



Office of the City Auditor

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

**RETIREMENT SERVICES:
THE OFFICE HAS NOT
CONSISTENTLY
FOLLOWED CITY
PROCUREMENT POLICIES
AND STANDARD
PRACTICES**

**Report 24-03
April 2024**

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April 4, 2024

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

Retirement Services: The Office Has Not Consistently Followed City Procurement Policies and Standard Practices

The City of San José (City) has two retirement plans, each overseen by an independent board. The boards have fiduciary responsibility for the investment of moneys and administration of the retirement plans, which includes defraying reasonable expenses of administering the system. The Office of Retirement Services (ORS) administers the plans. Even though the boards provide oversight, ORS is a City department and is staffed by City employees. Other City departments provide various support services to ORS and ORS uses a number of City systems.

This audit was conducted in response to direction from the City Council. An interim report was published in October 2023. That report covered part of the overall audit direction, to identify internal policies and procedures as well as conduct benchmarking research with other retirement systems in California. In accepting the audit report, the City Council gave the City Attorney's Office direction to amend the Municipal Code to clarify that the City's procurement process applies to the Retirement Boards. At the time of this audit, the City Attorney's Office had presented proposed plan amendments to the Retirement Boards in response to the Council's direction. Per the Municipal Code, the boards were given 60 days to review and make any recommendations.

This report reviews ORS compliance with City policies and procedures for purchasing and contracting.

Finding I: Updating Procedures and Staff Training Can Ensure Greater Compliance With City Procurement Rules. Per the California Constitution, Article 16 §17, the Retirement Boards have "plenary authority and fiduciary responsibility for investment of moneys and administration of the system." This includes entering into contracts on behalf of the retirement plans. We found:

- In many cases, ORS's processes have aligned with the City's standard practices; however, there have been some exceptions.
- We noted instances in which ORS did not competitively procure services, used non-standard payment processes because they did not have approved purchase orders, and retroactively executed contracts.

Recommendations:

To improve controls around procurement and contracting, the Office of Retirement Services should:

- Develop procedures for key areas, including following the Municipal Code's competitive bidding rules and establishing contracts or purchase orders, among others.

- ORS can strengthen its procurement and contracting practices by standardizing processes and having better coordination with other City departments.

→ Provide training to ORS staff on internal and City procurement and contracting procedures.

This report has 3 recommendations. We plan to present this report at the April 16, 2024, meeting of the City Council. We would like to thank the Office of Retirement Services for their time and insight during the audit process. The Office of Retirement Services has reviewed the information in this report, and their response is shown on the yellow pages.

Respectfully submitted,



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Board of Administration of the Federated City Employees' Retirement System
Board of Administration of the Police and Fire Department Retirement Plan

This report is also available online at www.sanjoseca.gov/audits

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Introduction

In June 2023, the Mayor and two Councilmembers directed the City Auditor to conduct an audit of the Office of Retirement Services (ORS) to address the following areas:

1. *Identifying internal process controls for financial activities such as accounting, purchasing and contracting;*
2. *Identifying policies and procedures around information systems and security;*
3. *Compliance with City policies for financial activities, information systems and security, and other relevant administrative functions;*
4. *A comparison of the governance structures of other pension plans, including board oversight of management's administrative functions and responsibilities.*

The direction was in response to concerns about reported confusion among ORS staff regarding administrative procedures and whether staff was required to follow City policies.

Interim Report on the Alignment of Controls Between the City and the Office of Retirement Services

In October 2023, our Office issued Retirement Services: Interim Report on the Alignment of Controls between the City and the Office of Retirement Services.¹ The objective of the interim report was to review policies and procedures for ORS' administrative responsibilities, including a comparison of other retirement systems' oversight of such responsibilities. The audit was responsive to items 1, 2, and 4 from the Council audit direction.

The audit found that that better alignment of ORS and City policies would strengthen internal controls over ORS operations. Not having clear direction or up-to-date procedures is an internal control weakness that can lead to practical difficulties in routine operations and could expose the retirement system and the City to unnecessary risks, including inefficient operations, fraud, and susceptibility to cybersecurity incidents.

Our report presented comparison information from other retirement systems in California. Those retirement systems are similarly staffed by individuals who are considered employees of their plan sponsor, like San José. When staff are using their plan sponsor's administrative functions, the systems report that staff generally follow their plan sponsor's policies, or that they have adopted policies that were aligned or in some cases stricter than the plan sponsor's.

¹ <https://www.sanjoseca.gov/home/showpublisheddocument/105906>

The report had one recommendation. We recommended that ORS and the Retirement Boards work with the City to either:

- a) Adopt the City's policies and procedures related to information systems and technology, and support services such as procurement, invoice processing, and other relevant administrative functions, or
- b) Develop a set of internal policies and procedures that are in alignment with the City's policies and procedures.

The report was heard and accepted by the City Council on October 24th, 2023. At that time, the City Council passed the following motion:

1. Accept the City Auditor's Report and express the City Council's intention for the Retirement Boards to follow all City policies contained in the City Administrative Policy Manual, including but not limited to the Finance and Procurement Policies. The Retirement Boards are directed to return to council in 45 days with an information memo detailing the changes or adoption of these policies.

2. Direct the City Attorney and City Administration to bring forward Municipal Code changes to amend the Plans (SJMC 3.28.155 and SJMC 3.36.385, and any other applicable sections) with provisions stating the City's procurement process in Part 4.12 of the Municipal Code and the City's procurement policies apply to the Boards' contracts and amend Section 7 in the Sunshine resolution to add its application to the Boards.

3. Direct the City Attorney and City Administration to review the City Charter and bring forward any proposed changes to ensure appropriate oversight, while maintaining the independence where necessary of the Retirement Boards.

Work on the audit recommendation included in the interim report, along with the response to the City Council direction, is ongoing. On March 7 and March 21, 2024, the City Attorney's Office presented to each Retirement Board proposed changes to the Municipal Code pursuant to Part 2 of the City Council's direction.² Per the Municipal Code, the Retirement Boards have 60 days to review and make recommendations to any proposed amendments to the plans.

The objective of this report was to assess compliance with City policies for procurement and contracting and is responsive to item 3 in the original Council direction. Compliance with City policies regarding information systems and security will be reviewed separately.

² These changes are to Municipal Code sections 3.28.155 and 3.36.385, as well as Chapter 4.12 regarding procurement and the Consolidated Open Government and Ethics Resolution (Sunshine Resolution).

Background

The City of San José (City) offers two defined benefit retirement plans to City employees:

- The Police and Fire Retirement Plan for qualifying members of the Police and Fire sworn services, and
- The Federated City Employees' Retirement System for qualifying employees not covered by the Police and Fire plan.

As of June 30, 2023, there were over 15,300 members of the plans (including active staff, retirees, deferred vested, and beneficiaries). In addition to pension benefits, the City provides Other Post-Employment Benefits (OPEB) to some employees.³ These benefits relate to post-employment healthcare, both medical and dental.

The retirement plans are overseen by two independent boards who have fiduciary responsibility for the administration and investment of the retirement plans, as well as the appointment and oversight of the work of ORS' Chief Executive Officer and the Chief Investment Officer. The boards are comprised of employee representatives, retiree representatives, and members of the public. Members of the public are appointed by the City Council and must have at least twelve years of experience relevant to the administration of a pension plan.

Retirement Board Oversight and Responsibility

Under the California Constitution, “[T]he retirement board of a public pension or retirement system shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the system.” Additionally, the Constitution states that the board shall discharge their duties solely in the interest of providing benefits to participants and “defraying reasonable expenses of administering the system.”⁴

The City Charter and Municipal Code provide additional direction around the plans. San José Municipal Code §3.36 Police and Fire Department Retirement Plan and §3.28 Federated Employees Retirement Plan establish the plans and some aspects of plan administration. This includes giving the Retirement Boards power to adopt rules and regulations that are necessary to maintain the qualified status of the plan.

In 2014, San José voters passed Measure G, which added sections 810 and 810.1 to the City Charter. Measure G gave direction on the separation of responsibility between the City Council and the Retirement Boards. This included requiring that

³ Benefits depend on an employee's tier. For example, Tier 2 members hired after September 2013 are not provided the same post-employment healthcare benefits as Tier 1 members. Tier 1 members could have opted out of OPEB in 2017.

⁴ Article 16 §17 of the California Constitution

the Retirement Boards administer the retirement plans in accordance with the fiduciary duties and obligations established by law, the City Charter, and as further prescribed by ordinance.

However, Measure G did not explicitly address all aspects of the plans' administration and operations. As noted in our interim report issued in October 2023, this has resulted in some confusion for staff and management in ORS regarding which City policies and procedures should apply to ORS administration and operations.

The Office of Retirement Services

ORS administers the retirement benefits provided by the City. ORS' Chief Executive Officer oversees the entire office, including authority to hire and fire ORS staff. In FY 2023-24, ORS has 43 full-time equivalent positions with a personnel budget of \$8.7 million.

Staff in ORS are City employees, including the Chief Executive Officer (CEO) and the Chief Investment Officer (CIO). The CEO and CIO are hired by the Retirement Boards, and other ORS staff are hired by the CEO. Most ORS staff are members of the Federated City Employees Retirement System, except for staff in the Investment Division (who are members of CalPERS, the California Public Employees' Retirement System). ORS staff also have the same benefits as other City employees and are subject to the same employment terms. Most ORS staff are members of an employee bargaining unit (either Municipal Employees' Federation (MEF) or City Association of Management Personnel (CAMP)); the remainder are unclassified (members of Unit 99).

The Office is split into several divisions which handle different aspects of ORS operations. This includes the Investment, Benefits, Accounting, Administration, and Information Technology divisions. Additionally, ORS has an internal auditor who is accountable to the joint audit committee of the Retirement Boards.

The City is the Plan Sponsor and City Departments Provide Support for ORS

The City is the plan sponsor of the two retirement plans. The City acts as the financial backstop for the plans and is required to make employer contributions into the pension funds. These may take the form of one annual payment into the funds or contributions throughout the year. In FY 2022-23, the City contributed \$401 million for pension and \$54 million for OPEB. City employees contributed an additional \$84 million for pension and OPEB.

Other City departments and offices provide support services to ORS. This includes payroll, invoice processing, human resources (such as new employee orientation and providing benefits), information technology (such as email and network

services), and employee relations (including negotiating with bargaining units on terms of employment).

The City also maintains the City Policy Manual (CPM). The CPM covers a range of topics, including ethics, workplace rules, compensation and benefits, finance, and technology. Per the City's website:

The policies contained within the CPM reflect not only the City's values as an employer, but also convey the standards that the City has for its employees.

Per the City's Code of Ethics, City employees are obligated to abide by all City policies.

The boards have worked with their outside legal counsel to identify which policies in the CPM to adopt for ORS staff. At the time of this audit, the boards had adopted the majority of policies in the CPM but were working with a consultant on creating separate policies and procedures for contracting and procurement. The boards were also considering adopting a policy to govern trustee travel. More information about the status of this work is included in the Finding.

City Policies and Procedures Related to Procurement and Contracting

Municipal Code Section 4.12 contains the City's procurement rules and regulations. These include guidelines for how goods and services should be procured, depending on the amount and type. For example, purchases of over \$10,000 must go through a competitive procurement process.

The Municipal Code also includes exceptions from competitive procurement. Two of the exceptions are for sole source and unique service procurements.

- **Sole source SJMC 4.12.230:** Materials or equipment can only be obtained from one vendor or manufacturer.
- **Unique service SJMC 4.12.235:** When an unusual or unique situation exists that makes a competitive procurement contrary to the public interest.

As noted in the Introduction, the City Council gave direction to the City Attorney's Office to amend Section 4.12 to state that the provisions apply to the Retirement Boards. The City Attorney's Office presented proposed plan amendments to the Retirement Boards in March 2024. The boards have 60 days to review and make any recommendations to the proposed amendments.

Finance Has Clear Guidelines to Help Ensure Compliance With the Municipal Code

Along with the Municipal Code, the Finance Department (Finance) has comprehensive procurement guidelines and checklists to guide City staff. For example, Finance has:

- **Sole source and unique service procurement** justification guidelines that include examples of acceptable and non-acceptable unique service and sole source purchases. Additionally, the guidelines have a checklist of items the department needs to include in the request. Finance or the City Manager's Office ultimately determines whether a service can qualify as unique.
- **Tactical procurement** guidelines for products and non-consulting services, up to an amount determined by the Municipal Code,⁵ that require selection based on low bid (lowest price).
- **Strategic procurement** for services or a combination of goods and services valued at over the Municipal Code limit for the initial term that require selection based on best value (evaluative).

In addition, the City's Open Government Resolution provides additional guidelines to address conflicts of interest and to ensure the integrity of the procurement and contract process.

Lastly, the City Policy Manual provides guidance and procedures around procurement and purchasing. Select policies include:

- CPM 5.1.1 Procurement and Contract Process Integrity and Conflict of Interest – Administrative Procedures
- CPM 5.1.2 City Procurement Cards
- CPM 5.1.4 Brand Name and Sole Source Procurements
- CPM 5.1.9 Procurement of Information Technology

Assistance from City Departments on Procurements and Contracting

Finance and other City departments provide support during the procurement and contracting process.

- Staff in the Finance Department's Purchasing Division support departments through procurements and have guidelines for following the San José Municipal Code. The Risk Management team works with departments through the contract development process by evaluating risks and identifying mitigations to protect the City. Finance also maintains the City's

⁵ At the time of the audit, the limit was \$250,000.

e-procurement software for City departments to post open competitive solicitations.

- The Information Technology Department approves IT-related purchases and provides guidance to departments. This includes evaluating procurement requests for reliability and security, in alignment with City standards.⁶
- The City Attorney's Office has developed contract templates with standard language covering key clauses such as indemnification, liability, disclosure of work product, and conflict of interest requiring disclosure of economic interests in Form 700. City Attorney's Office staff also review certain contracts for City departments prior to execution, as deemed necessary.
- The City Clerk's Office manages the records for the City. Departments submit contracts to the City Clerk to post on the City's library of legislative documents including ordinances, resolutions, and contracts (the Government Information Library Electronic System, or GILES). The City Clerk's Office also broadly coordinates the filing of Statements of Economic Interest (Form 700s).

⁶ See City Policy 1.7.2 *Technology Management and Deployments*.

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Finding I Updating Procedures and Staff Training Can Ensure Greater Compliance With City Procurement Rules

Summary

ORS has not consistently followed the City's procurement and contracting processes. In many instances, ORS' processes have aligned with the City's standard practices; however, there have been exceptions. For example, we noted instances where ORS had not used competitive selections to procure services. Additionally, ORS has used non-standard payment practices because they did not have approved purchase orders for subscription services. In some cases, ORS has also executed contracts retroactively. ORS can strengthen its procurement and contracting practices by standardizing processes and having better coordination with other City departments that support procurement and contracting. We recommend the Retirement Boards develop internal processes and procedures for key areas, such as following the Municipal Code guidance regarding competitive bidding and unique services, using approved master agreements and purchase orders for some services, and others. ORS should also train staff on these procedures to avoid any confusion in the future.

ORS Has Not Consistently Followed the City's Procurement Guidelines or Procedures

The Retirement Boards approve contracts for the retirement plans and oversee spending by ORS.⁷ ORS staff, working with the boards' outside legal counsel, draft contracts for board approval. Additionally, ORS staff regularly update the boards as to spending and budget for the administration of the plans.

In many instances, ORS' procurement and contracting processes align with the City's standard practices. Though there are exceptions as described later, ORS has:

- Followed standard procurement practices for some competitive procurements, such as using the City's e-procurement software to conduct Requests for Proposals (RFP) and using the City's standard consultant contract templates. Examples include a 2023 RFP to procure financial audit services and a 2020 RFP for legal consulting services.
- Worked with Finance to establish purchase orders so that payments for services can be processed through the City's standard accounts payable

⁷ For contracts under \$50,000, the boards have authorized the CEO of ORS to approve agreements.

process. In FY 2022-23, this included purchase orders for temporary staffing services, offsite data storage, and HVAC system maintenance.

- Worked with the City Clerk to ensure contracts are uploaded to GILES, the City's library of legislative documents and contracts, and that certain consultants file Statements of Economic Interests (Form 700s) as necessary.
- Used City procurement cards (p-cards), issued by the City's Finance Department, and prepared documentation according to City standards. According to ORS, they expect ORS staff to adhere to the City's p-card policy and require written explanations for violations of the policy to submit to Finance.

In addition, most payments to service providers in June and September of 2023 were processed by the City's Finance Department Accounts Payable team.⁸ In our limited review, these payments had appropriate approvals and documentation. However, there have been exceptions to the above standard practices that have varied from City policy and in some cases have led to confusion among staff.

ORS Has Not Always Used Competitive Selections for Service Providers

During a competitive bidding process, the City solicits and evaluates cost and scope proposals from prospective vendors.⁹ There are several mechanisms for this, including issuing a Request for Qualification (RFQ) or a Request for Proposal (RFP). Through an RFQ or RFP, the City can determine whether to select a vendor based solely on low price or by price along with other factors. The result is that the bidding is open to the public and that the City gets the best value for the services needed. However, ORS has not always used competitive processes to procure consulting or other services.

In one example, ORS entered into a contract with an investment analytics company in 2013 with a one-year agreement term totaling \$22,500 (across both plans). That agreement has been extended six times through 2024. ORS did not conduct a competitive procurement process over these eleven years. The awards across all extensions totaled \$273,000.

In another example, ORS has repeatedly contracted with a consulting firm for general governance-related consulting services, but the last competitive procurement was conducted thirteen years ago. According to ORS management, ORS began contracting with this firm in 2009 through a public RFQ process. The scope of work included reviewing governing legislation, policies, strategies, and

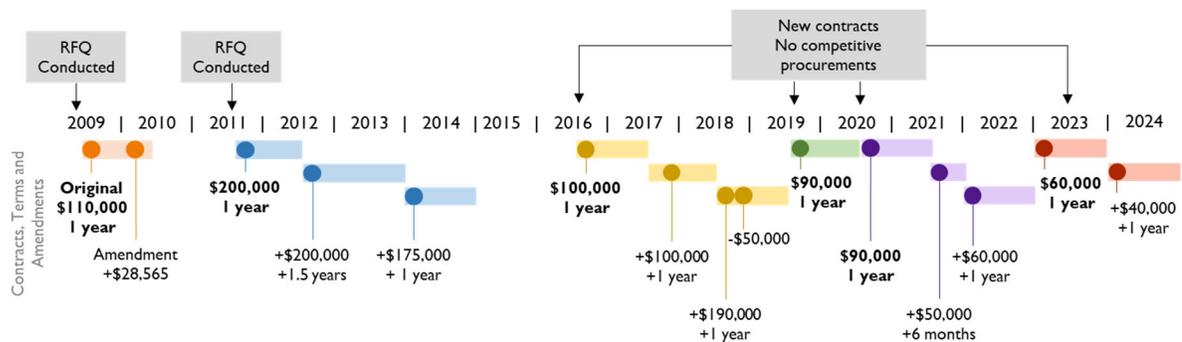
⁸ Municipal Code section 2.04.2020 provides that the Finance Department shall "Administer and supervise the accounts payable function of the city."

⁹ Municipal Code section 4.12.210 provides direction on requirements for competitive procurement processes. Section 4.12.215 provides exceptions for when competitive procurement processes may not be practicable, such as emergency, public agency, sole source, and unique services purchases.

performance relating to the two plans. They were awarded a second contract in 2011 through a second RFQ process; this contract continued through 2014.

In 2016, ORS contracted with them again, but without following a competitive process. Since then, there have been three other contract awards, and six separate contract amendments. The dollar amount awarded to the consultant for these four contracts and their subsequent contract amendments totaled \$730,000. The scope of services described in the last three contract awards is listed as “governance-related consulting services that may include, but are not limited to, policy review, support for various performance evaluations, organizational planning and education.” These contracts did not include descriptions of specific deliverables.

Exhibit I: ORS Has Repeatedly Contracted with a Consultant Without a Competitive Procurement



Source: Auditor analysis of ORS contracts with one consultant since 2009.

The City Uses Master Agreements for Some Consultant Services

For consultant agreements, the City Manager’s Office advises that scopes of services and deliverables should be clearly described. However, in some situations, the City executes master agreements to keep a competitively procured consultant on retainer. Departments then submit service orders when specific work is needed, up to the contract’s not-to-exceed amount. In this way, departments can maintain professional expertise for various services on an as needed basis.

This type of contracting would allow ORS to retain a consultant for a period of time and then develop more detailed scopes of work when needed.

Because ORS Does Not Have Approved Purchase Orders with All Service Providers, They Have Sometimes Relied on Non-Standard Payment Practices

ORS has not always secured agreements or purchase orders with service providers in accordance with City practices. For example, the ORS investment team uses subscription services for data and research. Although staff has begun presenting memoranda to the boards to seek approval for paying for these services, ORS does not have current agreements on file or purchase orders with those providers.

This appeared to have started in 2022, when a contract for one of these subscription services expired. Under normal circumstances, the City’s Finance Department will authorize payments to service providers when there is a contract on file with the City Clerk’s Office or if there is an active purchase order. ORS staff, needing to provide payment to the service provider, tried to extend the contract by providing the City Clerk’s Office with the invoice. The Clerk’s Office did not accept the invoice as a means to establish an agreement, though ORS had submitted invoices to the Clerk’s Office when the contract had been extended previously. ORS then asked to create a purchase order with Finance’s Purchasing Division. Because Purchasing did not have any involvement in the procurement of the service provider and could not verify that the procurement had followed the City’s requirements, they did not create the purchase order for ORS.

Without a valid contract in the City Clerk’s library of records (GILES) or a purchase order, Finance’s Accounts Payable team would not pay the invoice for ORS’s subscription service. After consulting with the boards’ external legal counsel regarding options for paying the invoice, ORS paid the invoice using a wire transfer. According to ORS, this was to ensure continuity of operations.

Subsequently, starting in June 2023, the ORS investment team paid other subscription services using wire transfers. The use of wire transfers continued as of the time of this audit.

In June and September 2023, wire transfers made up 16 percent of transactions, and 12 percent of the total dollar value of payments to service providers.

Exhibit 2: Summary of ORS Payments in June and September 2023

	Finance AP	Wire Transfers	TOTAL	% Wire
Total Amount	\$ 1,689,058	\$ 234,445	\$ 1,923,503	12%
Number of Transactions (individual check or wire)	107	21	128	16%

Source: Auditor analysis of financial management system records and ORS wire transfer documentation.

Note: Transactions processed via wire transfer do not include any payments to investment managers.

The Use of Wire Transfers to Pay for Services Varies from the City’s Standard Practices

In general, because wire transfers are primarily handled by one team, there is not the same segregation of duties compared to how other invoices are paid. For example, for non-wire transfers, staff in different departments review, approve, and make payments. With the current wire transfers, the review of the invoice and the initiation of the wire transfer is all within the Investment Division and by the CEO.

It should be noted that ORS does have some controls in place to reduce the risk associated with these wire transfers. These include reviews by senior management and requirements to have three separate staff initiate, approve, and authorize the

wire transfer. Staff report that if wire instructions change, they independently verify the change with the service provider. These controls are not all documented.

However, ORS Investment staff have expressed a preference for using the City's standard accounts payable process. Per ORS staff, the wire transfer process can add confusion for the service providers and additional work for ORS staff because each invoice must be paid with multiple wires, coming from each of the plans' accounts.

Finance Has a Purchase Order for Subscription Services Based on the Municipal Code's Unique Services Provision

In contrast to how ORS has procured subscription services, Finance has a purchase order for one of the same service providers as ORS. They established the purchase order using the Municipal Code's unique services exception. Finance had documented the need for the services and public benefit for bypassing the competitive process. The unique services exception was approved by Purchasing staff and a purchase order was established. This allowed payments for these subscription services to be processed through the City's standard accounts payable process.

ORS has reportedly considered the subscription services to be unique services. However, ORS has not always filed unique services requests with Finance, which could result in a valid purchase order or contract. In 2023, Investment staff submitted memos to the boards for approval to use the subscription services, but the memos did not clearly outline whether the services were considered to be unique.

Several ORS Contracts Have Been Executed Retroactively

ORS has executed contracts retroactively. Out of the 49 current ORS contracts, 22 (or 45 percent) were signed by ORS or the service provider after the effective start date of the agreement.¹⁰ While many were signed a few days after the term began, some were signed a month or more later.

Per Finance Purchasing, retroactive contracting is best avoided to reduce risk. The City Attorney's Office also reports that retroactive contracts pose some risk and may hinder the City's negotiating position with a service provider. As stated in the City Auditor's Office 2013 audit *Consulting Agreements: Better Enforcement of Procurement Rules, Monitoring, and Transparency Is Needed*:

However expedient it may be, permitting vendors to work off-contract is a bad idea... [T]he Municipal Code requires all agreements with contractors to be in writing, be approved as to form by the City Attorney, and be filed at the Clerk's Office. When

¹⁰ Contracts with each Retirement Board are counted separately. In some cases, it was not clear when ORS signed a contract.

City officials authorize the start of work prior to the completion of the City's legal contracting process, they exceed their legal authority.

Furthermore, when contracts are not legally formed, their enforceability is questionable. In those situations, the City may have no obligation to compensate the contractor for the work.

Standardizing Processes and Better Coordination with Other City Departments Can Strengthen Contracting and Procurement in ORS

The City has developed standard processes to address the risks of contracting. As noted earlier, ORS has followed many of these processes in the past. Further adherence to these practices can ensure contracting risks are minimized in the future.

- **Standard contract templates:** The City has standard contracting templates that simplify the contracting process and contain specific provisions to address contracting risks. These include standard language around indemnification, identification of consultants required to file Statements of Economic Interest (Form 700s) to identify conflicts of interest, and others. ORS has not always used these templates, and default vendor terms and conditions may not provide the same protections. In one contract, ORS promised to indemnify a consultant against any actions or costs relating to contract breaches or copyright infringement. According to the City Attorney's Office, this language is generally not included in City contracts. In other instances, ORS contracts have not clearly distinguished whether consultants should be filing Form 700s.
- **Coordination with other City departments:** As noted in the Background, other departments provide support for department contract development. This has not always occurred with ORS contracts. For example, the Finance Department's Purchasing Division has reported that they were not involved in some recent ORS procurements when they would have been for other City departments. Additionally, Finance's Risk Management team reviews City contracts to determine what insurance requirements are needed based on the services provided. Some, but not all, ORS contracts appear to have been reviewed by Risk Management.
- **Use of p-cards:** Several ORS staff have City-issued p-cards. Based on our limited review, many of the expenditures did comply with City policy. However, in one instance, an ORS employee had a newspaper subscription delivered to a non-City address. The City's Finance Purchasing Division considers this practice a violation of policy and advised that all deliveries should be made to City or City-controlled sites.¹¹

¹¹ Under the City Procurement Cards policy (CPM 5.1.2), the Chief Purchasing Officer, as delegated by the Director of Finance, is responsible for the Procurement Cards policy and program.

Direction for ORS to Follow City Policies and Procedures Has Been Unclear

As described in the background, the City has procurement policies in the Municipal Code and procedures established by the Finance Department. The City Council has expressed their intention that ORS staff should follow the Municipal Code procurement rules. However, the Retirement Boards have adopted the City's policies for only some types of procurements and are currently considering separate policies for other procurements.

Without Clear Policy Guidance, ORS and City Staff Have Expressed Confusion Over ORS Required Practices

In the absence of clear direction to follow the Municipal Code and Finance guidance, ORS staff have expressed confusion about whether the City procurement and contracting policies apply to them and all the steps required to comply. For example, staff were unclear on how to proceed with procuring subscription services when Finance Purchasing did not create a purchase order and a previous contract extension on file with the Clerk had expired. In another instance, staff were unsure about the appropriate process to extend a contract when it expired.

City staff have also expressed confusion over whether ORS staff are expected to follow City policy, as well as about ORS contracting procedures. This is due in part to differences between ORS and contracting by other City departments. Under the Municipal Code, the Retirement Boards have contracting authority for ORS. For other City offices and departments, the City Council, or the City Manager, Finance Director, or other designees, have contracting authority.

City staff expressed that because they were unsure about which policies and procedures would apply to ORS, it was sometimes difficult to understand how to best support ORS staff. Examples we noted include:

- **Finance's Purchasing and Risk Management Division** expected that the City Attorney's Office would review ORS contracts when necessary. However, that is not the case as the board's external legal counsel generally reviews ORS contracts. City staff also expected that ORS would engage with the Risk Management team during the contracting process to ensure all the service providers that work with ORS have the proper insurance. Some ORS contracts do go through Risk Management, but not all.
- **City Clerk's Office** staff expected that ORS would follow the City's typical process for submitting contracts to be on file with the Clerk. This has not always been the case and it has caused confusion for the City Clerk's Office staff when working with ORS on filing contracts.
- **City Manager's Office**, in coordination with the City Attorney's Office, has created a resource guide for contract creation, administration, and management. CMO staff expected that ORS would be required to follow

the City's procedures for procurement and contracting for consultant agreements, as well as competitive procurement requirements for goods and services. The boards have a vendor selection policy, but it does not specifically address competitive procurement requirements.

Based on the direction to the City Attorney's Office to bring forward Municipal Code changes to state that the City's procurement process in Part 4.12 of the Municipal Code apply to the boards, some of this should become clarified and future confusion can be mitigated.¹² In addition, internal training around the City's standard procedures can clarify expectations.

The Retirement Boards Have Adopted Some City Policies, but Not All

The boards are reviewing City policies, including those under procurement, to determine whether to adopt them for ORS staff.¹³ In October 2023, the City Council's direction for the Retirement Boards was to return in forty-five days with an update on the status of changes or adoption of the policies in the City Administrative Policy Manual. The boards worked with their outside legal counsel to determine which policies to adopt. In early December 2023, the ORS CEO returned to the City Council with a status report on policies that were adopted and those still under review.

The boards hired an outside consultant to develop their own policies and procedures for procurement and contracting. In January 2024, the boards' Joint Governance Committee discussed proposed policies and procedures drafted by the consultant. For specific goods and services, the committee adopted the City's procurement policies, but moved to modify the policy for consulting services and other functions that were deemed critical to the plan administration. The consultant is expected to continue to make edits to the proposed ORS procurement policy. ORS management expects to report back to the City Council on the results in spring 2024.

As noted previously, the City Attorney's Office brought forward proposed changes to the Municipal Code regarding procurement in March 2024 following direction from the City Council. These changes would stipulate that the Municipal Code governs the procurement of some ORS contracts. Excluded from this would be contracts relating to investments as well as medical services.

ORS Staff Should Be Trained on Procurement and Contracting Policies and Procedures

As ORS adopts City policies and establishes internal procedures, management should ensure that ORS staff are trained on how to follow these appropriately.

¹² <https://sanjose.legistar.com/View.ashx?M=F&ID=12391192&GUID=AE19E189-10C6-4BB0-95D2-B22F16439971>

¹³ The boards have an existing vendor selection policy that establishes the authority for the CEO to enter into agreements but does not provide specific guidance regarding procurement like City policies and procedures do.

Any ORS staff working on procurements or overseeing contracts should have appropriate training, including staff in the Investment Division.

The City periodically offers training opportunities to department staff for several City support functions, which could benefit ORS staff. These training opportunities include trainings for conducting competitive procurements, payment processing through Finance Accounts Payable, as well as procurement conflict of interest and ethics. In addition, the City has created a consultant contract creation, administration and management resource guide for staff which includes an annual certification process for contract administrators. When following City policies and procedures, these trainings and resources will help ORS staff navigate City processes. This will reduce the confusion and nonstandard practices that ORS has previously experienced.

In addition to training ORS staff on City procedures, ORS should develop training on any internal procedures as needed. This could include training on ORS processes put in place to enable staff to comply with City policy.

Along with Plan Amendments and New Policies, ORS Should Develop Internal Processes and Procedures

The proposed Municipal Code plan amendments would clarify the governance of some ORS procurements and contracts. Current ORS draft policies regarding procurement also provide direction on ORS staff responsibilities and authority. These draft policies are particularly relevant in areas that will remain unchanged in the Municipal Code regarding investments and medical services.

To implement policy-level changes and ensure strong controls, ORS should develop standard internal processes and procedures. This will provide clear direction for ORS staff on day-to-day operations and guide staff on how to follow the procurement policies.

Recommendation:

- I: To ensure appropriate controls over procurement and contracting, the Office of Retirement Services should develop internal processes and procedures for key areas, including:**
- a. Following the Municipal Code and City procedures regarding use of competitive bidding and unique services/sole source procurements.**
 - b. Establishing master agreements with service orders for consultants where specific scopes of services are not established at the time of the contract execution.**
 - c. Ensuring purchase orders or contract agreements are in place with service providers.**
 - d. Executing contracts prior to the start of the contract term.**

- e. **Using the City's standard terms and conditions for contracts as applicable.**
 - f. **Working with City support staff, such as Finance Purchasing, Risk Management, and the Information Technology Department on procurements and contracts when required by City policy.**
- 2: **To clarify responsibilities around the contracting process, the Office of Retirement Services should train its staff on internal and City procurement and contracting procedures. This should include instructions on when procurements or contracts should be coordinated with the Information Technology Department, Finance Purchasing, Finance Risk Management, and the City Clerk.**
- 3: **To ensure all invoice payments can be made through Finance Accounts Payable and avoid the use of wire transfers, the Office of Retirement Services should work with the City's Finance Department to create purchase orders or establish contracts to be filed with the City Clerk. This should be done for all current service providers and subscription services.**

Conclusion

ORS has not consistently followed the City's procurement guidelines or procedures. In many cases, ORS has followed City practices and relied on City support staff. However, ORS has not always engaged in competitive selection processes for contracting with some service providers. ORS has not always secured agreements or purchase orders for subscription services, resulting in the use of wire transfers to make payments. In addition, ORS has executed contracts retroactively which introduces risk to the contracting process. The City has standardized procurement and contracting policies and procedures to mitigate the risks associated with contracting for services. However, without clear guidance, both ORS and City staff have expressed confusion over what City policies and procedures apply to ORS' operations. We recommend that ORS establish internal procedures regarding procurement and contracting and ensure that ORS staff are trained on how to follow those procedures as well as City policies.

RECOMMENDATION

Finding 1: Updating Procedures and Staff Training Can Ensure Greater Compliance With City Procurement Rules

Recommendation #1: To ensure appropriate controls over procurement and contracting, the Office of Retirement Services should develop internal processes and procedures for key areas, including:

- a. Following the Municipal Code and City procedures regarding use of competitive bidding and unique services/sole source procurements.
- b. Establishing master agreements with service orders for consultants where specific scopes of services are not established at the time of the contract execution.
- c. Ensuring purchase orders or contract agreements are in place with service providers.
- d. Executing contracts prior to the start of the contract term.
- e. Using the City's standard terms and conditions for contracts as applicable.
- f. Working with City support staff, such as Finance Purchasing, Risk Management, and the Information Technology Department on procurements and contracts when required by City policy.

Recommendation #2: To clarify responsibilities around the contracting process, the Office of Retirement Services should train its staff on internal and City procurement and contracting procedures. This should include instructions on when procurements or contracts should be coordinated with the Information Technology Department, Finance Purchasing, Finance Risk Management, and the City Clerk.

Recommendation #3: To ensure all invoice payments can be made through Finance Accounts Payable and avoid the use of wire transfers, the Office of Retirement Services should work with the

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City's Finance Department to create purchase orders or establish contracts to be filed with the City Clerk. This should be done for all current service providers and subscription services.

APPENDIX A

Audit Objective, Scope, and Methodology

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, effectiveness, and equity of City operations and services. In accordance with the City Auditor's Fiscal Year (FY) 2023-24 Audit Work Plan, we have completed an audit on the accounting, purchasing, and contracting practices and processes of the Office of Retirement Services. The audit was conducted in response to a City Council request.

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.

The objective of this audit was to review ORS' compliance with City policies for financial activities and identify the internal process control of these activities. We sought to understand the relevant internal controls over Retirement Services, and have performed the following to achieve the audit objective:

- Reviewed the San José Municipal Code, City Policy Manual, and Finance Department guidelines to understand contracting and procurement regulations.
- Reviewed the California Constitution and San José City Charter regarding the governance and role of the Retirement Boards.
- Reviewed the City's Consolidated Open Government and Ethics Resolution and the California Brown Act to understand open government regulations.
- Selected a judgmental sample of ORS transactions processed through Finance Accounts Payable to understand the process, documentation, and approvals for those payments. Our review included nine vendors that received payments in June and September 2023.
- Reviewed procurement card statements from two ORS cardholders from June and September 2023 to test for compliance with the City's procurement card policy and understand payment processing for procurement cards.
- Selected a sample of four contracts encompassing different types of ORS service providers to review procurement processes and contract language.
- Reviewed all ORS payments to service providers completed via wire transfer for June and September 2023. This included seven payments (totaling 21 individual wire transfers) to five service providers.
- Compared totals paid on invoices in June and September 2023 to amounts paid via wire transfer to illustrate the extent to which wire transfers are used to make payments.
- Reviewed all ORS contracts with service providers on file to determine whether consultants had filed Form 700s if required and determine execution and term start date.
- Reviewed ORS procurement and contracting process and policies.
- Interviewed ORS staff to understand the procedures and policies.

- Interviewed City staff to understand how they support ORS operations and the impact of ORS operations on the City organization.

We should note that many Auditor's Office staff, including this audit team, are members of the Federated City Employees' Retirement System.

The Office of the City Auditor thanks the Office of Retirement Services, the City Attorney's Office, the City Manager's Office, and staff from Office of Employee Relations and Finance Department for their time and insight during the audit process.

TO: Joe Rois
City Auditor

FROM: Roberto Peña
Director

SUBJECT: See Below

DATE: March 22, 2024

Approved

Date

SUBJECT: Response to the audit of Retirement Services: Retirement Services: The Office Has Not Consistently Followed City Procurement Policies and Practices

BACKGROUND

The Office of Retirement Services (“ORS”) has reviewed the Audit of Retirement Services: Report titled Retirement Services: The Office Has Not Consistently Followed City Procurement Policies and Practices (“Report”), and we agree with the recommendations identified in the Report. The ORS response to the findings of the City Auditor’s recommendation is provided below.

Although ORS is a department of the City of San Jose (“City”), it is unique from any other City department. This is because, under San Jose Municipal Code (“SJMC”) § 2.04.3120, ORS serves and operates at the pleasure and direction of the Boards of Administration (“Boards”) for the Federated City Employees’ Retirement System (“Federated”) and Police and Fire Department Retirement Plan (“Police and Fire Plan”), who are independent fiduciaries separate from the City—the plan sponsor.

The California Constitution grants the Boards plenary and exclusive authority over the administration of the public retirement systems they are charged to oversee. Because the Boards are fiduciaries who owe a duty to the members and beneficiaries of the retirement plans, the City’s governing law provides the Boards with independence in administration so that the Boards have flexibility in how best to discharge those fiduciary duties. Indeed, the San Jose City Charter and Municipal Code acknowledge and recognize the Boards’ independence in matters relating to the administration of these public retirement systems. Charter § 810; SJMC §§ 3.28.310 (Federated), 3.36.510 (Police and Fire); *see also id.* § 3.28.100 (Federated), & 3.36.300 (Police and Fire).

ORS exists to serve the operational needs of the independent Boards in administering the retirement systems. The Boards delegate authority to ORS staff to assist the Boards in carrying out the day-to-day business operations of the plan. Although ORS carries out its functions at the direction of the Boards, it remains a City Department, subject to the City’s authority on compensation and budgeting issues.

Given this unique hybrid arrangement between the City and ORS, the Boards are engaging their governance consultant and legal counsel to clarify the rules, procedures and protocols that will apply to ORS in administering the retirement systems and will work with the City to establish ground rules where roles and responsibilities overlap.

RECOMMENDATIONS AND ADMINISTRATION'S RESPONSE

- I. To ensure appropriate controls over procurement and contracting, the Office of Retirement Services should develop internal processes and procedures for key areas, including:**
 - a. Following the Municipal Code and City procedures regarding use of competitive bidding and unique services/sole source procurements.**
 - b. Establishing master agreements with service orders for consultants where specific scopes of services are not established at the time of the contract execution.**
 - c. Ensuring purchase orders or contract agreements are in place with service providers.**
 - d. Executing contracts prior to the start of the contract term.**
 - e. Using the City's standard terms and conditions for contracts as applicable.**
 - f. Working with City support staff, such as Finance Purchasing, Risk Management, and the Information Technology Department on procurements and contracts when required by City policy.**

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

1.
 - a. The Plans are currently developing their policies on contract procurement and monitoring for the operation of plan administration. We expect to finalize these policies within the next month. ORS will follow the Municipal Code and City procedures regarding use of competitive bidding and unique services/sole source procurements when required.
 - b. ORS will work to establish master agreements with service orders for consultants where specific scope of services are not established at the time of the contract execution.
 - c. ORS will also work to ensure purchase orders or contract agreements are in place with service providers.
 - d. ORS will also work to ensure contracts are executed prior to the start of the contract term.
 - e. ORS will incorporate City's standard terms and conditions for contracts as applicable.
 - f. ORS will work with City support staff, such as Finance Purchasing, Risk Management, and the Information Technology when required.
- 2. To clarify responsibilities around the contracting process, the Office of Retirement Services should train its staff on internal and City procurement and contracting procedures. This should include instructions on when procurements or contracts should be coordinated with the Information Technology Department, Finance Purchasing, Finance Risk Management, and the City Clerk.**

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

2. As noted in this report, the past year has revealed inconsistencies and inefficiencies at ORS as a result of various audits and requests from the City Council for the ORS to

adhere to and abide by City policies. To address these concerns, ORS is proposing to add a position in the upcoming fiscal year, a Compliance Senior Analyst, to administer and oversee contracts, risk & performance.

The Compliance Senior Analyst will handle the following duties.

- Systematically plan, develop, implement, and monitor contracts.
- Identify and implement contract management and contract administration best practices.
- Lead the development of Requests For Proposal (RFPs) and other procurement processes including the preparation and management of all aspects of soliciting bids/proposals, evaluating the provider responses, and provider selections.
- Contracting and Procurement (procurement (including noncompetitive/competitive search), contracting, and ongoing monitoring of contracts as well as working with ORS managers to draft RFPs and maintain logs of RFPs/RFOs).
- Oversee Trustee and Staff Travel.
- Oversee compliance with policies and procedures.
- Serve as an internal point of contact for procurement at the ORS.
- Training ORS staff on procurement rules.
- Serving to coordinate ORS procurement activities.
- Ensuring compliance with applicable procurement rules and policies and procedures.
- Administering the ORS's procurement processes to ensure that the ORS has complete, reliable, and useful data to manage its contracts and comply with applicable ORS and City procurement and payment rules.
- Monitoring procurement and payment activities to identify and address instances where ORS procurement activities do not comply with applicable ORS and City rules.
- Develop new policies and procedures as needed and update existing policies that are outdated.
- Develop ORS/Board policy and procedure training schedule.
- Provide ORS/Board policy and procedure training to staff per the training schedule.
- To address this recommendation, ORS is seeking approval, through the City FY 2024-25 budgeting process, to create a new position that will result in a designated procurement point of contact to help design and maintain up-to-date procurement policies and procedures and help coordinate and manage the ORS's procurement activities to address. This position will be assigned overall responsibility for procurement oversight. They will provide necessary training to the staff member to meet the new job responsibilities.

This position will help ensure compliance with both Board and City policies and procedures and ensure more effective and efficient processes.

However, should this position not be approved as part of the FY 2024-25 budget process, ORS will continue to lack the resources to comprehensively administer and oversee procurement, contracts, risk & performance.

ORS staff will be trained on both internal and City procurement and contracting procedures.

City Auditor

February 22, 2024

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- 3. To ensure all invoice payments can be made through Finance Accounts Payable and avoid the use of wire transfers, the Office of Retirement Services should work with the City's Finance Department to create purchase orders or establish contracts to be filed with the City Clerk. This should be done for all current service providers and subscription services.**

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

3. ORS is working on establishing purchase orders or agreements with providers and will file with the City so that invoice payments can be made through Finance Accounts Payable.

CONCLUSION

The Office of Retirement Services would like to extend its gratitude to the City Auditor's Office which dedicated their time to the completion of this audit.

Roberto L. Peña
Chief Executive Officer
Office of Retirement Services