turnover

In recent years, the workload of the Benefits Division has changed as a result of new benefits and providers. For example, in FY 2016-17, the City implemented a new self-insured medical plan, as well as introduced a new health insurance provider. In FY 2017-18, the City implemented the new Voluntary Employees' Beneficiary Association program (VEBA).

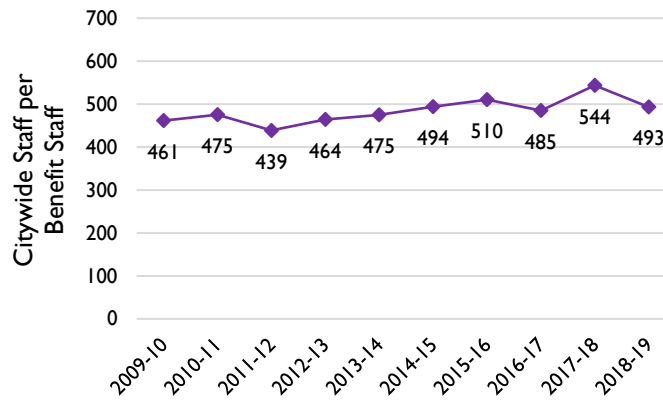
In addition, Citywide budgeted staffing has increased from roughly 5,800 in FY 2010-11 to roughly 6,400 today. A larger workforce Citywide can impact the workload of the Benefits Division during the annual open enrollment for benefits, new employee orientations, and ongoing customer service from questions through walk-ins, phone, or email.

Over that time, the Benefit Division's staffing remained relatively constant.²⁴ As shown in Exhibit 10, the number of City staff per benefits staff has grown as a result of the increase in City staffing overall. The exceptions to this were FYs 2016-17 and 2018-19. In FY 2016-17, one position was added to manage extended leaves of City employees and be the City's Family Medical Leave Act (FMLA) coordinator. At that time, another temporary position was added to implement new medical

²⁴ Interviews with benefits staff in other jurisdictions showed varying workloads due to different levels of benefits offered, number of vendors providing benefits, and management of some activities (i.e., leaves of absence, COBRA). As a result, direct staffing comparisons cannot be made.

plans and help coordinate Requests for Proposals for various benefits. Staffing was added in FY 2018-19 to support VEBA administration.

Exhibit 10: Ratio of Budgeted Staffing Citywide to Benefit Core Service Staffing



Note: Core Service staffing includes both the Benefits Division and HRIS assigned positions. In FY 2018-19, there were 10.5 FTE in the Benefits Division, and 2.5 FTE from HRIS.

Source: Adopted Operating Budgets.

Turnover and Vacancies Have Affected How Work is Allocated Among Staff

In recent years, high turnover and vacancies have contributed to senior-level staff performing tasks normally assigned to lower level staff members. For example, one Senior Analyst estimates that nearly one-fifth of their time is spent processing leaves, and all three Senior Analysts report regularly providing customer service support to City employees.²⁵ Each of these functions is also performed by Analysts or Staff Technicians in the Benefits Division. It should be noted, that even without vacancies, one of the Senior Analysts assigned duties included some work that is also performed by lower level staff.

In June 2017, the Benefits Division staff averaged less than two years of experience in HR, and about a year in their respective positions. As of January 2019, experience levels had improved with current staff averaging two years in their positions. While senior level staff have been in their position an average of 3.3 years, lower level staff have only been in their positions for an average of just one year, as shown in Exhibit 11.

²⁵ The City's Senior Analyst job classification includes responsibilities such as analyzing organizational structure and identifying and implementing process or program improvements.

Exhibit 11: Less Tenure at the Lower Staff Levels of the Benefits Division

	<i>Years in Division</i>	<i>Years in Position</i>
<i>Division Manager & Senior Analysts</i>	4.3	3.3
<i>Analysts, Staff Technician, Office Specialists</i>	1.6	1.0
Division Average	2.8	2.0

Source: PeopleSoft records as of January 1, 2019.

At the time of the audit, there were two vacancies: one Analyst and one Staff Technician.²⁶ Once the current vacancies are filled, the Benefits Division should reassess and clarify work assignments, so that senior staff can dedicate more time performing functions consistent with their job classifications. For example, Senior Analysts should be providing oversight and supervising administrative duties as opposed to handling day-to-day transactions.

Recommendation #4: The Human Resources Department should prioritize hiring for the current vacant positions in the Benefits Division.

Recommendation #5: To better align work with job classifications, the Human Resource Department should adjust work assignments of Senior Analysts in the Benefits Division from day-to-day transactions and service delivery roles to program management and oversight.

Leaves of Absence Can Be More Efficiently Managed

City employees are eligible to take extended leaves of absence resulting from life events or for other purposes. The Family Medical Leave Act (FMLA), California Family Rights Act (CFRA), and Pregnancy Disability Leave (PDL) provide employees medical leave to tend to their own serious health condition or that of an immediate family member, or for the birth of a child or to care for a child placed with the employee through adoption or foster care. Leaves initiated under FMLA, CFRA, or PDL are considered “protected” leaves.²⁷

Other employees take extended leaves that do not have the same FMLA, CFRA, or PDL protections. These are often unpaid leaves. For employees on unpaid

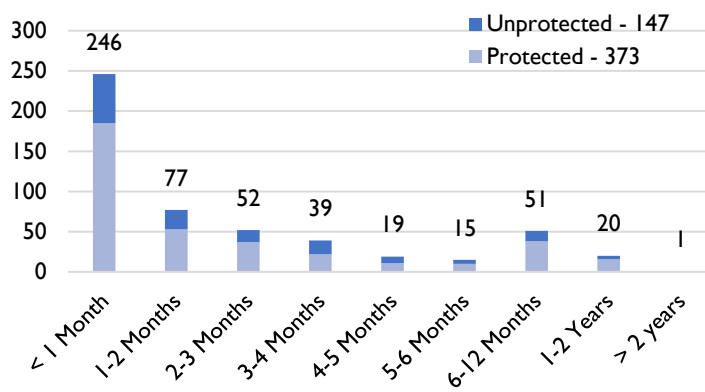
²⁶ During the audit, HR posted the staff technician position on the City’s employment website. The analyst position (specifically for VEBA) has been held vacant pending assessment of needs in the VEBA program. According to HR, this position is being modified going forward.

²⁷ Protected leaves provide employees job-protected leaves and the continuation of group health insurance coverage under the same terms and conditions as if the employee had not taken leave.

protected leaves, the employee is expected to remit to the City their portion of the cost of elected benefits on a monthly basis. For unpaid *unprotected* leaves, the employee is expected to remit to the City the full cost of benefits on a monthly basis. If they fall into arrears in the payments, they may be cut off from coverage and referred to the Finance Department for collections.

During FY 2017-18, 520 employees started leaves, which on average lasted about two and a half months. Over the year, there were about 170 employees on leave at any given time. Of these, about 23 percent were for unprotected leaves.

Exhibit 12: About a Quarter of Leaves Entered in FY 2017-18 Were Unprotected



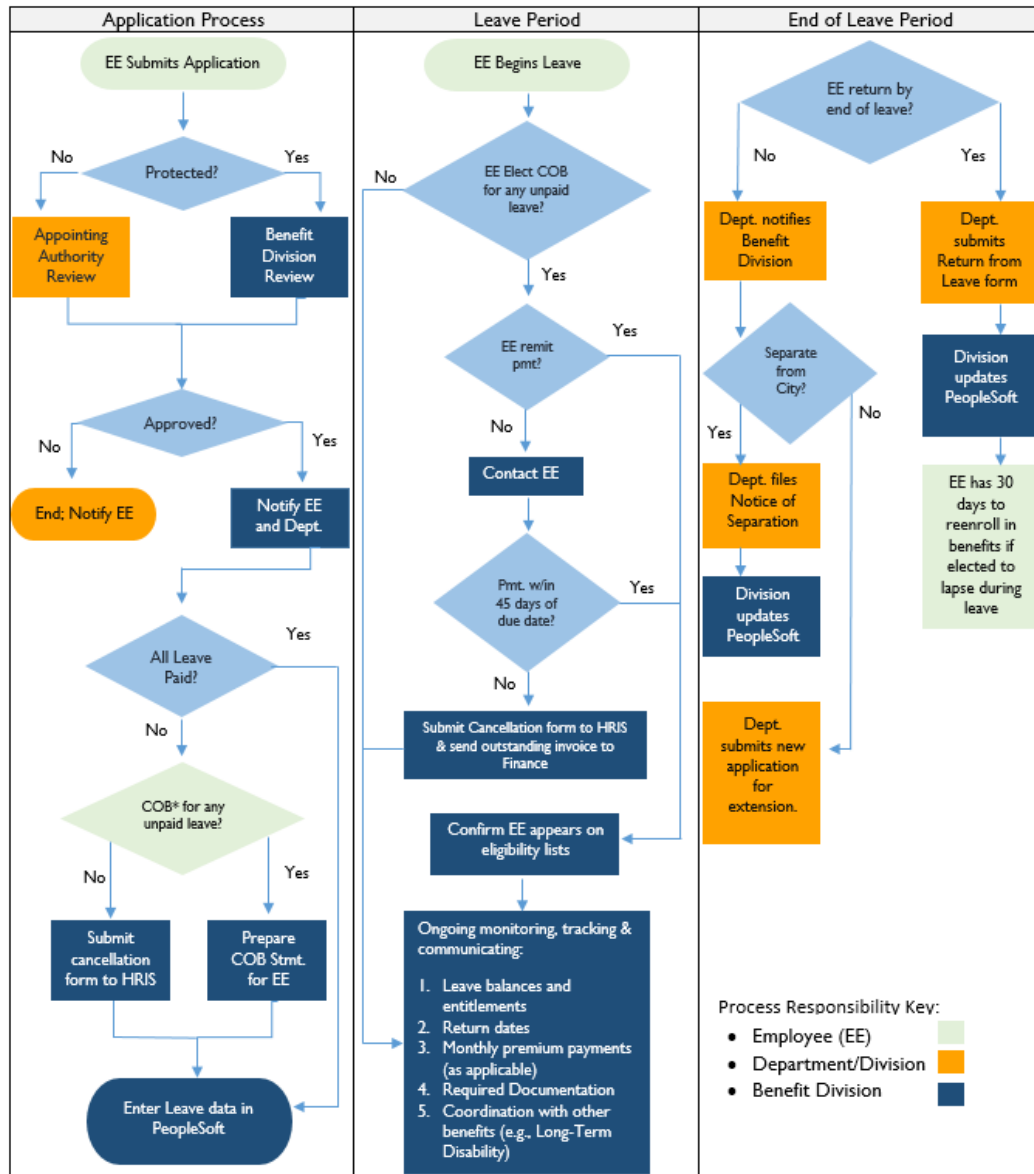
Note: These figures only account for employees with leaves of absence designated in the PeopleSoft system. This does not include employees on worker's compensation, or employees on paid vacation, executive, or sick leaves.

Source: Auditor analysis of a PeopleSoft report.

Managing Leaves is Complicated and Time-Consuming for Benefits Division Staff and Employees

Managing leaves of absence requires Benefits Division staff to review applications in accordance with applicable state and federal laws; coordinate with employees, departments, and divisions; and manually monitor, track, and communicate items such as leave balances, return dates, employee required premium payments, and required documentation. Exhibit 13 diagrams this process.

Exhibit I3: Process of Administering Leaves of Absence



* Continuation of Benefits (COB) – Employees can elect to continue benefit coverage while on unpaid leave. Employees electing to continue coverage are responsible for paying the employee premium or the full premium (City and employee portions), depending on whether the leave is considered protected or unprotected.

Note: This is the general leave of absence process, other variations of leave of absence processes can occur, depending on the type of leave and if any exceptions taking place.

Source: Auditor’s analysis of City Policy Manual and internal procedures and materials.

Multiple Benefits Staff Coordinate and Manage Employee Leaves

In FY 2016-17, a Senior Analyst position was added to the Benefits Division for leave management. The Adopted Operating Budget noted that the “position will be the City’s FMLA coordinator and work with all City departments to ensure

employees are aware of their rights and train timekeepers to ensure the appropriate recording of time for all extended absences.”

Currently, only about a fifth of this Senior Analyst’s time is spent on leaves. As noted in Finding 2, some of their work involves processing leaves, an activity that is also performed by staff in other job classifications. Benefits Division staff report six of the nine filled staff positions currently spend time working on leaves. They also report that a fifth of the Division’s overall staff time is spent on leaves. This equates to roughly 2 FTEs working on leaves.

Other jurisdictions manage leaves differently by dedicating staff to work solely on that function. For example, Sacramento has three FTE, separate from the benefit staff, dedicated to administering leaves of absence. Managing leaves may be more efficient by consolidating the work among a more limited number of staff assigned to leave management.

According to HR, they have been working with the City Manager’s Budget Office to reallocate staffing across the benefit funds, including for leave management. In the currently proposed staff assignments, HR has assigned two FTE for processing and managing leaves split among two Analysts and one Staff Technician, and assigned 0.06 FTE of Senior Analyst time to manage escalated issues and provide training.

Recommendation #6: To ensure consistency for City employees, the Human Resources Department should finalize and implement proposed staff assignments that consolidates leave management duties among staff in the Benefits Division.

Reconciliation of Premiums Requires Staff to Utilize Multiple Reports From PeopleSoft

Benefit staff, as part of their work responsibilities, regularly perform a premium reconciliation process for each benefit to ensure the City is only paying for benefits for eligible City employees. This is done at least twice a month and coincides with the City’s payroll calendar. Staff use a report that identifies employees that have missed premium deductions from payroll.²⁸ Benefits staff will go through the report and identify which of these individuals are on leave. Next they determine whether that employee has a continuation of benefits plan established and has paid their premium through check. This could be either just the employee portion, or the full premium, including both the employee and City portions.

The process involves compiling upwards of six separate vendor reports run out of PeopleSoft, the City’s human resources management system. These multiple

²⁸ This report also captures separated employees who have missed premiums.

reports are then consolidated into one report using a combination of copying/pasting, and inputting a series of formulas, which allows for risk of errors.

Because the multiple reports are pulled from the City's PeopleSoft system, it may be possible to program the system to produce one report with the necessary data, helping staff automate the process and reducing the risk of error. According to HR, this has been discussed in the past but has not been implemented because of competing priorities.

Recommendation #7: To manage the premium reconciliation process more efficiently, the Human Resources Department should work with the Finance and Information Technology Departments to create one specific report in the City's human resource management system that identifies missed premiums, and update office procedures accordingly.

The Benefits Division Has Taken Steps to Streamline Workload

HR has taken steps to streamline the workload in the Benefits Division and improve service delivery. For example, HR recently assigned monitoring of some benefit funds, a function that had previously been the responsibility of the Benefits Division, to a new Analyst in HR's Strategic Services Division. In recent years, the Benefits Division has also created new procedures to document various internal processes, including payments to benefit providers, premium reconciliations, termination reports, employee verifications, and enrollments.²⁹

Administering COBRA Benefits and Leave of Absence Policy Updates

The Benefits Division has also been planning additional ways to streamline workload. In December 2018, HR entered into an agreement with one of its current benefit vendors to administer COBRA benefits.³⁰ Furthermore, HR is in the process of updating the City's leave of absence policy. The result will be that benefits of employees who have exhausted protected leaves will be administered through COBRA. With unprotected leaves accounting for about a quarter of leaves administered by the Benefits Division, this could potentially reduce current staff workload and may provide further workload improvements.

²⁹ During our audit we noted that several recently updated internal procedures on benefits administration contained personal information. We raised this to the attention of the Directors of HR and IT, as well as the City's Information Security Officer. HR subsequently removed personal information from these internal procedures, and the IT department trained HR staff on the appropriate handling of personal information.

³⁰ COBRA refers to the Consolidated Omnibus Budget Reconciliation Act. Under the act, employees separating from the City have the ability to continue their health insurance coverage for an extended period of time, as required by state and federal laws.

Simplifying Cash in-lieu Documentation Requirements

HR is also in the process of simplifying the documentation required and the process for submitting the verification for cash in-lieu benefit payments. The City offers eligible employees a cash incentive to forego coverage under one of the City's available medical or dental plans when employees can furnish proof, on an annual basis, of alternate group medical or dental coverage, in accordance with Internal Revenue Service regulations. Proof of coverage has included a letter from the covered person's (e.g., parent, spouse, significant other) employer that indicates that coverage is for the full plan year. Getting such documentation is not always easy for employees because of different term years, or the inability of employers to furnish proof of a full year's coverage. Simplifying the proof of coverage requirements can reduce time spent gathering and checking documents for both employees and benefits staff during the months following open enrollment.

Recommendation #8: To streamline workload and better determine the scope of work of existing staff, the Human Resources Department should:

- A. Finalize the updates to the City leave policy;**
- B. Develop procedures to manage outside administration of COBRA benefits;**
- C. Determine the appropriate level of verification for cash in-lieu payments, and revise procedures for monitoring eligibility; and**
- D. Update the Employee Benefits Manual and the Benefits intranet site, accordingly.**

Conclusion

The City of San José offers various benefits to eligible full- and part-time employees and their dependents. The Human Resources Department (HR) administers many of the benefits, including medical, dental, vision, and other miscellaneous benefits. There are six separate benefit funds managed by HR, and created by the City for health, dental, life, unemployment, and several other miscellaneous benefits. Budgeted expenditures in the benefit funds totaled \$92 million dollars in FY 2018-19.

We found opportunities to improve controls around the administration of the benefit funds. This includes, developing procedures for monitoring the benefit funds; formalizing fund balance and reserve targets; better alignment of staff costs across benefit funds; and addressing a changing workload.

RECOMMENDATIONS

Finding 1: Fund Management Can Be Improved

Recommendation #1: The Human Resources Department should:

- A. Establish policies and procedures for monitoring all transfers, revenues, and expenditures in the Benefit Funds, and
- B. In coordination with the Budget Office, formalize fund balance and reserve targets.

Recommendation #2: The Administration should work with the City Attorney's Office to determine allowable uses of interest earnings and excess balances in the Employee Health Fund (fund 161).

Finding 2: Staff Costs Can Be Better Aligned with Job Duties Across Benefit Funds

Recommendation #3: The Human Resources Department should work with the Budget Office to review and adjust allocations of staffing costs across the benefit funds.

Finding 3: The Benefits Division Can Take Steps to Manage Its Changing Workload More Efficiently

Recommendation #4: The Human Resources Department should prioritize hiring for the current vacant positions in the Benefits Division.

Recommendation #5: To better align work with job classifications, the Human Resource Department should adjust work assignments of Senior Analysts in the Benefits Division from day-to-day transactions and service delivery roles to program management and oversight.

Recommendation #6: To ensure consistency for City employees, the Human Resources Department should finalize and implement proposed staff assignments that consolidates leave management duties among staff in the Benefits Division.

Employee Benefit Fund Administration

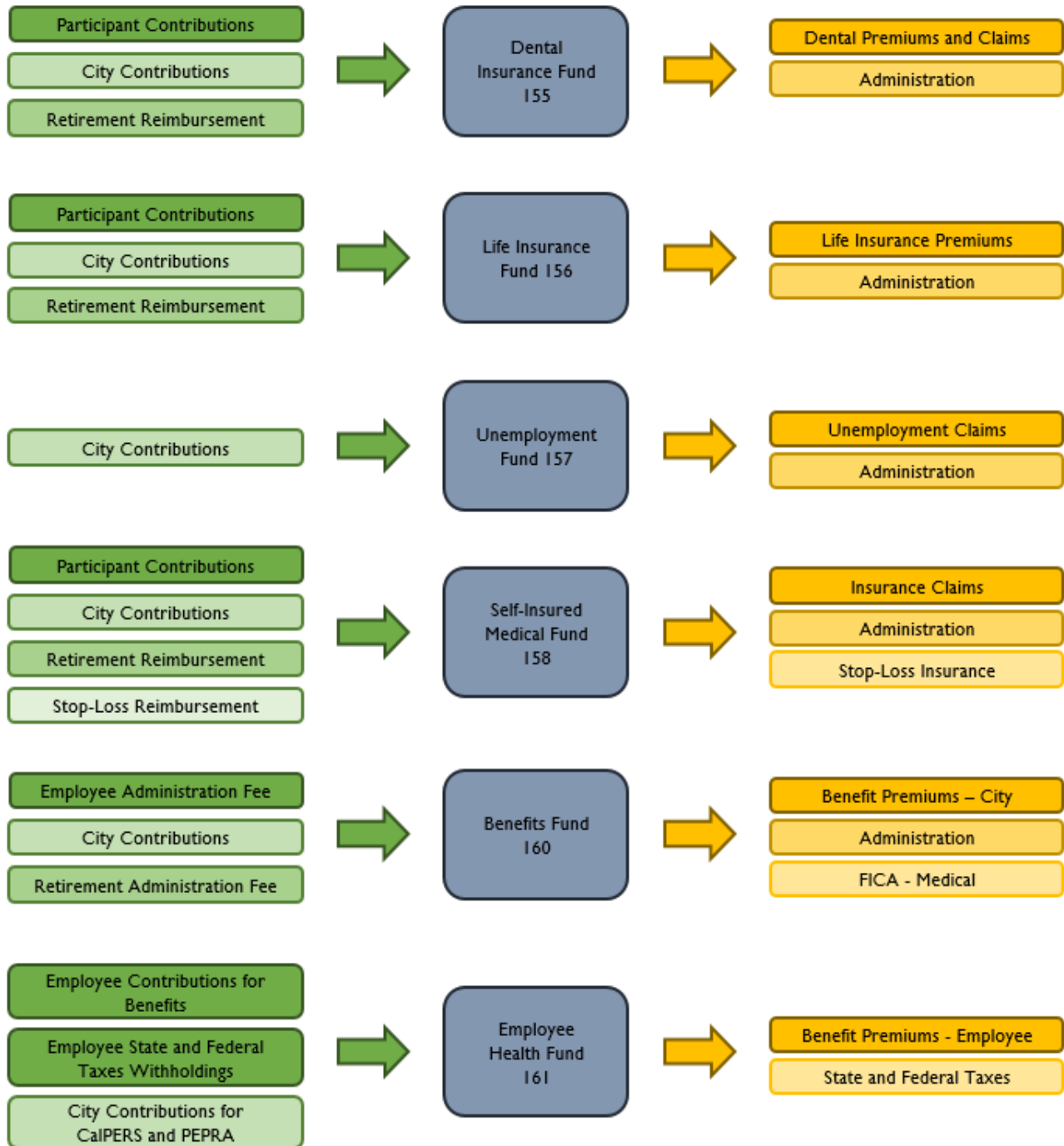
Recommendation #7: To manage the premium reconciliation process more efficiently, the Human Resources Department should work with the Finance and Information Technology Departments to create one specific report in the City's human resource management system that identifies missed premiums, and update office procedures accordingly.

Recommendation #8: To streamline workload and better determine the scope of work of existing staff, the Human Resources Department should:

- A. Finalize updates to the City leave policy;
- B. Develop procedures to manage outside administration of COBRA benefits;
- C. Determine the appropriate level of verification for cash in-lieu payments, and revise procedures for monitoring eligibility; and
- D. Update the Employee Benefits Manual and the Benefits intranet site, accordingly.

APPENDIX A

Flow of Money Through the Funds



Note: All funds received interest earnings and unrealized gains/losses.

Source: Auditor analysis of Adopted Operating Budgets, Budgeted Funds Guide, and FMS transactions.

Memorandum

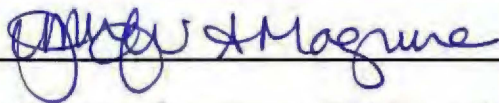
TO: Sharon Erickson
City Auditor

FROM: Jennifer Schembri

**SUBJECT: RESPONSE TO AUDIT
OF "EMPLOYEE BENEFIT FUND
ADMINISTRATION:
OPPORTUNITIES EXIST
TO IMPROVE CONTROLS"**

DATE: March 13, 2019

Approved



Date

3-13-19

The Human Resources Department (HR) has reviewed the report from the City Auditor (Employee Benefit Fund Administration: Opportunities Exist to Improve Controls) and agrees with the eight recommendations. The Human Resources Department greatly appreciates the important work of the City Auditor's Office and commends their efforts to provide recommendations supporting process improvements and efficiencies in the administration of employee benefits.

The following are the Human Resource Department's response to each recommendation.

BACKGROUND

When HR was notified that the City Auditor's Office was planning to audit the Employee Benefit funds, HR was in the initial stages of reviewing and identifying areas where certain Benefits Division staff work was no longer aligned with how positions were funded. Reasons for this misalignment were in part due to increased efficiencies in some programs such as the administration of the City's Deferred Compensation program, as well as the added volume and complexity in other benefits administered in HR. Some examples are leaves of absences, new and more complex medical plans, and new programs such as the Voluntary Employees' Beneficiary Association (VEBA).

In August of 2018, HR met with the Auditor's staff and shared areas identified as needing improvement. HR asked the Auditor's Office to assist with assessing where Benefits staff spend their time versus the budgeted fund where the time is allocated. After an extensive individual assessment by each Benefits staff member and evaluation and discussion by management, HR prepared recommendations to the City Manager's Budget Office on the reallocation of staff labor costs among the various Benefits Funds and the General Fund, where appropriate.

As a result of the recommended changes to how staff positions are funded as well as the implementation of several of the Auditor's recommendations described in this report, the efficiency of administration of the employee benefit funds has and will continue to improve.

RECOMMENDATIONS AND RESPONSE

Recommendation #1: The Human Resources Department should:

- a) Establish policies and procedures for monitoring all transfers, revenues, and expenditures in the Benefit Funds, and
- b) In coordination with the Budget Office, formalize fund balance and reserve targets.

Administration's Response: The Administration agrees with this recommendation.

Green: HR, in coordination with the Budget Office and the Finance Department as appropriate, will develop policies and procedures addressing the management of the Benefit Funds, including unbudgeted funds that account for employee contributions, and will work with the Budget Office to formalize fund balance and reserve targets.

HR currently monitors all transfers, revenue, and expenditures in seven separate funds pertaining to Employee Benefits. Two of these funds account for employee participation in voluntary programs, including the City's Voluntary Deferred Compensation program and the new VEBA plans. The Employee Health Fund (Fund 161) is the only Benefit related fund that is not currently actively monitored as this is an unbudgeted fund with almost no City money in this fund. This fund contains several employee payroll deductions and associated interest earnings to pay for an employee's portion of related benefit costs. These funds are deposited automatically as part of each payroll cycle and then are used to pay the appropriate benefit providers. Over the last year the HR has begun discussions with the Finance Department on the best ways to identify growing fund balances or any other anomalies in Fund 161. Once this is determined, procedures will be developed in coordination with the Finance Department.

HR will also work with the Budget Office to formalize fund balance and reserve targets for the Benefit Funds, incorporating any feedback from the City's Benefits actuary. These targets will be factored into the development of the Proposed Operating Budget each year.

Target Date of Completion: June 2019

Recommendation #2: The Administration should work with the City Attorney's Office to determine allowable uses of interest earnings and excess balances in the Employee Health Fund (Fund 161).

Administration's Response: The Administration agrees with this recommendation.

Green: The City Attorney's Office is reviewing state and federal regulations regarding the allowable uses of these funds. Once this review is complete, HR will work with the City Manager's Budget Office and the City Attorney's Office to develop and implement the appropriate use of these funds.

March 13, 2019

Response to the Audit of Employee Benefit Fund

Administration: Opportunities Exist to Improve Controls

Page 3 of 6

Target Date of Completion: June 2019

Recommendation #3: The Human Resources Department should work with the Budget Office to review and adjust allocations of staffing costs across the benefit funds.

Administration's Response: The Administration agrees with this recommendation.

Green: HR worked with the Budget Office to adjust the allocation of staffing costs across the Benefit Funds. These adjustments have been factored into the development of the 2019-2020 Operating Budget that is scheduled to be approved by the City Council in June 2019

Target Date of Completion: June 2019

Recommendation #4: The Human Resources Department should prioritize hiring for the current vacant positions in the Benefits Division.

Administration's Response: The Administration agrees with this recommendation.

Green: There are currently two vacancies in the Benefits Division, including 1.0 Staff Specialist and 1.0 Analyst positions. The hiring process is underway for the Staff Specialist position with interviews completed on March 11, 2019. The second vacancy is for a limit dated analyst position added to support the administration of the new VEBA program through 2018-2019. Due to the transactional nature of much of the VEBA program work, HR has determined that a 0.5 Staff Specialist position is needed to support this program rather than the Analyst position. The Administration plans to bring forward a 2019-2020 budget proposal adding the part-time Staff Specialist position instead. If approved as part of the 2019-2020 Budget, the recruitment for this position will be prioritized.

Target Date of Completion: July 2019

Recommendation #5: To better align work with job classifications, the Human Resources Department should adjust work assignments of Senior Analysts in the Benefits Division from day-to-day transactions and service delivery roles to program management and oversight.

Administration's Response: The Administration agrees with this recommendation.

Green: HR is currently transitioning the transactional duties related to Leaves of Absence Administration from a Senior Analyst to the existing Staff Specialist. Once the vacant Staff Specialist position is filled, the transition of any remaining day-to-day transactional work will be re-distributed among the appropriate staff.

Target Date of Completion: May 2019

Recommendation #6: To ensure consistency for City employees, the Human Resources Department should finalize and implement proposed staff assignments that consolidates leave management duties among staff in the Benefits Division.

Administration's Response: The Administration agrees with this recommendation.

Green: HR has finalized plans for the consolidation of leaves of absence management and administration to a select few Benefits staff. Work assignments under this new structure will begin to be implemented and will be completed once the vacant staff specialist position is filled.

Target Date of Completion: July 2019

Recommendation #7: To manage the premium reconciliation process more efficiently, the Human Resources Department should work with the Finance and Information Technology Departments to create one specific report in the City's human resource management system that identifies missed premiums, and update office procedures accordingly.

Administration's Response: The Administration agrees with this recommendation.

Yellow: HR is working with the Information Technology Department, the Finance Department, and the City Manager's Budget Office to prioritize and allocate the necessary programming resources within the City's existing Human Resources/Payroll/Budget system vendor contract to create this new report. Once it is complete, the procedures will be updated accordingly.

Target Date of Completion: December 2019

Recommendation #8a: To streamline workload and better determine the scope of work of existing staff, the Human Resources Department should finalize updates to the City leave policy;

Administration's Response: The Administration agrees with this recommendation.

Green: The updated Leaves of Absence Policy was finalized and posted on March 7, 2019

Target Date of Completion: Completed

Recommendation #8b: To streamline workload and better determine the scope of work of existing staff, the Human Resources Department should develop procedures to manage outside administration of COBRA benefits;

Administration's Response: The Administration agrees with this recommendation.

Green: The procedures are currently being drafted and will be finalized after the testing of the data file transfer to the COBRA administrator is complete.

Target Date of Completion: June 2019

Recommendation #8c: To streamline workload and better determine the scope of work of existing staff, the Human Resources Department should determine the appropriate level of verification for cash in-lieu payments, and revise procedures for monitoring eligibility;

Administration's Response: The Administration agrees with this recommendation.

Green: HR, in coordination with the City Attorney's Office, is moving forward with a simplified process for annual verification for cash in-lieu payments. The finalization of the new form and the associated procedures are in progress and will be finalized prior to the next Open Enrollment period in 2019.

Target Date of Completion: July 2019

Recommendation #8d: To streamline workload and better determine the scope of work of existing staff, the Human Resources Department should update the Employee Benefits Manual and the Benefits intranet site, accordingly.

Administration's Response: The Administration agrees with this recommendation.

Green: HR will update the Employee Benefits Manual and the Benefits Intranet site with the changes recommended in this report once each is complete.

Target Date of Completion: December 2019

CONCLUSION

The Audit identifies ways the City can improve controls in the administration of the City's Benefit Funds and potentially provide savings to employees and the City by streamlining workloads related to employee benefit administration, simplifying processes and ensuring a more accurate alignment of staff costs to the appropriate benefit fund. HR will continue to coordinate its efforts to address the recommendations and develop or maintain newly developed processes

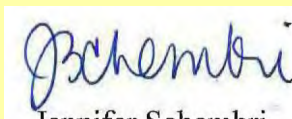
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Response to the Audit of Employee Benefit Fund

Administration: Opportunities Exist to Improve Controls

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and procedures with the Finance Department, the Information Technology Department, and the City Manager's Budget Office.

A handwritten signature in blue ink that reads "J. Schembri". The signature is written in a cursive style with a small dot above the 'i'.

Jennifer Schembri

Director of Human Resources/

Director of Employee Relations