

OFFICE OF THE CITY AUDITOR

AUDIT OF THE DEPARTMENT OF HUMAN RESOURCES' PROCESS OF HIRING CITY RETIREES



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September 1, 2006

Memorandum



CITY OF DALLAS

September 1, 2006

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted a performance audit of the Department of Human Resources' (HR) process for hiring retired City of Dallas (City) employees.

There has been much debate about the costs and benefits of hiring retired City employees. We believe that this strategy is sound when it is used by management to maintain or enhance the delivery of City services to our citizens. However, specific policies and procedures need to be in place to ensure compliance with City Code, personnel rules, and other governmental oversight agencies. Additionally, the use of these retirees should not impose an undue funding burden upon the Employees' Retirement Fund (ERF).

Our audit focused on determining the costs and benefits of hiring a retired City employee, determining the current policies and procedures for hiring a retired City employee, and evaluating compliance with City Code requirements. As a result of our review, we found that:

- The City does not have policies and procedures on how to hire retired City employees.
 - 35 retired City employees were on the payroll during calendar year 2005.
 - Although classified as "temporary", employees have been employed for many years and these same employees are receiving both a salary and a pension.
 - Seven employees had no true separation from service with the City and several managers requested the employees be rehired before they actually retired.
 - The employees were rehired at different pay rates with some employees being paid more than their original salary.
 - Some temporary employees are in executive-level positions.
- The actuary determined there was no significant funding impact on the ERF as a result of the hiring of the 35 retired City employees.

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Honorable Mayor and Members of the City Council
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- The ERF needs to have sufficient controls in place to monitor the use of retired City employees to ensure compliance with City Code and ensure the favorable tax status of employee contributions.

Our concerns are addressed in the Opportunities for Improvement Section of this report.

We appreciate the cooperation of City staff during our examination.

Paul T. Garner

Paul T. Garner
Assistant City Auditor

Attachment

c: Mary K. Suhm, City Manager

**Audit of the Department of Human Resources' Process of Hiring City
Retirees**

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INTRODUCTION

Authorization

We conducted a performance audit of the Department of Human Resources' (HR) process for hiring retired City of Dallas (City) employees. We conducted this audit under the authority of Chapter IX, Section 3 of the Dallas City Charter and in accordance with the Annual Audit Plan approved by City Council.

Scope and Methodology

Our audit reviewed 35 previously retired civilian City employees that were identified by Human Resources as being rehired and on the City payroll during calendar year 2005. Attached is a list that identifies the 35 positions discussed in this report.

Our audit included (a) interviewing HR management and staff, various City personnel, and Employees' Retirement Fund (ERF) management; (b) analyzing the City Code; (c) determining the federal, state and other municipal government organizations process for hiring retired former employees; and (d) obtaining an actuarial assessment to determine the impact that hiring retired City employees has on the Employees' Retirement Fund. We included tests of records and other audit procedures that we considered necessary under the circumstances. Our audit period was October 1, 2004 through December 31, 2005 however we reviewed certain related procedures, events, and matters occurring before and after this period.

Our audit objectives were to determine the costs and benefits of hiring a retired City employee, determine the current policies and procedures for hiring a retired City employee, and evaluate compliance with City Code requirements.

The audit was performed in accordance with generally accepted government auditing standards, except for the constraints imposed by scope impairment. As defined by the American Institute of Certified Public Accountants, scope impairments occur when sufficient evidential matter cannot be collected because of restrictions imposed by management. Such restrictions prevent discovery of essential information to answer audit objectives.

Our scope impairment occurred because:

- ERF management restricted our access to information and we could not independently validate pension benefit data for the 35 rehired retired City employees.

Management's Response:

The Employees' Retirement Fund City of Dallas has supported the Auditor's Office in their performance audit of the processing of rehired retirees. ERF completed questionnaires and responded to many diverse written and oral requests for information.

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After a long series of differing requests, ERF held a meeting to confirm the Auditor's Office needs. Once the information needs were established, everyone agreed that the Internal Revenue Service reporting information for individual pension benefits was appropriate and ERF promptly provided the information.

- The City Attorney's Office did not have criteria or guidelines for rehiring retired City employees and we could not completely assess compliance with City codes, ordinances or statutes.

City Attorney's Response:

The City Auditor has stated in discussions with the City Attorney's Office that "data collection impediments" allegedly caused by the City Attorney's Office refers to the Auditor's inability to obtain (from the City Attorney's Office) such criteria, guidelines and information that are necessary to analyze the data and reach conclusions in his audit of the Department of Human Resources. The Auditor understands that the City Attorney's Office was not in a position to give the Auditor's Office the requested information at the time it was requested, because the City Attorney's Office had requested and was awaiting a legal opinion from outside counsel on the same legal issue of rehiring retirees.

During the conduct of the Audit and while the Auditor's Office was attempting to conduct the Audit, personnel from the Auditor's Office requested (from the City Attorney's Office) guidelines and legal rules regarding the employment status of temporary employees, City retirees who were working for the City, and other law applicable to the issue of rehiring retirees to perform their audit. The City Attorney's Office informed the City Auditor's Office personnel that the City Attorney's Office had requested and was awaiting a legal opinion from outside counsel retained specifically for the purpose of analyzing the issue of rehiring retirees.

Overall Conclusion:

We concluded that:

- The City of Dallas can benefit by hiring City retirees. These benefits include maintaining the institutional knowledge, skills, and abilities of long-term employees. Further, an actuarial assessment determined there was no significant impact on the ERF by rehiring these 35 retired City employees.
- There are no written policies and procedures that guide the hiring of City retirees.
- The City of Dallas is in conflict with the City Code for the hiring of retired City employees.

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Specific issues are discussed in the Opportunities for Improvement section of this report.

Background

Hiring retired employees throughout federal, state and municipal governments is commonly used as a management tool to deal with shortages of specific skills. Most governmental entities have formal structured programs with rules and regulations regarding acceptable reasons and circumstances to rehire a retiree. However, the rehire processes and procedures vary widely. For example, some policies and procedures are specifically prescribed by law or an Administrative Directive while others' policies and procedures are *ad hoc* and undocumented. As of July 21, 2006 the federal government's Office of Personnel Management is proposing changes to make it easier for federal agencies to reemploy retired federal employees when faced with unusual circumstances.

The Dallas City Code, Chapter 34: (1) defines an employee as a person employed and paid a salary or wage by the City, whether under civil service or not, and includes a person on a part-time basis, but does not include an independent contractor or City Council member; and (2) states that a permanent employee is eligible for employee benefits (e.g. retirement benefits, health plan membership, life insurance, etc.),

However, Chapter 34 also states that (1) a temporary employee is not eligible for any benefits; and (2) an employee is designated as temporary when appointed to any of the following:

- An assignment less than six months in duration;
- A position funded under a federal employment and training program as a participant meeting federal eligibility requirements, but not including administrative or staff positions;
- Positions in the City's temporary help service program;
- A co-operative work-study program with an educational institution;
- A seasonal position, even though the assignment may last more than six months;
- A position that is intended to give introductory work experience to a person preparing to enter into the workforce; and
- A position scheduled to work less than 20 hours per week.

The Dallas City Code, Chapter 40A, provides guidelines regarding the hiring of retired City employees. The Dallas City Code states that a rehired City retiree:

- irrevocably waives all rights to payment of pension benefits for the period of re-employment if rehired in a position normally covered by the ERF.

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- has the option of contributing to the ERF and earning additional service credit, or they can choose to not contribute to the ERF and not earn additional service credit.

The Dallas City Code, Chapter 40A, also states that an employee is designated as permanent when appointed in any situation not defined as temporary; and, an employee does not mean an individual, other than a leased employee, given a temporary designation for the purpose of employment by the City.

The Dallas City Code, Chapter 40A, created the ERF as the retirement trust fund for the City employees. The Dallas City Code empowered the ERF Board of Trustees (board) with the authority and the responsibility to manage the ERF. One of the responsibilities of the Board and their delegates is the duty to make a final determination of the eligibility of any member for pension benefits. Another duty is to correct administrative errors and remedy any effects of those errors.

OPPORTUNITIES FOR IMPROVEMENT

During our audit, we identified certain policies, procedures, and practices that can be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not be all-inclusive of areas where improvements may be needed.

1. The City does not have policies and procedures to comply with City Code requirements for the rehiring of retired City employees.

The City does not have policies and procedures to implement City Code for hiring retired City employees. As a result, we observed certain practices that are in conflict or violate the City Code. Additionally, the ERF does not have effective compliance monitoring and controls to assure the eligibility of a retiree for applicable pension benefits.

In 1999, the former City Manager notified department directors that: “Effective January 1, 2000, retired City employees who are receiving payment benefits from the Employment Retirement Fund may no longer be hired as temporary City employees.”

Our audit showed that:

A. Rehired retired City employees are being improperly designated as “temporary” employees and are improperly receiving both a salary and pension.

Twenty-five of the 35 retired City employees that were rehired have been working for the City of Dallas for more than six months and did not meet any of the criteria for being designated as a temporary employee.

Number of Employees	Year Hired
1	1997
6	2003
12	2004
6	2005

City Codes Chapter 34, and Chapter 40A, provide for the appointment of “temporary employees,” who receive no benefits and do not contribute to the ERF. Because they are not “normally covered by the Fund,” they are not prohibited from drawing their pension and concurrently earning a salary.

Unless otherwise allowed by the code, after six months, an employee no longer meets the definition of a “temporary employee” and should not, according to the City Code, receive both a salary and pension. Further, all rehired retirees that were on the City’s payroll as “temporary employees” on January 1, 2005 received the 2% across-the-board pay increase authorized by the City Council.

OPPORTUNITIES FOR IMPROVEMENT

B. Seven of the rehired retired City employees had no “true separation from service.”

Seven of the 35 rehired retired City employees (20%) returned to work less than one month after retiring. Of these seven, three were rehired the next day. Our review of the personnel information showed that in several instances the managers requested to rehire an employee before they actually retired.

An example of a policy defining separation of service is the Retirees' Returning to Work Instruction of the Los Alamos National Laboratory (LANL) of University of California (UC). These instructions state, “To ensure compliance with Internal Revenue Service regulations...a UC employee must have a ‘true separation from service’.... A true separation from service means that the employee, at the time of retirement, has no intention to return to work at LANL...in any event the separation must be at least thirty days.”

Without a “true separation from service” by the retiree, this situation may be referred to as a “sham” retirement. This practice could jeopardize the qualified status of the employee’s retirement fund. This view is also shared by the actuaries that assisted in the audit.

C. The process to rehire a City retiree is not documented and is not consistent.

We were informed that the City did not have any written policies and procedures regarding the hiring of retired City employees. To determine who approved the hiring of the retired City employees, we judgmentally selected 12 of the 35 rehired retirees and found the:

- department personnel or directors approved three rehires; and
- City manager approved nine rehires.

The documentation for hiring employees was inconsistent. For example, a memorandum by an Assistant City Manager to request rehiring one of the two retirees stated that this retiree is “uniquely suited to this endeavor because of his experiences with infrastructure construction, contract negotiations, and project planning.” While this is an example of justification for the rehiring, in another case we found the Assistant City Manager’s request for rehiring the other retiree did not specify the reason for rehiring.

Further analysis showed the rehired retired City employees are receiving different pay relative to their pre-retirement pay. The following table shows the differences in pay:

OPPORTUNITIES FOR IMPROVEMENT

Number of Employees	Pay Rate
7	More than original salary
5	Same as original salary
3	At least 90% of original salary
7	From 70% to 90% of original salary
5	From 50% to 70% of original salary
8	Data not provided by HR

D. Actuarial assessments were not conducted before hiring City retirees.

For several years, it has been recommended that the City hire retirees to provide the continuity of services to the public or to allow an orderly transfer of institutional knowledge. The principal argument used by City management in the past was the financial impact that hiring retired employees would have upon the ERF.

We requested whether the ERF had conducted a study of the actuarial impact of the rehired retirees. We were told that such a study has never been conducted. Therefore, the City Auditor's office requested approval to hire an actuary to assess the costs to the ERF of rehiring City retirees and not having them contribute into the ERF. The City Manager's Office approved the Administrative Action (AA) to hire an actuary on July 31, 2006, which was after we completed our audit field work. The actuary completed the assessment and provided the report to the City Auditor office on August 28, 2006 and is attached to this report.

The actuary report showed there was no significant impact to the ERF for rehiring these 35 employees. However, the City needs to understand the cost and impact of rehired retirees on the ERF in order to assess the cost and potential risks to the fund.

We recommend the Director of Human Resources:

- In consultation with the City Attorney's Office and the Board of Trustees of the Employees' Retirement Fund, develop and implement policies and procedures regarding the rehiring retiree process to ensure such a process is in accordance with applicable laws, rules, and guidelines and is applied to all retirees consistently and uniformly.
- Ensure a periodical reconciliation of the name and number of City's retired rehires by the City's Payroll Office and the Employees' Retirement Fund is performed.
- Ensure the cost and impact of rehired retirees on the ERF is assessed. If any significant impact is noted, the City should compensate for the funding impact.

OPPORTUNITIES FOR IMPROVEMENT

Management's Response:

The City has an informal procedure for rehiring retirees in those departments subject to the supervision of the City Manager's Office. Since 1999, the practice and procedure has been to require the City Manager's explicit approval for the rehire of retired civilian employees. The requesting department provides the City Manager with the retiree's name, nature of work to be done, hourly rate of pay and proposed length of assignment. The approval is granted at the City Manager's discretion. Retirees are rehired on an exception basis; 35 rehires out of a workforce of 12,500 (.3%) does not reflect that the City relies on rehired retirees for a significant portion of the employee population.

Management does not think that the rehire of retirees is an effective management practice for the long-term health of the organization. Effective succession planning is essential to be prepared for the departure of retirement-eligible employees. However, there are situations that call for the specialized skill set of a particular incumbent. To allow for those situations and ensure compliance with City Code, we propose an addition to the Personnel Rules (Section 34-8 (a)) that would allow the City Manager the discretion to hire temporary employees for specific assignments.

Within the internal control structure of ERF there are several layers of electronic and manual controls that ensure compliance and accuracy. It is very important to note that ERF relies on the City's payroll system to properly classify and report information regarding employees and contributions. The Board's determination of pension eligibility occurs when a person begins receiving pension payments. The ongoing responsibility to ensure that a person who is rehired either loses or retains eligibility depends entirely on information provided by the City. Since ERF systems verify and report based on Social Security Numbers, electronic verification of payroll records is fairly simple. Fortunately for purposes of this audit, in December 2004, a person was erroneously classified and the system of checks and balances between the HR Department and ERF worked as designed.

As noted above, ERF's Board is responsible for ERF's compliance process that includes outside service providers who independently verify information and has instituted several internal controls that ensure compliance.

As stated above, management proposes an addition to Section 34-8 (a) of the Personnel Rules that would clarify and grant the Manager the discretion to hire temporary employees for specific needs.

Section 34-4 (6) of the Personnel Rules includes the following definition: "Benefit means an employer-sponsored program that includes, but is not limited to, paid leave and health and life insurance benefits, but does not include wages, merit increases, service credit or seniority." Cost of living increases are not benefits. It is within the

OPPORTUNITIES FOR IMPROVEMENT

discretion (and previous practice) of the City Manager to include temporary employees in across-the-board increases.

Two of the three rehired retirees were approved by department directors (without the City Manager's signature); one retiree is a school crossing guard. Retirees re-hired as school crossing guards were not covered by the 1999 City Manager's memo, as there were several retirees employed as crossing guards at that time. The City Manager verbally communicated to DPD that employment of retirees as crossing guards would continue to be allowed. The other retiree who was rehired without the City Manager's signature was in Park & Recreation. We acknowledge that the proper procedure was not followed in this instance.

The retiree who was hired through Temporary Help Services was re-hired prior to the 1999 change in practice. In addition, a memo from City Manager Ted Benavides (dated 12/30/99) specifically instructed that the particular retiree be retained.

Of the 35 retirees who had been re-hired during 2005, only one (the former PKR employee) did not have the signature of the City Manager.

The correlation (or lack thereof) between the pay received by a rehired retiree and the pay received prior to that employee's retirement is not relevant. The availability in the general labor market of a particular skill set and level of experience drives pay more than a retired employee's previous rate of pay. The City Manager has the discretion to authorize what he or she deems is the appropriate level of pay for the work to be performed.

Note: the ten employees for whom the pay rate was "not provided by HR" actually refers to these employees' pre-retirement rate of pay. Their current rate of pay as temporaries was provided. The pay rate of employees who retired prior to the implementation of the HRIS (July 2002) is not included in the payroll system. The pre-retirement pay rate would have been available through file research or a check of LINC (previous payroll system) records, but HR was not asked to conduct such research.

To uphold its duties, the ERF Board conducts an actuarial valuation every year. The objective of the actuarial valuation is to determine the funding status of ERF as of the valuation date, and to develop the actuarially determined level of contributions for ERF for the calendar year. In determining liabilities, contribution rates and funding periods for retirement plans, actuaries must make assumptions about the future. Among the assumptions that must be made are Retirement rates; Mortality rates; Turnover rates; Disability rates; Investment return rate; and Salary increase rates. For some of these assumptions, such as the mortality rates, past experience provides important evidence about the future. Actuaries review their assumptions periodically and determine whether these assumptions are consistent with actual past experience. The Board of Trustees reviews and approves the assumptions.

OPPORTUNITIES FOR IMPROVEMENT

The reconciliation process between ERF and the City's payroll office is already in place. ERF receives a payroll feed from the City consisting of all employees contributing to ERF every two weeks. ERF compares the social security numbers on the payroll feed to the pension accounting system every two weeks. On July 5, 2006, ERF informed the auditor about the process again and detailed an example of how ERF identified an employee who was labeled incorrectly as an Active Full Time. The first time this employee was on the payroll feed, the pension system noted that she was on the payroll as a full time active employee and set up to stop paying her pension. In accordance with ERF office procedures, an ERF employee contacted the retiree and told her that ERF will need to stop her pension checks if she has returned as an active employee. The employee informed ERF that she was hired as a part time temporary to relieve others. Then, the ERF employee contacted HR and told HR that the employee's classification was wrong in the system. Because of the system checks at ERF, the payroll was never posted to the pension system and ERF received neither employer nor employee contributions. The City's pension contributions in this situation never left the City's accounts.

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Auditor's Comment:

We requested from the ERF the actuarial study that showed the impact of the 35 rehired personnel but did not receive the study that showed the impact. We advised the ERF that we would need that data and that we would conduct the study to determine the impact using the ERF actuary.

ERF payroll reconciliations should have detected and reported that employees were retiring and being rehired by the City without a true separation of service. This should have then been brought to the attention of the board. The lack of this critical control could place the fund in a position of losing its preferred tax status.

OPPORTUNITIES FOR IMPROVEMENT

2. “Temporary employees” are employed as Department executives.

Two separate City Departments have “temporary employees” working in positions of senior management. They have authority normally reserved for permanent employees. This authority includes managing million dollar operations and one “temporary employee” was also identified as an official in the City Bond Offering Prospectus.

In our opinion, “temporary employees” should not be placed in the role of executives, as the City Code requires that “temporary employees” only serve less than six months and individuals in these executive positions puts them in the position of establishing policy by which the City will be bound.

We recommend the Director of Human Resources work with City departments to ensure that rehired retired City employees are not in positions of authority that either result in establishing policy or making financial commitments for the City.

Management’s Response:

The City Manager has the discretion to draw on the experience of a former executive, as there are situations in which the skill level and expertise of a retired executive are of great value in a temporary assignment. As to the establishment of policy or the making of financial commitments, only the City Council can take such actions.

ATTACHMENT

Retired Rehires on the City's Payroll during calendar year 2005					
Position Title at Rehire	Rate of Pay @ Rehire	Date of Rehire	Retirement Date	Position Title at Retirement	Pre-Ret Rate of Pay
Coordinator II – General	\$23.69	11/26/2003	10/16/2003	Manager II	\$33.33
Heavy Equipment Operator	\$12.35	07/18/2005	10/01/2002	Heavy Equipment Operator	\$17.86
Project Coordinator III	\$23.44	03/30/2005	05/27/2004	Project Coordinator III	\$22.70
Sr. Coordinator-General	\$28.57	10/01/2003	10/02/2003	Sr. Budget Analyst	\$26.68
Sr. Design Technician	\$21.16	02/16/2005	08/07/2002	Sr. Design Technician	\$21.60
Sr Engineer	\$33.75	06/08/2005	06/10/2004	Sr. Engineer	\$42.21
Sr. Program Manager	\$34.89	06/06/2005	01/06/2005	Sr. Program Manager	\$46.52
Supervisor III - General	\$26.34	10/17/2005	09/15/2005	Supervisor III	\$26.87
Temporary Help	\$57.10	04/16/2003	04/17/2003	Manager III	\$55.98
Temporary Help	\$26.35	05/14/2004	05/15/2003	Manager III	\$39.64
Temporary Help	\$26.52	10/29/2003	04/17/2003	Coordinator	\$23.86
Temporary Help	\$18.87	01/21/2004	05/03/2001	Sr. Cont Comp Admin	Unavailable
Temporary Help	\$13.88	03/25/2004	10/16/2003	Sr. Truck Driver	\$18.14
Temporary Help	\$12.24	07/21/2004	12/31/1999	Truck Driver II	Unavailable
Temporary Help	\$13.63	07/21/2004	04/21/2004	Crew Leader	\$16.53
Temporary Help	\$13.63	07/21/2004	09/10/2002	Crew Leader	\$15.40
Temporary Help	\$13.63	07/21/2004	12/31/1999	Truck Driver	Unavailable
Temporary Help	\$13.63	07/21/2004	12/31/1999	Heavy Equipment Operator	Unavailable
Temporary Help	\$19.89	09/29/2004	04/08/1998	File not found	Unavailable
Temporary Help	\$26.38	12/06/2004	09/15/2004	Sr. Electronic Technician	\$25.86
Temporary Help	\$15.30	12/27/2004	12/31/1999	LVN	Unavailable
Temporary Help	\$50.53	02/16/2005	02/02/2005	Director II	\$63.16
Temporary Help	\$30.02	03/02/2005	03/01/2005	Coordinator III	\$30.02
Temporary Help	\$28.63	03/16/2005	01/06/2005	Manager II	\$28.08
Temporary Help	\$18.76	07/08/2005	06/09/2005	Office Assistant II	\$18.76
Temporary Help	\$27.89	08/03/2005	06/03/2005	Coordinator II	\$27.89
Temporary Help	\$28.35	08/31/2005	07/07/2005	Sr. Inspector	\$28.35
Temporary Help	\$27.98	10/26/2005	10/13/2005	Executive Assistant	\$27.98
Temporary Help	\$45.00	10/26/2005	10/12/2005	Manager II	\$34.75
Temporary Help	\$55.14	02/03/1997	06/30/1996	Asst City Attorney	Unavailable
School Crossing Guard	\$8.16	09/04/2003	07/28/1995	Auto Equip Operator	Unavailable

ATTACHMENT

Retired Rehires on the City's Payroll during calendar year 2005					
Position Title at Rehire	Rate of Pay @ Rehire	Date of Rehire	Retirement Date	Position Title at Retirement	Pre-Ret Rate of Pay
School Crossing Guard	\$8.16	10/02/2003	01/08/2003	Equipment Operator	\$15.54
School Crossing Guard	\$8.16	05/12/2004	07/15/2000	School Crossing Guard	Unavailable
School Crossing Guard	\$8.16	10/13/2004	02/16/1994	Bldg. Maint. Lead	Unavailable
School Crossing Guard	\$8.16	09/14/2005	05/15/2002	Laborer II	\$13.51

SOURCE: CITY OF DALLAS DEPARTMENT OF HUMAN RESOURCES

ATTACHMENT



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August 28, 2006

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**Re: Impact of Current Rehired Retirees on the Employees' Retirement Fund of the
City of Dallas**

Dear Mr. Garner:

As requested by the Office of the City Auditor, Gabriel Roeder Smith & Company has examined the estimated cost impact on the Employees' Retirement Fund ("ERF") of the City of Dallas of rehiring retirees.

Background

As you are aware, currently 35 retirees of the ERF are employed by the City of Dallas ("the City"). Under Chapter 40A-19 of the City Code, a retiree who is re-employed by the City in a position that would normally be covered by the ERF would have his or her pension benefit suspended and forfeited for as long as the retiree remains employed in such position with the City. The retiree does have the option of becoming a contributing active member of the ERF for the purposes of earning additional future benefits, but there is no option to continue to receive the retiree's current monthly pension payment at the same time.

Chapter 40A-1(16) defines an employee as a person employed by the City on a permanent basis who receives regular compensation from the City. It excludes from the definition of employee a contract employee, an individual who is employed on a part-time basis at less than one-half time, and an individual defined as a temporary employee.

It is our understanding that the 35 retirees who were re-employed by the City were classified as temporary employees by the City and, therefore, these retirees have continued to draw their monthly pension amounts from the ERF while at the same time receiving compensation from the City. After reviewing the data provided by the Auditor's office, it is apparent that many of these employees (if not all of them) are not temporary employees. For example, some of the individuals have now been re-employed for more than three years.

ATTACHMENT

Mr. Paul T. Garner
 August 28, 2006
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Impact on ERF

We have been asked to determine the impact on the ERF of these retirees continuing to receive their ERF pensions while being re-employed by the City. While it is possible that the City intended to hire some of these employees into a truly short-term temporary position, we have no way of identifying those employees and so for the purpose of this analysis we will assume that all of the employees are in fact permanent employees working at least on a part-time basis of 50%. Also, one could argue that some or many of these retirees may not have come back to work for the City if they knew their pension payments would be suspended and, thus, forfeited for the period of time when they were re-employed. Therefore, the estimated impact on the ERF that we detail below should be considered the maximum impact on the ERF from the action of rehiring these retirees.

We will examine the cost impact on the ERF from two points of view. The first will be the benefit payments made from the ERF to these retirees that should not have been made if the retirees had been reported as permanent employees. The second will be the contributions that would have been made to the ERF if the positions these retirees filled had instead been filled with new employees.

The table below shows the estimated benefit payments that have been made to the 35 retirees since they were rehired through December 31, 2005. It also shows the payments that the ERF would expect to pay to these retirees over the next five years. In determining the future payments it was assumed that annual cost-of-living-adjustments would be 3.0% each year.

Payment Period	Total Estimated Payments
Date of re-employment through December 31, 2005	\$1,976,096
Additional calendar year 2006 payments	\$1,659,279
Additional calendar year 2007 payments	\$1,704,560
Additional calendar year 2008 payments	\$1,749,840
Additional calendar year 2009 payments	\$1,795,120
Additional calendar year 2010 payments	<u>\$1,840,401</u>
Total	\$10,725,296

We have estimated that the above amount of \$1.98 million in additional benefit payments paid to these retirees as of December 31, 2005 increased the calculated contribution rate to the ERF by approximately 0.04% of payroll. Should these retirees continue to receive these payments while remaining employed with the City for the next five years, we have estimated that the calculated contribution rate will be three to four basis points higher each year than it otherwise would have been (these effects are cumulative so that by the end of calendar year 2010 the contribution rate will be 18 to 20 basis points higher than it otherwise would have been. As you are probably aware, the actual contribution rate has a corridor around it which keeps the actual contribution rate stable from year to year. As long as the calculated contribution rate is within 300 basis point of the actual contribution rate, the actual contribution rate will not change. Therefore, it is not expected that

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these additional payments will change the actual contribution rate to the ERF. However, the additional payments may shorten the amount of time before an increase in the contribution rate is necessary or lengthen the amount of time before a contribution rate reduction is allowed.

The second impact we wish to explore is the impact of missing contributions. If these retirees had not been rehired then it is fair to assume that they would have been replaced in the City of Dallas workforce by new employees. Both the City and the actual new employees would be required to make contributions to the ERF. The combined contribution rate of the member and City go to cover the cost of the benefits promised by ERF and to pay the debt service on the Pension Obligation Bonds issued by the City in 2005. We will examine the estimated cost impact on these two items separately.

If new employees were in the positions filled by the retirees, these employees would accrue benefits in the ERF. Since the ERF is currently "overfunded," the contributions (member and City) paid to the ERF are slightly less than the normal cost of the ERF, which means the contributions for these new employees would only go to cover the cost of the benefits they have earned. Therefore, there is no impact on the ERF from these missing contributions.

The remaining contributions are allocated to pay the debt service payment on the Pension Obligation Bonds. This is not a liability of the ERF and the actual debt service payment is not truly a function of the contributions received, but is a fixed dollar amount set by schedule. Therefore, the missing contributions for these retirees will not have an actual impact on the debt service payment. Instead, it will only make the debt service payment appear as a larger percentage of payroll because of the exclusion of the pay for the rehired retirees from the calculation.

Other Comments

It should be noted that of the 35 rehired retirees, seven of them were separated from employment less than one month (some actually never separated). The IRS would most likely consider these "sham" retirements which could in theory jeopardize the qualified status of the ERF. In addition to these seven employees, another six were separated for a period of less than three months. It is unclear what the IRS would think of these re-employments as they use a facts and circumstances method for determining compliance with the separation from service rules. It is clear that if these employees had agreements in place to return to work when they retired then those rules may well have been violated.

Please note that we have not estimated the actuarial losses that may have been generated by the retirees who retired without truly separating from service. It is possible some of these employees would have retired anyway even if they did not plan to return to work for the City. The next phase of our project will be to examine the estimated cost to the ERF should a formal program be put in place to rehire retirees without causing them to forfeit their pensions. That report will be sent under separate cover.

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If you have any questions concerning this information, or if you need additional information, please do not hesitate to contact us.

Sincerely,



Lewis Ward
Consultant



Mark R. Randall
Senior Consultant & Actuary

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cc: Mr. Andrew Knight

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