



Office of Audit Services
Region IX
50 United Nations Plaza, Room 171
San Francisco, CA 94102

October 18, 2004

Report Number: A-09-04-00037

Ms. Donna Arduin
Director
California Department of Finance
915 L Street
Sacramento, CA 95814

Dear Ms. Arduin:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General final report entitled "Audit of the Appropriateness of California Pension Charges to the Federal Government for State Employees for Fiscal Year Ended June 30, 2003." If you have any additional questions or comments concerning the matters commented on in this report, please direct them to the HHS official named below.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), Office of Inspector General reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-09-04-00037 in all correspondence.

Sincerely,

A handwritten signature in black ink, appearing to read "Lori A. Ahlstrand", is written over a circular stamp or seal that is mostly obscured by the signature.

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosures – as stated

HHS Official:

Mr. David S. Low
Director, Division of Cost Allocation
Program Support Center, Western Office
U.S. Department of Health and Human Services
50 United Nations Plaza, Room 347
San Francisco, California 94102

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF THE APPROPRIATENESS OF
CALIFORNIA PENSION CHARGES TO
THE FEDERAL GOVERNMENT FOR
STATE EMPLOYEES FOR
FISCAL YEAR ENDED
JUNE 30, 2003**



**OCTOBER 2004
A-09-04-00037**

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the department.

Office of Evaluation and Inspections

The OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs. The OEI also oversees State Medicaid fraud control units, which investigate and prosecute fraud and patient abuse in the Medicaid program.

Office of Investigations

The OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. The OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. The OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops model compliance plans, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

The Federal Government makes contributions to States' public employee retirement systems on behalf of State employees who work on federally sponsored programs or activities. The retirement contributions are made through statewide central service cost allocation plans, which the States submit annually for approval by the U.S. Department of Health and Human Services, Division of Cost Allocation. Retirement contributions are subject to cost principles in Office of Management and Budget (OMB) Circular A-87, which provides that pension plan costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

The California Public Employees' Retirement System (CalPERS) was created by legislation effective January 1, 1932. Membership in CalPERS includes State employees, nonteaching school employees, and employees of various local agencies that have elected to participate in the system. As of June 30, 2001, CalPERS was the nation's largest public pension fund and the second largest in the world, with assets of over \$156 billion. To establish the actuarially required retirement contribution rates for fiscal year ended June 30, 2003, CalPERS staff actuaries performed the valuation of the State plan using data as of June 30, 2001.

OBJECTIVE

Our objective was to determine whether the State of California (State) appropriately charged the Federal Government for the pension expenses of State employees working on Federal programs during the period July 1, 2002 through June 30, 2003. Specifically, we reviewed the State's pension plan (CalPERS) and its contributions to determine whether (1) the retirement fund contribution rates were based on actuarially determined estimates in accordance with Federal regulations and (2) the appropriate contribution amounts were claimed for Federal reimbursement.

RESULTS OF AUDIT

The State appropriately charged the Federal Government for the pension expenses of State employees working on Federal programs, in accordance with OMB Circular A-87. Specifically, for fiscal year ended June 30, 2003, the State's retirement fund contribution rates were based on actuarial projections that complied with Federal regulations, and the appropriate contribution amounts were claimed for Federal reimbursement.

STATE COMMENTS

In written comments on the draft report, the State concurred with the facts as presented.

INTRODUCTION

BACKGROUND

The Federal Government makes contributions to States' public employee retirement systems on behalf of State employees who work on federally sponsored programs or activities. The retirement contributions are made through statewide central service cost allocation plans, which the States submit annually for approval by the U.S. Department of Health and Human Services, Division of Cost Allocation.

Federal Cost Principles for Retirement Contributions

Retirement contributions are subject to the provisions of OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." Circular A-87 provides that pension plan costs are allowable, provided such benefits are granted under established written policies. The benefits shall be allocated to Federal awards in the same manner used to allocate the salaries and wages of employees. Circular A-87 further provides that pension plan costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

California Public Employees' Retirement System

CalPERS was created by legislation effective January 1, 1932 (it was initially called the State Employees' Retirement System). Membership in CalPERS includes State employees, nonteaching school employees, and employees of various local agencies that have elected to participate in the system. As of June 30, 2001, CalPERS was the nation's largest public pension fund and the second largest in the world, with assets of over \$156 billion.

The CalPERS Board of Administration has exclusive authority and fiduciary responsibility for administration and the investment of monies pursuant to the State constitution, article XVI, section 17. To establish the actuarially required retirement contribution rates for fiscal year ended June 30, 2003, CalPERS staff actuaries performed the valuation of the State plan using data as of June 30, 2001.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the State appropriately charged the Federal Government for the pension expenses of State employees working on Federal programs during the period July 1, 2002 through June 30, 2003. Specifically, we reviewed the State's pension plan (CalPERS) and its contributions to determine whether (1) the retirement fund contribution rates were based on actuarially determined estimates in accordance with Federal regulations and (2) the appropriate contribution amounts were claimed for Federal reimbursement.

Scope

Our audit covered the period July 1, 2002 through June 30, 2003. We did not review the State's overall internal controls, since such a review was not necessary to accomplish our objective.

For this audit, we relied on the CalPERS Comprehensive Annual Financial Report for the year ended June 30, 2001, which was audited by an independent public accountant and given an unqualified opinion. We also relied on the calculations of the in-house CalPERS actuary staff, who attested to performing an actuarial valuation of the retirement fund in accordance with generally accepted actuarial principles. The CalPERS valuation was subjected to a parallel valuation by an independent, private actuarial consulting firm, which certified that the liabilities and costs computed by CalPERS were reasonably accurate and computed in accordance with generally accepted actuarial principles. In addition, we relied on the work of the State Auditor to verify that the appropriate rates were used in the State payroll system and that the appropriate amounts were charged to the various agencies and transferred to CalPERS.

We conducted fieldwork from January through June 2004 at the offices of CalPERS, the State Auditor, the State Controller, and the State Department of Health Services in Sacramento, CA.

Methodology

To accomplish our objective, we:

- reviewed Federal regulations and standards relating to pension expenditures, including OMB Circulars A-87 and A-133 and Government Accounting Standards Board Statements 25 and 27
- obtained the CalPERS Comprehensive Annual Financial Reports for fiscal years 2001 through 2003 to review the financial statements, actuarial methodology, and other material related to retirement contributions
- held discussions with officials from CalPERS relating to the employer's share of pension expenses for State employees
- met with officials from the State Auditor's office and the State Controller's office to verify the retirement fund contributions made to CalPERS
- reviewed the pension contributions reported by the State Department of Health Services (as an example of a major recipient of Federal funds) on the quarterly CMS-64 report submitted to the Centers for Medicare & Medicaid Services

We conducted our audit in accordance with generally accepted government auditing standards.

RESULTS OF AUDIT

The State appropriately charged the Federal Government for the pension expenses of State employees working on Federal programs, in accordance with OMB Circular A-87. Specifically, for fiscal year ended June 30, 2003, the State's retirement fund contribution rates were based on actuarial projections that complied with Federal regulations, and the appropriate contribution amounts were claimed for Federal reimbursement.

STATE COMMENTS

In written comments, the State concurred with the facts as presented. We have included the State's comments in their entirety as an appendix to this report.

APPENDIX



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

September 27, 2004

Lori A. Ahlstrand, Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Audit Services
Region IX
50 United Nations Plaza, Room 171
San Francisco, CA 94102

Re: Report Number A-09-04-00037

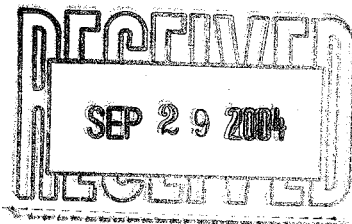
Dear Ms. Ahlstrand,

This correspondence is in response to your draft report entitled "Audit of the Appropriateness of California Pension Charges to the Federal Government for State Employees for Fiscal Year Ended June 30, 2003." The findings of this audit stated that California appropriately charged the federal Government for the pension expenses of State employees working on federal programs, in accordance with OMB Circular A-87. We concur with the facts as presented in the report and are pleased that California was found to be in compliance with OMB Circular A-87.

Sincerely,

A handwritten signature in cursive script that reads "Stephen W. Kessler".

STEPHEN W. KESSLER
Deputy Director



ACKNOWLEDGMENTS

This report was prepared under the direction of Lori A. Ahlstrand, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff who contributed include:

Thomas Lenahan, *Audit Manager*

Shelton Jensen, *Senior Auditor*

Amelia Cojuangco, *Auditor*

For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.