



# Memorandum

**TO:** Jennifer Maguire, City Manager  
Nora Frimann, City Attorney

**FROM:** Joe Rois  
City Auditor

**SUBJECT:** Internal Control Risks Regarding  
the Office of Retirement Services

**DATE:** May 11, 2023

The Office of Retirement Services' (ORS) internal auditor recently issued an audit of ORS' procurement and contract oversight. The audit can be found on the agenda for the May 18 meeting of the Retirement Boards' Joint Audit Committee at

(<https://sjrs.legistar.com/View.ashx?M=A&ID=1102107&GUID=078ECD44-4DBB-4122-9762-D382654CA5CC>).

The auditor raised serious concerns around ORS' contracting processes, including using non-competitive procurement practices, paying vendors without valid contracts, paying vendors through wire transfers that bypassed normal payment rules, performance monitoring, and others. Of particular concern are statements attributed to ORS staff in the audit about the applicability of City policies to ORS. For example,

- "ORS staff disagreed among themselves on whether the ORS is required to follow San José's procurement rules, as stated in the San José Municipal Code and the Finance Department's procurement policies and procedures." (Page 15 of the audit report)
- "Some ORS staff stated that the City's procurement rules apply to the ORS. Others, citing the ORS's independence from the City under Measure G, stated that the ORS is not required but may choose to use the City's procurement rules." (Page 25)

In response to the audit (Page 62), ORS management also states the following:

- "In Management's view, the Report mistakenly describes the authority of various City officers, and the Plans' obligation to comply with City policies and practices. The Report assumes without foundation that the City has certain discretionary authority over the Plans' contracting with vendors, not recognizing that with reference to the Plans' contracting and payment processes, the City's role is purely ministerial."
- "The Report confuses ORS' role and responsibilities, and treats it as a City Department carrying out the work of the City. "

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- “The Report confuses historical practices that ORS may have followed with its legal obligations, per the direction of the Retirement Boards. That ORS followed certain City protocols in practice in the past does not bind the plans to follow those protocols in the future.

The auditor responded to those comments (Page 63) with different citations from the Municipal Code that appear to refute management’s assertions in its response (e.g., “*the city director of finance is the custodian of the retirement fund*”, “*All payments from the [retirement] fund shall be made in the manner required for the disbursement of other public funds.*”). He also notes section 2.04.3100 that establishes the “*Department [emphasis added] of Retirement Services.*”

As you are aware, contributions to the retirement funds account for a significant portion of the City’s budget (totaling roughly \$475 million in FY 2021-22 across the pension and OPEB funds). Because of this, the City has a significant interest in ORS having a strong internal control system in place to reduce risk to the City. It should also be noted that ORS uses many of the City’s business systems, such as the Financial Management System (FMS) and the City’s Human Resource Management System (PeopleSoft).

The first recommendation in the audit report reads:

*Recommendation 1.1 In coordination with ORS’ legal counsel and the City’s Finance Department, identify and memorialize (e.g., in a policy) the procurement rules that the ORS is required to follow.*

Because of the risks to the City and the disagreements among ORS staff of the applicability of City policies, I believe it would be prudent for the City to address this recommendation, either in a response to the audit for the Joint Audit Committee or with ORS management directly. Specifically, the City should clarify whether or how City procurement (and other policies) are applicable to ORS.

I would be happy to discuss further.

Sincerely,

/s/

Joe Rois  
City Auditor