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SAN DIEGO TRANSIT CORPORATION

PENSION PLAN

APRIL 1974

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Honorable James Mills
President Pro Tempore of the Senate
Room 5100, State Capitol
Sacramento, California 95814

Dear James:

Transmitted herewith is the Auditor General's report on the financing of the employee pension plan of the San Diego Transit Corporation, a wholly-owned corporation of the City of San Diego.

Since the city acquired the transit operations from the privately-owned San Diego Transit System in 1967, no cash funds have been set aside and invested to pay for employees' future pension benefits. The employees include administrative, clerical and maintenance personnel as well as bus drivers.

This unfunded liability for employees' future pension benefits earned prior to June 30, 1973 was $12,679,000, as estimated by the corporation's certified public accounting firm in an actuarial report. The firm estimated that this amount will increase to $26.7 million by 1983. The report also clearly stated that these amounts are understated by an unknown amount because of changes in the retirement plan.

Before the city acquired the privately-owned system, its task force criticized the failure to set aside funds for employees' future pension benefits. The former operator was required to pay the city's new corporation $650,000 for future retirement benefits earned prior to the transfer. These funds, which were invested, have been substantially depleted by payments to retired employees.

The corporation's audited financial statements as of June 30, 1973 show an accrued liability of only $8,689,000 and these statements were based on an erroneous assumption that such funds have been set aside and are earning interest to pay employees' future pension benefits of the entire $12,679,000. As a result, reported pension liabilities are understated by $4,008,000 and the future $12,679,000 liability must be provided from operating revenues or public tax support.

The Auditor General recommends immediate action by the corporation's board of directors to begin funding the future pension costs and to eventually invest $8,689,000 in order that taxpayers in the San Diego area can minimize their liability by the earning of interest income.

With my warm best wishes,

Sincerely,

Vincent Thomas

VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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INTRODUCTION

In response to a legislative request, we have reviewed the adequacy of the San Diego Transit Corporation's retirement fund and of the contributions being made to it on behalf of the corporation's employees.

Our review was limited to an examination of the corporation's financial statements and the reports of its actuarial consultants, and did not include verification of supporting data.

The San Diego Transit Corporation is a wholly-owned corporation of the City of San Diego. It came into existence in July 1967 by acquiring a private corporation known as the San Diego Transit System which had provided transit service prior to that time.

The transit corporation provides bus service within the San Diego area. The employees of this corporation, which are covered by the retirement plan, include administrative and clerical personnel, bus drivers and maintenance employees.

FINDINGS

NO CASH FUNDS HAVE BEEN SET ASIDE BY THE SAN DIEGO TRANSIT CORPORATION TO PROVIDE FOR PAYMENT OF AN ESTIMATED $12,679,000 FOR FUTURE PENSION BENEFITS

Since the city acquired the transit operation from a private operator in 1967, the San Diego Transit Corporation has not set aside and invested any funds to pay for employees' future pension benefits. According to the audited financial statements of the corporation, the pension plan does not require the funding of pension costs accrued for future years. The only cash set aside and paid annually has been those monies paid to retired employees for their current actual benefits in those years.

As of June 30, 1973, the total unfunded liability for future pension benefits was $12,679,000 as estimated in an actuarial report and study by the corporation's certified public accounting firm. The firm expects this amount to increase to $26.7 million by 1983. Their study clearly states, however, that these amounts are understated because there had been a number of changes in the retirement plan. The firm states that all of these changes will increase pension costs but, because of the lack of experience, such increased costs could not be estimated accurately.

Before the city acquired the private San Diego Transit System, a 1966 city task force report stated:

> "The cost of a retirement system of employees involved in the transit operation should be considered as a separate financial matter, since under any form of public acquisition, a change in the present retirement system of the San Diego Transit System appears warranted.
>
> "The present retirement benefits to retired employees of the San Diego Transit System are not on a funded basis, but rather, are absorbed as a part of the annual cost of operation. This would appear to be an outmoded concept which is not actuarily sound. Thus, for the benefit of both the public agency and the transit employees, there should be changes and improvements."

The agreement transferring the transit operation to the city required the payment of $650,000 by the former operator to the new corporation for future retirement benefits earned by employees prior to the transfer. This amount was invested by the corporation, but benefit payments from it have reduced the fund balance to $180,484 as of June 30, 1973.

Even though the city recognized in 1966 that it was actuarially unsound not to fund future pension costs, it continued the same practice for which it criticized the prior operator.

In the corporation's audited financial statements for the year ended June 30, 1973, pension costs for the year were $1,733,000, including the "normal" current costs and an amount required to amortize the unfunded accrued liability over 40 years. The computation is based on unfunded future pension benefits amounting to $12,679,000; however, the financial statements show an accrued liability for future pension costs of only

$8,689,000. None of this amount has actually been invested to earn interest other than the $650,000 received from the prior operator.

Therefore, the corporation's audited financial statements as of June 30, 1973 were based on an erroneous assumption that $8,689,000 was set aside and invested for the purpose of earning interest to pay employees' future pension benefits of the entire $12,679,000.

As a result, reported pension liabilities are understated by $4,008,000 and the entire $12,679,000 liability must be provided from operating revenues and/or public tax support in order to maintain a solvent retirement plan. Taxpayers of the San Diego area could minimize their liability through interest income if funds of $8,689,000 were eventually set aside and invested.

RECOMMENDATION

We recommend that the Board of Directors of the city's wholly-owned San Diego Transit Corporation immediately begin funding the pension costs accrued for future years.

Harvey M. Rose
Auditor General

April 3, 1974

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