INTERIM REPORT #1

EXHIBITS

EXHIBIT 1

design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material violations of provisions of contracts or grant agreements. If specific information comes to the auditors' attention that provides evidence concerning the existence of possible violations of provisions of contracts or grant agreements that could have a material indirect effect on the financial statements or significant indirect effect on other financial data needed to achieve audit objectives, auditors should apply audit procedures specifically directed to ascertain whether violations have occurred or are likely to have occurred.

4.19 Abuse is distinct from fraud, illegal acts, and violations of provisions of contracts or grant agreements. When abuse occurs, no law, regulation, or provision of a contract or grant agreement is violated. Rather, abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances.[51] Auditors should be alert to situations or transactions that could be indicative of abuse. When information comes to the auditors' attention (through audit procedures, allegations received through a fraud hotline, or other means) indicating that abuse may have occurred, auditors should consider whether the possible abuse could affect the financial statement amounts or other financial data significantly. If indications of possible abuse exist that significantly affect the financial statement amounts or other financial data, the auditors

[51]For example, in a financial statement audit, auditors might find abuse when examining sensitive payments such as travel of senior management officials to locations chosen for personal reasons rather than less costly locations which would have been appropriate to satisfy the business objectives of the travel. While auditors generally will not view travel expenses of senior management officials as quantitatively material to the financial statements, this expense generally would be considered qualitatively material to the financial statements.

EXHIBIT 2

KPMG LLP
Three Embarcadero Center
San Francisco, CA 94111

Telephone 415 951 0100

October 11, 2004

Leslie J. Girard, Esq.
Assistant City Attorney
Office of the City Attorney
City of San Diego
1200 Third Avenue, Suite 1620
San Diego, CA 92101

RE: CITY OF SAN DIEGO FISCAL YEAR 2003 AUDIT

Dear Mr. Girard:

As shared in previous meetings and correspondence, including our letters dated August 9, 2004 and September 1, 2004, we do not believe that the City of San Diego ("City") has conducted an adequate investigation in order to conclude that likely illegal acts have not occurred, or that appropriate remedial action has been taken. Such an investigation is necessary in order for an auditor to complete an audit in accordance with generally accepted auditing standards and *Government Auditing Standards.*

The primary purpose of this letter is to express KPMG's position on what additional action KPMG believes the City should take relating to the investigation and remediation of potential illegal acts to enable KPMG to complete its audit of the City's basic and fund financial statements for the fiscal year ended June 30, 2003. KPMG has been concerned that the City was not undertaking an investigation specifically designed for the purpose of addressing audit responsibilities under generally accepted auditing standards and *Government Auditing Standards* relating to possible illegal acts. At the City's request, and as reflected in our September 1, 2004 letter, KPMG agreed to await the completion of the Vinson & Elkins ("V&E") report (the "Report"), to review the Report, and to advise the City as to what, if any, further information KPMG required in order to be in a position to complete its audit and issue its audit reports. As discussed, and as explained in more detail below, our overriding concern has been and remains, that an investigation must be of sufficient scope and thoroughness to provide a sound basis for concluding either that illegal acts with relevance to the City's financial reporting have not occurred or that appropriate remedial action has been taken with respect to any conduct which the City and its counsel cannot definitively conclude was legal.

At your request and to make our next meeting as constructive as possible, we have attempted in this letter to synthesize what additional action we believe the City needs to take to enable KPMG to complete its audit, and also to explain in general terms why this additional action is necessary.

KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is a member of KPMG International, a Swiss association.

BACKGROUND

We understand that the SEC is conducting a formal investigation of the City of San Diego's public disclosures relating to the SDCERS in the City's bond offerings during the period 1996 through January 2004. This investigation was commenced following the City's filing of a Voluntary Report of Information on January 27, 2004 with the Municipal Securities Rulemaking Board and the Nationally Recognized Municipal Securities Information Repositories. That Voluntary Report made new disclosures regarding the City's obligations to fund the SDCERS and also disclosed that there had been errors in the City's 2002 CAFR.

We also understand that the U.S. Attorney and FBI are conducting a criminal investigation relating to the City's pension funding and disclosures. There have also been press reports of an additional investigation by the FBI relating to possible "public corruption" issues relating to the process by which the City and SDCERS have negotiated and approved various agreements in which the City's obligations to make payments to fund SDCERS were reduced and/or deferred in exchange for agreements to increase or expand benefits.

We understand that all of these investigations are focused on the conduct of individuals who either are currently employed by the City, were employed by the City during the period covered by KPMG's ongoing audit, or were acting in some manner on behalf of the City or SDCERS during the relevant time period.[1]

V&E was retained by the City and conducted an investigation into the City's disclosure practices and prepared a report. The V&E Report, which was made public on September 16, 2004, describes systemic failures in the City's financial reporting and disclosure processes related to the SDCERS pension plan. See e.g., Report at 170-171 (referring to "across the board failures of the City's internal disclosure processes.") It also reflects that, as late as the fall of 2003 the City's Disclosure Counsel thought information was being withheld from him and there were fundamental disagreements about whether acknowledged errors in the historical financial statements were material. Report at 114-120. The Report acknowledges that the City's prior SDCERS related disclosures were inadequate, and while it appears to stop short of concluding that there were material misstatements in the City's disclosures, it describes a dysfunctional disclosure system and also comments upon the City's "minimalist approach to public disclosure." Among the observations supporting this conclusion is the statement that "the City Auditor was disinclined to

[1] Potential illegal acts by SDCERS or its board are relevant to KPMG's audit. Your position (expressed in the September 20, 2004 letter), that SDCERS is an "entity independent of the City," does not address the fact that the financial condition of SDCERS is reported as a fiduciary fund in the City's CAFR.

include information in the City disclosure that reflected badly on the City and would sometimes excise negative statements from disclosure documents." Report at 117.

The V&E report includes two paragraphs under a heading "Conclusions Regarding Intent." Report at 164. These paragraphs state that because many of the "gaps" in the City's disclosures are "closed" when information in the SDCERS CAFRs is considered and because local press coverage of the pension plan highlighted many of the risks surrounding the more controversial City funding agreements (Managers 1 and 2) and the presence in the Municipal Code of the menu for distribution of surplus earnings, any attempt to conceal the SDCERS funding situation would have been an "exercise in futility."

While we understand that V&E has concluded that it has gathered sufficient evidence to support this conclusion, for purposes of our audit, we note that this conclusion does not address the questions we have posed as being important to our completion of our audit, and therefore, does not end our inquiry. Indeed at our meeting on August 27, 2004, Both the City and V&E have made it clear to KPMG that V&E was not retained to investigate issues relating to intent or whether any individual's conduct violated any law, rule or regulation, and that the scope of its investigative efforts were not designed to do so. At that meeting, we informed the City that, in the absence of conclusions on such issues, KPMG anticipated advising the City that additional investigative procedures may be necessary before KPMG would be in a position to complete its audit; and, in turn, we were advised that the City would perform any additional inquiries that KPMG believe were necessary for it to be able to conclude on issues that might affect its ability to issue an audit opinion.

Unfortunately, based upon the information we have been provided to date regarding the scope and method of the V&E investigation, we do not believe the statement in the report that "it is difficult to attribute the City's failure to fully and accurately describe [pension] matter[s] to intentional misconduct on the part of individual employees" is sufficient to resolve the issue of potential illegal acts for purposes of KPMG's audit because it is not based on an investigation that had a scope and methodology that would provide a reliable basis for reaching a conclusion as to whether City officials engaged in intentional misconduct or other conduct, which violated any law, rule or regulation having the force of law.

It is in this context and against these background facts, that KPMG's requirements, as outlined in this letter, must be understood. Most fundamentally, because there is evidence of possible illegal acts by the City or persons whose acts are attributed to it, under Generally Accepted Auditing Standards (GAAS) and Generally Accepted *Government Auditing Standards* (GAGAS), as well as other relevant professional guidance, to the extent the following questions are not directly

addressed in the V&E Report, additional investigative procedures are required in order to determine if illegal acts are likely to have occurred, to assess the direct or indirect effect of such acts on the City's financial statements as well as the implications for the reliability of representations being made by City employees to KPMG in the course of our audit, and to determine if any such illegal acts have been adequately remediated by the City.

The report based on such an investigation must include clear conclusions and be supported by a thorough investigation. However, as stated above, and as KPMG has been advised, the V&E investigation was not conducted as a forensic investigation, and did not result in a report that reached clear conclusions about whether federal securities laws (or any other relevant laws) had been violated, did not explore potential individual conduct that may be fraudulent or unlawful, and thus does not provide a basis for determining potential financial statement effects or determining KPMG's ability to rely on management representations from the City.

Further, the Report's discussion of certain evidence raises a concern that the investigation, for our purposes, did not adequately follow up on evidence which might suggest that certain of the deficiencies in financial reporting may have been the result of conscious efforts by one or more persons at the City. In the absence of an investigation and report that adequately explores these issues, it is not possible to determine if the City has taken appropriate remedial measures or if the representations made to us during our audit by certain individuals can be relied upon by us in reaching our opinion on the financial statements. [2]

In this regard it also bears noting that the remedial measures recommended in the Report are all prospective and entail structural reforms to address the City's process of disclosure in the future. These reforms are subject to approval by the City Council and, even if adopted, would have no impact on the manner in which the City will have prepared its 2003 audited financial statements.

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[2] See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions Exchange Act Release No. 44969, 2001 SEC LEXIS 2210 (Oct. 23, 2001), arising out of an investigation into financial reporting by Seaboard Corporation.

OVERVIEW OF RELEVANT AUDITING AND ACCOUNTING REQUIREMENTS

AICPA State and Local Audit and Accounting Guide § 4.44.

(1) Illegal Acts with Direct and Material Effects on Financial Statement Amounts

GAAS requires an auditor to plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatements arising from illegal acts that have a direct and material effect on the determination of financial statement amounts. The auditor's consideration of those potential misstatements is a matter of professional judgment and is influenced by his or her perceptions of the needs of a reasonable person who will rely on the financial statements.

The professional literature identifies the following types of legal compliance requirements as among those that may have a "direct and material" effect on the determination of financial statement amounts.

- GAAP Requirements. Governments often are subject to legal or contractual provisions that require them to prepare their financial statements in conformity with GAAP.

- Federal and State Taxes. Governments are subject to various federal tax requirements, including those relating to employment taxes, employee benefits, and tax-exempt debt (such as arbitrage rebate requirements). State-level tax requirements also may apply.

(2) Illegal Acts With Indirect Effects on Financial Statements

The auditing literature also recognizes that Governments often are affected by many other laws or regulations, which generally relate more to an entity's operating aspects than to its financial and accounting aspects, and that the financial statement effect of those laws and regulations is "indirect". Although an auditor is not required to plan the audit to detect noncompliance with such laws and regulations, the auditor does have certain detection, consideration, and reporting responsibilities relating to potential violations of such laws, which require the auditor to insist that when potential violations of such laws come to light, they must be investigated.

Moreover, GAAP requires a government entity, such as the City, to disclose in its financial statements material violations of finance-related legal and contractual provisions. Accordingly, the

auditor of a governmental entity is alert to the possible financial reporting effect of noncompliance with law that has a material indirect effect on financial statements. Because the government entity itself has financial statement reporting obligations related to violations of such laws, the government and the auditor both have a shared interest in assuring that when potential violations of such laws come to light, they are fully investigated so that the financial statements can include the GAAP[3] required disclosure.

In considering whether the financial statements are free of material misstatements arising from (1) illegal acts that have a direct and material effect on the determination of financial statement amounts, or (2) illegal acts that have an indirect material effect on financial statements, the auditor should consider both quantitative and qualitative factors. Qualitative factors that the auditor may consider relevant to that evaluation include the following:

- The potential effect of the noncompliance on the government's ability to raise resources (for example, through taxes, grants, contributions, or debt or loan financings) in the future.
- The potential effect of the noncompliance on the continuation of existing relationships with vendors, employees, and elected and appointed officials.
- Whether the noncompliance involves collusion or concealment.
- Whether the noncompliance involves an activity that often is scrutinized by elected or appointed officials, citizens, the press, creditors, or rating agencies.
- Whether the fact of the noncompliance is unambiguous rather than a matter of judgment.
- Whether the noncompliance is an isolated event or instead has occurred with some frequency.

[3] GASB standards require governments to disclose certain violations of compliance requirements. NCGA Interpretation 6, Notes to the Financial Statements Disclosure, paragraph 4, states that the notes to the financial statements should disclose material violations of finance-related legal and contractual provisions. In addition, material violations, or potential violations, of finance-related legal and contractual provisions should be considered for recording a loss contingency. Id. at § 4.48.

- Whether the noncompliance results from management's continued unwillingness to correct internal control weaknesses.

- The likelihood that similar noncompliance will continue in the future.

- The cost-benefit of establishing internal control to prevent similar noncompliance in the future.

The risk that possible undetected noncompliance would affect the auditor's evaluation.[4]

Finally, an auditor is required by applicable auditing standards to "consider the implications of an illegal act in a relation to other aspects of the audit, particularly the reliability of representations of management." AU § 317.16. In considering such issues, the auditor must be provided with sufficient information relating to the potential illegal acts to exercise professional judgment concerning the implications of a particular illegal act for the audit. Id. ("The implications of particular illegal acts will depend on the relationship of the perpetration and concealment, if any, of the illegal act to specific control procedures and the level of management or employees involved.") Our April 13, 2004 engagement letter allows KPMG to make such a determination as to the sufficiency of the investigation for audit purposes.

INFORMATION AND REOCRDS REQUESTED, NOT YET PROVIDED

There are several open items which have been promised, but not yet provided to KPMG.

- KPMG has yet to receive all V&E interview notes, memoranda and supporting documents as requested. The basis for this request is outlined in our engagement letter.

- KPMG needs information concerning the scope and status of the criminal investigation(s), which we understand V&E is not handling. We will need to speak with the attorney representing the City in those matters.

ITEMS REQUIRING RESOLUTION BY THE CITY

Based on our review of the V&E investigation and Report, and in light of the auditing standards discussed above, KPMG has attempted to synthesize the issues that remain, which must be

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[4] Id. at § 4.46

resolved before we are able to complete our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*. They are as follows:

- The City needs to determine whether the City's public disclosures, including its financial statements, likely violate the antifraud provisions of the securities laws (e.g., failure to disclose pension related matters) or any other Federal, State or local laws, and if so, what, if any, impact is there to the June 30, 2003 financial statement amounts and disclosures? The report from the investigation team should include clear conclusions (with adequate support for such conclusions) whether an illegal act has occurred and whether such illegal act has been timely and adequately remediated. The report and investigation must be in sufficient scope and detail to allow us to reach our own conclusions as to (i) whether it is likely that an illegal act has occurred and, if so (ii) whether any likely illegal act that is identified will have a material effect on the entity's financial statements and, if so (iii) whether timely and appropriate remedial action has been taken. Closely related to this set of issues is whether City employees or agents have engaged in fraudulent actions including concealment, related to the potential illegal acts. The City needs to investigate and determine, and report to us, the relationship of the perpetration and concealment, if any, of likely illegal acts to specific control objectives and the level of management, employees, or consultants involved.

- The scope of the investigation needs to extend to all possible illegal acts and needs to expand, as necessary, based on findings made during the investigation. In other words, the investigators should be able to pursue all evidence of possible illegal acts no matter where they may lead.

- According to the Report, retiree healthcare benefits were paid directly out of the pension system from 1983 until 1992 when a determination was made that this violated federal tax regulations. A new system was set up which was also determined to be legally flawed in 1995, which was addressed by making payments a SDCERS benefit. While the Report compiles facts relating to this violation, and concludes that the funding method was violative of federal regulations, it does not address the possible consequences of this violation. What has the city done to consider and address the financial statement impact of possible IRS sanctions, or other contingent liabilities or disclosure obligations arising from the conduct that could impact the June 30, 2003 financial statement amounts and disclosures?

- The issues from our August 9, 2004 letter must be addressed (see discussion in Exhibit I)

We look forward to meeting with the City to discuss further how the City can conduct an adequate investigation in order to conclude whether it is likely or not illegal acts have occurred, or that appropriate remedial action has been taken.

Very truly yours,

KPMG LLP

Steven G. DeVetter

Steven G. DeVetter
Partner

cc: Mr. Dick Murphy, Mayor
Mr. P. Lamont Ewell, City Manager
Ms. Terri Webster, Acting City Auditor and Comptroller

Exhibit I
Specific Comments Regarding September 20, 2004 City Response to KPMG's August 9, 2004 Letter

Attachments:
April 13, 2204 Engagement Letter
August 9, 2004 Letter from KPMG Re: Investigation
September 1, 2004 Letter from KPMG Re: Follow-up from meeting on August 27, 2004
September 20, 2004 letter from Les Girard Re: City of San Diego Fiscal Year 2003 Audit

SPECIFIC COMMENTS REGARDING SEPTEMBER 20, 2004 CITY RESPONSE TO KPMG'S AUGUST 9, 2004 LETTER

In your letter, you conclude by stating your view that the V&E Report "is sufficiently comprehensive to allow [KPMG] to reach the conclusions necessary for compliance with Section AU§317 of the AICPA Professional Standards and for the issuance of [KPMG's] audit report." For reasons previously articulated and expanded upon below, we are unable to agree with that conclusion.

As in many aspects of auditing, the conclusions involved in determining that potential illegal acts have been adequately investigated and remediated is one that entails an auditor's exercise of judgment. However, in the instant case, we believe that the issue is sufficiently clear that an informed and diligent auditor should not conclude that the V&E report adequately addresses the issues necessary for the completion of KPMG's audit. The Report may satisfy the City's needs (a conclusion we defer to the City to make); but, without more, it does not provide a sufficient basis for KPMG to conclude that all questions necessary to the completion of the audit have been sufficiently investigated and resolved in a manner that would permit KPMG to issue an audit report.

In response to your letter, we offer the following comments.

KPMG's Question 1

Whether or not the financial statements and or the disclosures in the financial statements were intentionally misleading and, if yes, what individuals were involved and what, if any, remedial action is recommended?

City's Comment on Question 1

Your comment seems to make two essentials points. First, that with the departure of the City's prior independent auditor and the departure of the City Auditor and Comptroller, there is no need for an investigation into whether there were any intentional illegal acts relating to the City's underfunding of the SDCERS pension plan and/or financial reporting related thereto. Secondly, your comment seems to imply that the comments in the V&E Report at page 159 concerning the possible intent of City officials to allow the City to issue misleading financial disclosures should be sufficient for KPMG in the absence of KPMG's ability to cite you to investigative reports for municipal issuers or other issuers that address the issue of intent in a manner that goes beyond the V&E Report.

Response to City's Comment on Question 1

The subsequent departure of Mr. Ryan does not change the fact that, for the entire period KPMG is auditing, he was ultimately responsible for supervising the preparation of the City's financial

statements. Moreover, numerous individuals were (and remain) involved in the financial reporting process at the City, including individuals who, according to the Report, may have been involved in the disclosure deficiencies criticized by the Report.

Under AU 317.16: "The auditor should consider the implications of an illegal act in relation to other aspects of the audit, particularly the reliability of representations of management. The implications of particular illegal acts will depend on the relationship of the perpetration and concealment, if any, of the illegal act to specific control procedures and the level of management or employees involved."

Both the City and V&E have made it clear to KPMG that V&E was not retained to investigate issues relating to intent and that the scope of its investigative efforts were not designed to do so. Based upon what we have been told about the investigation, we do not believe the statement in the report that "it is difficult to attribute the City's failure to fully and accurately describe [pension] matter[s] to intentional misconduct on the part of individual employees" is one that can be relied upon to resolve the issue of potential illegal acts for purposes of KPMG's audit because it is not based on an investigation that had a scope and methodology that would provide a reliable basis for making such a conclusion.

KPMG's Questions 2

Did the City enter into any agreement, including the "Managers Two" agreement, or otherwise take any actions that resulted in the underfunding or misuse of pension funds that is a violation of State, City or other laws?

City's Comment on Question 2

Your comment on question 2 makes essentially three points. First, that the City's potential liability for any violations of law from the alleged underfunding of the pension plan has been dealt with through the settlement of the Gleason case. Second, you state that there has never been any allegation that the City's net pension obligation reported in the City's balance sheet has been misstated. And third, that based on certain legal propositions discussed in the V&E Report at page 11, the motivations of individual members of the City Council in taking certain action are not a basis upon which that action may be voided by the courts.

Response to City's Comment on Question 2

On point 1,GASB standards require governments to disclose certain violations of compliance requirements. NCGA Interpretation 6, Notes to the Financial Statements Disclosure, paragraph 4, states that the notes to the financial statements should disclose material violations of finance-related legal and contractual provisions. In addition, material violations, or potential violations, of finance-related legal and contractual provisions should be considered for recording a loss contingency. Accordingly we do not believe that only considering the loss contingency is sufficient in these circumstances. Additionally, the considerations in AU § 317.16 need to be addressed in the context of this question.

On point 2, The reported June 30, 2002 $39 million net pension obligation was misstated due to the payment of retiree healthcare benefits from the pension plan. At KPMG's suggestion, The City has calculated the corrected June 30, 2002 net pension obligation to be $103 million. The considerations in AU § 317.16 need to be addressed in the context of this question. The City needs to investigate and determine the relationship of the perpetration and concealment, if any, of likely illegal acts to specific control objectives and the level of management, employees, or consultants involved. For example, V&E states that a letter from the Actuary to Mike Phillips in 1998 highlights knowledge of potential errors in the financial statements that were not changed/corrected until recommended by KPMG for the June 30, 2003 financial statements:

> "All these number presuppose that the 1996-97 is the first year in which the calculated actuarial contribution is greater than the actual contribution. You made an excellent point a year ago that this may not be the case. This issue may go back close to a decade after the use of 'bifurcated' rates was implemented. The case could be made that the City has a Net Pension obligation".

Finally, on point 3, while the legal proposition to which you refer, while may be relevant to whether a court will decline to question the motivation behind proper legislative action for reasons grounded in separation of powers, we do not believe that such a consideration alters the nature of the our responsibilities as the City's independent auditor, nor the need for the City to perform additional inquiry before determining whether an illegal act has (or has not) occurred, and if so, that it has been appropriately remediated.

KPMG's Questions 3

Did the SDCERS Board breach their fiduciary duty by allowing the City to underfund the plan in exchange for additional benefits for current employees and could this action have been in violation of any laws?

City's Comment on Question 3

Your comment on this item is essentially that the SDCERS board is independent of the City of San Diego and based on that you question why the actions of SDCERS or the members of its board "relate to" KPMG's audit.

Response to the City's Comment on Question 3

The basic financial statement of the City consist of (a) the primary government, (b) organizations for which the primary government is financially accountable, and (c) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

The definition of the reporting entity is based primarily on the notion of financial accountability. A primary government is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a

voting majority of an organization's governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government. A primary government may also be financially accountable for governmental organizations that are fiscally dependent on it.

The City's basic financial statements include SDCERS, and any audit opinion issued by KPMG reporting on the City's basic financial statements would, therefore, cover SDCERS. Accordingly, financial accounting and disclosure of activities occurring within SDCERS are relevant to our audit under GAAS and GAGAS.

KPMG's Question 4

Is the use of surplus earnings to pay city obligations such as benefits outside of the plan illegal?

City's Comment on Question 4

Your comment refers us to the history of the surplus earnings issue as discussed in the V&E Report.

Response to City's Comment on Question 4

According to the Report, retiree healthcare benefits were paid directly out of the pension system from 1983 until 1992 when a determination was made that this violated federal tax regulations. A new system was set up, which was also later determined to be legally flawed in 1995, which was addressed by making payments a SDCERS benefit. Report at 36. This underscores, rather than ameleorates our concerns. We must understand what the City has done to address possible IRS sanctions, and also learn what the possible impact is to the City's June 30, 2003 financial statement amounts and disclosures. Additionally, we believe that the considerations raised by AU § 317.16 need to be addressed in the context of this question.

KPMG's Question 5

Did the City violate the City Charter by failing to fund its retirement plan as required by the City Charter?

City's Comment on Question 5

Your comment on this question refers us to the fact, discussed above, that the City believes that the Gleason settlement "resolves the economic consequences" of the City's actions and thus, suggests that any issue with respect to whether that conduct was unlawful is irrelevant.

Response to City's Comment on Question 5

Potential liabilities are one reason violations of laws are relevant to an auditor. Because GAAP require governments to disclose material (whether quantitative or qualitative) violations of

finance-related legal and contractual provisions, the auditor of a governmental entity should be alert to the possible financial reporting effect of noncompliance that has a material indirect effect on financial statements. Additionally, KPMG believes that the considerations of AU 317.16 needs to be addressed in the context of this question.

KPMG's Question 6

Did the SDCERS Board and/or the City violate the California Constitution by allowing the City to intentionally underfund the plan?

City's Comment on Question 6

Your comments in this section refer to your earlier comments relating to Question 2 and Question 3.

Response to City's Comment on Question 6

Please see our comments above regarding these items.

KPMG's Question 7

Was undue influence placed on the actuary to change assumptions to reduce the shortfall of the City's contribution compared to the Actuarial Required Contribution (ARC), and, if yes, at whose direction and what action does the City plan to take to rectify this action, if applicable?

City's Comment on Question 7

Your comment on this item refers us to the discussion at page 91 of the V&E Report and asks for the details of any remaining concerns.

Response to City's Comment on Question 7

The auditor should consider the implications of an illegal act in relation to other aspects of the audit, including the reliability of representations to be obtained from members of management. The implications of particular illegal acts will depend on the relationship of the perpetration and concealment, if any, of the illegal act to specific control procedures and the level of management or employees involved.

The City needs to investigate and determine the relationship of the perpetration and concealment, if any, of likely illegal acts to specific control objectives and the level of management, employees, or consultants involved.

Other Issues Raised in the City's September 20, 2004 Letter

Your letter also commented on electronic discovery. With respect to electronic discovery, both the City and V&E have made it clear to KPMG on August 27, 2004 that V&E was not retained to investigate issues relating to intent and that the scope of its investigative efforts were not designed to do so. We believe that determining intent is required with respect to certain of the questions posed in our August 9 letter, and electronic discovery is an effective procedure in that regard, as it may provide relevant evidence for the City, its counsel, and KPMG to consider in determining whether there are unresolved questions which might affect the City's financial statements or disclosures.

April 13, 2004

Ms. Lisa Irvine
Director, Financial Management Department
The City of San Diego
202 C Street
San Diego, California 92101

Dear Ms. Irvine:

This letter will confirm KPMG LLP's ("KPMG") understanding of our engagement to report upon our audit of the financial statements of the City of San Diego (the "City") as of and for the year ended June 30, 2003.

Objectives and limitations of services

We will conduct the audit of the financial statements in accordance with auditing standards generally accepted in the United States of America and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of an audit carried out in accordance with such standards is the expression of an opinion as to whether the presentation of the financial statements conforms with accounting principles generally accepted in the United States of America. In conducting the audit, we will perform tests of the accounting records and such other procedures as we consider necessary in the circumstances to provide a reasonable basis for our opinion on the financial statements. We also will assess the accounting principles used and significant estimates made by management, as well as evaluate the overall financial statement presentation.

Our report will be addressed to the City Council of the City. We cannot provide assurance that an unqualified opinion will be rendered. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement. Our audit is planned and performed to obtain reasonable, but not absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, there is a risk that material errors, fraud (including fraud that may be an illegal act), and other illegal acts may exist and not be detected by an audit performed in accordance with auditing standards generally accepted in the United States of America. Also, an audit is not designed to detect matters that are immaterial to the financial statements.

In planning and performing our audit, we will consider the City's internal control in order to determine the nature, timing and extent of our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. The limited purpose of this consideration may not meet the needs of some users who require additional information about internal control. We can provide other services to provide you with additional information on internal control which we would be happy to discuss with you at your convenience.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of the City's compliance with certain provisions of laws, regulations, contracts and grants violations of which could have a direct and material affect on the financial statements. However, our objective is not to provide an opinion on overall compliance with such provisions.

Our responsibility to communicate with the City Council

In accordance with *Government Auditing Standards*, we will prepare a written report, *Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards* (GAS report), on our consideration of internal control and tests of compliance made as part of our audit of the financial statements. While the objective of our audit of the financial statement is not to report on the City's internal control and we are not obligated to search for reportable conditions as part of our audit this report will include any reportable conditions to the extent they come to our attention. Reportable conditions are significant deficiencies in the design or operation of internal control which could adversely affect the City's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements under audit. This report will also include all illegal acts and fraud and material violations of grants and contracts, and abuse. It will indicate that it is intended solely for the information and use of the City Council and management of the City and that it is not intended to be and should not be used by anyone other than these specified parties.

In accordance with *Government Auditing Standards* we will also issue a management letter to communicate other deficiencies in internal controls that are not reportable conditions and other violations of grants and contracts, and abuse that comes to our attention unless clearly inconsequential.

In accordance with *Government Auditing Standards*, we are also required in certain circumstances to report fraud or illegal acts directly to parties outside the auditee.

We will also communicate to you verbally disagreements with management or other serious difficulties encountered in performance of our audit or review services. We believe verbal

communication of matters such as those noted above is the appropriate forum to provide open and frank dialogue.

We will report to you, in writing, the following matters:

- Audit adjustments arising from the audit that could, in our judgment, either individually or in aggregate, have a significant effect on the City's financial reporting process. In this context, audit adjustments, whether or not recorded by the entity, are proposed corrections of the financial statements that, in our judgment, may not have been detected except through the auditing procedures performed.

- Uncorrected misstatements aggregated during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in aggregate.

- Other matters required to be communicated by Statement on Auditing Standards No. 61, *Communication with Audit Committees.*

We will also read minutes, if any, of audit committee meetings for consistency with our understanding of the communications made to you and determine that you have received copies of all material written communications between ourselves and management. We will also determine that you have been informed of i) the initial selection of, or the reasons for any change in, significant accounting policies or their application during the period under audit, ii) the methods used by management to account for significant unusual transactions and iii) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

If, in performance of our audit procedures, circumstances arise which make it necessary to modify our report or withdraw from the engagement, we will communicate to you our reasons for withdrawal.

Management responsibilities

The management of the City is responsible for the fair presentation, in accordance with generally accepted accounting standards, of the financial statements and all representations contained therein. Management also is responsible for preventing and detecting fraud, for adopting sound accounting policies and establishing and maintaining effective internal controls and procedures for financial reporting to maintain the reliability of the financial statements and to provide reasonable assurance against the possibility of misstatements that are material to the financial statements. Management also is responsible for informing us of all reportable

conditions, of which it has knowledge, in the design or operation of such controls. Management also is responsible for identifying and ensuring that City complies with laws, regulations, contracts and grants applicable to its activities, and for informing us of any known material violations of such laws and regulations.

The City agrees that all records, documentation, and information we request in connection with our audit will be made available to us, that all material information will be disclosed to us, and that we will have the full cooperation of the City's personnel. As required by auditing standards generally accepted in the United States of America, we will make specific inquiries of management about the representations embodied in the financial statements and the effectiveness of internal control, and obtain a representation letter from management about these matters. The responses to our inquiries, the written representations, and the results of audit tests comprise the evidential matter we will rely upon in forming an opinion on the financial statements.

In accordance with *Government Auditing Standards,* as part of our planning of the audit we will consider the results of previous audits and follow up on known significant findings and recommendations that directly relate to the objectives of the audit. To assist us, management agrees to identify previous financial audits, attestation engagements, performance audits, or other studies related to the objectives of the audit being undertaken and to identify corrective actions taken to address significant findings and recommendations prior to the date of our auditors' report.

Management is responsible for adjusting the financial statements to correct material misstatements and for affirming to us in the representation letter that the effects of any unrecorded misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements being reported upon. Because of the importance of management's representations to the effective performance of our services, the City agrees to release KPMG and its personnel from any claims, liabilities, costs and expenses relating to our services under this letter attributable to any misrepresentations in the representation letter referred to above.

Management is also responsible for providing us with written responses in accordance with *Government Auditing Standards* to the findings included in the GAS report within seven days of being provided with draft findings.

Management is responsible for the distribution of the reports issued by KPMG. In accordance with *Government Auditing Standards,* the reports issued citing *Government Auditing Standards* are to be made available for public inspection.

Offering documents

We understand that the City will, from time to time, wish to include these financial statements in a document offering securities and may request that we agree to include our report on these financial statements in the offering document. We will consider agreeing to the inclusion of our report by separate agreement.

Other engagement matters

The City has retained the law firm of Vinson & Elkins LLP ("Counsel") to conduct an independent investigation of the City's disclosures relating to pension matters in its municipal bond offering from 1996 to February 2004 and certain other matters (the "Investigation") and to prepare a written report with observations, conclusions and recommendations (the "Report"). The City agrees to provide complete and unrestricted access to the Investigation, including but not limited to the scope of the Investigation and the periods covered, procedures performed, people interviewed, interview notes or memoranda, other paper and electronic data collected, including responsive emails, email "search" terms used, findings, recommendations and remedial actions, if any. In addition, we will require a complete briefing as to the status of the Investigation as soon as possible after retaining KPMG and we will require weekly status updates.

We will not issue our auditors' report on the City's basic financial statements until such Investigation is complete. In the event that KPMG determines that the Investigation or any aspect thereof is insufficient to allow us complete our audit of the City's basic financial statements or any fund financial statements, KPMG may modify our report or withdraw from the engagement. KPMG requests and the City agrees that public announcements pertaining to KPMG's engagement as the City's auditors or its ongoing audit progress and findings will be subject to review and consent by KPMG prior to dissemination.

This letter shall serve as the City's authorization for the use of e-mail and other electronic methods to transmit and receive information, including confidential information, between KPMG and the City and between KPMG and outside specialists or other entities engaged by either KPMG or the City. The City acknowledges that e-mail travels over the public Internet, which is not a secure means of communication and, thus, confidentiality of the transmitted information could be compromised through no fault of KPMG.

Further, for purposes of the services described in this letter only, the City hereby grants to KPMG a limited, revocable, non-exclusive, non-transferable, paid up and royalty-free license, without right of sublicense, to use all names, logos, trademarks and service marks of the City solely for presentations or reports to the City or for internal KPMG presentations and intranet sites.

KPMG is a limited liability partnership comprising both certified public accountants and certain principals who are not licensed as certified public accountants. Such principals may participate in the engagements to provide the services described in this letter.

Work paper access by regulators and others

The work papers for this engagement are the property of KPMG. Pursuant to *Government Auditing Standards*, we are required to make certain work papers available in a full and timely manner to regulatory agencies upon request for their reviews of audit quality and for use by their auditors. In addition, we may be requested to make certain work papers available to regulators pursuant to authority given to it by law or regulation. Access to the requested work papers will be provided under supervision of KPMG personnel. Furthermore, upon request, we may provide photocopies of selected work papers to regulatory agencies. These regulatory agencies may intend, or decide, to distribute the photocopies or information contained therein to others, including other government agencies. We agree to maintain the work papers for a period of not less than seven (7) years.

In the event KPMG is requested pursuant to subpoena or other legal process to produce its documents relating to this engagement in judicial or administrative proceedings to which KPMG is not a party, the City shall reimburse KPMG at standard billing rates for its professional time and expenses, including reasonable attorney's fees, incurred in responding to such request.

Additional reports

We expect to issue as part of this engagement independent auditors' reports on the following:

- Financial Statements of the Metropolitan Wastewater Utility Fund;
- Financial Statements of the Water Utility Fund.

Other *Government Auditing Standards* matters

As required by *Government Auditing Standards*, we have attached a copy of KPMG's most recent peer review report and letter of comments.

We may also assist management in drafting the financial statements and notes. In accordance with *Government Auditing Standards*, we are required to confirm that management accepts responsibility for the financial statements and notes and, therefore, has a responsibility to be in a position in fact and appearance to make an informed judgment about them and that management will:

- Designate a qualified management-level individual to be responsible and accountable for overseeing the drafting of the financial statements.
- Establish and monitor the performance of the engagement to ensure that it meets management's objectives.
- Make any decisions that involve management functions related to the engagement and accept full responsibility for such decisions.
- Evaluate the adequacy of the financial statements and notes.

Timing

The City requests, and KPMG agrees, that KPMG will commence its audit of the financial statements for the fiscal year ended June 30, 2003, for the City's basic financial statements, and the audits of the Metropolitan Wastewater Utility fund and Water Utility fund financial statements for the fiscal year ended June 30, 2003 at the same time. However, no assurance can be given as to the completion of our audits or the timing of the issuance of the auditors' reports on either the basic financial statements, the Metropolitan Wastewater Utility fund financial statements or the Water Utility fund financial statements.

Compensation

Our fees will be based on the following hourly rates:

Partner	$400
Senior Manager	$350
Senior Associate	$200

Associate	$150
Clerical	$ 60

In addition, expenses for items such as travel, telephone, postage, and typing, printing and reproduction of the financial statements will be billed for reimbursement as incurred.

KPMG estimates that the cost of all services pursuant to this engagement will be approximately $700,000 to $800,000. This is an estimate only, and the City acknowledges that additional expenditures may be required to complete the engagement. This agreement shall be supplemented as appropriate upon the further authorization of the City Council.

This agreement may be terminated at any time by the City or KPMG for convenience, but the City agrees that KPMG will be compensated for actual services rendered pursuant to this agreement at the hourly rates and expenses as set forth in the table set forth above, but in no event in an amount exceeding the amount authorized by the City Manager and, if applicable, by the City Council. KPMG shall provide weekly billings for its services; payment is due within ten (10) days of receipt. We understand that Lisa Irvine will be the contract administrator for our engagement.

We shall be pleased to discuss this letter with you at any time. For your convenience in confirming these arrangements, we enclose a copy of this letter. Please sign and return it to us.

Very truly yours,

KPMG LLP

Steven D. DeVetter

Steven DeVetter
Partner

ACCEPTED:

The City of San Diego

Lisa Irvine, Director, Financial Management Department

4/13/2004

Date

APPROVED AS TO FORM AND CONTENT:

CASEY GWINN, City Attorney

by

Leslie J. Girard, Assistant City Attorney

KPMG LLP
Three Embarcadero Center
San Francisco, CA 94111

Telephone 415 951 0100

August 9, 2004

Mr. Leslie J. Girard
Assistant City Attorney
Office of the City Attorney
City of San Diego
1200 Third Avenue, Suite 1620
San Diego, CA 92101

Re: Investigation

Dear Mr. Girard:

To date, we have had several discussions with Paul Maco of Vinson & Elkins (V&E) and have read the material provided by V&E with reference to their investigation and the formal inquiry and investigation being conducted by the Securities and Exchange Commission (SEC), the Department of Justice and US Attorney Office. Based on these discussions and our reading of the documents provided, we understand the following:

1. In September 2003, Ms. Diann Shipione, a San Diego City Employees' Retirement System (SDCERS) Board Member and Trustee, notified city officials and underwriters of errors and omissions in the City's financial statements dating back to 1996 and asserted the errors falsely improved the City's financial condition and were done intentionally to misstate and hide the real condition of the pension system.

2. Subsequent to the notification by Ms. Shipione, the City retracted the Preliminary Official Statement relating to a $505 million bond offering, filed a voluntary disclosure statement with the SEC acknowledging errors and omissions and engaged V&E to investigate and issue a report on the disclosure practices of the City.

3. The city has sold more than $2.3 billion in municipal bonds using financial statements believed to contain certain errors or omissions.

4. Ms. Shipione has alleged in various communications with the City Council, Mayor and other top city officials, that the steps taken to deliberately underfund the plan are illegal, violate the City Charter, and are at odds with statutes and court cases of the State of California.

5. Ms. Shipione has alleged that the decision to allow the underfunding was reached through a corrupt process in which the required funding was deferred to garner benefits for current employees.

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6. On June 11, 2004, the City reached a tentative settlement on the Gleason lawsuit. The Gleason lawsuit alleged that the underfunding of the pension plan was illegal and violated the City Charter, Municipal Code and California Constitution and that the SDCERS Board breached their fiduciary duties by allowing the City to underfund the plan. The settlement was reached without resolving the legal questions raised.

7. The SEC launched a formal inquiry in February 2004 under the anti-fraud provisions of section 17(a) 2&3 of the Securities Act of 1933 with reference the City's previous bond offerings. As part of that inquiry, we understand that the SEC may be considering allegations made in the press, and in particular allegations made by Ms. Shipione.

8. An e-mail provided to the SEC appears to indicate the SDCERS actuary may have worked with the City to change assumptions with the intent of lowering the calculated actuarial required contribution by the City.

AICPA Professional Standards state in section AU 317:

> .10 When the auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstances in which it occurred, and sufficient other information to evaluate the effect on the financial statements. In doing so, the auditor should inquire of management at a level above those involved, if possible. If management does not provide satisfactory information that there has been no illegal act, the auditor should—
>
> a. Consult with the client's legal counsel or other specialists about the application of relevant laws and regulations to the circumstances and the possible effects on the financial statements. Arrangements for such consultation with client's legal counsel should be made by the client.
>
> b. Apply additional procedures, if necessary, to obtain further understanding of the nature of the acts.

As indicated in our engagement letter dated April 13, 2004, we will not issue our auditors' report until a determination is made that the investigation being conducted by V&E is sufficient and complete. We acknowledge V&E's effort and cooperation in explaining the process they are undertaking to KPMG.

Based on discussions with you, V&E, and the reading of the documents provided and, consistent with our previous conversations, we are providing you the following

observations regarding our understanding of the scope of the investigation to help avoid surprises once we review the draft report.

We believe the investigation being conducted by V&E should address and resolve the following questions:

1. Whether or not the financial statements and or the disclosures in the financial statements were intentionally misleading and, if yes, what individuals were involved and what, if any, remedial action is recommended?

2. Did the City enter into any agreement, including the "Managers Two" agreement, or otherwise take any actions that resulted in the underfunding or misuse of pension funds that is a violation of State, City or other laws?

3. Did the SDCERS Board breach their fiduciary duty by allowing the City to underfund the plan in exchange for additional benefits for current employees and could this action have been in violation of any laws?

4. Is the use of surplus earnings to pay city obligations such as benefits outside of the plan illegal?

5. Did the City violate the City Charter by failing to fund its retirement plan as required by the City Charter?

6. Did the SDCERS Board and/or the City violate the California Constitution by allowing the City to intentionally underfund the plan?

7. Was undue influence placed on the actuary to change assumptions to reduce the shortfall of the City's contribution compared to the ARC, and, if yes, at whose direction and what action does the City plan to take to rectify this action, if applicable?

It is our understanding that the electronic evidence gathered by the investigation has been limited to documents identified by City employees in response to a SEC subpoena. In order to adequately address the allegations raised, we believe the investigation should consider conducting independent electronic discovery.

As the investigation progresses and we are provided access to information as outlined in our engagement letter, we may request that the investigation consider additional items.

We respectfully request your written response to these questions regarding the investigation.

Very truly yours,

KPMG LLP

Steven G. DeVetter

Steven G. DeVetter
Partner

KPMG LLP
Three Embarcadero Center
San Francisco, CA 94111

Telephone 415 951 0100

September 1, 2004

Leslie J. Girard, Esq.
Assistant City Attorney
Office of the City Attorney
City of San Diego
1200 Third Avenue, Suite 1620
San Diego, CA 92101

Re: Follow-up from meeting on August 27, 2004

Dear Mr. Girard:

We write to follow-up on our meeting on Friday in San Diego. We appreciate the opportunity afforded by that meeting to hear from the Vinson & Elkins ("V&E") representatives a status report on their investigation and to discuss with them and with you our respective views on the scope of the investigation as well as how its results will be shared with us.

On several occasions over the last few months we have had discussions about the investigation and we think it is fair to say that over that period we have expressed concerns about the scope of the investigation as it has been described to us. We expressed some of those concerns in our August 9, 2004 letter. While we remain concerned that the scope of the investigation may not be sufficient to enable us to conclude that the City has adequately addressed certain issues pertinent to our audits of the City's financial statements, we are prepared to proceed as outlined in our meeting by continuing to review the additional information being provided to us while we await the opportunity to review the final report.

Based upon our discussion on Friday, we understand that a number of the concerns raised in our August 9, 2004 letter may be addressed to some extent in the V&E report. However, you and V&E made it clear that V&E was retained only to investigate the City's disclosure practices and that, while there may be factual information pertinent to our broader concerns discussed in the report, we should not anticipate that all of the questions identified in our August 9, 2004 letter to you will be answered by the report. We will work diligently to review the information provided to us, determine whether such information is sufficient for our purposes and discuss our conclusions with you. We also appreciate your assurances that we will have access to V&E to discuss their report and the investigation; that the City will respond fully to any questions KPMG may pose that may not be addressed in the V&E report; and that the City is not imposing any deadline on KPMG to complete its work.

However, without in any way prejudging what our reaction to the final report will be, you should be aware that, if following our review of the V&E report we conclude that the V&E report is not sufficient to resolve all of the issues we face in the audit, we may advise you that additional investigative procedures may be necessary before KPMG can complete its work. In certain circumstances, we, as auditors may be obligated

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to raise any unresolved questions with the City Council which, according to our engagement letter, is the body to which our audit report is to be addressed. In addition, KPMG reserves the right to resign this engagement if it concludes, in its professional judgment, that the City's investigation of these issues has not been sufficiently comprehensive to enable KPMG to reach conclusions necessary for the issuance of an audit report.

In light of the issues currently facing us and to ensure that KPMG's position is clear to all concerned, we believe it is appropriate that we provide a copy of this letter to Lamont Ewell, City Manager, and Terri Webster, Acting City Auditor and Comptroller.

Thank you again for your time on Friday. Please contact us at your convenience to discuss any of the foregoing issues in greater detail.

Very truly yours,

KPMG LLP

Steven G. DeVetter

Steven G. DeVetter
Partner

cc: Mr. P. Lamont Ewell, City Manager
Ms. Terri Webster, Acting City Auditor and Comptroller

LESLIE E. DEVANEY
ANITA M. NOONE
LESLIE J. GIRARD
SUSAN M. HEATH
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TELEPHONE (619) 236-6220
FAX (619) 236-7215

September 20, 2004

VIA FACSIMILE AND U.S. MAIL

Mr. Steven G. DeVetter, Partner
KPMG
Three Embarcadero Center
Suite 2000
San Francisco, CA 94111-4073
Fax: (415) 986-3439

Dear Mr. DeVetter:

Re: City of San Diego Fiscal Year 2003 Audit

I am writing in response to the letters of KPMG dated August 9, 2004 and September 1, 2004. At the outset, let me express the City's intention to assist KPMG in performing all reasonable steps necessary in order to conduct the audit of the financial statements of the City of San Diego (the "City") as we have to date, in accordance with auditing standards generally accepted in the United States and the standards for financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States

As stated in our letter agreement with KPMG dated April 13, 2004 (the "Agreement"), the City retained the law firm of Vinson & Elkins LLP ("Counsel") to conduct an independent investigation of the City's disclosures relating to pension matters in its municipal bond offering from 1996 to February 2004 and certain other matters (the "Investigation") and to prepare a written report with observations, conclusions and recommendations (the "Report"). On September 16, 2004, Counsel filed the Report with the Office of the City Clerk and the City Council will receive the report in open session today at 2:00 p.m. The Report fully satisfies, and indeed exceeds, the requirements of our terms of engagement with Counsel. We believe that the City is the only municipal government to have commissioned an investigative report of its disclosure practices. However, we ask that, to the extent you are aware of similar reports prepared for municipal governments, you share the portions you consider relevant with us.

The City now wishes to determine what additional needs, if any, KPMG has in order to issue its audit opinion with respect to the City's Fiscal Year 2003 Comprehensive Annual

Financial Report ("2003 CAFR"), as well as the additional services covered by the Agreement. Your correspondence to date does not clarify this issue in light of the Report.

Please regard the following comments in response to your letters as made in order to further the dialogue between the City and KPMG. In your letter of August 9, you made certain initial observations that we believe misinterpret documents and records provided to you. For example, you state that SDCERS Trustee Diann Shipione has "pointed out" errors in the City's accounting going back to 1996. To our knowledge, Ms. Shipione has never alleged *any* errors in the City's financial statements other than with respect to one statement in a footnote to the City's financial statements for the fiscal year ended June 30, 2002. As discussed in the Report at page 109, that error, which was certainly not material in itself, was the result of a failure to update the City's footnote disclosure from the previous year (when the statement was accurate). The footnote did have other, more serious problems, as Paul Webber and City staff later discovered. Ms. Shipione's criticisms have, in the main, gone not to the City's accounting but to its failure to adequately fund SDCERS. The Report, as a general matter, agrees with these criticisms and discusses in detail their relevance to the City's financial disclosure.

As another example, you stated that the CERS actuary "may have worked with the City to change assumptions with the intent of lowering the calculated actuarial required contribution by the City." In the communication at issue, Mr. Roeder did not propose any change in actuarial "assumptions." He pointed out that under applicable standards, it is permissible to use a different amortization period for expensing a pension system's unfunded actuarial accrued liability than is used for calculating employer contributions. This view was confirmed in documents provided to you that express the views of Gary Caporicci, Caporicci & Larson, and Leslie Finertie, an actuary with the firm of Towers Perrin. In his review of the City's financial disclosure, this view was also accepted by Paul Webber, Orrick Herrington. If you have reason to believe these opinions are incorrect, please so inform us. We will request that Counsel make itself available at your convenience to discuss these and other matters that appear from your correspondence to be of concern to KPMG.

With respect to the seven questions raised in your letter, please note my comments below:

Question 1, Comment. As the City publicly disclosed on January 27, 2004, the footnotes to the City's financial statements for the fiscal year ended June 30, 2002, contained various errors and omissions. Some of these errors and omissions also affected previous years' financial disclosure. The footnotes were prepared, as required by contract, by the City's former independent auditor, Calderon, Jaham, and Osborn, which firm was acquired by Caporicci and Larson in January 2003. The City has terminated its relationship with Caporicci and Larson. The City's financial statements for the relevant period were prepared under the supervision of the former City Auditor and Comptroller, Ed Ryan. Mr. Ryan retired on February 13, 2004. He declined to be interviewed by Counsel in connection with its Report. The City is actively engaged in finding a new Auditor and Comptroller. The Report addresses on page 159 the issue

of the possible intent of City officials to allow the City to issue misleading financial disclosure. We would appreciate being referred to relevant extracts from investigative reports for municipal issuers or other issuers that address the issue of intent in a manner that goes beyond this statement.

Question 2. Did the City enter into any agreement ... or otherwise take any actions... that is a violation of State, City, or other laws?

Question 2, Comment. Please note that the City's potential liability for any violations of law arising from the alleged underfunding of its pension system was addressed through settlement in the recent *Gleason* suit. According to the terms of the settlement, the terms are binding upon all who might have standing to sue on such matters. To our knowledge there are no other claims that have been asserted in connection with the City's relationship to its pension system, or related disclosure issues. To the extent any potential claims can be identified, we will, of course, have no objection to appropriate disclosure of the related contingent liabilities.

As you know, the only direct reflection of the City's obligation to fund SDCERS in the City's balance sheet is the line item "net pension obligation." We are not aware of any allegations that this item has ever been materially misstated. Various errors in the City's previous footnote disclosure concerning pension matters are discussed in detail in the Report and in the City's January 27, 2004 voluntary disclosure. If you have any reason to believe the City's disclosure of these errors and omissions is in any way incomplete or inadequate, please so inform us.

More generally, please note the general, long standing, principle of the law of municipal corporations cited in the Report at page 11: "A legislative act by a city council that violates or is not in compliance with that city's charter is void, but the actions of the individual members of the city council in taking such action generally are not open to challenge in the courts, and where the enactment of legislation is challenged as resulting from improper or fraudulent motives, the law may not be voided on such grounds." Please identify and explain for us the details of any remaining concerns under Question 2 that affect your ability to issue your audit letter under GAAS, so that we may determine appropriate actions to address your concerns.

Question 3, Comment. The actions of the SDCERS Board are described in the Report, including the extensive reliance upon fiduciary counsel. The SDCERS Board is independent of the City of San Diego. Three of the thirteen Trustees of SDCERS are, by City Charter, officials of the City. Please identify and explain for us (a) how actions of an entity independent of the City and (b) the three City individuals serving as SDCERS Trustees, relate to your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

Question 4, Comment. The history of the use of surplus earnings is discussed in Part II of the Report. Please identify and explain for us the details of any remaining concerns under

Question 4 that affect the issuance of your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

Question 5, Comment. See the discussion under Part II and note that the *Gleason* settlement resolves the economic consequences of the City's actions. Please identify and explain for us the details of any remaining concerns under Question 5 that impair the issuance of your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

Question 6, Comment.

(a) SDCERS. Please note that the SDCERS Board is a separate legal entity from the City. The Report contains a discussion of actions of the SDCERS Board, but such discussion is subject to the limited cooperation and access to relevant information provided by this entity. As with Question 3, please identify and explain for us (a) how actions of an entity independent of the City and (b) the three City individuals serving as SDCERS Trustees, relate to your ability to issue and impair the issuance of your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

(b) The City. An analysis of the actions of the City is contained in the Report. In light of the general legal principle cited in the Report as described in the Comment to Question 2 and the resolution of any economic exposure resulting from such actions through the *Gleason* settlement, please identify and explain for us the details of any remaining concerns under Question 6 that affect the issuance of your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

Question 7, Comment. Please note the discussion on page 91 of the Report concerning any undue influence on the SDCERS actuary in connection with Manager's Proposal 2. Please explain for us the details of any remaining concerns under Question 7 that impair the issuance of your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

With respect to your suggestion that we consider independent electronic discovery, given the findings of the Report, and considering the lack of interest by the SEC and US Attorney expressed in such activity, as well as the additional cost to the City, please identify and explain for us the details of any remaining concerns relating to the use of independent discovery that affect the issuance of your audit letter under GAAS so that we may determine appropriate actions to address your concerns.

We note that Counsel has produced the key documents behind the Report to you in two shipments, one delivered Saturday and one sent today. Please advise us of any additional requests you have.

We are encouraged that KPMG has retained the services of Sidley, Austin, Brown and Wood in this matter. In addition to their expertise in the representation of accounting firms, we are aware of their expertise in municipal finance.

We are sensitive and intend to support KPMG in meeting its professional obligations prior to issuing its audit report. We ask that KPMG recall the oral assurances KPMG provided the City at the time it pursued this engagement this past spring, in particular its sensitivity to the timing needs of the City to be able to enter the public securities markets. We are now advised by Standard & Poore's Rating Services that they have suspended the City's rating "due to the continued absence and lack of estimated release date for the city's fiscal 2003 audited financial statements." As a result, our bondholders and the City may suffer economic harm.

In our view the Report is sufficiently comprehensive to allow you to reach the conclusions necessary for compliance with Section AU 317 of the AICPA Professional Standards and for the issuance of your audit report. We also believe this letter addresses each of the particular questions that you raised in your previous correspondence. After your review of this letter, please call me so that we can schedule a timely meeting to discuss any remaining issues relating to the impact on the financial statements and the issuance of the audit report.

Sincerely,

CASEY GWINN, City Attorney

By

Leslie J. Girard
Assistant City Attorney

LJG:km
cc: City Manager

EXHIBIT 3

prosecutors and the courts. The investigation of fraud, because it deals with the individual rights of others, must be conducted only with adequate cause or predication.

Predication is the totality of circumstances that would lead a reasonable, professionally trained, and prudent individual to believe a fraud has occurred, is occurring, and/or will occur. Predication is the basis upon which an examination is commenced. Fraud examinations should not be conducted without proper predication.

Fraud Theory Approach

Each fraud examination begins with the proposition that all cases will end in litigation. To solve a fraud without complete evidence, the examiner must make certain assumptions. This is not unlike the scientist who postulates a theory based on observation and then tests it. In the case of complex fraud, fraud theory is almost indispensable. Fraud theory begins with the assumption, based on the known facts, of what might have occurred. Then that assumption is tested to determine whether it is provable. The fraud theory approach involves the following steps, in the order of their occurrence:

- ❑ Analyze available data
- ❑ Create a hypothesis
- ❑ Test the hypothesis
- ❑ Refine and amend the hypothesis

A case study on internal fraud that is based on an actual incident, and one that is common in the commercial and governmental environment, illustrates the concepts involved in the fraud examination process. The names and certain other facts have been changed for purposes of illustration.

LINDA REED COLLINS CASE STUDY

Linda Reed Collins is purchasing manager for Bailey Books Incorporated in St. Augustine, Florida. Bailey, with $226 million in annual sales, is one of the country's leading producers of textbooks for the college and university market as well as technical manuals for the medical and dental professions.

Bailey's headquarters consists of 126 employees, plus numerous sales personnel in the field. Because of the competitive nature of the textbook business, their profit margins are quite thin. Bailey's purchases average about

EXHIBIT 6

Vinson&Elkins
ATTORNEYS AT LAW

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THE WILLARD OFFICE BUILDING
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February 18, 2004

Casey Gwinn, Esq.
San Diego City Attorney
Office of the City Attorney
Civic Center Plaza
1200 Third Avenue, Suite 1620
San Diego, CA 92101

Dear Mr. Gwinn:

We appreciate being asked to represent the City of San Diego in connection with the Securities and Exchange Commission's ("SEC") inquiry *In the Matter of San Diego Municipal Bond Securities Offerings (MLA-2842)*. Our experience has been that it is mutually beneficial to set forth, at the outset of our representation, the role and responsibilities of both our law firm and the client. That is the purpose of both this letter and the separate Standard Terms of Engagement for Legal Services that is enclosed with this letter.

Client

The client for this engagement is the City of San Diego ("the City"). This engagement does not create an attorney-client relationship with any related persons or entities, such as parents, subsidiaries, affiliates, employees, officers, directors, shareholders, or partners. Our representation of the City will not involve the representation of any City employee in their individual capacity.

Scope of Engagement

As your counsel we will provide legal advice and representation to the City in the SEC and U.S. Attorney inquiry. As part of our representation, we will conduct an internal review of City disclosure relating to pension matters in its municipal bond offerings from 1996 to the present and prepare a report with observations, conclusions and recommendations (the "Report"). The initial scope of internal review will be agreed upon by separate cover. We agree that the Report is not to be an advocacy document, but an objective "warts and all" report. This engagement will include only the matter described in this paragraph and any additional matters that are made part of the engagement by written supplement to this letter.

We understand and agree that this is not an exclusive agreement, and you are free to retain any other counsel of your choosing. We recognize that we shall be disqualified from representing any other client with interests materially and directly adverse to yours (i) in any matter which is substantially related to our representation of you and (ii) with respect to any matter where there is a reasonable probability that confidential information you furnished to us could be used to your disadvantage. You understand and agree that, with those exceptions, we are free to represent other clients, including clients whose interests may conflict with yours in litigation, business transactions, or other legal matters. You agree that our representing you in this matter will not prevent or disqualify us from representing clients adverse to you in other matters and that you consent in advance to our undertaking such adverse representations.

This engagement and our attorney-client relationship will be terminated when we have completed the services in the matters covered by this engagement letter and any written supplements to this engagement letter. If you later retain us to perform further or additional services, our attorney-client relationship will be established by another engagement letter.

Our firm represents a number of lawyers and law firms in professional liability, business, tax and other matters. This means that we may have represented, may currently represent, or in the future may represent counsel opposing your interests in a matter in which we represent you. This will not in any way affect the diligence or vigor with which we represent your interests in the matter or the matters on which you engage our firm. If this is a concern to you, please let us know and we will check on the particular lawyers involved in your matter or matters.

We understand that our initial representation is in an amount not to exceed $150,000. This amount may be supplemented in the future based upon mutual agreement.

Cooperation

In order to enable us to render effectively the legal services contemplated, the City has agreed to disclose fully and accurately all facts and keep us informed of all developments relating to the inquiry. We necessarily must rely on the accuracy and completeness of the facts and information you and your agents provide to us. The City has agreed to cooperate fully with us and to make certain City representatives available to attend meetings, discovery proceedings and conferences, hearings and other proceedings. We will attempt to schedule depositions, hearings, etc. to serve the convenience of those representatives, but it is the nature of inquiries and of litigation that such schedules are often not within our control.

We will of course make our best efforts to achieve a result in this inquiry that is satisfactory to the City. However, because the outcome of inquiry and any subsequent litigation is subject to the vagaries and risks inherent in the litigation process, it is understood that we make no promises or guarantees to the City concerning the outcome and cannot do so.

Fees

For this matter, our fees will be based on the time spent by the lawyers and paralegal personnel who work on the matter. Based on our understanding of this matter, we anticipate that most of the work on the City's matter will be undertaken by me and my partner, Richard Sauer with the assistance of several associates as needed. We will also be assisted by our partner Mark

Tuohey. My hourly rate for this matter will be $425, Rick Sauer's will be $425 and Mark's will be $450. All associates will be billed at our reduced level II rates, in recognition of the governmental nature of the client. In addition to Mark Tuohey, we expect to seek the advice of partners with expertise in certain areas, such as pension and employee benefits law. Their time will be charged at the lower of our level II rates or $450 per hour. In an effort to reduce overall legal costs, we utilize paralegal personnel whenever appropriate. Time devoted by such paralegal personnel to client matters is currently charged at billing rates generally ranging from $145 to $175 per hour. Billing rates for both attorneys and paralegal personnel are, from time to time, reviewed and adjusted and may be changed with or without notice.

In further effort to minimize legal costs, we anticipate working with and utilizing the staff of the City Attorney's Office in a variety of tasks, including the assembly and production of documents and other materials as requested by the SEC.

By engaging us, you acknowledge and agree that you are responsible for payment of fees, expenses and disbursements. In appropriate matters as an accommodation to you, we may agree to direct our bills to third-party payors (*e.g.*, an insurer), but you agree that you will remain fully responsible for timely payment of our bills if for any reason the third party does not timely pay such bills. Likewise, we agree that we owe our professional obligations to you, even when a third party pays our bills.

Other Charges

In addition to our fees, there will be other charges for items incident to the performance of our legal services, such as photocopying, messengers, travel expenses, long-distance telephone calls, facsimile transmissions, postage, overtime for secretaries and other non-legal staff, specialized computer applications such as computerized legal research, and filing fees. The basis upon which we establish these other charges is set forth in the Standard Terms of Engagement For Legal Services.

Investment Disclosures

Many of the Firm's lawyers, directly or beneficially, own interests in corporations and other entities or in real property. Although our computerized system used for checking conflicts of interest tracks all investments made in the name of the Firm, it does not contain data as to investments made individually by each of the Firm's lawyers. If you are at all concerned about these individual investments, we will be pleased to canvass our lawyers about their individual investments in any entity or entities about which you may be concerned.

Withdrawal or Termination

Our relationship is based upon mutual consent and you may terminate our representation at any time, with or without cause, by notifying us. Your termination of our services will not affect your responsibility for payment of fees for legal services rendered and of other charges incurred before termination and in connection with an orderly transition of the matter.

We are subject to the rules of professional conduct for the jurisdictions in which we practice, which list several types of conduct or circumstances that require or allow us to

withdraw from representing a client, including for example, nonpayment of fees or costs, misrepresentation or failure to disclose material facts, fundamental disagreements, and conflict of interest with another client. We try to identify in advance and discuss with you any situation which may lead to our withdrawal, and if withdrawal ever becomes necessary, we give you written notice of our withdrawal. If we elect to withdraw for any reason, you will take all steps necessary to free us of any obligation to perform further, including the execution of any documents necessary to complete our withdrawal, and we will be entitled to be paid for all services rendered and other charges accrued on your behalf to the date of withdrawal.

Other

If the foregoing, including the items set forth in the enclosed Standard Terms of Engagement For Legal Services, correctly reflects your understanding of the terms and conditions of our representation, please so indicate by executing the enclosed copy of this letter in the space provided below and return it to the undersigned.

Please contact me if you have any questions. We are pleased to have this opportunity to be of service and to work with you.

Very truly yours,

VINSON & ELKINS L.L.P.

By _____
Paul S. Maco

Enclosure

AGREED TO AND ACCEPTED:

The City of San Diego

By: _____
Leslie J. Girard
Assistant City Attorney

VINSON & ELKINS L.L.P.

Standard Terms of Engagement for Legal Services

This statement sets forth certain standard terms of our engagement as your lawyers and is intended as a supplement to the engagement letter that we have with you as our client. Unless modified in writing by mutual agreement, these terms will be an integral part of our agreement with you as reflected in the engagement letter. Therefore, we ask that you review this statement carefully and contact us promptly if you have any questions. We suggest that you retain this statement in your file with the engagement letter.

The Scope of Our Work

You should have a clear understanding of the legal services we will provide. Any questions that you have should be dealt with promptly.

We will at all times act on your behalf to the best of our ability. Any expressions on our part concerning the outcome of your legal matters are expressions of our best professional judgment, but are not guarantees. Such opinions are necessarily limited by our knowledge of the facts and are based on the state of the law at the time they are expressed.

It is our policy that the person or entity that we represent is the person or entity that is identified in our engagement letter, and absent an express agreement to the contrary does not include any affiliates of such person or entity (*e.g.*, if you are a corporation or partnership, any parents, subsidiaries, employees, officers, directors, shareholders or partners of the corporation or partnership, or commonly owned corporations or partnerships; or, if you are a trade association, any members of the trade association). If you believe this engagement includes additional entities or persons as our clients you should inform us immediately.

It is also our policy that the attorney-client relationship will be considered terminated upon our completion of any services that you have retained us to perform. If you later retain us to perform further or additional services, our attorney-client relationship will be revived subject to the terms of engagement that we agree on at that time.

This engagement shall be subject to the Disciplinary Rules of Professional Conduct for the District of Columbia.

Who Will Provide the Legal Services

Customarily, each client of the firm is served by a principal attorney contact. The principal attorney should be someone in whom you have confidence and with whom you enjoy working. You are free to request a change of principal attorney at any time. Subject to the supervisory role of the principal attorney, your work or parts of it may be performed by other lawyers and legal assistants in the firm. Such delegation may be for the purpose of involving lawyers or legal assistants with special expertise in a given area or for the purpose of providing

services on the most efficient and timely basis. Whenever practicable, we will advise you of the names of those attorneys and legal assistants who work on your matters.

How Our Fees Will Be Set

Generally, our fees are based on the time spent by the lawyers and paralegal personnel who work on the matter. We will charge for all time spent in representing your interests, including, by way of illustration, telephone and office conferences with you and your representatives, consultants (if any), opposing counsel, and others; conferences among our legal and paralegal personnel; factual investigation; legal research; responding to your requests for us to provide information to your auditors in connection with reviews or audits of financial statements; drafting letters and other documents; and travel. We will keep accurate records of the time we devote to your work in units of quarters of an hour.

The hourly rates of our lawyers and legal assistants are reviewed and adjusted annually on a Firm-wide basis to reflect current levels of legal experience, changes in overhead costs, and other factors. The fees for this engagement will be as set forth in the letter to which this document is attached, unless modified by subsequent amendment to such letter.

Although we may from time to time, at the client's request, furnish estimates of legal fees and other charges that we anticipate will be incurred, these estimates are by their nature inexact (due to unforeseeable circumstances) and, therefore, the actual fees and charges ultimately billed may vary from such estimates.

Additional Charges

In addition to our fees, there will be other charges for items incident to the performance of our legal services, such as photocopying, messengers, travel expenses, long-distance telephone calls, facsimile transmissions, postage, overtime for secretaries and other non-legal staff, specialized computer applications such as computerized legal research, and filing fees. The current basis for these charges is set forth below. The Firm will review this schedule of charges on an annual basis and adjust them to take into account changes in the Firm's costs and other factors.

Duplicating

The Firm charges $.15 per page.

Courier Services

The Firm charges an amount which generally represents cost including the distribution service provided by the Firm. Depending on the volume of work performed by a service provider, the Firm may receive a volume discount during a particular accounting period for which no adjustment is made on an individual client's bill.

Computer Aided Legal Research (CALR)

Third party providers of CALR services charge the Firm amounts each month based on the type, extent, and duration of the services provided. The Firm charges clients for client research only based on the computed cost to the Firm for the use of the services. This cost is monitored and revised periodically to achieve an average "at cost" rate for clients.

Telefax

The Firm charges $1.00 per page for outgoing telefaxes, which includes all telephone costs.

Telephone

The Firm does not charge for local calls. Due to the Firm-wide volume of long distance calls and multitude of rates for the various area codes and exchanges (over 65,000), the Firm does not bill each individual call based on the statements received from providers, but rather charges a flat rate of $.41 per minute for each long distance call made within the United States. This rate ($.41) is an approximation of third party provider charges and internal costs associated with this service. International calls are charged based on the rate in effect for the country being called.

Travel-Related Expenses

Airfare, meals, and related travel expenses charged to the client represent actual, out-of-pocket cost. Depending on the volume of both Firm and personal travel, the Firm may receive beneficial services, including airline tickets from its travel agent for which no adjustment is made on an individual client's account. In addition, credits earned under the Frequent Flyer Programs accrue to the individual traveler and not to the Firm.

All Other Costs

The Firm charges actual disbursements for third-party services like court reporters, expert witnesses, etc., and may recoup expenses reasonably incurred in connection with services performed in-house, such as mail services, secretarial overtime, file retrieval, etc.

Unless special arrangements are otherwise made, fees and expenses of others (such as experts, investigators, consultants and court reporters) will be the responsibility of, and billed directly to, the client. Further, all invoices in excess of $500 will be forwarded to the client for direct payment.

Billing Arrangements and Terms

Our billing rates are based on the assumption of prompt payment. Consequently, unless other arrangements are made, fees for services and other charges will be billed monthly and are payable within thirty days of receipt.

By engaging us, you acknowledge and agree that you are responsible for payment of fees, expenses and disbursements. In appropriate matters as an accommodation to you, we may agree to direct our bills to third-party payors (*e.g.*, an insurer), but you agree that you will remain fully responsible for timely payment of our bills if for any reason the third party does not timely pay such bills. Likewise, we agree that we owe our professional obligations to you, even when a third party pays our bills.

Confidentiality

We will preserve the confidentiality of information you provide us consistent with applicable law including the rules of professional conduct governing lawyers. This confirms your agreement that, with respect to firm brochures or other material or information regarding the firm and its practice, we may indicate the general nature of our representation of you and your identity as a firm client.

Client and Firm Documents

We will maintain any documents that you furnish to us in our client file (or files) for this matter. At your request, we will return your documents to you at the conclusion of the matter (or earlier, if appropriate). It is your obligation to tell us which, if any, of the documents that you furnish us that you want returned. We will return those documents to you promptly after our receipt of payment for outstanding fees and charges. Our own files pertaining to this matter, including the work performed by our attorneys, will be retained by the firm. Any documents retained by the firm will be kept for a certain period of time, and ultimately we will destroy them in accordance with our record retention program schedule then in effect.

EXHIBIT 8

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

EXHIBIT 10

Three Embarcadero Center
San Francisco, CA 94111

Telephone 415 951 0100

October 29, 2004

The Honorable Dick Murphy, Mayor
Mr. Lamont Ewell, City Manager
City of San Diego
1200 Third Avenue
San Diego, CA 92101

Gentlemen:

We write this letter in an earnest attempt to make progress with the City of San Diego towards addressing the issues that must be resolved before KPMG can complete its audit of the City's 2003 financial statements.

The immediate topic we must address is the letter dated October 28, 2004 from Paul Maco of Vinson & Elkins (V&E) addressed to Les Girard, Assistant City Attorney. That letter, which appears to have been posted immediately on the City's website, in our opinion seriously impairs, rather than advances, the prospects for a prompt resolution of the issues that currently stand in the way of KPMG completing its audit.

We will not in this letter seek to correct all of the statements in Mr. Maco's letter which we believe are inaccurate. However, we do wish to convey to you, as two individuals with significant responsibility for the City's affairs, several points, which are intended to be direct, but constructive:

First, KPMG cannot, and will not, complete an audit of the 2003 financial statements unless the City completes an independent investigation of potential illegal acts as we have outlined in our prior correspondence.

Second, KPMG does not seek, as Mr. Maco asserts, "broad and unspecified assurances that the City and its officials have not committed 'illegal acts.' " Nor do we request that the City retain counsel to "speculate on an unbounded universe of unasserted claims." We believe that our prior letters cannot reasonably be construed to have made such requests. To the contrary, we have laid out what our concerns are, and repeatedly advised the City's representatives that these concerns must be addressed through an investigation that was designed to develop facts that would enable the City and its counsel to address those concerns.

Third, while we believe it is somewhat unusual for an auditor to provide a detailed explanation to a client of the auditing standards that justify an auditor's request for information, we have done so here. In our correspondence, we not only discussed relevant auditing literature, but also explicated for the City some of the applicable accounting principles that require the City in its financial

KPMG, LLP. KPMG LLP, a limited liability partnership, is a member of KPMG International, a Swiss association.

statements to make disclosures of any violations of finance-related laws and regulations.[1] We believe that the City cannot comply with this requirement unless it conducts the kind of investigation we have requested and described in our October 11, 2004 letter. Accordingly, the investigation we are requesting is one that the City ought to desire to complete so that it can discharge its own financial reporting obligations and not solely because KPMG is insisting that it do so. The City, as the issuer of its financial statements, must conclude on the question of whether any of the issues discussed in our October 11, 2004 letter and its attachments and the conduct discussed in the V&E report was illegal and, if so, whether any violations must be disclosed, and have been adequately disclosed, in the financial statements in accordance with GAAP. We would further expect the City would also determine to its satisfaction that all necessary and appropriate remedial actions have been taken with respect to conduct that is investigated. It is because it is the City's obligation to reach these conclusions that KPMG has suggested that the City obtain from its investigators sufficiently clear legal conclusions to enable the City to make the necessary determinations; we have not, as Mr. Maco suggests requested that any law firm issue a legal opinion to KPMG on any subject and his allusion to the ABA protocol for FAS 5 (Contingent Liability) attorney letters is completely off subject. It is, thus, extremely disappointing and surprising that Mr. Maco's letter so ardently contends that KPMG has not explained the auditing standards motivating its request. It is equally troubling that his letter erroneously asserts that KPMG "was not following established auditing standards."[2]

In light of the foregoing, and considering both that Mr. Maco may not speak for the City on these matters and that (at least according to certain press reports) there may not have been adequate communication within the City about our position, we believe that a key element of our meeting on Monday November 1, 2004 will be to secure the authoritative position of the City on these important issues. Our fundamental goal for this meeting is the same one we expressed in our letter dated October 27, 2004: "to discuss how the City plans to conduct an adequately detailed investigation that will permit KPMG to conclude its audit."

If the City is prepared to proceed with an appropriate investigation, then we urge you to consider retaining counsel other than V&E to do so. The positions asserted in, and oppositional tone of, Mr. Maco's letter raises questions about V&E's willingness or ability in these circumstances to complete the investigation of, and reach conclusions on, the audit-critical questions posed in our prior oral and written communications and to do so in an objective and independent manner. Our

---

[1] In light of these requirements, the fact that the City may be exempt from Section 10A of the Securities Exchange Act of 1934 as Mr. Maco asserts, does not eliminate the City's obligations under Generally Accepted Accounting Principles ("GAAP") applicable to governments.

[2] Again, in the interest of assisting the City in understanding its obligations and explaining the professional guidance that KPMG believes is applicable here, we are enclosing a copy of a very recent Practice Alert published by the American Institute of Certified Public Accountants on "Illegal Acts".

reading of the letter suggests to us that, at this point, conducting the kind of investigation that is necessary may be in tension with V&E's ongoing representation of the City in the pending SEC investigation.

KPMG's ability to complete its audit of the City's financial statements is dependent on resolution of these outstanding issues. We have been, and will continue, to perform the service we understood the City wanted us to perform (i.e. to objectively exercise our professional judgment in the application of professional standards). We stand ready to do so in the independent manner we believe the City, the investing public and the taxpayers expect.

Very truly yours,

KPMG LLP

Steven G. DeVetter

Steven G. DeVetter
Partner

cc: Mr. Leslie Girard, Assistant City Attorney, City of San Diego

EXHIBIT 17

San Diego City Attorney
MICHAEL J. AGUIRRE

NEWS RELEASE

FOR IMMEDIATE RELEASE: December 9, 2004

Contact: Maria Velasquez, Press Secretary: (619) 235-5725 (pager & voicemail) mvelasquez@sandiego.gov

STATEMENT FROM CITY ATTORNEY MICHAEL J. AGUIRRE
FINANCIAL DISCLOSURE PRACTICES INVESTIGATION, AND DECISION NOT TO JOIN SAN DIEGO'S RETIREMENT SYSTEM
Action Taken to Ensure Public Confidence

The City Attorney's Office is undertaking a separate and independent investigation into issues raised in the *Report on Investigation of the City of San Diego's Disclosures of Obligations to Fund the San Diego City Employee's Retirement System and Related Disclosure Practices 1996-2004,* dated 16 September 2004. After the investigation is completed, a decision will be made whether to refer any matters to the City Attorney's new Public Integrity Unit in the Criminal Division.

The City Attorney has also announced that he will not become a member of the San Diego Retirement System until the conclusion of the San Diego City Attorney's investigation of the outstanding legal issues addressed, arising out of, or related to the *Report on Investigation of the San Diego Disclosures of Obligations to Fund the San Diego City Employee's Retirement System and Related Disclosure Practices 1996-2004*, dated 16 September 2004. He is taking this action to ensure public confidence in the resolution of any investigations undertaken by the San Diego City Attorney's office.

Please note the City Attorney is permitted to not become a member of the retirement system under Municipal Code § 24.1702 which provides:

§24.1702 Membership by Elected Officers Permissive
Every Elected Officer in office at the time this section becomes effective, or elected after the effective date of this section, may become a Member of this System if he files with the Board a written election to become a Member.
(Retitled from "Membership by Legislative Officers Permissive" and amended 10-8-2001 by O-18994 N.S.)

Thus, City Attorney Aguirre will not be filing a written election to become a member of the San Diego City retirement system at this time.

###

1200 Third Avenue, Suite 1620, San Diego, California 92101-4188 (619) 236-6220

EXHIBIT 18

BLUE RIBBON COMMITTEE REPORT
ON
CITY OF SAN DIEGO FINANCES

FEBRUARY 2002

BLUE RIBBON COMMITTEE REPORT
ON
CITY OF SAN DIEGO FINANCES
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3. Moody's The Nation's Cities Ratings
4. Long Term Debt Analysis
5. Debt Service Analysis
6. General Fund Revenue Per Capita
7. General Fund Expenditures Per Capita

III. RETIREMENT BENEFITS AND UNFUNDED PENSION LIABILITIES

All full time City employees participate in the San Diego City Employee Retirement System (SDCERS), which is the City's Defined Benefit Pension Plan. As a defined benefit plan, retirement benefits are determined primarily by a member's age at retirement, the length of membership service and the member's final compensation earnable based on the highest one-year period.

The level of retiree benefits is a policy issue. The question to be addressed by the Committee is how these benefit policies affect the fiscal health of the City. The Committee did not address the issue of how the City's pension assets are invested.

Employee retirement benefit liabilities of the City comprise two issues:

- Pension Benefits
- Retiree Health Benefits

A. PENSION BENEFITS

The Committee has two concerns regarding the Retirement Benefit Liability:

1. *Whether the City is paying out of its current year's budget the full cost being incurred by its current workforce for their future pension and retiree health benefits.*

2. *Whether the budgetary process adequately comprehends the steadily growing annual expense obligation, particularly given the uncontrollable and non-discretionary nature of this liability.*

The potential risk is that policy makers grant benefit enhancements today (to satisfy employee concerns, to negotiate trade offs with unions, etc.), but avoid recognizing the actual annual cost of such by actuarially spreading the cost over years far out in the future, long after the individuals who made the policy decisions are gone. This is particularly acute where the retiree benefit enhancements are granted "retroactively", i.e. new improved benefits, which are applied to past, as well as future, years of service for active employees. This retroactive approach is the general practice of the City.

Major pension improvements (20% increase) were implemented in Fiscal Year 1997 and benefits were increased by another 12% in Fiscal Year 2000 as a result of a litigation settlement. San Diego County is in the final stages of approving major pension improvements, exceeding San Diego City benefits. This will undoubtedly lead to pressure for further increases for City employees.

The City's annual cash contribution expense for pension was $68 million for Fiscal Year 2001. This is one of the larger items in the City's overall budget. Further, this expense line item has been growing at about a 9% per year compound rate the last five years and at a much faster rate if measured back 10 years.

binding obligation appears to be an "indirect" part of the actuarial computation to develop the annual pension cash contribution. The City's practice is in accordance with current Generally Accepted Government Accounting Principles (GAAP). However, 12 years ago GAAP was changed for private industry to require the recognition annually of the cost of future retiree health benefits being "earned" that year by the current work force. The reason for this accounting change was the growing concern over the very sizeable liabilities for future payments that were not being fully recognized.

The Committee recognizes the City has the potential for this same problem, i.e. a sizeable, growing liability for future payments. The City has a growing workforce, an early age for retirement (50 for Public Safety employees and 55 for General employees), a lengthening of life spans, and an ever increasing cost of health care. As a consequence, retiree medical costs represent a "non-discretionary" expense, which will grow faster and most probably much faster, than the current employee salary base in the City budget.

While this retiree medical cost is currently a relatively small budget item, it will most likely grow at an increasing rate, in essence for costs of prior years' employee service. It is conceivable this liability at today's present value could exceed $100 million. It is unclear how well the City policy makers appreciate this overall expense issue and how it will affect the City budget in the future.

C. FUNDING LEVEL

SDCERS is not in a fully funded position. It is currently funded at 97% (i.e. its current assets equaled 97% of the actuarially computed present value of the future Pension Plan liabilities). The absolute dollar amount of under funding hit a peak of $148 million in Fiscal Year 1999. Excellent Pension asset investment performance reduced that unfunded liability to $69 million in Fiscal Year 2000. However, investment performance in Fiscal Year 2001 was less than half of the excellent performance in Fiscal Year 2000. Investment performance in the first seven months of Fiscal Year 2002 is lower than in Fiscal Year 2001. It is expected that the forthcoming actuarial report will show an increase in the unfunded dollar amount.

San Diego City Employees' Retirement System Financial Information
For Fiscal Years 1996 – 2001
($ IN MILLIONS)

	2001	2000	1999	1998	1997	1996
Pension Fund Assets	$2,807	$2,999	$2,476	$2,272	$1,855	$1,604
City Pension Expense	$68	$61	$56	$51	$48	$44
Pension Plan & Health Benefits Paid	$155[1]	$112	$100	$85	$67	$62
Unfunded Actuarial Accrued Liability	Not available	$69	$148	$125	$117	$140
Retiree Health Benefits Expense	$7	$5	$5	$4	$5	$5

[1] includes $24 million Corbett pay out settlement.

EXHIBIT 19

Advisory Committees

Blue Ribbon Advisory Committee

- **NEW!!** Blue Ribbon Committee Reports

At the beginning of his term in office, Mayor Dick Murphy set ten goals for the City to achieve in order for San Diego to be "a city worthy of our affection in the Year 2020." Mayor Murphy recognized that these ten goals would require substantial financial resources. Therefore, he announced he would convene a Blue Ribbon Committee on City Finances to make an independent evaluation of the City's current fiscal health and make any appropriate recommendations.

The Blue Ribbon Committee on City Finances has a mission to:

- Perform an independent evaluation of the fiscal health of the City of San Diego
- To review the budgeting principles of the City of San Diego
- Report the findings and recommendations to the City Council's Rules Committee

The Committee has met regularly since formation (in early April 2001) and is diligently researching fiscal aspects of the City in order to achieve its mission and is staffed by Ed Ryan, City Auditor and Comptroller, and Terri Aja Webster, Assistant City Auditor and Comptroller.

In April 2001 the Mayor announced the formation of the Blue Ribbon Committee on City Finances. The Committee members are all professionals in the community, not City employees.

Members of Blue Ribbon Committee on City Finances

- **Joe Craver** - Chairman, Public Facility Finance /Authority for the City of San Diego; past Chairman, San Diego Regional Chamber of Commerce; President and Chief Executive Officer, Galaxie Management, Inc; Retired Colonel, U.S. Air Force
- **Mary Ball** - President, San Diego County Taxpayers Association; Vice President of Government and Community Relations, Cox Communications; and former Chief of Staff to County Supervisor Dianne Jacob
- **April Boling** - Vice President, San Diego County Taxpayers Association; Certified Public Accountant; Member, City of San Diego Citizens' Budget Committee.
- **William McCurine, Jr.** - Attorney; Partner, Solomon, Ward, Seidenwurm & Smith, LLP; former Partner, Gray, Cary, Ware & Friedenrich; and recipient, Thurgood Marshall Award.

- **April Riel** - Certified Public Accountant, Certified Fraud Examiner, MPA ; former employee, County of San Diego-Auditor & Comptroller's Department, Audits Division; and Member, San Diego Filipino Accountants Association
- **Victor A. Vilaplana** - Attorney, Seltzer Caplan McMahon Vitek; former managing partner, Sheppard, Mullin, Richter & Hampton; and Counsel, San Diego Regional Economic Development Corporation
- **Richard H. Vortmann** - Vice President, General Dynamics and President, National Steel and Shipbuilding Company (NASSCO); Member, Executive Council of the San Diego Chamber of Commerce's CEO Roundtable; and former Faculty Member, University of California, Berkeley Business School
- **Linc Ward** - Chair, City Council Select Committee on Government Operations and Fiscal Reform; former, Vice President/General Manager, Pacific Bell (San Diego)

The Committee is on track to report their recommendations to the City Council's Rules Committee in the Fall of 2001.

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EXHIBIT 20

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

between the roles of City Council and SDCERS Board contemplated by the City Charter – with the Council granting benefits and the Board administering them – was thereby significantly compromised.

Although the SDCERS staff had participated over several months in fashioning the proposal, it was viewed skeptically by some members of the Board, and its complexities confused almost all, even after lengthy discussion. In promoting the proposal to the Board – as well as to its actuary and fiduciary counsel – City representatives emphasized two "safeguard" provisions intended to protect the System's funded ratio. First, the City was required to resume paying the full PUC rate by no later than July 1, 2009, as described below. Second, a drop of 10% or more from the FY 1996 funding level would trigger an immediate adjustment in the City's contributions. The level at June 30, 1996 was approximately 92.3%. Thus, the trigger level was 82.3%.[153]

The pending changes in actuarial assumptions and methodology were recognized at June 30, 1996, increasing the UAAL by approximately $25 million. This amount, with 8% interest compounded annually over the intervening years, has contributed significantly to SDCERS' present UAAL. Ironically, at the time of MP1, the City was eager to have the revision of actuarial assumptions be as immediate and extensive as possible to create "breathing room from the 10% deal breaker."[154]

Several years later, when it became probable that the 82.3% threshold would be crossed, the potential consequences for the City's contribution rate became a matter of controversy. The final version of Manager's Proposal 1 provides:

> The City will pay the agreed-to rates shown above for FY 96 through FY 2007.[155] In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation which will include the impact of the benefit improvements included in this Proposal, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation.

This would appear to require that the City make a lump sum payment in the amount necessary to restore the funding level to 82.3%. Nevertheless, individuals involved in negotiating this agreement insist that the intention was to "sunset" the proposal beginning the fiscal year after the

[153] Members of the City staff have contended that the actual ratio was 81.4%. Whatever the merits of this position, the 82.3% figure has been widely accepted and will be used for purposes of this Report.

[154] E-mail from Terri Webster to city_mgr.CTL, Re: Proposal (June 21, 1996).

[155] The reference is to the table provided above.

EXHIBIT 21

City of San Diego
Labor Relations Office
MEMORANDUM

Date: July 23, 1996

To: Larry Grissom, Retirement Administrator

From: Cathy Lexin, Labor Relations Manager

Subject: *CITY MANAGER'S RETIREMENT PROPOSAL*

Per your request, attached hereto is a consolidation of the *final* Retirement Proposal as presented to the Retirement Board at its meeting of June 21, 1996. This Proposal was subsequently presented to and approved by the City Council at its meeting of July 2, 1996.

It is my understanding that the action taken by the Board was to defer any action required of them on **Issue No. 1 - Retiree Health Insurance** based on advice of Fiduciary Counsel Dwight Hamilton until such time as a specific health plan was presented for his review and advice and until a Charter amendment occurred enabling the Retirement Board to administer retiree health insurance.

Issue No. 2 - CERS Benefit Changes identified benefit improvements being recommended by the Manager to the City Council; no action was required of the Retirement Board.

It is further my understanding that the Retirement Board approved in concept the recommended actions contained under **Issue No. 3 - Employer Contribution Rates**, and **Issue No. 4 - Surplus Undistributed Earnings and Reserves**, including the set aside of approximately $135 million from excess undistributed earnings for the purpose of carrying out the proposal, contingent upon the retiree health insurance portion being successfully resolved by January 1, 1997.

RETIREMENT SYSTEM PROPOSAL

(Consolidated from Proposal Dated June 7, 1996 as modified by June 21, 1996 Proposal)

It is the City Manager's intent to recommend changes to the City Employees Retirement System related to: **(1) retiree health insurance, (2) retirement plan benefits, (3) employer contribution rates, and (4) retirement system reserves.** These proposed changes to plan benefits, retiree health insurance, employer rates and system reserves will require approval of the City Council, CERS Board of Administration as well as an affirmative vote of plan members. The City Manager's proposal is being reviewed by outside fiduciary counsel engaged through the City Attorney's Office and has been presented to the CERS Board's fiduciary counsel and actuary for review and advice to the Board. All proposed changes are conditioned upon and subject to final approval by fiduciary counsel, City Council approval, Retirement Board approval, vote of plan participants, and confirmation of cost estimates by the System's actuary.

The interrelationship of these various issues to each other necessitate that the entire proposal be considered and acted upon concurrently. Furthermore, the substantial financial implications to the City compel that certain actions occur in time for Fiscal Year 1997 budget decisions. Necessary ordinances can be prepared for formal amendments to the Municipal Code subsequent to actions by appropriate bodies (City Council, CERS Board, Plan Participants, Employee Unions). Following are the proposed changes.

Issue No. 1 - RETIREE HEALTH INSURANCE

A. It is proposed that the obligation for Retiree Health Insurance be moved to CERS effective July 1, 1997, contingent upon advice from its fiduciary counsel that the specific terms of this action are deemed legal and appropriate prior to January 1, 1997. It is the City's intent and expectation in this Proposal that the cost of providing retiree health insurance will not be amortized but rather will be paid on an annual basis from excess undistributed earnings.

B. Increase premium reimbursement for POA and Local 145 Retiree Health Plans from $4500/year to $4995 only for FY97.

C. Retiree Health Insurance for Pre-1980 Retirees will be provided by the City at the same rate as in FY96 for one additional year, FY97. Contingent upon the approval of item A above, Pre-1980 Retiree Health Insurance will become an ongoing benefit as described in the June 7, 1996 Proposal.

D. During FY97, a Task Force of City Manager, CERS Board and Labor Organizations working with actuaries, consultants and legal counsel can develop the necessary documentation to design a tax exempt health insurance benefit to be effective July 1, 1997. The Task Force will recommend benefit level subject to approval by CERS, City Council, and issue an RFP for selection of a common provider. POA and Local 145 will assume full responsibility for any incurred claims under existing health insurance policies.

It is the intent that the Task Force described in the June 7 Proposal complete its work and present a recommendation by November 1, 1996. Final approval of the specific Retiree Health Benefit that will be transferred to CERS will be subject to approval of the City Council.

E. The existing City Health Insurance Trust (@ $12.5m) will be used to pay for FY97 Retiree Health Insurance.

F. CERS will establish a Health Insurance Reserve within CERS. Each year, the upcoming year's projected cost of retiree health insurance will be transferred from undistributed earnings and credited to the Health Insurance Reserve.

G. Actual premium costs and administrative charges will be charged to the Health Insurance Reserve on a pay-as-you-go basis and will not be actuarially funded.

Issue No. 2 - CERS BENEFIT CHANGES

The following benefit changes do not require any action by the CERS Board, but rather are presented as part of the overall proposal.

A. **Eliminate** the existing requirement to **offset Disability Income.**

B. **Purchase of Service Credit:** Continue the existing service credit provisions related to refunds, probationary periods, 1981 Plan waiting period and Military & Veteran Code; incorporate all others into a new general provision of a five (5) year purchase of service credit feature, which would also be available to ½ time and 3/4 time employees. Employees would pay into the retirement fund an amount, including interest, equivalent to the employee and employer full cost of such service.

C.. Increase the calculation of the **13th Check** for Pre-10/6/80 retirees from $30 per creditable year of service to $60 per creditable year of service, and to $75 per creditable year of service for Pre-12/31/71 retirees. It is also the Manager's intent to conduct a study during the first quarter of FY98 on COLA alternatives including but not limited to a 75% purchasing power formula.

D. Increase the benefit to General Members for industrial disability retirements from 33-1/3% to 50%; and increase the General Member formula as described below.

General Member Formula

Age	Present Factor	Proposed Factor
55	1.48%	2.00%
56	1.56%	2.00%
57	1.63%	2.00%
58	1.72%	2.00%
59	1.81%	2.08%
60	1.92%	2.16%
61	1.99%	2.24%
62	2.09%	2.31%
63	2.20%	2.39%
64	2.31%	2.47%
65+	2.43%	2.55%

Cost of General Member Improvements:

	Employer-Paid	Employee-Paid	Total Cost
Normal Cost	+1.13%	+1.13%	+2.26%
Past Liability	+1.43%		+1.43%
TOTAL COST	+2.54%	+1.13%	+3.69%

Past liability for these two benefit improvements will be paid for by the City through excess earnings. Normal cost (prospective costs) will be paid for equally by employee and employer. The employer's share will be added to the actuarial rate (PUC) calculations beginning mid-year FY97. The employee's share will be paid from excess earnings for FY97, and by increasing the employee's contribution in FY98 and FY99 as follows: +.56% on 12/27/97 and +.57% effective the earliest date in FY99 that General Employees receive a salary increase.

E. Improve **Lifeguard Safety Member Formula** as follows and establish a 90% cap. Any employees who are eligible for a percentage above 90% on 4/1/97, the effective date of implementation of the DROP will be frozen at their rate in effect on 4/1/97. Past liability for this benefit improvement will be paid for by the City through excess earnings. Normal cost (prospective costs) will be paid for equally by employee and employer. The employer's share will be added to the actuarial rate (PUC) calculations beginning mid-year FY97. The employee's share will be paid from excess earnings in FY97, and by increasing the employee's contribution in FY98 and FY99 as follows: +.25% on 12/27/97 and +.25% effective the earliest date in FY99 that Lifeguard employees receive a salary increase.

Age	Present Factor	Proposed Factor
50	2.00%	2.20%
51	2.10%	2.32%
52	2.22%	2.44%
53	2.34%	2.57%
54	2.47%	2.72%
55+	2.62%	2.77%

Cost of Lifeguard Safety Member Improvements:

	Employer-Paid	Employee-Paid	Total Cost
Normal Cost	+. 50%	+. 50%	+1.00%
Past Liability	+. 55		+. 55%
TOTAL COST	+1.05%	+. 50%	+1.55%

F. Improve Police and Fire Safety Member Formula as follows and establish a 90% cap. Any employees who are eligible for a percentage above 90% on the date the new formula becomes effective, will be allowed to remain under the current formula with no cap. Past liability for this benefit improvement will be paid for by the City through excess earnings. Normal cost (prospective costs) will be paid for equally by employee and employer. The employer's share will be added to the actuarial rate (PUC) calculations beginning mid-year FY97.

Age	Fire Factor	Police Factor	Proposed Factor for Fire & Police
50	2.20%	2.50%	2.50%
51	2.32%	2.54%	2.60%
52	2.44%	2.58%	2.70%
53	2.57%	2.62%	2.80%
54	2.72%	2.66%	2.90%
55+	2.77%	2.70%	2.9999%

Cost of Safety Member Improvements:

FIRE	Employer-Paid	Employee-Paid	Total Cost
Normal Cost	+ .75%	+. 75%	+1.50%
Past Liability	+ .95%		+ .95%
Total	+1.70%	+ .75%	+2.45%

Fire employees will pay one-half of the normal cost by an increase in the employee contribution of .75% effective 7/1/98.

POLICE	Employer-Paid	Employee-Paid	Total Cost
Normal Cost	+ .49%	+ .49%	+ .98%
Past Liability	+ .95%		+ .95%
Total	+1.44%	+ .49%	+1.93%

Police employees will pay one-half of the normal cost by an increase in the employee contribution of .49% effective 7/1/98.

G. The City agrees to implementation of a *Deferred Retirement Option Plan* (DROP) effective April 1, 1997, on the condition that such a plan is approved by the City Attorney's Office as legal under applicable Federal, State and Local laws and regulations, and that such a plan would not increase cost greater than the savings to the City nor CERS. Employees may participate in this program for up to five (5) years. At the end of three (3) years, the City will evaluate the cost impact of this program. If the cost impact to the City or CERS is greater than the savings, the City agrees to meet and confer to impasse prior to imposing any changes in the DROP Plan. If the City proposes to change the DROP Plan, the 90% cap on CERS would also be re-negotiated. Employees who elect to participate in DROP will cease participation in CERS, and will participate in an SPSP-type plan with a mandatory 3.05% employee contribution matched by 3.05% employer contribution.

Issue No. 3 - EMPLOYER CONTRIBUTION RATES

A. Employer rates will be calculated using the Projected Unit Credit (PUC) method. For FY96 and FY97, the City will pay the budgeted rates (bifurcated rate) of 7.08% (blended rate) and 7.33% respectively, and increase the rate paid by 0.50% each year until the rate paid reaches the EAN calculated rate. At such time as the PUC and Entry Age Normal (EAN) rates are equal, the System will convert to EAN.

Employer Contribution Rate Stabilization Plan

Period	PUC Rate	City Paid Rate	Difference %	Difference $
FY96	8.60%	7.08%	1.52%	$5.33m
FY97	10.87%	7.33%	3.79%	$13.88m
FY98	12.18%	7.83%	4.35%	$16.67m
FY99	12.18%	8.33%	3.85%	$15.40m
FY2000	12.18%	8.83%	3.35%	$14.00m
FY2001	12.18%	9.33%	2.85%	$12.45m
FY2002	12.18%	9.83%	2.35%	$10.72m
FY2003	12.18%	10.33%	1.85%	$8.82m
FY2004	12.18%	10.83%	1.35%	$6.73m
FY2005	12.18%	11.33%	.85%	$4.43m
FY2006	12.18%	11.83%	.35%	$1.91m
FY2007	12.18%	12.18%	-0-	-0-
FY2008	13.00	13.00%	-0-	-0-
TOTAL				$110.35*

*$110.35 million paid from excess earnings includes $71.31 million in contributions as a result of benefits improvements recommended herein.

B. The City will pay the agreed-to rates shown above for FY 96 through FY 2007. In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation which will include the impact of the benefit improvements included in this Proposal, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation.

C. If the System's actuary makes changes in actuarial assumptions or methodology which are approved by the Board prior to July 1, 2007, any changes in the employer contribution rate will adjust the PUC rate to be achieved through extended incremental increases shown in paragraph A above. If the phase-in would require an extension past July 1, 2009 in order to achieve the full actuarial PUC rate, the City-paid rate will be adjusted by the amount necessary to achieve full phase-in by that date.

Issue No. 4 - SURPLUS UNDISTRIBUTED EARNINGS AND RESERVES

The System's actuary performs an annual actuarial valuation which shows the present value of accrued liabilities and the value of assets allocated to funding. To the extent that liabilities exceed assets, the System will show an unfunded liability. The System's liabilities will be impacted in the following ways, including those related to the City Manager's proposal for restructuring the System.

NORMAL LIABILITIES - This liability relates to the impact of actuarial gains or losses recognized when actuarial assumptions are compared to the System's actual experience. When experience is better than assumptions, the System shows actuarial gains and liabilities decrease. When experience is worse than assumptions, the System shows actuarial losses and liabilities increase. This will take place regardless of whether or not the restructuring proposal is approved.

NORMAL COST OF INCREASED BENEFITS - When benefits are increased, liability is created representing the prospective value of those benefits. Employee and employer contribution rates are increased for the purpose of paying that cost as it is accrued.

PAST SERVICE LIABILITY OF INCREASED BENEFITS - The proposed restructuring provides for an increase in the formula for calculating benefits. This means that, in the case of a general member, each year of accrued service that had a value of 1.45% of final average salary at age 55, increases in value to 2.00% of final average salary at age 55 upon the effective date of the increase. This increases the cost to the System to pay the benefit, which increases liabilities since no contributions have been received in the past to fund the benefit at this level. This is what is known as past service liability.

The actuary has estimated the amount of past service liability created by the restructuring proposal to be $76.7 million expressed in 1996 dollars.

CONTRIBUTION SHORTFALL LIABILITY - The restructuring proposal provides that the employer contribution rate will be "ramped up" to the actuarially recommended rate in increments over the next 10 years. This means that the System will be receiving less in contribution dollars over that period, which creates an additional liability.

The actuary has estimated the amount of contribution shortfall liability created by the restructuring proposal to be $30.0 million expressed in 1996 dollars.

A. The system has "surplus" undistributed earnings and a balance in the Earnings Stabilization Reserve as follows:

FY ended 6-30-95	$ 38,813,314
FY ended 6-30-96	85,472,254
Earnings Stabilization Reserve	10, 769,620
Total	$135, 055,188

The actuary has estimated increased liabilities associated with the restructuring proposal in the amount of $106,700,000 (see the discussion segment above). Credit the Employer Contribution Reserve in the amount of $106,700,000 for the purpose of discharging the restructuring liability. Credit the Employer Contribution Reserve with $28,356,188 (the remaining balance) for the purpose of reducing the System's normal unfunded liability.

TOTALITY OF THE PROPOSAL

If the necessary contingencies identified to approve this Proposal in its entirety are not affirmatively met by January 1, 1997, then:

A. Retiree Health Insurance will remain a City provided benefit, rather than CERS;

B. The CERS benefit improvements listed in Issue No. 2 would not occur;

C. The employer contribution rates to be paid would be those established by the System's Actuary.

In order to facilitate the accomplishment of this Proposal, it is recommended that the CERS Board direct that the $106,700,000 identified in Issue No. 4 as the amount necessary to discharge the restructuring liability be set aside in a reserve until January 1, 1997.

ATTACHMENT #2

SCHEDULE FOR DISTRIBUTION OF EARNINGS
FISCAL YEAR ENDED 6-30-00

UNDISTRIBUTED EARNINGS AT 6-30-00			$415,934,184
DISTRIBUTIONS:			
SDMC 24.1502 (a) (1)	EMPLOYER CONTRIBUTION RESERVE	$ 33,631,231	
SDMC 24.1502 (a) (1)	EMPLOYEE CONTRIBUTION RESERVE	21,119,014	
SDMC 24.1502 (a) (2)	ADMINISTRATIVE BUDGET	17,700,930	
SDMC 24.1502 (a) (3)	GENERAL RESERVE	22,431,567	
SDMC 24.1502 (a) (3)	CREDIT DROP ACCOUNTS AT 8%	2,333,465	
	SUBTOTAL	97,216,200	$ 318,717,984
SDMC 24.1502 (a) (3)	CREDIT 13TH CHECK RESERVE AT 8%	282,915	
SDMC 24.1502 (a) (3)	CONTINGENCY RESERVE (CITY)	100,000,000	
SDMC 24.1502 (a) (4)	CONTINGENCY RESERVE (UPD)	5,838,008	
SDMC 24.1502 (a) (5)	EMPLOYER CONTRIBUTION RESERVE CITY (HEALTH INSURANCE)	12,771,254	
SDMC 24.1502 (a) (6)	13th CHECK	3,537,072	
SDMC 24.1502 (a) (7)	CORBETT RETROACTIVE PAYMENT	23,614,741	
SDMC 24.1502 (a) (8)	CREDIT SUPP. COLA RESERVE AT 8%	2,643,834	
SDMC 24.1502 (a) (8)	CREDIT EMPLOYEE CONTRIBUTION RATE RESERVE AT 8%	3,341,244	
SDMC 24.1502 (a) (3)	NPO RESERVE	7,937,000	
	SUBTOTAL		159,966,068
SDMC 24.1502 (b)	TO EMPLOYER CONTRIBUTION RESERVE	$158,751,916	

FILE: W:\EXEC\BDSEC\EARNINGS 00 (3)
UPDATE 08/09/01

ATTACHEMENT TO DISTRIBUTION OF EARNINGS FOR FY 00

CKGROUND:

The earnings of the System are defined as realized, or cash, earnings. They are comprised of interest and dividends received, net purchase discounts and premiums on fixed income instruments, and net realized gains and losses on the sale of stocks. Distribution of earnings is determined by the Board in priority order established in the Municipal Code. A description of the Municipal Code provisions is shown below and the recommended distribution is shown on the attached schedule.

SDMC 24.1502 (a) (1)	Credit the contribution accounts of the employers (City and UPD) and members of the System (City and UPD) at a rate determined by the Board. Historically, the rate has been the actuarial assumption rate, which is currently 8%.
SDMC 24.1502 (a) (2)	The System's operating budget.
SDMC 24.1502 (a) (3)	"An amount necessary to maintain such reserves as the Board deems appropriate on advice of its investment counselor and/or Actuary;" The Board has created four reserves under this section: the General Reserve; the Reserve for Employee Contributions; and, the NPO Reserve. NPO stands for Net Pension Obligation, which is the actuarial present value of the difference between the employer contribution rate recommended by the Actuary and the rate actually paid by the City. As a part of the annual actuarial valuation, the Actuary recommends the amount of this reserve. The schedule shows the difference between that recommendation and the current reserve balance.
SDMC 24.1502 (a) (4)	Proportional share of earnings to UPD. This represents the UPD's share of earnings used to fund programs or benefits in which they do not participate, such as retiree health insurance.
SDMC 24.1502 (a) (5)	Health Insurance.
SDMC 24.1502 (a) (6)	13th Check.
SDMC 24.1502 (a) (7)	Corbett Retiree Liability
SDMC 24.1502 (a) (8)	Credit the Supplemental COLA Reserve and the Employee Contribution Reserve with earnings at the same rate as the Employee and Employer Contribution Reserves above, currently 8%.
SDMC 24.1502 (b)	The remaining balance is credited to the Employer Contribution Reserve "... for the sole and exclusive purpose of reducing Retirement System liability."

File: w:\exec\pdsec\earnings 00 (3) Update 8/9/01

EXHIBIT 22

(Amendment voted 11-06-1990; effective 02-19-1991.)
(Amendment voted 11-08-1994; effective 01-30-1995.)
(Amendment voted 11-05-1996; effective 02-10-1997.)

Section 142: Employment of Actuary

The Board of Administration hereinafter provided, shall secure from a competent actuary a report of the cost of establishing a general retirement system for all employees of The City of San Diego. Said actuary shall be one who has had actual experience in the establishing of retirement systems for public employees, and his position shall be considered one requiring expert or technical training within the meaning of subdivision (k) of Section 118 of Article VIII of this Charter.

Section 143: Contributions

The retirement system herein provided for shall be conducted on the contributory plan, the City contributing jointly with the employees affected thereunder. Employees shall contribute according to the actuarial tables adopted by the Board of Administration for normal retirement allowances, except that employees shall, with the approval of the Board, have the option to contribute more than required for normal allowances, and thereby be entitled to receive the proportionate amount of increased allowances paid for by such additional contributions. The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employees. The mortality, service, experience or other table calculated by the actuary and the valuation determined by him and approved by the board shall be conclusive and final, and any retirement system established under this article shall be based thereon.
(Amendment voted 03-13-1945; effective 04-09-1945.)
(Amendment voted 06-08-1954; effective 01-10-1955.)

Section 143.1: Approval of Amendments by Members

No ordinance amending the retirement system which affects the benefits of any employee under such retirement system shall be adopted without the approval of a majority vote of the members of said system. No ordinance amending the retirement system which affects the vested defined benefits of any retiree of such retirement system shall be adopted without the approval of a majority vote of the affected retirees of said retirement system.
(Addition voted 06-08-1954; effective 01-10-1955.)
(Amendment voted 11-06-1990; effective 02-19-1991.)

Section 144: Board of Administration

The system shall be managed by a Board of Administration which is hereby created, consisting of the City Manager, City Auditor and Comptroller, the City Treasurer, three members of the Retirement System to be elected by the active membership, one retired member of the retirement system to be elected by the retired membership, an officer of a local bank, and three other citizens of the City, the latter four to be appointed by the Council. Such appointees shall serve without compensation. Members of the Board, other than ex-officio, shall serve six years or until their successors are elected and qualified, and shall so classify themselves by lot that one term shall expire each year. The members of the existing Board shall serve out their unexpired terms.

The Board of Administration may establish such rules and regulations as it may deem proper; shall elect one of its members president and appoint a secretary and may appoint such other employees as may be necessary. Such appointments, except the actuary, shall be made under the provisions of Article VIII of this Charter.

The Board of Administration shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under which persons may be admitted to benefits of any sort under the retirement system; and shall have exclusive control of the administration and investment of such fund or funds as may be established; and shall be permitted to invest in any bonds or securities which are authorized by General Law for savings banks; and, further, shall be permitted to invest in such additional classes or types of investments as are approved by resolution of the Council of The City of San Diego; provided, however, that individual investments within the classes or types approved by the Council must be approved by independent investment counsel; and, provided, further, the board may place such funds in the hands of the Funds Commission for investment. Provided, however, that the Auditor and Comptroller shall refuse to allow any warrant drawn for payment of a retirement allowance if, in the opinion of the Auditor and Comptroller, such retirement allowance has been granted in contravention of this Article or any ordinances passed under the authority granted herein.
(Amendment voted 03-13-1951; effective 03-26-1951.)
(Amendment voted 11-08-1960; effective 01-09-1961.)
(Amendment voted 11-04-1969; effective 01-29-1970.)
(Amendment voted 06-04-1974; effective 08-13-1974.)
(See Article X for additional members.)

Section 145: Retirement Fund

All moneys contributed by employees of the City or appropriated by the Council or received from any other source under the terms of this Article, shall be placed in a special fund in the City Treasury to be known as the City Employees' Retirement Fund, which said fund is hereby created. Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article. No payments shall be made

EXHIBIT 23

Report on Investigation

The City of San Diego, California's

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Vinson & Elkins L.L.P.
Washington, D.C.

Trust Fund really need[s] to build its equity and halt cost increases to ride through the next few years and keep a fiscally sound funding ratio.[249]

Under the interpretation urged by the Manager's Office and Mr. Grissom, the trigger provision would require that the City begin paying the full PUC rate as of the first fiscal year after the floor was breached. The Manager's Office estimated that this would mean a payment of approximately $25 million in the first year.[250] As it was later calculated, avoiding paying the full PUC rate in FY 2004, the first fiscal year after the SDCERS actuary determined that the trigger had been hit, reduced contributions to SDCERS from the City's General Fund by approximately $44 million.[251]

Alternatively, if the trigger provision were read to require that the City restore System funding to the 82.3% level, the implications were even more ominous.[252] If the funded level fell only slightly below the floor, such a lump sum payment could have been less costly to the City than going to the full PUC rates. On the other hand, a more substantial drop could have mandated a massive infusion of cash from the City into SDCERS. As we now know, SDCERS' funding fell 15% below the floor level by June 30, 2003. By rough estimate, the City would have needed to pay more than $500 million in FY 2004 and 2005 to restore the funded level to 82.3%.

The concern that the trigger would be hit that year or the next increased substantially when a draft of the actuarial report for FY 2001 became available on February 12, 2002. The actuarial valuation for June 30, 2001 showed a funded ratio of 89.9%, a decline of approximately 8% over the previous year, not including the effects of the contingent element of the *Corbett* settlement. Given the continued decline in the market that had occurred after June 30, 2001, it was apparent that a significant additional deterioration in SDCERS' funded ratio should be anticipated at the next valuation.[253] In addition, SDCERS' realized earnings for fiscal year 2001 were too meager to fund any of the contingent benefits in the Waterfall. In a May 29, 2002 Board meeting, Mr. Grissom:

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249 Memorandum from Terri Webster, Deputy Auditor and Comptroller, to Cathy Lexin, Deputy City Manager, Re EEEK, (October 11, 2001). The $100 million referred to here and mentioned above was a Reserve for Contingencies set aside from excess earnings in FY 2001. It was transferred into the Employer Contribution Reserves the following year and, therefore, did not result in any diminution of System assets.

250 Memorandum from Cathy Lexin, Human Resources Director, and Elmer Heap, Head Deputy City Attorney, to Mayor and City Council, Re: Meet and Confer: Contingent Retirement Benefits – Modified Proposal to San Diego City Employees Retirement System Board of Administration (June 14, 2002). In interviews with Vinson & Elkins, both Mr. McGrory and Mr. Herring conceded that the language of the trigger provision requires the City to restore System funding to the 82.3% level, whatever the intention of its drafters might have been.

251 Closed Session Council Briefing by Luce Forward Hamilton and Scripps LLP (Jan. 27, 2004) (PowerPoint presentation).

252 This interpretation was adopted by System actuary Rick Roeder, fiduciary counsel Robert Blum, and Board member Ron Saathoff. Minutes of SDCERS Board Meeting, at 16-17 (June 21, 2002) (remarks of Mr. Roeder, Mr. Blum and Mr. Saathoff). At other times, however, Mr. Roeder appears to have subscribed to the competing interpretation.

253 Another factor pointing toward additional declines in SDCERS' funded ratio was the use by Gabriel, Roeder, Smith & Co. of actuarial "smoothing" to calculate rates of return on fund assets. In essence, returns were blended over a five-year period to avoid

EXHIBIT 24

Office of
The City Attorney
City of San Diego

MEMORANDUM

DATE: January 13, 2005

TO: FILE

FROM: Michael J. Aguirre, City Attorney

SUBJECT: Telephone Conversation with Sally Zumwalt

On Tuesday, January 11, 2005, I spoke to Sally Zumwalt by telephone wherein she informed me that she was the person who worked for the CERS board who distributed the minutes and that she previously worked as an assistant to Terri Webster and that it was her, Sally Zumwalt's, practice to deliver the actuary reports by hand to Ms. Webster's office on the Thursday before the third Friday – that is the week before the third Friday (so, the second Thursday).

Michael J. Aguirre

MJA:meb

EXHIBIT 26

Mary

SAN DIEGO CITY EMPLOYEES RETIREMENT SYSTEM

Date Issued: February 5, 2003

Attention: City Council Committee on Rules, Finance and Intergovernmental Relations

Subject: Response to the Blue Ribbon Committee Report on City Finances dated February 2002 Regarding Pension and Health Insurance Funding

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THIS IS AN INFORMATION ITEM ONLY. NO ACTION IS REQUIRED ON THE PART OF THE COMMITTEE OR THE CITY COUNCIL.

Background

In February 2002, the Mayor's Blue Ribbon Committee on City Finances issued it's report. Among the recommendations were two related to the City's funding of its pension and health insurance obligations for retired City employees. The City Manager has asked the San Diego City Employees Retirement System (SDCERS) to review the Blue Ribbon Committee's Report and recommendations, and comment on projected pension expenses, revenue sources and the current present value of retiree health benefits.

The Board of Administration of SDCERS has been studying these issues with its actuary for the past several months. The declining investment market over the past three years, along with changes in benefits such as the addition of the Corbett settlement liability, have dramatically impacted the funding level of the Retirement Fund. In addition, since 1996, the City has been making its contributions to the Retirement Fund under a negotiated agreement known as the Manager's Proposal. The Proposal allows the City to make its required annual contribution to the Fund at a rate less than the rate calculated by the actuary. As a result of these factors, the Retirement Fund is at its lowest funded ratio (assets to liabilities) in well over a decade, and the compounding effect of a less than full-actuarial contribution policy has impacted the current and future strength of the City's Retirement Fund.

Discussion

SDCERS provides retirement benefits for approximately 4,570 retirees of the City of San Diego and another 260 retirees of the Unified Port District (UPD). In addition, SDCERS invests and administers the Retirement Fund for the future pension benefits of approximately 13,650 active employees of the City of San Diego and the UPD. Beginning January 1, 2003, SDCERS will also include the Airport Authority and its approximately 200 employees as members in the Retirement Fund. As of the end of the most recent Fiscal Year (6/30/02), the Fund had total assets of $2.53 Billion dollars invested in a well-diversified portfolio representing all of the major asset classes. Based on the annual Actuarial Valuation of June 30, 2002, the Retirement Fund's actuarial accrued liability for all current and future retiree's of the City of San Diego was $3.17 Billion Dollars. The shortfall between Total Assets and Total Liabilities of over $720 million (based on the actuarial value of assets) means the Retirement Fund would not be able to pay 100% of its required pension obligations, absent additional funding by the City, were the City to close its doors today and immediately begin paying all City employees their accrued retirement benefits.

Of course, the City is not like a private company that could conceivably go out of business in a single day. That is why SDCERS approaches its fiduciary responsibility to ensure the safety and soundness of the Retirement Fund with a longer-term horizon. While today's funding shortfall is a concern, the more important analysis centers on 1) whether or not the City is taking sufficient steps to fully fund its future pension obligations; 2) whether or not the City should actuarially account for future retiree health benefits; and 3) the projected costs of funding these benefits given expected changes in the employee and retiree demographics.

1. Pension Obligations

The City funds the Retirement Fund by making annual Employer Contributions, and by paying a portion of the Employees' Contribution as negotiated through the Meet & Confer process. This latter contribution is known as the Offset contribution. The City also makes an annual contribution for those Members who enter an alternate benefit program known as the Deferred Retirement Option Program (DROP). The City's contributions help support two different types of pension obligations: vested benefits which, once conferred, cannot be diminished and contingent benefits that are only paid if the Retirement Fund experiences "excess" realized earnings in a given year.

In calculating future pension obligations, actuarial science recognizes several different methods for funding this future obligation. The method currently being used by the City of San Diego is the Projected Unit Credit (PUC) funding method. This method evaluates the future actuarial liability of the covered population as a total group based on certain funding objectives, calculations and assumptions. Another actuarial funding method, Entry Age Normal (EAN), evaluates the projected benefit of each individual in the covered population

based on the individual's entry age and assumed exit age. The EAN method is recognized as a more conservative means of funding future actuarial liability.

Based on the PUC funding method, the Retirement Fund's ratio of actuarial assets to liabilities as of June 30, 2002 was 77.3%. This means that if the City had to suddenly pay the accrued retirement benefits for all of the current active members in the Retirement Fund (approximately 12,600 individuals) along with the monthly retirement benefits it is currently providing to the approximately 4,500 current retirees, the City and the Retirement Fund would be "short" approximately $720 million as of the June 30, 2002 actuarial market value of assets. This $720 million is known as the Unfunded Actuarial Accrued Liability of the Fund. This unfunded liability has been increasing in recent years for two primary reasons: the investment performance of the Fund has declined dramatically in the past two years compared to investment performance in previous years, and the City's contribution rate under the Manager's Proposal permits an annual contribution less than the actuarially calculated contribution rate necessary to cover the present value of benefits (the Normal Cost) and future actuarial cost of these benefits (the Unfunded Actuarial Accrued Liability). The following charts illustrate these points:

HISTORY OF INVESTMENT RETURNS

	Year Ending 6/30/98	Year Ending 6/30/99	Year Ending 6/30/00	Year Ending 6/30/01	Year Ending 6/30/02
Fund's Total Return	+14.62%	+9.53%	+14.93%	-0.45%	-2.48%
Avg Public Fund's Total Return	+17.60%	+10.82%	+9.45%	-4.06%	-5.15%
Fund's Percentile Ranking	94%	56%	6%	17%	14%
Fund's Target Rate of Return (Actuarial Rate)	8.00%	8.00%	8.00%	8.00%	8.00%
Fund's Realized Earnings	$246.1 Million	$189.3 Million	$415.9 Million	$168.0 Million	$51.2 Million

HISTORY OF EMPLOYER CONTRIBUTION SHORTFALL

Fiscal Year End	City Employer Contribution Rate	Actuarial Contribution Rate	Contribution Shortfall (in millions)
6/30/1998	7.83%	10.87%	$11.1
6/30/1999	8.33%	10.86%	$9.7
6/30/2000	8.83%	11.48%	$10.6
6/30/2001	9.33%	11.96%	$11.2
6/30/2002	9.83%	12.58%	$12.3
6/30/2003	10.33%	15.59%	$25.3
TOTAL	CUMULATIVE	IMPACT	$80.2
TOTAL	COMPOUNDED	IMPACT (8%)	$102.1

2. Contingent Benefit Obligations

The decline in investment performance of the Fund over the past two years has also impacted the Fund's realized earnings and therefore the payment of Contingent Benefits. Contingent Benefits, which include the13th check for current retirees and the increase in annual retirement benefits required by the settlement of the Corbett lawsuit in 1997 (the Corbett Payment), are not part of the actuarially computed contribution rate or the City's contribution rate. These benefits are only paid if, at the end of any fiscal year, the Fund has sufficient positive or "excess" earnings to begin paying these benefits in the order prescribed by the Municipal Code. Prior to the most recent year, these Contingent Benefits have been paid each year since they were first approved as contingent benefits. In the case of the 13th check, the Retirement Fund has been paying this benefit since the early 1980s. However, last year, with the Retirement Fund realizing $51 million in earnings, there were insufficient "excess" earnings to make the 13th check payments (approximately $3.8 million annually), or the Corbett payments (approximately $5.5 million annually). Instead, last year's realized earnings, as mandated by the Municipal Code, were used to pay interest at the actuarial 8% rate of return to the employer, employees' and DROP accounts, and to pay the administrative and investment expenses of the Fund. The City Council did, however, authorize a one-time payment of the 13th check from Retirement Fund reserves in 2002. The Corbett payment, under the terms of the lawsuit, is accrued in any year in which

it is not paid, and becomes an obligation of the City to pay in the following year from realized earnings. Thus, in 2003, the Corbett payment will be approximately double this year's estimated payment of $5.5 million, and will continue to accrue and "rollover" as an obligation of the City until paid. Because of this requirement, some have argued that the Corbett payment should not be treated as a "contingent" benefit, and should be "priced" and included in the actuarially computed contribution rate of the Fund.

In addition to the Contingent Benefits described above, two other benefits are impacted by "excess" earnings. These are the Supplemental COLA Reserve and the Employee Contribution Rate Reserve. The Supplemental COLA provides those retirees who retired on or before June 30, 1982 with an amount necessary to increase their benefit to a level equal to 75% of the purchasing power of the dollar they retired with. This Reserve was initially created in 1998 and funded with $35 million dollars from "excess" earnings that year. It is has been credited with interest at 8% from "excess" earnings, when available. Interest was not credited in 2002, and may not be for the next several years. Even without future interest crediting, the Supplemental COLA Reserve is projected to be sufficient to pay the existing benefit until at least 2009, although no increases in this benefit would be possible.

The Employee Contribution Rate Reserve was also created in 1998 and funded with $35 million dollars from "excess" earnings that year. The Reserve's purpose is to fund the City's portion of the Employees Contribution (the Offset) as negotiated each year between the City and its Labor Unions. The Reserve has been credited with interest at 8% from "excess" earnings, when available. Originally, the City's Employee Contribution Offset rate was 0.49% of payroll. This was increased to 0.65% of payroll in 2000. Until recently, interest crediting from "excess" earnings each year actually exceeded the amount transferred out to pay the Offset, and the Reserve has increased. However, no interest was credited in 2000, and may not be for several years.

The Offset rate was increased through the Meet and Confer process to 1.7% of safety payroll effective July 1, 2002, and an additional 1.0% of safety payroll and 1.6% of general payroll effective July 1, 2003. Without interest crediting, we estimate that the Employee Contribution Rate Reserve will be depleted in two to three years, and the annual payment will be approximately $16 million dollars. At that time, the City and its Labor groups will have to negotiate whether or not the City will continue its Offset payments at the currently negotiated percentages of projected payroll.

3. Retiree Health Insurance Obligations

The City currently pays for Retiree Health Insurance on a "pay-as-you-go" basis which is the way the majority of governmental agencies pay for this benefit. The cost for retiree health insurance is not part of the actuary's

pension funding calculations, and, therefore, is not funded as part of the City's Employer Contribution rate. Over the years, "excess" earnings from the Retirement Fund have been set aside in the Retiree Health Insurance Reserve to pay the health insurance premiums for eligible retirees based on the City's agreements negotiated through the Meet and Confer process. Last year, approximately $10 million dollars was paid to cover retiree health insurance premiums. The Retirement Fund has approximately $30 million in its Retiree Health Insurance Reserve. Assuming an annual health insurance cost increase of 10% and current benefit levels, this reserve will be depleted in approximately two to three years absent any replenishment. The Municipal Code does call for a contribution to this reserve when the Fund's "excess" earnings are sufficient in any given year to make a contribution. However, if investment performance does not improve in the next few years such that "excess" earnings of the Fund are insufficient to replenish the Retiree Health Insurance Reserve, the City will have to either reduce the health insurance benefit, or begin paying for the retirees' health insurance premiums from sources other than the Retirement Fund.

In addition, SDCERS' Actuary has estimated that the present value of the liability for paying the health insurance premiums for current active members in the Plan who have not yet retired is in the neighborhood of $1.1 billion dollars. This future liability, if it is deemed to be a contractual right of all current active City employees, remains unaccounted for in terms of the funding of the Retirement Fund. Unless it is included in the actuarially computed contribution rate for the Fund and the City's Contribution Rate under the Manager's Proposal, or unless earnings from the Fund return to sufficient levels to create on-going "excess" earnings, this potential future liability of the City would have to be paid for from other sources.

4. Projected Costs of Pension, Contingent and Health Benefits

The Mayor's Blue Ribbon Committee on City Finances raised concerns about the City's funding of its pensions benefits and health benefits, and recommended that the cost of these benefits be fully accounted for in the City's current and future budgeting process. In analyzing the Committee's concerns, it is best to separate the City's obligations and projected future costs into three components: pension obligations, contingent benefit obligations and health benefit obligations.

a) Projected Pension Obligations

Effective July 1, 2002, SDCERS' Retirement Board and the City of San Diego agreed to revise and update the funding arrangement under the original Manager's Proposal. The revised agreement, known as Manager's Proposal II, requires the City to reach a contribution rate equal to the full actuarially computed rate using the PUC funding method by 2009 if the funded ratio of the Fund falls below 82.3%. This funding "trigger" event has occurred as of the

Fund's June 30, 2002 actuarial valuation. Given this fact, under Manager's Proposal II, the City's contribution rate will increase each year between now and 2009. One projection of this increase is shown in the table below. It assumes that City payroll will increase 4.25% per year between now and 2009, that the actuarial contribution rate will increase 3% next year and 1% per year thereafter, and that investment returns will be weak for at least several years:

PROJECTED PENSION FUNDING COSTS

Fiscal Year	City Employer Contribution	% of Payroll	Actuarial Contribution Rate (PUC)
2004	$76 million	13.43%	21.13%
2005	$92 million	15.57%	24.13%
2006	$111 million	17.96%	25.13%
2007	$133 million	20.68%	26.13%
2008	$160 million	23.91%	27.13%
2009	$197 million	28.13%	28.13%

In addition to this basic pension funding, the City also pays for a portion of the Employees' Contribution (the Offset) and makes a contribution to the DROP accounts. Using the same payroll increase assumptions as above, and assuming that the Employee Contribution Reserve fund will be depleted by 2006 and, therefore, the City's Offset contribution will be reduced in that year going forward, the total City contributions into the Retirement Fund project out as follows:

PROJECTED TOTAL CITY CONTRIBUTIONS (IN $MILLIONS)

Fiscal Year	ER Contribution	EE Contribution	DROP Contribution	Total Contribution	% of Payrolls
2004	$76	$31	$1.3	$108.3	17.8%
2005	$92	$34	$1.4	$127.4	20.0%
2006	$111	$36	$1.4	$148.4	22.4%
2007	$133	$38	$1.5	$172.5	24.9%
2008	$160	$39	$1.6	$200.6	27.9%
2009	$197	$41	$1.6	$239.6	31.8%

Although Manager's Proposal II will bring the City's contribution rate to the full actuarial rate using the PUC method in 2009, it is estimated that the Retirement Fund will still not be fully funded in 2009. Part of the reason for this is due to the contribution shortfall that began with the original Manager's Proposal in 1996. This contribution shortfall is projected to be in excess of $423 million by 2009 assuming an 8% rate of return on the difference between the dollars the City has been and will contribute under both Manager's Proposals I and II, and the dollars that would be contributed using the actuarially computed contribution rate.

b) Projected Contingent Benefit Obligations

The estimated annual cost of the 13th check ($3.8 million), the Corbett Payment ($5.5 million) and the Retiree Health Insurance Premiums ($10 million) combine for an annual cost of $19.3 million. Assuming the costs for the 13th check and the Retiree Health Insurance Premiums increase by 5.5% per year, and that the Corbett payment remains constant each year, the City's annual cost to pay for these contingent benefits in 2009 would be approximately $57 million (assuming there are no "excess" earnings to pay these benefits in the intervening years). As mentioned earlier, the contingent nature of each of these three benefits is slightly different. The 13th check is only required to be paid if there are sufficient "excess" earnings to do so in a given year. The benefit has been paid each and every year since 1980. Last year, when there were not sufficient excess earnings to pay this benefit, retirees lobbied the City Council to use a reserve account within the Retirement Fund to pay the benefit, and the City Council approved this request. It is unlikely that this year's 13th check will be paid in November because we project that there will not be sufficient excess earnings.

Payment of the Retiree Health Insurance premiums is negotiated through the Meet and Confer process. The $10 million annual cost should increase in future years due to the ever-increasing cost of the City's various health insurance programs. The Retirement Fund has been paying these premiums on behalf of the City out of reserves specifically set up for this purpose. We estimate these reserves will be depleted by 2006 at which time the City will have to pay for these premiums from other funds. By that time, assuming a compounded 5.5% increase in costs, we estimate that the Retiree Health Insurance premiums will be approximately $15 million dollars annually.

Finally, the Corbett payment is the least "contingent" of the contingent benefits. That is because the legal settlement requires the payment of this benefit to retirees whether or not there are sufficient excess earnings. In a year where there are not sufficient excess earnings to make this approximately $5.5 million annual payment to retirees, as was the case in 2002, the payment accrues to the following year. Thus, at the end of this year, the Corbett payment obligation will be approximately $11 million. There is no requirement to pay

interest on an accrued Corbett payment, so the projected amount of the Corbett payment expense to the City in 2009 assuming there are insufficient "excess" earnings in the Retirement Fund until then would be approximately $38.5 million dollars.

c) Projected Health Benefit Obligations

It is important to distinguish between the City's costs to pay the premiums for current retiree's health insurance from the potential future liability of the City to pay for the same health insurance coverage for existing active employees when they retire. In the most recent Meet and Confer session, the retiree health benefit was modified to index any future Retiree Health Insurance premium reimbursements to a national health expenditure formula, with an annual increase cap of 10%. Using an assumption that health costs will continue to increase at least10% per year, and that the corresponding cost of health insurance premiums will also increase at a similar pace, we estimate that the average City reimbursement of the highest retiree health insurance premiums could increase from the current $500 per month to $1,000 per month by 2009. This would balloon today's $10 million dollar annual payment for current retirees to over $60 million dollars based on today's retiree population of approximately 5,000 health eligible retirees. The Fund's Actuary, using very simple assumptions and basic calculations, has estimated that the present value of the liability just for today's health insurance eligible retirees is in the vicinity of $400 million.

Projecting the City's cost to pay for the health insurance of active employees when they retire is certainly more difficult. On the assumption that the current benefit structure for health insurance as stated in the Municipal Code does not change, and using the same assumptions on future health costs that were applied to the retiree population, the Fund's Actuary has estimated the present value of the City's liability for today's active employees' health insurance benefits is in the neighborhood of $750 million.

Thus, taken as a group, the City's future liability to cover the health insurance reimbursements of its retirees and active employees is in excess of $1.1 billion dollars. The City is not making any contributions to the Retirement Fund today for this liability, nor is the Fund's Actuary pricing the cost of this benefit and future liability in calculating the actuarial contribution rate of the Fund. Absent a change in the benefit and the Municipal Code, and a dramatic decrease in future health insurance costs, the City of San Diego could be facing significant funding obligations to cover this benefit in future years. The Retirement Fund would not be a resource for this payment absent increases in current contribution payments to include and cover this significant future liability.

Conclusion

Future scenarios are difficult to predict, and it's important to remember that the City's Retirement Fund is $2.5 billion dollars strong and will continue to provide monthly retirement benefits to current retirees and to current City employees when they retire. The performance of the investment markets over the past three years has definitely impacted the earnings of the Fund, and consequently impacted the Fund's ability to pay contingent benefits. The investment decline has also been the primary contributor to the Fund's declining funding ratio in recent years. However, under Manager's Proposal II, the City is committed to achieving the full PUC actuarial rate contribution by 2009 and moving quickly to funding at the EAN actuarial rate thereafter. These steps will eventually improve the Retirement Fund's funding ratio. While the short-term horizon may continue to bring "weak" investment returns, it's important to remember that the Retirement Fund's 10-year average annual return for the period ending June 2002 was 9.26%. This is well above the actuarially assumed rate over this same time period of 8%. The projections in this report have assumed that investment returns may not be sufficient to pay some or all of the various contingent benefits between now and 2009. If this projection holds true, then the City will have to asses whether or not it wishes to fund these benefits from other sources and pay the contingent benefit that continues to accrue (the Corbett payment) from increased contributions.

With regard to health insurance, the current "pay-as-you-go" approach will almost certainly require either a change in this benefit or funding from sources other than the Retirement Fund and its reserves in the not too distant future. Given the dramatic rise in health insurance costs predicted by the experts, the City of San Diego might want to consider beginning to fund the future liability of health insurance for current retirees and future retirees as part of its annual employer contribution to the Retirement Fund.

SAN DIEGO CITY EMPLOYEES RETIREMENT SYSTEM:

REPORT ON THE MAYOR'S BLUE RIBBON COMMITTEE ON CITY FINANCES

Outline of Today's Meeting

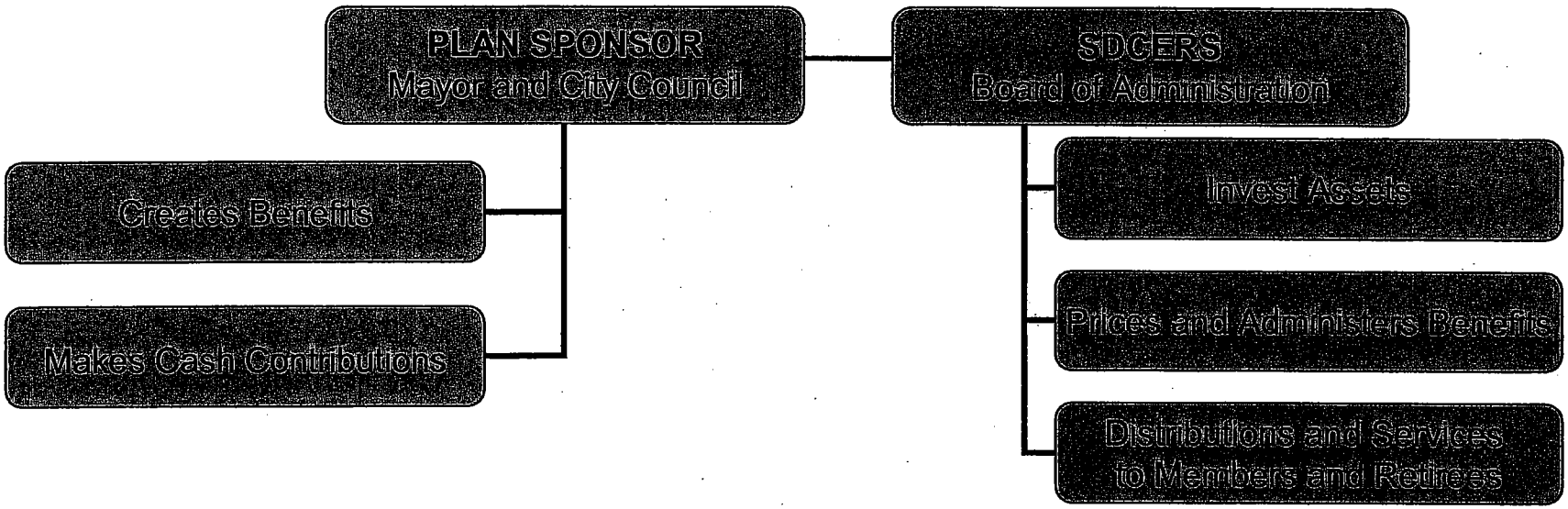
- Background of SDCERS
- Defining the Issues
- Historical Perspective and Contingent Benefits
- Looking into the Future
- Corridor Funding (the Manager's Proposals) and Health Insurance
- Funding Alternatives and Discussion

SDCERS: WHO WE ARE

- SDCERS is responsible for administering and managing the defined benefit retirement funds for the City of San Diego, the Unified Port District and the Airport Authority (the Plan Sponsors), and for their General Members, Safety Members, Elected Officers and Retirees.

- Roles and Responsibilities: the City Council, as the Plan Sponsor, establishes benefits and makes contributions to support benefits; SDCERS invests the assets to reduce future City contributions, administers the benefits and provides the cost of these benefits.

Roles and Responsibilities



SDCERS: WHO WE ARE

- The 13 Member Retirement Board is comprised of:
  - 3 representatives from the City (Manager, Auditor and Treasurer, or designees);
  - 4 citizens appointed by the City Council;
  - 3 representatives elected by General Members;
  - 2 representatives elected by police and fire safety members (one of each), and
  - 1 representative elected by retired members.

SDCERS: WHO WE ARE

- The Membership in the Fund as of June 30, 2002:

	City Plan	UPD Plan
Active General Employees	9,359	763
Active Safety Employees	3,323	188
Retirees	4,569	259
TOTAL	17,242	1,210

SDCERS: CURRENT STATUS

- The Investments of the Fund as of December 31, 2002:

Equities (51.0%)	$1,228,211,382
Fixed Income (38.7%)	$932,300,222
Real Estate (10.1%)	$243,665,393
Cash (0.2%)	$5,194,336
TOTAL MARKET VALUE	$2,409,371,333

SDCERS INVESTMENT PERFORMANCE

Despite difficult market conditions, the SDCERS Retirement Fund has performed in the top 15% of performance for Public Funds for the past one year, three years and five years:

Fund's 1,3 & 5 year Annualized Returns (as of 6/30/02)	-2.48%, +3.69%, & +6.97%
Average Public Fund's 1,3 & 5 year Annualized Returns (as of 6/30/02)	-5.15%, +0.52%, & +5.57%

SDCERS RETIREMENT TRUST FUND

Target Rate of Return (actuarial rate)	8%
Funding Ratio as of 6/30/02 (PUC Funding Method)	77.3%
Total Liabilities as of 6/30/02	$3.17 billion
Total Assets as of 6/30/02 (market value)	$2.53 billion
Total Assets as of 6/30/02 (actuarial value)	$2.45 billion
Unfunded Liability as of 6/30/02 (actuarial value)	$720 million

DEFINING THE ISSUES – WHY ARE WE HERE TODAY?

Responding to the Blue Ribbon Committee Report

- The Committee had two concerns:
  - Whether the City is paying out of its current year's budget the full cost being incurred by its current workforce for their future pension & retiree health benefits.
  - Whether the budgetary process adequately comprehends the steadily growing annual expense obligation, particularly given the uncontrollable & non-discretionary nature of this liability.

DEFINING THE ISSUES – WHY ARE WE HERE TODAY?

The Blue Ribbon Committee had two recommendations:

- Change the City's funding strategy to one that results in the City fully funding, on a current basis, its future obligations earned today which includes the pension benefits as well as health benefits.
- Obtain a current & comprehensive analysis of projected pension expenses & revenue sources, which includes the current present value of retiree health benefits to determine the impact on future City finances.

DEFINING THE ISSUES – WHY ARE WE HERE TODAY?

SDCERS summary analysis of the Blue Ribbon Committee's Report confirms the following:

1. The City is not paying out of current year's budget the full cost being incurred… for future pension & retiree health benefits.

2. There is a very significant growth in required annual pension cost which the City's budget must fund.

SDCERS: HISTORICAL PERSPECTIVE

As recently as two years ago, when the investment markets were very strong,

- The S&P 500's annualized return for 1, 3 and 5 fiscal years was +7.24%, +19.6% and +23.8%.

- The Retirement Fund was well funded with a funding ratio (ratio of assets to liabilities) of 97.3% as of 6/30/00.

SDCERS: HISTORICAL PERSPECTIVE

Over the last two years,

- The S&P 500 returned -14.83% in FY 2001 and -17.99% in FY 2002.
- The City settled the Corbett lawsuit resulting in an increased liability of $158 million plus an on-going contingent liability of approximately $5.5 million per year for retirees.
- Retirement Benefit Factors for General Members were increased from 2.0% to 2.25% on 7/1/00, and from 2.25% to 2.50% on 7/1/02. This equates to a 25% increase in the average pension for General Member retirees in two years.

SDCERS: HISTORICAL PERSPECTIVE

- The Plan benefited greatly (e.g. good funding ratio) as a result of the unprecedented investment market boom of the '90's.

- The Plan suffered from the "bubble burst" and sizeable losses in the investment markets of the last 3 years.

- However, over the long run the Plan's investment returns have **exceeded** the actuarial earnings assumption of 8%/yr (even including the losses of the recent past):
  - 10 year average annual returns through 6/1992 = 14.34%
  - 10 year average annual returns through 6/2002 = 9.26%

SDCERS CORRIDOR FUNDING: WHAT IS IT?

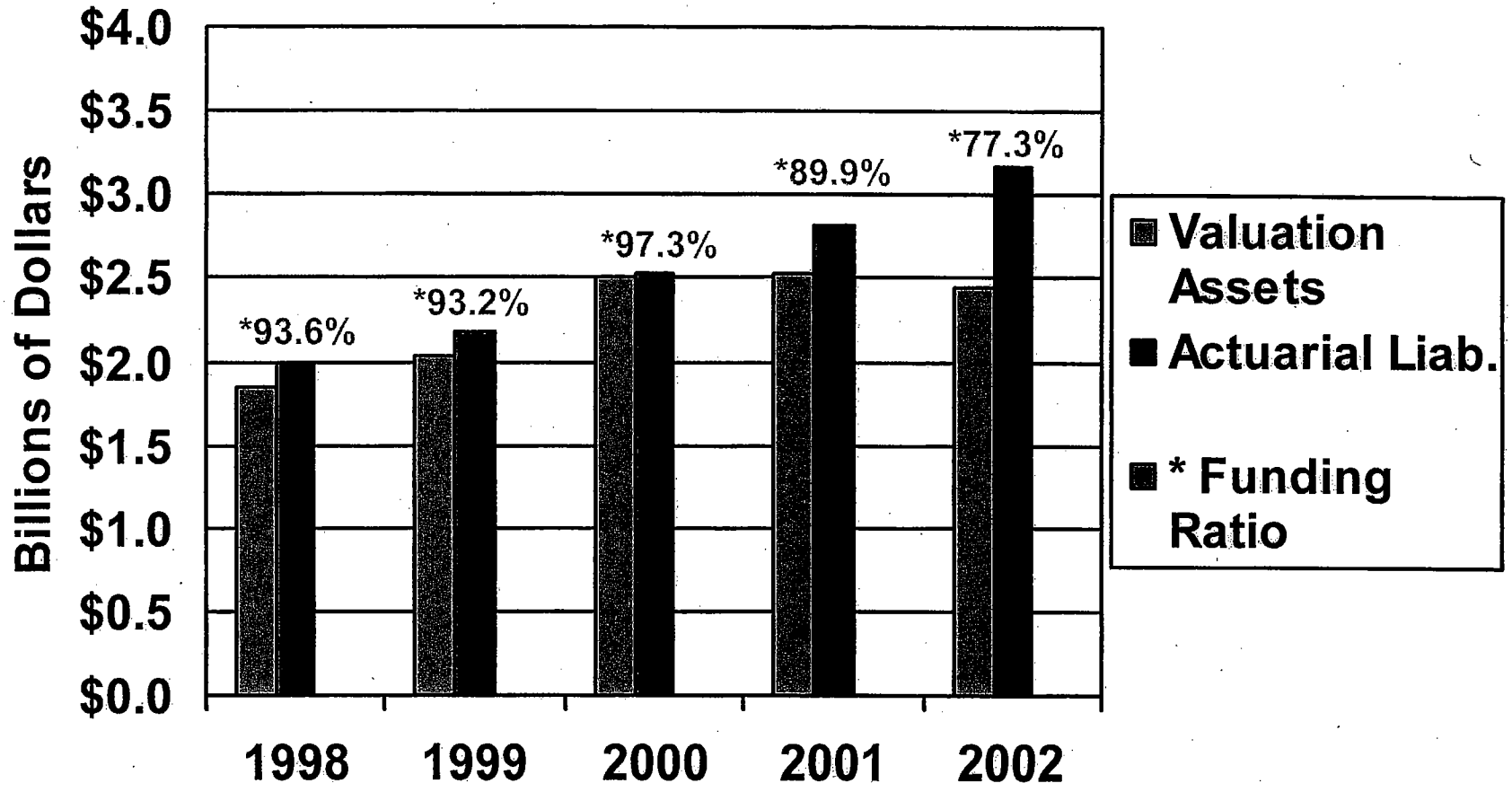
- In 1996, the City and the Retirement Board reached agreement on a proposal (the Manager's Proposal) to stabilize the City's annual employer contribution to the Fund. This Proposal allowed the City to contribute less than the actuarially computed contribution rate.

- Under the Manager's Proposal, the City's employer contribution rate increased 0.5% of payroll per year even though the actuarially computed rate increased more than 0.5% of payroll per year.

SDCERS CORRIDOR FUNDING: WHAT HAVE BEEN THE RESULTS?

- From 7/1/97 through 6/30/03, the difference between what was contributed by the City and what would have been contributed under the amounts computed by the actuary, plus earnings on the difference, results in a funding shortfall of approximately $102 million.
- New Manager's Proposal II has been approved by the City, the Retirement Board and Members which requires the City to "ramp up" its employer contributions each year until it achieves the actuarially computed PUC funding rate by 2009.

FUNDING HISTORY

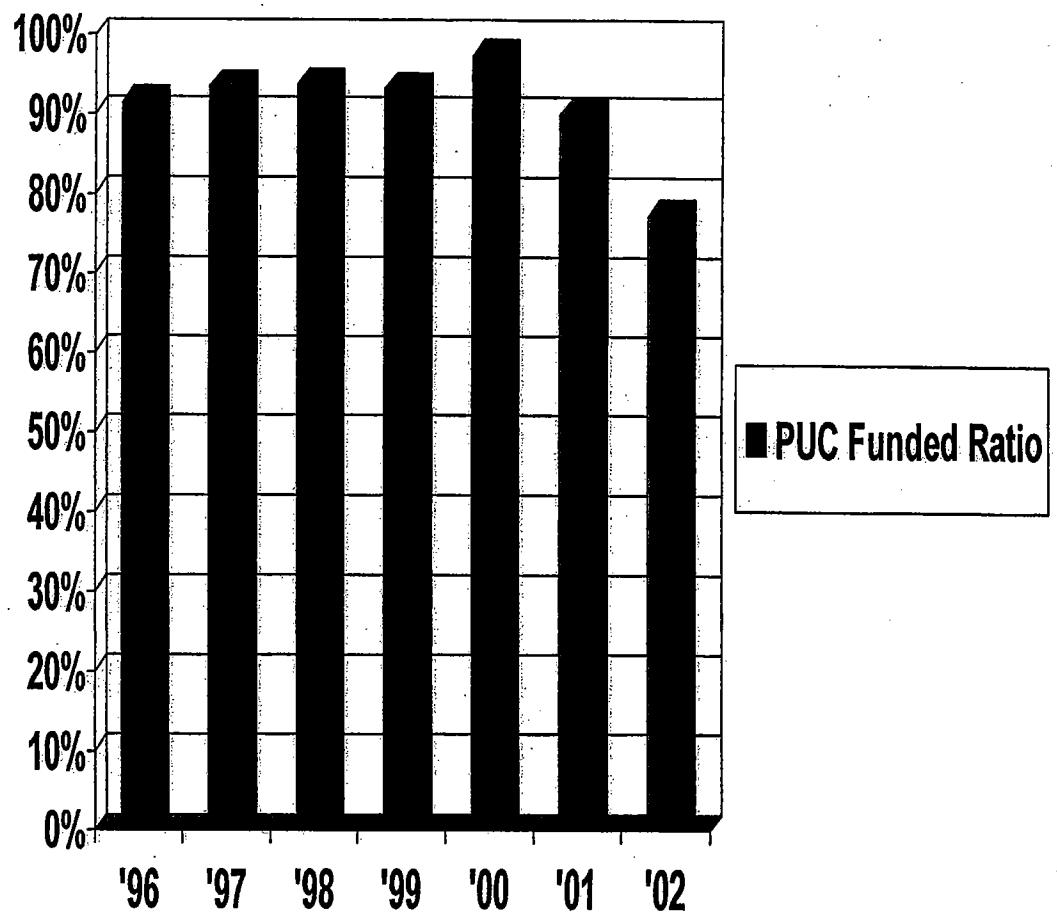


FUNDING HISTORY

Fiscal Year End (June 30)	City Employer Contribution Rate	Actuarial Contribution Rate	Contribution Shortfall (in millions)
1998	7.83%	10.87%	$11.1
1999	8.33%	10.86%	$ 9.7
2000	8.83%	11.48%	$10.6
2001	9.33%	11.96%	$11.2
2002	9.83%	12.58%	$12.3
2003	10.33%	15.59%	$25.3
TOTAL	**CUMULATIVE**	**IMPACT =**	**$80.2**
TOTAL	**COMPOUNDED**	**IMPACT (8%) =**	**$102.1**

PUC FUNDING RATIO
(ratio of assets to liabilities)

FY Year End	Funded Ratio
1996	91.4%
1997	93.3%
1998	93.6%
1999	93.2%
2000	97.3%
2001	89.9%
2002	77.3%



SDCERS: CONTINGENT BENEFITS

- Contingent Benefits are benefits which are only paid each year if the Fund generates "excess" realized earnings. There is a hierarchy defined in the Municipal Code for paying these benefits until all of the "excess" realized earnings are paid out in a given year.
- The Contingent Benefits of the Fund, in the order prescribed by the Municipal Code, include:
  - the Reserve for Retiree Health Insurance;
  - the 13th check;
  - the Corbett Payment;
  - crediting of the Supplemental COLA reserve;
  - crediting of the Employee Contribution reserve

SDCERS: REALIZED EARNINGS

- In the "up" market of recent years, the Retirement Fund's realized earnings were strong, reserves were high and all Contingent Benefits were paid.
- The trend has changed. Realized earnings as of 6/30/02 were $51.2 million, insufficient to pay all Contingent Benefits.

Year	Realized Earnings	All Contingent Benefits paid
1999	$189.3 Mil	Yes
2000	$415.9 Mil	Yes
2001	$168.0 Mil	Yes
2002	$51.2 Mil	No
2003 (as of 11/30/02)	- $55.5 Mil	Unlikely

SDCERS: CONTINGENT BENEFITS

Contingent Benefit	Paid Since	Avg. Total Annual Cost	Number of retirees receiving payment
Health Insurance	1982	$10 million	3,543
13th Check	1980	$3.8 million	4,695
Corbett	2000	$5.5 million	4,267

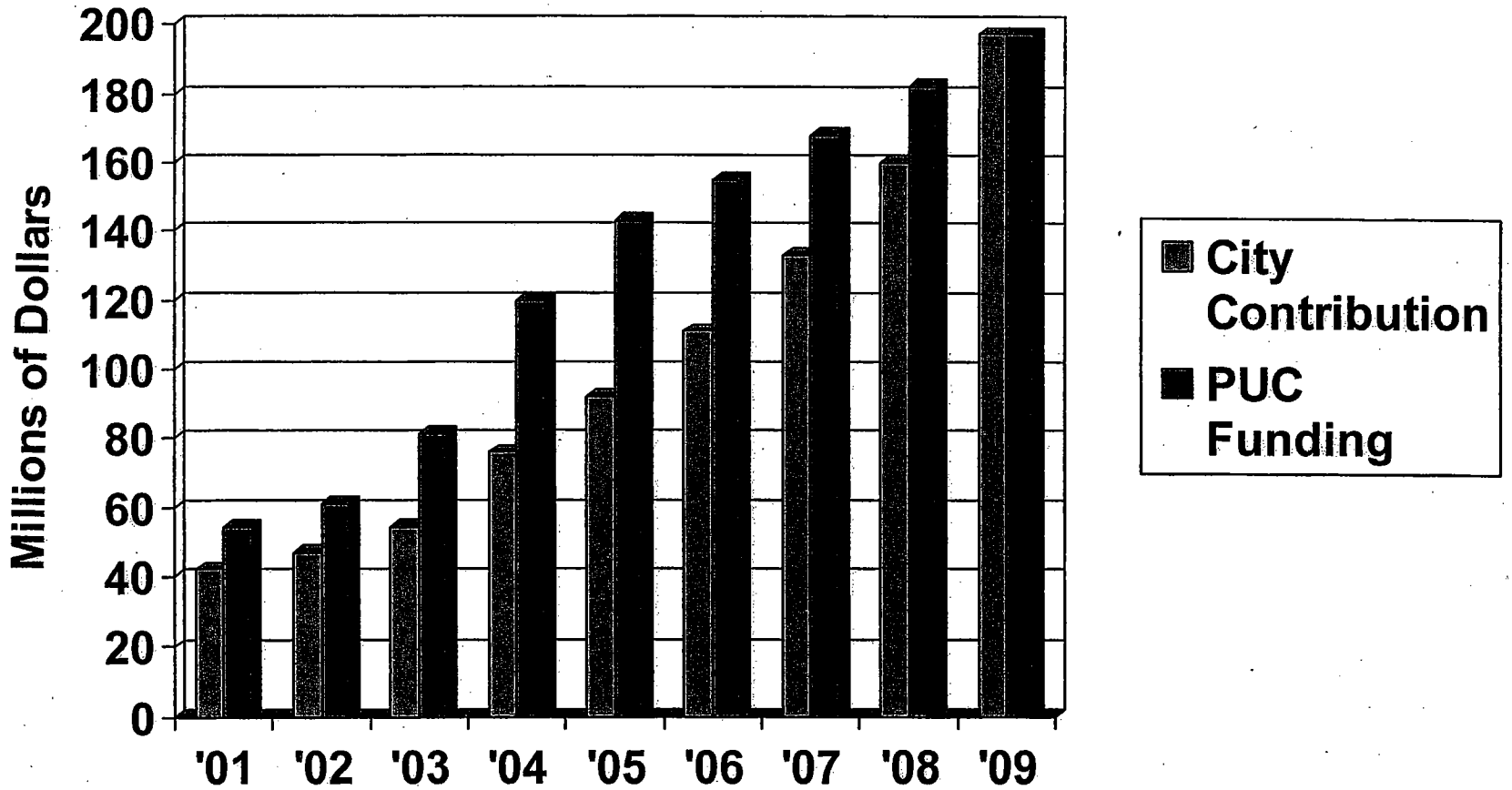
PROJECTIONS OF CONTINGENT BENEFITS COST AND LIABILITIES

Contingent Benefit	Amt Pd from inception to 6/30/02	Total Amount of last annual Payment	Projected Payment FY '03	Projected Liabilities (Present Value in Today's Dollars)
Health Insurance	$56.8 million	$9.5 million	$10 million	$1.1 Billion
13th Check	$58.0 million	$3.8 million	Not paid	$58 million
Corbett	$28.9 million	$5.6 million	Not paid	$75 million
Employee Cont Rate Reserve	$15.3 million	$3.2 million	Not Paid	$0
Sub COLA Reserve	$11.0 million	$2.8 million	Not Paid	$0
TOTAL	**$170.0 million**	**$24.9 million**	**$10 million**	**$1.23 Billion**

PROJECTIONS INTO THE FUTURE

- This year's City Employer Contribution was $54 million, or 10.33% of payroll (the City also paid another $28 million on behalf of employees' required contribution – the Offset).
- By 2009, assuming covered payroll increases by 4.25% per year, the actuarial contribution rate increases 3% next year due to increased benefits, and 1% per year thereafter, the City's payment in 2009 would be $197 million (this does not include the amount of any City offset payments towards employee contributions).
- If Contingent Benefits are also paid by the City in 2009, assuming no "excess" earnings in the intervening years, the contribution would have to increase by another $57 million to $254 million.

THE CONTRIBUTION SHORTFALL

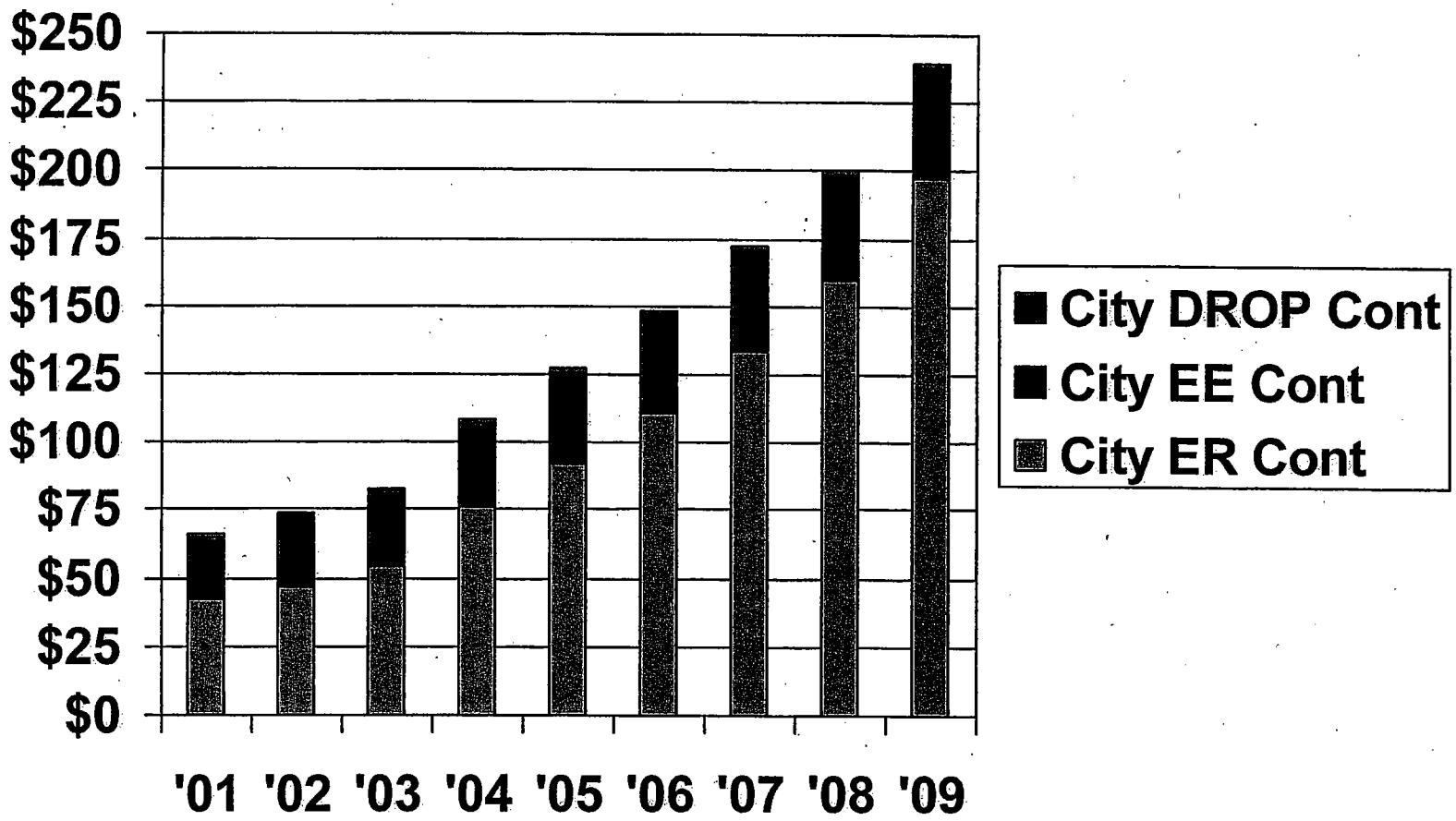


A PROJECTED FUNDING FUTURE

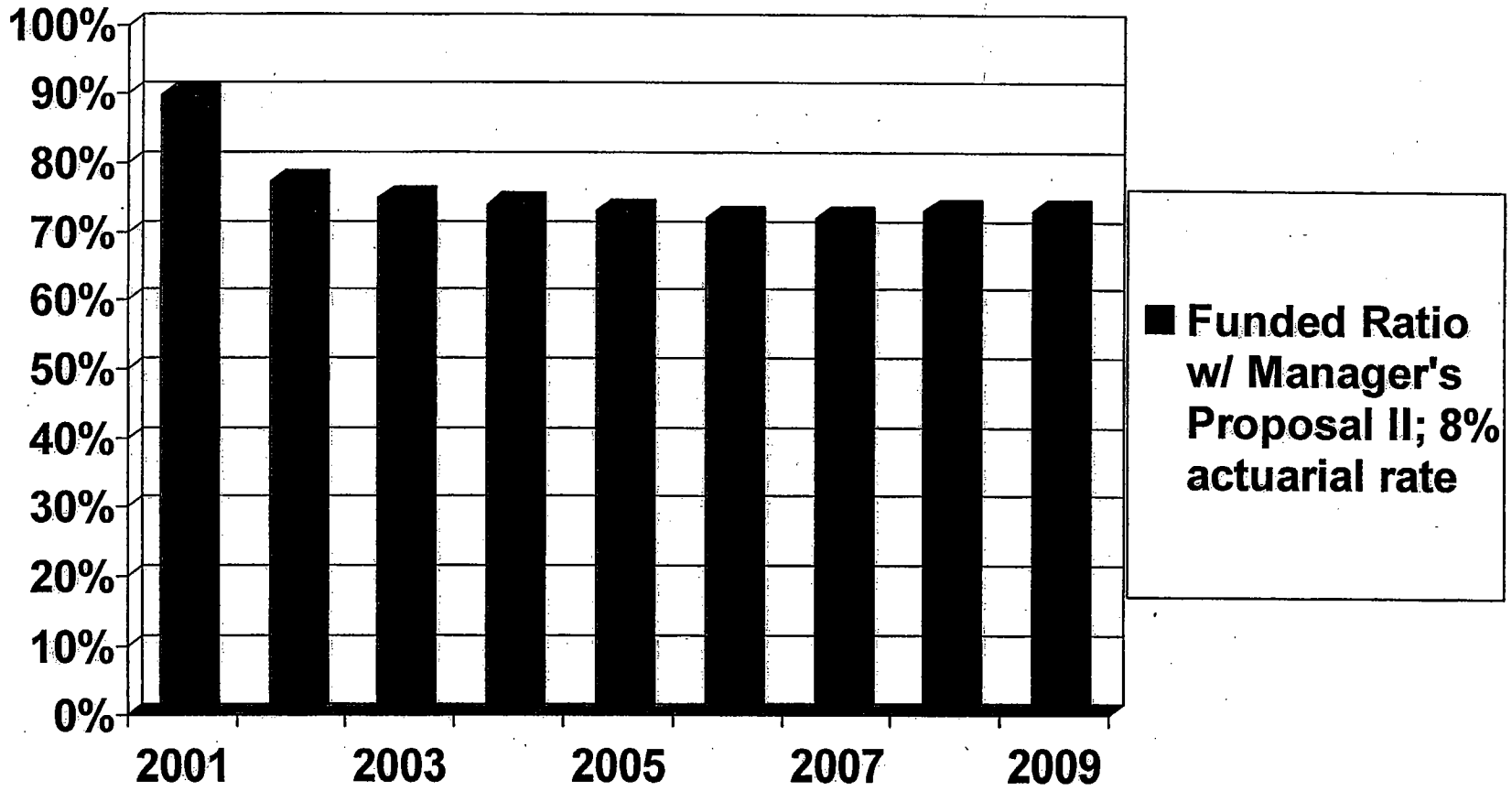
Year	City Employer Contribution	City Employee Contribution	City DROP Contribution	Total Contribution
2001	$42 million	$23 million	$1.0 million	$66.0 million
2002	$47 million	$26 million	$1.1 million	$74.1 million
2003	$54 million	$28 million	$1.2 million	$83.2 million
2004	$76 million	$31 million	$1.3 million	$108.3 million
2005	$92 million	$34 million	$1.4 million	$127.4 million
2006	$111 million	$36 million**	$1.4 million	$148.4 million
2007	$133 million	$38 million**	$1.5 million	$172.5 million
2008	$160 million	$39 million**	$1.6 million	$200.6 million
2009	$197 million	$41 million**	$1.6 million	$239.6 million

**assumes Employee Rate Reserve is depleted and Offset contributions not made by the City.

FUNDING PROJECTIONS



PROJECTED PUC FUNDING RATIO
(ratio of assets to liabilities)



SDCERS: HEALTH INSURANCE TODAY

- Current benefits provide for payment of the premiums for eligible retirees' health insurance from SDCERS' "surplus earnings".

- Two Health Insurance reserves within the Retirement Fund will cover the payment of premiums for approximately 2 to 3 years.

- After these reserves are depleted, the City is obligated to pay from other funds (current cost is approximately $10million per year).

SDCERS: HEALTH INSURANCE IN THE FUTURE

- The actuarial liability of the City's retiree health insurance commitment is not required to be actuarially funded. Therefore, it is not included in the calculation of the City's contribution to the Retirement Fund.
- The City, through the Retirement Fund, is only paying health insurance premiums for current retirees – no contributions are being made for the future health insurance liability of today's employees. Thus future taxpayers may have to pay for prior year's expense which will become a significant annual cost.

MAXIMUM PROJECTED LIABILITIES OF PENSION, CONTINGENT AND HEALTH

Unfunded Pension Liability (6/30/02)	$720 million
13th Check and Retiree Health Insurance	$433 million
Future Retiree Health Insurance	$750 million
Corbett Contingent Benefit	$75 million
TOTAL	$1.978 Billion

SDCERS: ANALYSIS OF ALTERNATIVES

1. Maintain Status Quo: City's annual cost will increase approximately 16% to 18% each year until 2009. Thereafter, increases will continue to grow in order to shift from PUC to EAN funding.
2. Issue Pension Obligation Bonds with the objective of reducing the unfunded liability.
3. Increase the Contribution Rate now to improve future actuarial funding.
4. Do both #2 and #3 to achieve full funding.

EXHIBIT 28

CITY OF SAN DIEGO
OFFICE OF THE CITY AUDITOR AND COMPTROLLER

MEMORANDUM

DATE: December 26, 2000

TO: SDCERS Board of Administration
Via Larry Grissom, Retirement Administrator

FROM: Ed Ryan, City Auditor and Comptroller

SUBJECT: Auditor and Comptroller Memorandum of Understanding for Services to the Retirement System for Fiscal Year 2002

During this fiscal year our office has provided high quality services to your department for the Retirement Fund. Our Accounting Staff has provided monthly and annual financial reports, prepared in accordance with applicable accounting pronouncements, to the Retirement Board. They also process the daily payment and accounting transactions.

Our Financial Systems Staff was responsible for programming the Corbett Settlement accrual terms, as outlined in City Ordinance 18835. Due to the timing of Council approval, additional retro payments had to be quickly programmed to stay in compliance. Our efforts were successful on very short notice as the programming was tested and implemented by the middle of July 2000. The Corbett five-year retro payout was programmed and combined with this year's 13th check payout in November as also was specified in the ordinance.

Our Payroll Staff provided oversight and assistance to your department for the five-year retro settlement payout. They closely monitored the Supplemental COLA II benefit and the DROP benefits. They continue to provide excellent customer service to retirees regarding their pension checks, 1099R tax forms, direct deposit transactions, tax withholding, and changes in benefits, such as Supplemental COLA, Cost-of-Living and Fluctuation increases. Our Payroll Staff also provides excellent service to active and terminating employees, including accurate accounting for and timely processing of retirement contributions, refunds, and purchases of service credit. During the year they worked closely with your staff to provide reconciled payroll transmittal files for the MBS conversion. In addition, our Payroll Staff continues to provide information, research and timely assistance to your department on many issues affecting active members and retirees.

Our Audit staff audited records related to the Corbett and the Supplemental COLA II payouts and performed the Death Match audit.

The "Summary of Estimated Charges" on page 2, shows the Fiscal Year 2001 budget amounts and the proposed Fiscal Year 2002 Budget for Auditor and Comptroller services to the Retirement Fund. These charges are based on the scope of services described in Attachment I, "Scope of Accounting Services Provided" and the detailed charges listed in Attachment II, "Direct Billing Estimate".

In accordance with our past practice, we will not bill your office for the time spent on the MBS Project by Audit and Financial Systems Staff. Audit services will be provided upon request or if we see an audit need. Any Audit charges will be agreed to in advance.

Once the MBS System is fully operational, we anticipate that efficiencies in the new system may allow us to reduce the time spent on certain core functions. It is our policy to direct bill for staff dedicated to a specific customer. **Please note that we only bill actual charges; actual charges will not exceed the total estimate without your approval.**

Summary of Estimated Charges

Ongoing Operations:	**FY 2001 Budget**	**FY 2002 Proposed Budget**
Accounting Services	$40,090	$42,039
Payroll Services	$87,682	$91,941
Non Personnel Expenses	$4,838	$7,330
Subtotal - Ongoing Operations	$132,610	$141,310
MBS:		
Accounting Services	$5,653	$8,167
Payroll Services	$21,445	$23,400
Subtotal - MBS	$27,098	$29,567
Total Auditor and Comptroller Services	$159,708	$170,877

Please sign below to confirm your understanding of the stated scope of services and related charges.

City Auditor and Comptroller

Retirement Administrator

ATTACHMENT I

SCOPE OF SERVICES PROVIDED

Accounting

Core Services:

- Prepare monthly financial statements, in accordance with applicable accounting pronouncements, for the Retirement Board.
- Analyze the annual actuary report and make projections of the fiscal impact of contributions as needed. Calculate City contribution rates using information provided on the actuary report and advance to Retirement Fund.
- Prepare annual financial statements and supporting schedules for Retirement Board and for Comprehensive Annual Financial Report, including Schedule of Distribution of Undistributed Earnings.
- Prepare the annual State Controller's Report (Report of Financial Transactions of Public Retirement Systems).
- Compute the cash requirements necessary to cover the monthly pension payroll and annual 13th check and Corbett payment and order cash from the investments trustee as needed.
- On a monthly basis, reconcile the pension payroll subsidiary accounts to the General Ledger.
- On a daily basis, review and process administrative budget transactions, including Direct Payment Requests (DPs), Purchase Requisitions, Journal Vouchers, and Budget Transfer Requests.
- Maintain account tables and set up new accounts as needed to maintain accurate records of the fund's activities.

Services Provided Upon Request:

- General technical assistance and information concerning fund status.
- Assist in the reconciliation of monthly investment activity.
- Perform special projects, define available options and make recommendations.

ATTACHMENT I

SCOPE OF SERVICES PROVIDED

Payroll

Monthly Processing:

- Verify new retirees and their monthly allowances have been approved by the Retirement Board and added to pension payroll for the approved amounts.
- Verify authority for changes in retirement allowances and review for reasonableness.
- Initiate jobs to update Pension Payroll Master File and print the warrant register.
- Authorize printing of checks and ACH (direct deposit) stubs.
- Notify City Treasurer's Investments personnel of gross pension to be paid, and provide tax withholding figures to Auditor's Payroll Accountant.
- Prepare AMRIS (general ledger) transactions to record pension expense.
- Special handling of warrant checks with uncommon requirements (foreign address, inserts to be mailed with check, etc).
- Void checks issued in error (paid wrong due to last-minute changes, garnishments, or notifications of retiree death).
- Prepare manual checks as necessary.
- Stuff and mail pension checks and ACH (direct deposit) stubs.
- Monitor, record usage of , and maintain security for all checks, including posting of voids and issues using Advantis bank reporting software.
- Interpret court orders, withhold money, and pay institutions and/or individuals benefitting from assignments, garnishments, and attachments.
- Prepare 1099-Rs and 1099-Ms, and submit to the Internal Revenue Service, California Franchise Tax Board (FTB), retirees, and vendors, annually and as requested by recipients.
- Maintain and update tables for state and federal withholding and ACH depository financial institutions (DFI).

ATTACHMENT I

SCOPE OF SERVICES PROVIDED

Payroll (continued)

- Prepare bank reconciliation for all pension transactions and provide to Treasurer's personnel for inclusion in their reconciliation of City accounts, and make necessary adjustments to AMRIS (general ledger).
- Record and deposit checks received from beneficiaries for overpaid benefits due to retiree deaths.
- Adjust retirees' balances to ensure accurate tax reporting.
- Update and generate ACH transactions, and provide data to the ACH processing service provider for posting to retirees' accounts.
- Issue affidavits and process stop payments for retirees and members.

Other Payroll Activities:

- Ensure accurate and timely postings of payroll deductions, adjustments, refunds and retirements to the Retirement Contribution System and AMRIS.
- Reconcile the Retirement Contribution System to AMRIS.
- Provide customer service for retirees and members inquiring about pensions, direct deposit, 1099-Rs, refunds, retirement contributions, etc.
- Compile financial data and prepare invoice and supporting schedules for annual billing to Unified Port District for its share of administrative costs, and ensure payment by specified deadlines.
- Research and resolve computer system and reporting errors.
- Research stale-dated and undeliverable pension checks and other disbursements, and authorize reissue of payments to appropriate payees, when applicable.
- Coordinate transactions and procedures with Unified Port District (UPD) to ensure accuracy of member contributions, payments by UPD, and retirement balances reported on UPD employee payroll checks.
- Verify Cost-of-Living adjustments, fluctuation increases, and interest apply correctly and test for reasonableness.
- Complete special projects and research issues as requested by Retirement Office personnel.

SCOPE OF SERVICES PROVIDED

Payroll (continued)

- Prepare bank reconciliation for all pension transactions and provide to Treasurer's personnel for inclusion in their reconciliation of City accounts, and make necessary adjustments to AMRIS (general ledger).
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- Ensure accurate and timely postings of payroll deductions, adjustments, refunds and retirements to the Retirement Contribution System and AMRIS.
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- Verify Cost-of-Living adjustments, fluctuation increases, and interest apply correctly and test for reasonableness.
- Complete special projects and research issues as requested by Retirement Office personnel.

ATTACHMENT A

FISCAL YEAR 2002
RETIREMENT FUND - ACCOUNT 79089
SUMMARY OF ESTIMATED CHARGES

Assumes:	Salaries adjusted for projected raises.	
	Fringe Rate	30.9%
	Cost Recovery	8.3%

PERSONNEL

0.5 Accountant III - Accounting

Labor	$30,200		
Fringe	$9,332		
Cost Recovery	$2,507		
Total Accountant III - Accounting			$42,039

0.5 Accountant II - Payroll

Labor	$27,503		
Fringe	$8,498		
Cost Recovery	$2,283		
Total Accountant II - Payroll		$38,284	

1 Audit Specialist II - Payroll

Labor	$38,547		
Fringe	$11,911		
Cost Recovery	$3,199		
Total Audit Specialist II - Payroll		$53,657	
SUBTOTAL - Payroll			$91,941
TOTAL PERSONNEL			$133,980

NON-PERSONNEL

	Qty	Price per Unit		
1099 R Tax Forms	8,500	$0.150	$1,275	
Envelopes	70,000	$0.045	$3,150	
Paychecks	70,000	$0.035	$2,450	
ACH Fees (monthly)	13	$35.000	$455	
TOTAL NON-PERSONNEL				$7,330
TOTAL BUDGET (not including MBS)				**$141,310**

ATTACHMENT II

FISCAL YEAR 2002
RETIREMENT FUND - ACCOUNT 79089
SUMMARY OF ESTIMATED CHARGES

MBS IMPLEMENTATION SERVICE REQUESTED:

PERSONNEL

120 Hours - Accountant III - Accounting

Labor	$4,430		
Fringe	$1,369		
Cost Recovery	$368		
Total Accountant III - Accounting		$6,167	

500 Hours - Accountant II - Payroll

Labor	$16,811		
Fringe	$5,194		
Cost Recovery	$1,395		
Total Accountant II - Payroll		$23,400	
TOTAL PERSONNEL - MBS			$29,567

TOTAL AUDITOR AND COMPTROLLER SERVICES **$170,877**

SAN DIEGO COUNTY EMPLOYEES RETIREMENT SYSTEM

SALARY SCHEDULE

Position Title	Employee	Position Years FY 2001	Position Years FY 2002	Salaries and Wages Salary	Salaries and Wages Fringe	Salaries and Wages Total
Administration						
Retirement Administrator	Larry Grissom	1.00	1.00	$150,159	$42,045	$192,204
Assistant Administrator	*--Interviewing--*	1.00	1.00	$90,000	$25,200	$115,200
Executive Secretary	Sally Zumalt	1.00	1.00	$44,726	$13,439	$58,165
Executive Secretary	Cynthia Hilliard	1.00	1.00	$44,726	$13,439	$58,165
Clerical Assistant II	Delia Lencioni	0.50	0.50	$15,236	$5,364	$20,601
Investments						
Chief Investment Officer	Doug McCalla	1.00	1.00	$116,471	$35,612	$152,083
Assistant Investment Officer	Dawne Clark	1.00	1.00	$74,922	$20,978	$95,900
Retirement Financial Specialist III	Robin Oleksow	1.00	1.00	$62,641	$16,843	$79,484
Retirement Financial Specialist II	*--Interviewing--*	1.00	1.00	$55,687	$15,506	$71,194
Clerical Assistant II	Delia Lencioni	0.50	0.50	$15,236	$5,364	$20,601
Legal Services						
General Counsel	Lori Chapin	1.00	1.00	$140,140	$39,239	$179,380
Assistant General Counsel	Roxanne Story Parks	1.00	1.00	$113,430	$31,761	$145,191
Associate General Counsel	Sheila Leone	1.00	1.00	$88,066	$24,658	$112,724
Senior Legal Assistant	Jean Struiksma	1.00	1.00	$58,829	$16,117	$74,946
Legal Assistant	Merfita Hilario	1.00	1.00	$52,974	$15,005	$67,980
Legal Assistant	*--Requested--*	0.00	0.50	$26,487	$7,503	$33,990
Legal Secretary	Sally Nadeau	1.00	1.00	$43,974	$13,297	$57,271
Clerical Assistant II	Olivia Zatarain	1.00	1.00	$30,473	$10,728	$41,201
Disability						
Medical Review Officer	Nancye Launer	1.00	1.00	$68,058	$20,899	$88,957
Clerical Assistant II	Bernadette Stratton	1.00	1.00	$30,473	$10,728	$41,201

SAN DIEGO CITY EMPLOYEES RETIREMENT SYSTEM

SALARY SCHEDULE

Position Title	Employee	Position Years FY 2001	Position Years FY 2002	Salaries and Wages Salary	Salaries and Wages Fringe	Salaries and Wages Total
Accounting/Systems						
Chief Financial Officer	Patrick Lane	1.00	1.00	$68,058	$20,899	$88,957
Internal Auditor	*--Interviewing--*	1.00	1.00	$55,687	$15,506	$71,194
MBS Auditor	Vince Aikels	1.00	1.00	$55,687	$15,506	$71,194
MBS Auditor	*--Interviewing--*	1.00	1.00	$55,687	$15,506	$71,194
Budget Analyst	***--Requested--***	**0.00**	**0.50**	$27,844	$7,753	$35,597
Associate Management Analyst	*--Interviewing--*	1.00	1.00	$55,687	$15,506	$71,194
Information Systems Analyst II	***--List Requested--***	1.00	1.00	$54,135	$18,148	$72,283
Clerical Assistant II	*--Interviewing--*	1.00	1.00	$30,473	$10,728	$41,201
Operations						
Chief Operations Officer	Vincent Hayes, Jr.	1.00	1.00	$90,728	$25,404	$116,132
Benefits Manager	***--Classification Requested--***	1.00	1.00	$68,058	$20,899	$88,957
Benefits Counselor	Gloria Oloya	1.00	1.00	$55,687	$15,506	$71,194
Benefits Counselor	Sussan Johnsen	1.00	1.00	$55,687	$15,506	$71,194
Benefits Counselor	Lance Haim	1.00	1.00	$55,687	$15,506	$71,194
Benefits Counselor	Mercedes Barcelona	1.00	1.00	$55,687	$15,506	$71,194
Health Insurance Analyst	Jan Beaton	1.00	1.00	$55,687	$15,506	$71,194
Benefits Analyst	Shirley Cunningham	1.00	1.00	$55,687	$15,506	$71,194
Communication Specialist	***--Classification Requested--***	1.00	1.00	$55,687	$15,506	$71,194
Administrative Aide II	Jean Evans	1.00	1.00	$43,604	$13,217	$56,822
Administrative Aide II	***--Requested--***	**0.00**	**0.50**	$21,802	$6,609	$28,411
Retirement Assistant	Marcie Cataquis	1.00	1.00	$39,031	$12,359	$51,390
Retirement Assistant	Ron White	1.00	1.00	$39,031	$12,359	$51,390
Retirement Assistant	Rosemarie Palestini	1.00	1.00	$39,031	$12,359	$51,390
Retirement Assistant	*--Interviewing--*	1.00	1.00	$39,031	$12,359	$51,390
Retirement Assistant	***--List Requested--***	1.00	1.00	$39,031	$12,359	$51,390
Retirement Assistant	***--Requested--***	**0.00**	**0.50**	$19,516	$6,180	$25,695
Retirement Assistant	***--Requested--***	**0.00**	**0.50**	$19,516	$6,180	$25,695
Benefits Representative I	Brenda Clark	1.00	1.00	$32,033	$10,973	$43,006
Benefits Representative I	Monty Perello	1.00	1.00	$32,033	$10,973	$43,006

SAN DIEGO COUNTY EMPLOYEES RETIREMENT SYSTEM
SALARY SCHEDULE

Position Title	Employee	Position Years FY 2001	Position Years FY 2002	Salaries and Wages Salary	Salaries and Wages Fringe	Salaries and Wages Total
Account Clerk	Sherrill Dalrymple	1.00	1.00	$31,942	$11,013	$42,956
Clerical Assistant II	Colleen Reiss	1.00	1.00	$30,473	$10,728	$41,201
Clerical Assistant II	*--Interviewing--*	1.00	1.00	$30,473	$10,728	$41,201
Clerical Assistant II	Lee Chiles	1.00	1.00	$30,473	$10,728	$41,201
Clerical Assistant II	Caroline Hoofman	1.00	1.00	$30,473	$10,728	$41,201
Clerical Assistant II	Marilyn DeJarnette	1.00	1.00	$30,473	$10,728	$41,201
Clerical Assistant II	*--List Requested--*	1.00	1.00	$30,473	$10,728	$41,201
Clerical Assistant II	*--Requested--*	0.00	0.50	$15,236	$5,364	$20,601
Clerical Assistant II	*--Requested--*	0.00	0.50	$15,236	$5,364	$20,601
Hourly Wages/Temporary Help						$323,000
Ex Performance Pay-Classified						$310,500
GRAND TOTAL =		49.00	52.50	$2,883,479	$860,167	$4,377,146

Updated as of 3/6/2001

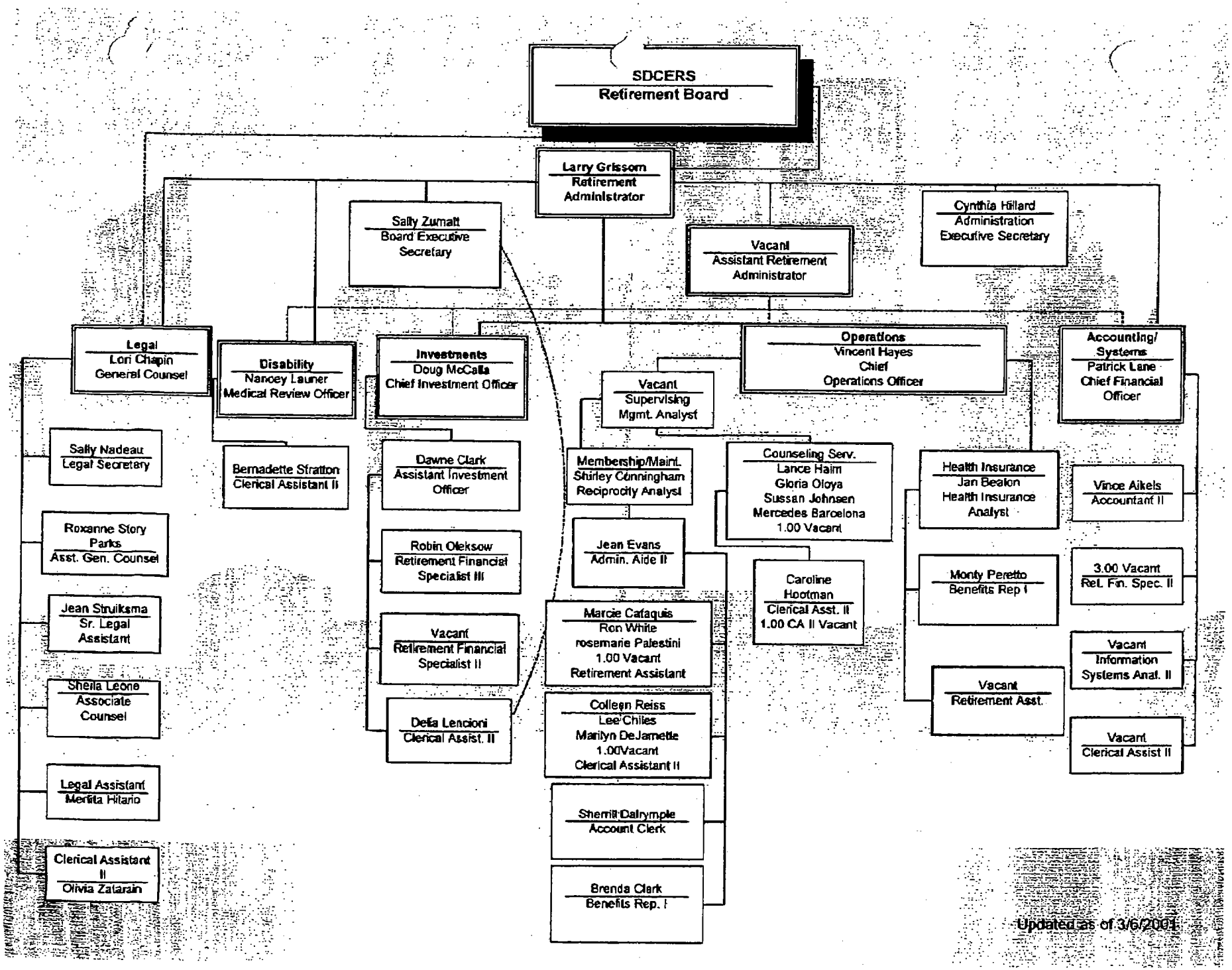
SDCERS
Retirement Board
Larry Grissom
Retirement Administrator
Sally Zumalt
Board Executive Secretary
Vacant
Assistant Retirement Administrator
Cynthia Hillard
Administration Executive Secretary
Legal
Lori Chapin
General Counsel
Disability
Nancey Launer
Medical Review Officer
Investments
Doug McCalla
Chief Investment Officer
Operations
Vincent Hayes
Chief Operations Officer
Accounting/ Systems
Patrick Lane
Chief Financial Officer
Sally Nadeau
Legal Secretary
Roxanne Story Parks
Asst. Gen. Counsel
Jean Struiksma
Sr. Legal Assistant
Sheila Leone
Associate Counsel
Legal Assistant
Merlita Hitario
Clerical Assistant II
Olivia Zatarain
Bernadette Stratton
Clerical Assistant II
Dawne Clark
Assistant Investment Officer
Robin Oleksow
Retirement Financial Specialist III
Vacant
Retirement Financial Specialist II
Delia Lencioni
Clerical Assist. II
Vacant
Supervising Mgmt. Analyst
Membership/Maint.
Shirley Cunningham
Reciprocity Analyst
Jean Evans
Admin. Aide II
Marcie Cataquis
Ron White
rosemarie Palestini
1.00 Vacant
Retirement Assistant
Colleen Reiss
Lee Chiles
Marilyn DeJamette
1.00Vacant
Clerical Assistant II
Sherrill Dalrymple
Account Clerk
Brenda Clark
Benefits Rep. I
Counseling Serv.
Lance Haim
Gloria Oloya
Sussan Johnsen
Mercedes Barcelona
1.00 Vacant
Caroline Hootman
Clerical Asst. II
1.00 CA II Vacant
Health Insurance
Jan Beaton
Health Insurance Analyst
Monty Peretto
Benefits Rep I
Vacant
Retirement Asst.
Vince Aikels
Accountant II
3.00 Vacant
Ret. Fin. Spec. II
Vacant
Information Systems Anal. II
Vacant
Clerical Assist II
Updated as of 3/6/2001

EXHIBIT 29

provided for in this Charter or by ordinances of the City, including the journal of all proceedings of the Council and all its ordinances and resolutions.

(Amendment voted 09-17-1963; effective 02-11-1964.)

SECTION 38.1. MICROFILMING OF RECORDS.

(Addition voted 04-19-1949; effective 05-20-1949.)
(Repeal voted 11-04-1958; effective 02-19-1959.)

SECTION 39. CITY AUDITOR AND COMPTROLLER.

The City Auditor and Comptroller shall be elected by the Council for an indefinite term and shall serve until his successor is elected and qualified. The City Auditor and Comptroller shall be the chief fiscal officer of the City. He shall exercise supervision over all accounts, and accounts shall be kept showing the financial transactions of all Departments of the City upon forms prescribed by him and approved by the City Manager and the Council. He shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period, detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof. No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the Auditor and Comptroller shall certify in writing that there has been made an appropriation to cover the expenditure and that there remains a sufficient balance to meet the demand thereof. He shall perform the duties imposed upon City Auditors and Comptrollers by the laws of the State of California, and such other duties as may be imposed upon him by ordinances of the Council, but nothing shall prevent the Council from transferring to other officers matters in charge of the City Auditor and Comptroller which do not relate directly to the finances of the City. He shall prepare and submit to the City Manager such information as shall be required by the City Manager for the preparation of an annual budget. He shall appoint his subordinates subject to the Civil Service provisions of this Charter.

(Amendment voted 06-04-1974; effective 08-13-1974.)

SECTION 40. CITY ATTORNEY.

At the municipal primary and general election in 1977, a City Attorney shall be elected by the people for a term of seven (7) years. A City Attorney shall thereafter be elected for a term of four (4) years in the manner prescribed by Section 10 of this Charter.

Notwithstanding any other provision of this Charter and commencing with elections held in 1992, no person shall serve more than two (2) consecutive four-year terms as City Attorney. If for any reason a person serves a partial term as City Attorney in excess of two (2) years, that partial term shall be considered a full term for purposes of this term limit provision. Persons holding the office of City Attorney prior to the November 1992 election shall not have prior or current terms be counted for the purpose of applying this term limit provision to future elections.

The City Attorney shall be the chief legal adviser of, and attorney for the City and all Departments and offices thereof in matters relating to their official powers and duties. The attorney and his or her deputies shall devote their full time to the duties of the office and shall not engage in private legal practice during the term for which they are employed by the City, except to carry to a conclusion any matters for which they have been retained prior to taking office.

The City Attorney shall appoint such deputies, assistants, and employees to serve him or her, as may be provided by ordinance of the Council, but all appointments of subordinates other than deputies and assistants shall be subject to the Civil Service provisions of this Charter.

It shall be the City Attorney's duty, either personally or by such assistants as he or she may designate, to perform all services incident to the legal department; to give advice in writing when so requested, to the Council, its Committees, the Manager, the Commissions, or Directors of any department, but all such advice shall be in writing with the citation of authorities in support of the conclusions expressed in said written opinions; to prosecute or defend, as the case may be, all suits or cases to which the City may be a party; to prosecute for all offenses against the ordinances of the City and for such offenses against the laws of the State as may be required of the City Attorney by law; to prepare in writing all ordinances, resolutions, contracts, bonds, or other instruments in which the City is concerned, and to endorse on each approval of the form or correctness thereof; to preserve in the City Attorney's office a docket of all cases in which the City is interested in any of the courts and keep a record of all proceedings of said cases; to preserve in the City Attorney's office copies of all written opinions he or she has furnished to the Council, Manager, Commission, or any officer. Such docket, copies and papers shall be the property of the City, and the City Attorney shall, on retiring from office, deliver the same, together with all books, accounts, vouchers, and necessary information, to his or her successor in office.

The City Attorney shall have charge and custody of all legal papers, books, and dockets belonging to the

EXHIBIT 31

THE COMMITTEE ON
RULES, FINANCE AND INTERGOVERNMENTA L RELATIONS
OF THE CITY COUNCIL OF THE CITY OF SAN DIEGO
(MAYOR DICK MURPHY, CHAIRPERSON)

Action Items for meeting of Wednesday, February 27, 2002

ITEM-1: Discussion re: Report from the Mayor's Blue Ribbon Committee on Budget and Finance.

The Committee voted 4-0 to accept the report and to direct the City Manager to prepare a response and to return to the Rules Committee on March 20, 2002. (Motion: Madaffer; Second: Atkins; Not Present: Stevens)

ITEM-2: Discussion re: San Diego's Proposed Urban Forest.

The Committee voted 4-0 to accept the Tree Advisory Board's "Community Roots" report and to refer all recommendations contained therein to the City Manager to prepare a response and to return to the Rules Committee on April 10, 2002. (Note: The Tree Advisory Board was invited to return on April 10, 2002, to present their funding recommendations.) (Motion: Wear; Second: Atkins; Not Present: Stevens)

ITEM-3: Discussion re: Proposal to amend Municipal Code Section 35.0111 to reflect an increase in the room rental charge amount exempt from Transient Occupancy Tax (TOT) from $20 per night to $25 per night.

The Committee voted 4-0 to approve the City Manager's recommendation contained in City Manager's Report 02-041. (Motion: Wear; Second: Atkins; Not Present: Stevens)

EXHIBIT 32

SAN DIEGO CITY

EMPLOYEES' RETIREMENT SYSTEM

ANNUAL ACTUARIAL VALUATION

June 30, 2001

CITY OF SAN DIEGO

Submitted to

THE RETIREMENT BOARD

San Diego City Employees' Retirement System

San Diego, California

San Diego City Employees' Retirement System

June 30, 2001 Actuarial Valuation

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February 12, 2002

Retirement Board
San Diego City Employees' Retirement System
401 "B" Street, Suite 400
San Diego, CA 92101

Dear Members of the Board:

Submitted in this report are results of the regular Annual Actuarial Valuation as of June 30, 2001 of the San Diego City Employees' Retirement System. The valuation is intended to provide a measure of the funding status of the retirement system and actuarially computed contribution rates. These rates are higher than rates specified by the Manager's Proposal, and will be superceded by Manager's Proposal Rates, as long as certain parameters are met. This valuation forms part of the basis for the employer contribution rates for the year beginning July 1, 2002.

Beginning of Year Contributions	June 30, 2000	June 30, 2001
General Members	8.62%	11.03%
Safety Members	19.83%	24.48%
Weighted City Total	12.58%	15.59%

The member statistical data on which the valuation was based was furnished by the Retirement Office, together with pertinent data on financial operations. Data was reviewed for reasonableness, but was not audited by the actuary.

Valuation results indicate that there was a large experience loss of $193.2 million. This loss represents 7.6% of actuarial accrued liabilities as of the previous valuation date of June 30, 2000. Losses were primarily due to lower investment returns and higher pay increases than projected.

The cooperation of the Retirement Office in furnishing materials requested for this valuation is deeply acknowledged with appreciation.

Respectfully submitted,

GABRIEL, ROEDER, SMITH & COMPANY

Rick A. Roeder, E.A., F.S.A., M.A.A.A.

FINANCIAL PRINCIPLES
AND
OPERATIONAL TECHNIQUES

COSD 00998

San Diego City Employees' Retirement System

Financial Principles and Operational Techniques

of the Retirement System

Promises Made, and To Be Paid For. As each year is completed, the Retirement System, in effect, hands an "IOU" to each member then acquiring a year of service credit -- the "IOU" says: "The San Diego City Employees' Retirement System owes you one year's worth of retirement benefits, payments in cash commencing when you qualify for retirement."

The related key financial questions are:

Which generation of taxpayers contributes the money to cover the IOU?

The present taxpayers, who receive the benefit of the member's present year of service?

Or the future taxpayers, who happen to be in San Diego at the time the IOU becomes a cash demand, years and decades later?

The principle of level percent of payroll financing intends that this year's taxpayers contribute the money to cover the IOUs being handed out this year. By following this principle, the employer contribution rate will remain approximately level from generation to generation -- our children and our grandchildren will contribute the same percents of active payroll we contribute now.

(There are systems which have a design for deferring contributions to future taxpayers, lured by a lower contribution rate now and putting aside the consequence that the contribution rate must then relentlessly grow much greater over decades of time.)

An inevitable by-product of the level-cost design is the accumulation of reserve assets, for decades, and income produced when the assets are invested. Invested assets are a by-product and not the objective. Investment income becomes the 3rd contributor for benefits to employees, and is interlocked with the contribution amounts required from employees and employer.

(Concluded on next page)

(Concluded)

Translated to actuarial terminology, this level-cost objective means that the contribution rates must total at least the following:

Current Cost (the cost of members' service being rendered this year)

. . . plus. . .

Interest on Unfunded Accrued Liabilities (unfunded accrued liabilities are the difference between liabilities for service already rendered, and the accrued assets of the Retirement System).

Computing Contributions To Support System Benefits. From a given schedule of benefits and from the employee data and asset data furnished, the actuary determines the contribution rates to support the benefits, by means of an actuarial valuation and a funding method.

An actuarial valuation has a number of ingredients such as: the rate of investment return which plan assets will earn; rates of withdrawal of active members who leave covered employment; rates of mortality; rates of disability; rates of pay increases; and the assumed age or ages at actual retirement.

In an actuarial valuation the actuary must assume what the above rates will be for the next year and for decades in the future. Only the subsequent actual experience of the plan can indicate the degree of accuracy of the assumptions.

Reconciling Differences Between Assumed Experience and Actual Experience. Once actual experience has occurred and been observed, it will not coincide exactly with assumed experience, regardless of the skill of the actuary and the many calculations made. Most retirement systems cope with such differences by having annual actuarial valuations. Each actuarial valuation is a complete recalculation of assumed future experience, taking into account all past differences between assumed and actual experience. The result is continuing adjustments in financial position.

COSD 01000

THE ACTUARIAL VALUATION PROCESS

The financing diagram on the opposite page shows the relationship between the two fundamentally different philosophies of paying for retirement benefits: the method where contributions match cash benefit payments (or barely exceed cash benefit payments, as in the Federal Social Security program) which is an increasing contribution method; and the level contribution method which equalizes contributions between the generations.

~ ~ ~ ~ ~ ~

The actuarial valuation is the mathematical process by which the level contribution rate is determined. The flow of activity constituting the valuation may be summarized as follows:

A. Covered people data, furnished by plan administrator, including:

Retired lives now receiving benefits

Former employees with vested benefits not yet payable

Active employees

B. + Asset data (cash & investments), furnished by plan administrator

C. + Assumptions concerning future experience in various risk areas, which are established by the Retirement Board after consulting with the actuary

D. + The funding method for employer contributions (the long-term, planned pattern for employer contributions)

E. + Mathematically combining the assumptions, the funding method, and the data

F. = Determination of:

Plan Financial Position and/or

New Employer Contribution Rate

VALUATION RESULTS
&
COMMENTS

FUNDING OBJECTIVE

The funding objective of the Retirement System is to establish and receive contributions, expressed as percents of active member payroll, which will remain approximately level from year to year and will not have to be increased for future generations of citizens.

CONTRIBUTION RATES

The Retirement System is supported by member contributions, City contributions, and investment income from Retirement System assets.

Contributions which satisfy the funding objective are determined by the annual actuarial valuation and are sufficient to:

(1) cover the actuarial present value of benefits allocated to the current year by the actuarial cost method (the normal cost); and

(2) finance over a period of future years the actuarial present value of benefits not covered by valuation assets and anticipated future normal costs (unfunded actuarial accrued liability).

Computed contributions as of June 30, 2001 apply to fiscal year beginning July 1, 2002.

San Diego City Employees' Retirement System

Computed City Contribution Rates

(Expressed as Percents of Active Payroll)

June 30, 2001

GENERAL

General Contributions Based on Valuation of	June 30, 2001 General	June 30, 2001 Legislative	June 30, 2001 Weighted Totals	June 30, 2000 General	June 30, 2000 Legislative	June 30, 2000 Weighted Totals
Normal Cost *	9.12%	21.65%	9.14%	8.92%	28.86%	8.94%
Amortization Payment *	2.25%	44.95%	2.32%	(0.02)%	25.42%	0.02%
SUBTOTAL	11.37%	66.60%	11.46%	8.90%	54.28%	8.96%
Adjusted for payment at beginning of year	10.94%	64.09%	11.03%	8.56%	52.23%	8.62%

SAFETY

Safety Contributions Based on Valuation of	June 30, 2001 Weighted Totals	June 30, 2000 Weighted Totals
Normal Cost *	17.61%	17.66%
Amortization Payment *	7.83%	2.95%
SUBTOTAL	25.44%	20.61%
Adjusted for payment at beginning of year	24.48%	19.83%

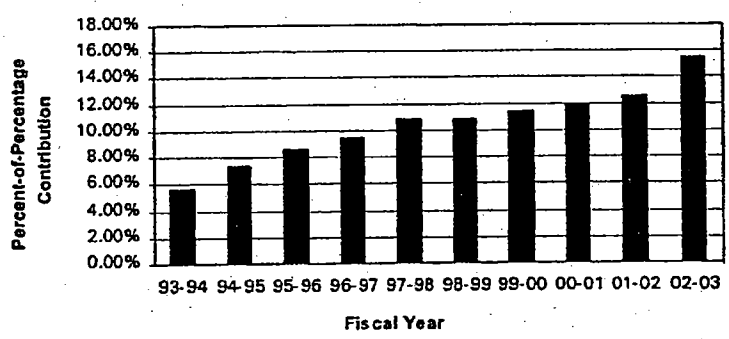
* Rates assume that contributions are made uniformly during the plan year.

ego City Employees' Retirement Sys

Computed City Contributions - Historic Comparison

Expressed as Percents of Payroll[1]

Fiscal Year	Valuation Date	General Members	Safety Members	Weighted Total	Valuation Payroll
93-94	6/30/92[2]	2.08%	11.37%	5.67%	$313,176,024
94-95	6/30/93[3]	3.15%	14.19%	7.39%	$320,623,685
95-96	6/30/94[4]	4.34%	15.42%	8.60%	$338,440,247
96-97	6/30/95	5.28%	16.42%	9.55%	$350,583,835
97-98	6/30/96	4.81%	15.20%	8.71%	$365,088,750
97-98	6/30/96[5]	7.35%	16.74%	10.87%	$365,088,750
98-99	6/30/97	7.52%	16.46%	10.86%	$382,715,084
99-00	6/30/98[4]	7.87%	17.75%	11.48%	$399,035,094
00-01	6/30/99	8.06%	19.05%	11.96%	$424,515,968
01-02	6/30/00	5.65%	13.30%	8.35%	$448,501,827
01-02[6]	6/30/00	8.62%	19.83%	12.58%	$448,501,827
02-03	6/30/01	11.03%	24.48%	15.59%	$481,863,318



[1] Rates shown are adjusted for payment at the beginning of the year and exclude negotiated "pick ups"

[2] Reflects change in benefits for certain member groups

[3] Reflects changes in member contribution rates for certain member groups, early retirement incentive program activity, and methodology with regard to member refunds and employer pickup

[4] Reflects revised actuarial and economic assumptions

[5] After Manager's Proposal

[6] Reflects non-contingent benefit increases

COSD 01005

San Diego City Employees' Retirement System

June 30, 2001

Elements of Normal Cost

(Expressed as Percents of Active Payroll)

	General	Safety	Total
Service Retirement	14.80%	23.44%	17.75%
Vested Deferred Retirement	1.43%	0.63%	1.16%
Death-in-Service	0.24%	0.49%	0.32%
Disability	2.16%	5.64%	3.34%
Contribution Refunds	0.49%	0.25%	0.41%
Total Normal Costs	19.15%	30.45%	22.98%
Employee Contributions	10.01%	12.84%	10.97%
Normal Costs	9.14%	17.61%	12.01%

(Mid-year contributions assumed for this illustration)

NOTES: In this presentation, Disability costs could be viewed as "overstated" and Service Retirement costs "understated" since ALL costs for accrued benefit service are included and encompass those eligible to service retire at date of disability grant.

In addition to City contributions, the system is also funded by employee contributions. The rate at which members contribute is expressed as a percent of pay and varies according to age of entry into the system. Please refer to Appendix A for a detailed list of these rates by member group.

Average, long-term employee contribution rates for each member group are shown below, and reflect Corbett increases.

	June 30, 2000	June 30, 2001
General Members	9.97%	10.01%
Safety Members	12.83%	12.84%

All or part of the employee rate is subject to potential "offset" ("pick up") by the employer. The rates above are shown prior to any applicable offset. Please refer to page 50 for other relevant assumptions. Assumed offset amounts by member group are shown for information purposes ONLY and will be updated effective as of December 2001.

Estimated Average Offsets

Group	Offset
General	
Represented	5.0%
Non-Represented	6.0
Legislative	6.9
Safety	
Lifeguards	6.5
Police/Fire	7.3

Such offset and related accumulated interest are not to be refunded to employees at termination. The City pick up, contributed to the System, is reduced by anticipated savings for reduced employee refunds prior to being contributed. See Comment J in this regard.

an Diego City Employees' Retire System
Unfunded Actuarial Accrued ity
June 30, 2001

(City Only)

Derivation of Experience Gain (Loss)

The actuarial gains or losses realized in the operation of the Retirement Association provide an experience test. Gains and losses are expected to cancel each other over a period of years (in the absence of double-digit inflation) and sizable year-to-year fluctuations are common. Detail on the derivation of the actuarial gain(loss) is shown below.

1)	UAAL* at beginning of year	$68,959,110
2)	Expected beginning of year accrued liability payment	(11,298,121)
3)	Interest accrual ((1) - (2)) x .08	6,420,578
4)	Increase in STAR COLA and 401(h) Reserves	4,045,944
5)	Expected UAAL at end of year (1) - (2) + (3) + (4)	90,723,753
6)	Actual UAAL at end of year	283,892,737
7)	Gain(loss): (5) - (6)	(193,168,984)
8)	Gain(loss) as percentage of actuarial accrued Liabilities at beginning of year ($2,528,773,900)	(7.6)%

* Unfunded Actuarial Accrued Liability

COSD 01008

San Diego City Employees' Retirement System

Unfunded Actuarial Accrued Liability

June 30, 2001

Unfunded Actuarial Accrued Liability

Total actuarial liabilities	$2,809,537,745
Assets allocated to funding	$2,525,645,008
Unfunded Actuarial Accrued Liability	$283,892,737

Elements of Experience Gain (Loss)

Estimated Gain(Loss) attributed to pay increases	($37,000,000)
Estimated Gain(Loss) attributed to investment experience	(95,647,385)
Estimated Gain(Loss) attributed to post-retirement mortality	1,867,000
Estimated Gain(Loss) attributed to retirement incidence	(9,000,000)
Estimated Gain(Loss) attributed to combination of vested deferred data refinements and "rehires" who were previously classified as vested deferreds	(32,162,000)
Estimated Gain(Loss) from employee turnover, pre-retirement mortality and miscellaneous factors	(21,226,599)
Total Estimated Experience Gain(Loss)	($193,168,984)

Experience Gain(Loss) - Comparative Schedule

Valuation Date	Gain (Loss)	Previous Year Accrued Liability	Gain (Loss) Percentage
6/30/92	$57,952,320	$1,006,299,729	5.8%
6/30/93	(42,605,778)	1,057,238,917	(4.0)
6/30/94	(6,744,850)	1,220,830,059	(0.6)
6/30/95	(11,370,990)	1,338,279,541	(0.8)
6/30/96	59,592,960	1,476,710,662	4.0
6/30/97	38,473,993	1,682,604,532	2.3
6/30/98	31,086,010	1,822,432,018	1.7
6/30/99*	29,750,299	1,979,668,038	1.5
6/30/00	286,639,160	2,181,547,453	13.1
6/30/01	(193,168,984)	2,528,773,900	(7.6)

* Beginning with June 30, 1999 valuation, experience schedule is City only.

San Diego City Employees' Retirement System
Actuarial Balance Sheet – June 30, 2001

($ in Millions)

PRESENT VALUE AND EXPECTED FUTURE RESOURCES

	General	Safety	Total
A. Actuarial value of system assets	1,172.6	1,353.0	2,525.6
B. Present value of expected future contributions			
1. For normal costs	338.4	211.7	550.1
2. For unfunded actuarial accrued liability	103.8	180.1	283.9
3. Totals	442.2	391.8	834.0
C. Present value of expected future member contributions	325.6	204.8	530.4
D. Total Present and Expected Future Resources	1,940.4	1,949.6	3,890.0

PRESENT VALUE OF EXPECTED FUTURE BENEFIT PAYMENTS AND RESERVE

	General	Safety	Total
A. To retirants and beneficiaries	447.6	722.5	1,170.1
B. To vested and terminated members	42.6	16.0	58.6
C. To present active members			
1. Allocated to service rendered prior to valuation date	729.0	684.2	1,413.2
2. Allocated to service likely to be rendered after valuation date	721.2	526.9	1,248.1
3. Totals	1,450.2	1,211.1	2,661.3
D. Total Present Value of Expected Future Benefit Payments	1,940.4	1,949.6	3,890.0

COSD 01010

San Diego City Employees' Retire[illegible] System

Funding Progress Indicators

June 30, 2001

There is no single all-encompassing indicator which measures a retirement system's funding progress and current funded status. A traditional measure has been the relationship of valuation assets to unfunded actuarial accrued liability -- a measure that is influenced by the choice of actuarial cost method.

We believe a better understanding of funding progress and status can be achieved using the following indicators which are independent of the actuarial cost method.

(1) The ratio of assets to the actuarial present value of credited projected benefits allocated in the proportion accrued service is to projected total service -- a plan continuation indicator. The ratio is expected to increase in the absence of benefit improvements or strengthening of actuarial assumptions.

(2) The ratio of the unfunded actuarial present value of credited projected benefits to member payroll -- a plan continuation indicator. In a soundly financed retirement system, the amount of the unfunded actuarial present value of credited projected benefits will be controlled and prevented from increasing in the absence of benefit improvements or strengthening of actuarial assumptions. However, in an inflationary environment, it is seldom practical to impose this control on dollar amounts which are depreciating in value. The ratio is a relative index of condition where inflation is present in both items. The ratio is expected to decrease in the absence of benefit improvements or strengthening of actuarial assumptions.

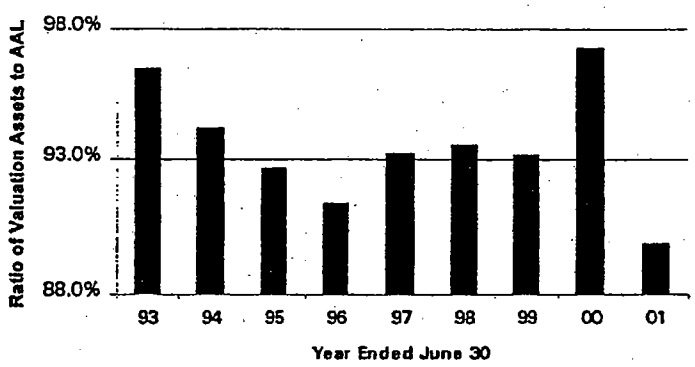
San Diego City Employees' Retire. System
Funding Process Indicators - Historic Comparison

($ in Thousands)

Valuation Date	Valuation Assets	Continuation Indicators: AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
6/30/93	$1,137,019	$1,178,311	96.5%	$41,292	$320,624	12.9%
6/30/94[1]	$1,216,063	$1,290,927	94.2%	$74,864	$338,440	22.1%
6/30/95	$1,316,903	$1,421,150	92.7%	$104,247	$350,584	29.7%
6/30/96[2]	$1,480,772	$1,620,373	91.4%	$139,602	$365,089	38.2%
6/30/97	$1,632,361	$1,748,868	93.3%	$116,507	$382,715	30.4%
6/30/98[1]	$1,852,151	$1,979,668	93.6%	$127,517	$399,035	32.0%
6/30/99	$2,033,153	$2,181,547	93.2%	$148,394	$424,516	35.0%
6/30/00	$2,459,815	$2,343,400	105.0%	($116,414)	$448,502	(26.0)%
6/30/00[3]	$2,459,815	$2,528,774	97.3%	$68,959	$448,502	15.4%
6/30/01	$2,525,645	$2,809,538	89.9%	$283,893	$481,864	58.9%

AAL - Actuarial Accrued Liability
UAAL - Unfunded Actuarial Accrued Liability

Historic Comparison of Funding Value



[1] Reflects revised actuarial and economic assumptions
[2] Reflects Manager's Proposal
[3] Reflects Corbett non-contingent benefit increases

COSD 01012

June 30, 2001

COMMENT A: The computed actuarial rate increased from 12.58% to 15.59% due to adverse actuarial experience in numerous areas. The aggregate actuarial loss was $193.2 million dollars. The funded ratio decreased from 97.3% to 89.9%.

COMMENT B: There is a sizable new contingency reserve of $105 million. We were unsure as to whether this should be counted in valuation assets. If the purpose of this reserve is to pay valued benefits, then this reserve should be counted. If not, and the primary focus of this reserve is to pay potential Corbett, contingent benefits, then this asset should be excluded. At staff request, we have included this as an asset. However, we want all parties to FULLY understand that we would not view this money as primarily available for Corbett contingencies since we do not include such contingency in our liabilities.

If this asset is not included in valuation assets, the funded ratio would have dropped all the way to 85.6%.

COMMENT C: Half the experience loss can be attributable to investment losses of $95.6 million. To give some flavor for the precipitous change in investment return, the return on the actuarial value of assets was 21.4% for the year ended June 30, 2000. The rate dropped all the way to 4.1% in 2001, well below the 8% assumption. The System was well served by the 5-year smoothing of the actuarial value of assets due to the terrific performance in the previous four years.

However, there will be larger investment losses on an actuarial basis next year unless the markets improve over the next five months. Evidence of the brewing financial storm cloud: the City's actuarial value of assets exceeds the City's apportioned share of market value (assets are commingled with Unified Port District) by $225 million dollars.

The average compensation increase of 7.7% is the highest in the past decade. While this is an excellent development for employees, an actuarial loss of $37 million dollars is attributable to higher pay increases than expected.

We would have expected that the heavy retirement incidence would have muted pay increases more since older active members often have above average pay levels. There was also a heavy retirement incidence. There were 386 retirees with an average annual allowance of $40,436. The impact was so significant that the average new retirant allowance went up by over 10%, from $35,054 to $40,436. We estimate that earlier retirement incidence than anticipated created a loss of roughly $9 million dollars.

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(continued)

COMMENT D: In the upcoming experience study, we will likely be recommending some changes in retirement assumptions to reflect earlier retirement incidence to more accurately measure liabilities. We will definitely make a strong recommendation that all Safety members be assumed to retire after 30 years of service. We initially made this recommendation three years ago and will be again doing so with even more vigor.

COMMENT E: We have NOT included any Corbett contingent liabilities in the valuation. If we had included the value of such liabilities, estimated to be in the $70-76 million range, the funded ratio would drop in the 2-2.5% range.

We offer a comment related to disposition of Surplus Undistributed Earnings. Suppose that your System earns 0% in the current fiscal year and 16% next year. Our understanding is that a contribution to Surplus Undistributed Earnings will be made for the 16% year even though there will be no net gain from investments over the two-year period. If extra benefits are conferred during the "good" years, then the median, "after the fact" investment return to finance all other benefits should theoretically be correspondingly lower. We will revisit this issue in the experience investigation.

COMMENT F: The popularity of the DROP program continues unabated. City membership rose from 412 to 547. There are also 2 UPD members in DROP. The DROP reserves soared from $38.2 million to 66.4 million. After mid-year 2002, this reserve may level off. The DROP program was instituted in mid-1997 with a five-year maximum DROP period. Thus, the 1997 DROPpers, who have not yet unDROPped, will be reaching their maximum in 2002. The annual amounts credited to the 170 new City DROP members AVERAGED $48,443, a marked increase from the $37,751 average in the 2000 valuation.

Advocates of the 1996 Manager's Proposal felt that there would be cost savings due to an anticipated reduction of the average age of the non-DROP active member work force. For funding, DROPs have been treated as retirants at the date they initiate their DROP period. This has clearly not come to pass. The average age of actives was 41.3 years as of the 1996 valuation. In this

valuation, the average [illegible] the non-DROP actives is 42.1 [illegible] This is evidence of low employee turnover in the past five years, not surprising in view of the high level of offered pension benefits.

San Diego City Employees' Retirement System
Comments & Recommendations

June 30, 2001

(continued)

COMMENT G: Pursuant to the Manager's Proposal, the City has agreed to pay the following rates (exclusive of pick up):

Fiscal Year End	City-Paid Rate
2002	9.83%
2003	10.33%
2004	10.83%
2005	11.33%
2006	11.83%
2007	12.18%
2008	13.00%

Part of the Manager's Proposal stipulates that the full actuarial rate would be paid if the funded ratio falls below 82.3%.

We note that there was no adjustment to this agreement in light of the significant 2001 Corbett benefit increases.

COMMENT H: One of the many complexities of the System is that there is a reserve for an Employee Contribution Rate Increase pursuant to the Manager's Proposal, currently $40.5 million. As such, a small part of this reserve account should be transferred into the Member Deposit Reserve each year to pay for such increase. Our calculations reflect the entire employee contribution amount and are also reflected in the member rates included in the back of the report. As such, we add the following amounts to the rates on data provided us, based on our understanding as to negotiations, pursuant to the Manager's Proposal and Corbett:

Manager's Proposal	Corbett	Total

General	+0.45%	+0.16	+0.61%
Police	+0.51%	+0.16%	+0.67%
Lifeguard	+0.55%	+0.16%	+0.71%
Fire	+0.47%	+0.16%	+0.63%
Legislative	-0-	+0.16%	+0.16%

San Diego City Employees' Retirement System
Comments & Recommendations

June 30, 2001

(continued)

Also, for both the 2000 and 2001 valuations, we have added the July 1, 2001 Corbett increase in employee rate that will not be funded from this reserve since these amounts are not reflected on the data tape. These amounts are:

General	+0.49%
Police	+0.53%
Fire	+0.53%
Lifeguards	+1.23%
Legislative	+0.49%

COMMENT I: As in recent years, we continue to work with Retirement Staff to help resolve certain data issues. We understand that staff resources have been diverted to some extent to the long, always maddening process of system conversion. We are recommending that we receive service credit data for service purchases. Currently, valued liabilities for active members are understated to the extent that they have purchased service. There also needs to be ongoing refinement to data received for current vested deferreds, including identification of reciprocal members. One of the reasons that the vested deferred liability and number count went up significantly (from 1,016 to 1,438) relates to data issues. We have also raised the issue of the appropriateness of 2% COLA payments on supplemental COLA payments.

COMMENT J: Our understanding is that the City is phasing in, over a four-year period, a reduction in the discounts applied to offsets for anticipated saved refunds. Over the four years, the discount will be reduced from 22% to 5% for General members and 7% to 1% for Safety members.

COMMENT K: The Legislative contribution rates have soared from 39.10% to 64.09% in the past two valuations. This is attributable to a benefit increase and a doubling of the retiree group.

COMMENT L: We have been requested to complete an Entry Age Normal valuation annually. In the Manager's Proposal, it was contemplated that City rate increases would eventually be enough to

support an Entry Age [illegible] This prospect seems more [illegible]ly in view of subsequent benefit increases. This year's Entry Age rate is 17.75%.

<u>COMMENT M</u>: Overall, the financial condition of the retirement system continues to be in sound condition in accordance with actuarial principles of level-cost financing. However, we want all parties to be acutely aware that the current practice of paying less than the computed rate of contribution or pickup will help foster an environment of additional declines in the funding ratios in absence of healthy investment returns.

SUMMARY OF BENEFIT PROVISIONS

AND

VALUATION DATA SUBMITTED BY RETIREMENT SYSTEM

an Diego City Employees' Retir System
Brief Summary of Benefit Provisions Evaluated
June 30, 2001

Section references refer to Article 4 of the Municipal Code, unless otherwise noted

1. Membership Requirements
   Salaried Employees - immediate eligibility upon employment (compulsory). (§24.0105)

2. Monthly Salary Base for Benefits
   Highest one-year average. (§24.0103), subject to a 10% increase, if the General or Safety Member elects such increase in lieu of an increased benefit formula. (Such change is effective as of July 1, 2000 and is being valued in the 2000 valuation). For Legislative Members, there shall be an increase of 10% in this average, effective as of July 1, 2000.

3. Service Requirement
   A. Eligibility
      1) General Members - Age 62 with 10 years of service, or age 55 with 20 years of service. (§141 of City Charter)
      2) Safety Members - Age 55 with 10 years of service, or age 50 with 20 years of service. (§141 of City Charter)
      3) Legislative Members - Age 55 with 4 years of service. Reduced retirement with 8 years of service regardless of age. (§24.0545)

   B. Benefit Formula Per Year of Service
      1) General and Safety Members
         Member choice of formula in place of June 30, 2000 or "Corbett" formula effective as of July 1, 2000. (§24.0402). See Appendix B.

      2) Legislative Members – 3.5% (§24.0546). A 2% annual reduction factor applies to benefits for Legislative members retiring prior to age 55.

   C. Maximum Benefit

      1) Safety Members,
         90% of Final Average Compensation (subject to 10% increase).

      2) General and Legislative Members - None

   D. Unmodified Form of Payment - Monthly payments continued for the life of the member, with 50% continuance to the eligible spouse upon member's death. (§24.0521)

Note: City employees withdrew from Social Security January 1, 1982 (§24.0104). We are assuming that all future benefits for active members will be determined on a non-integrated basis.

Note: Effective July 1, 1991, credited service earned under the 1981 Pension System will be considered equivalent to CERS service for the purpose of benefit calculation (i.e., the above formulas will apply to 1981 Pension System service).

(Continued on Next Page)

(Continued)

4. Non-industrial Disability
   A. Eligibility - Ten years of service. (§24.0501)

   B. Benefit Formula Per Year of Service
      1) General Members - Greater of 1.5% per year of service, one-third of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §34.0505.1)
      2) Safety Members - Greater of 1.8% per year of service, one-third of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §24.0503.1)

5. Industrial Disability
   A. Eligibility - No age or service requirement. (§24.0501)

   B. Benefit
      1) General Members - Greater of one-half of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §24.0504.1)
      2) Safety Members - Greater of one-half of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §24.0503)
      3) Legislative members - Earned service retirement benefit (§24.0547)

6. Non-industrial Death Before Eligible to Retire
   Refund of employee contributions with interest plus one month's salary for each completed year of service to a maximum of six month's salary. (§24.0703)

7. Non-industrial Death After Eligible to Retire for Service
   50% of earned benefit payable to surviving eligible spouse. (§24.0704.2)

(Continued on Next Page)

(Continued)

8. Industrial Death - 50% of the final average compensation preceding death payable to eligible spouse. (§24.0710.2, §24.0706)

9. Death After Retirement
   50% of member's unmodified allowance continued to eligible spouse. (§24.0521)
   $2,000 payable in lump sum to the beneficiary or the estate of the retiree.

10. Withdrawal Benefits (§24.0206, §24.0306)
    A. Pre-12/8/76 Hires - If contributions left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.
    B. Post-12/7/76 Hires
       1) Less than ten years of service - Refund of accumulated employee contributions with interest, or may keep deposits in the System and earn additional interest.
       2) Ten or more years of service - If contributions left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.

11. Post-retirement Cost-of-Living Benefits
    A. General Members and Safety - Based on changes in Consumer Price Index, to a maximum of 2% per year. (§24.0531)

12. Computed Contribution Rate
    Determined by the Projected Unit Credit Funding Method with a 30-year amortization (§24.0801) of Unfunded Actuarial Accrued Liability beginning on July 1, 1991.

(Concluded on Next Page)

(Concluded)

13. Member Contributions - Vary by age at time of entrance into the system. (§24.0201, §24.0301). While a significant portion of these contributions are "picked up", such pickups are not directly reflected in either the employee contributions or related refund calculations.

14. Internal Revenue Code Compliance

Benefits provided by the Plan are subject to the limitations set forth in Section 415 in accordance with the "grandfather" election in Section 415(b)(10) of the Internal Revenue Code.

NOTE: The summary of major plan provisions is designed to outline principal plan benefits. If the City should find the plan summary not in accordance with the actual provisions, the City should alert the actuary IMMEDIATELY so all parties can be sure the proper provisions are valued.

San Diego City Employees' Retirement System

Summary of Reported Asset Information

Submitted for the June 30, 2001 Valuation

Market Value of Reported Assets	
Cash/Short-term	$234,194,670
Domestic Stocks	1,093,158,064
International Stocks	353,605,176
Bonds	803,756,585
Mortgages	1,617,777
Real Estate	267,515,151
Receivables	41,695,256
Miscellaneous	11,903,939
Total Market Value	$2,807,446,618

Reserves	
Member Deposit Reserve	$316,365,007
DROP Reserve	66,373,564
Employer Reserve	439,122,663
Retired Members Reserve	1,139,754,674
General Reserve	109,160,143
Undistributed Reserve	106,795,160
Encumbrance Reserve	2,689,362
Supplemental Benefit Reserve	3,713,427
Receivables Reserve	3,386,133
Fixed Assets Reserve	264,578
Retiree Health Insurance Reserve	12,771,253
401(h) Reserve	13,984,279
Supplemental COLA Reserve	31,530,240
City Changes Reserve	82,498,325
UPD Changes Reserve	4,272,283
Employee Cont. Rate Inc.	40,490,052
NPO Reserve	30,983,989
Corbett Contingency Reserve	105,848,108
Payables	205,633,450
Total Reserves	$2,715,636,690
Unrealized Appreciation	91,809,928
Total Market Value	$2,807,446,618

(Continued on Next Page)

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San Diego City Employees' Retirement System

Summary of Reported Asset Information

Submitted for the June 30, 2001 Valuation

(Continued)

Revenues and Disbursements in Fund Balances

Total Reserves - Beginning of year	$2,729,171,102
Revenues	
Employees' contributions	$35,413,089
Employees' DROP contributions	947,881
Employer contributions	44,598,473
Employer DROP contributions	954,894
Offset contributions	25,566,207
DROP Monthly Pension Allowances	24,183,501
DROP Supplemental Benefit	2,217,733
Income - Investment	164,114,160
Income - Other	371,123
To Liability Reserve	(140,884,461)
Total Revenues to Liability Reserve	$157,482,600
Disbursements	
Monthly Retirement Allowances	$85,627,070
Monthly Retirement Allowances - DROP	24,182,501
Monthly Ret. Allowances - Supp. COLA	4,161,525
Health Insurance Payments	7,207,618
Supplemental Benefit Payments	3,540,643
Corbett Benefit Payments	23,630,603
DROP Payments to Members	4,274,698
DROP Payments to Beneficiaries	49,662
Death Benefits	524,990
Refunds of Member contributions	1,462,746
Administrative Expenses	16,326,250
Depreciation Expense	28,706
Total Disbursements	$171,017,012
Total Reserves - End of Year	$2,715,636,690
Net Unrealized Appreciation	91,809,928
Total Market Value	$2,807,446,618

Valuation assets are developed on the following page.

San Diego City Employees' Retirement System

Development of Actuarial Value of Assets

Year Ending June 30, 2001

The actuarial valuation of the System as of June 30, 2001 was based on the unaudited Statement of Assets and Liabilities and additional reconciliations provided by the Retirement Office.

The total book value of applicable assets for the valuation of the System as of June 30, 2001 was determined as follows:

1) Total book value of assets	$2,715,636,690
2) Less reserves and liabilities excluded from valuation	
a. Liabilities (other than PPE Conversion Liability)	205,366,282
b. Reserve for supplemental payments	3,713,427
c. Reserve for Retiree Health Insurance	12,771,253
d. Reserve for Post Retirement Health Care	13,984,279
e. Reserve for DROP contributions	66,373,564
f. Reserve for Employee Contribution Rate Increase	40,490,052
g. Reserve for Supplemental COLA	31,530,240
h. Total Excludables: Sum of a. through g.	374,229,097
Net applicable assets as of June 30, 2000: 1)-2)h.	$2,341,407,593

The net applicable assets (book value) along with the corresponding market value was used to determine an actuarial value of assets, as shown on the following page.

(Concluded on Next Page)

San Diego City Employees' Retirement System

Development of Actuarial Value of Assets

Year Ending June 30, 2001

(Concluded)

	(a) Net Market Value	(b) Net Book Value	(a) / (b)
1. Market Value as a percentage of book value of assets:			
a. June 30, 2001	$2,433,217,521	$2,341,407,593	103.92%
b. June 30, 2000	2,514,858,618	2,245,019,575	112.02%
c. June 30, 1999	2,196,756,520	1,868,267,506	117.58%
d. June 30, 1998	2,069,293,140	1,744,483,835	118.62%
e. June 30, 1997	1,843,396,647	1,559,233,474	118.22%
2. Average percentage for most recent 5-year period			114.07%
3. Current net book value of assets			$2,341,407,593
4. Preliminary actuarial value of assets: (2) * (3)			2,670,922,806
5. Actuarial value of assets: item 4, adjusted to be within 20% of market value			2,670,922,806

Valuation assets, for purposes of cost development, were allocated among groups in accordance with their relative proportions of applicable reserves reported at book value.

Member Group	Book Value of Reserves	Valuation Assets Used
General	$862,499,180	$1,170,137,975
Legislative	1,871,593	2,539,158
Safety	997,261,612	1,352,967,875
Unified Port District	107,083,083	145,277,798
Total	$1,968,715,468	$2,670,922,806

San Diego City Employees' Retirement System

Retirants and Beneficiaries June 30, 2001

General Members

Allowances Being Paid as of July 1, 2001

Type of Allowance	Annual No.	Annual Allowances
Service Retirement		
Life Annuity Only	461	$8,505,341
Cash Refund Annuity	74	1,198,150
Joint & 100% Survivor	91	2,641,338
Joint & 50% Survivor		
Automatic	1,298	24,744,518
Elected	6	127,799
Option 4[1]	2	88,291
Social Security Option	22	363,519
Total Service Retirement	1,954	$37,668,956
Disability Retirement		
Life Annuity Only	151	1,624,277
Cash Refund Annuity	4	40,172
Joint & 100% Survivor		
Automatic	0	0
Elected	12	159,163
Joint & 50% Survivor		
Automatic	265	3,078,214
Elected	1	8,579
Option 4[1]	2	28,937
Social Security Option	1	3,647
Total Disability Retirement	436	$4,942,989
Death Before Retirement	8	83,260
Death After Retirement		
Service Retirement	426	2,439,206
Disability Retirement	113	643,537
Total Death After Retirement	539	$3,082,743
Total Allowances Being Paid	2,937	$45,777,948

[1] §24.0607 of the San Diego Municipal Code allows, upon approval of the Board, other benefits that are the actuarial equivalent of the retirement allowance.

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San Diego City Employees' Retirement System

Retirants and Beneficiaries June 30, 2001

Safety Members

Allowances Being Paid as of July 1, 2001

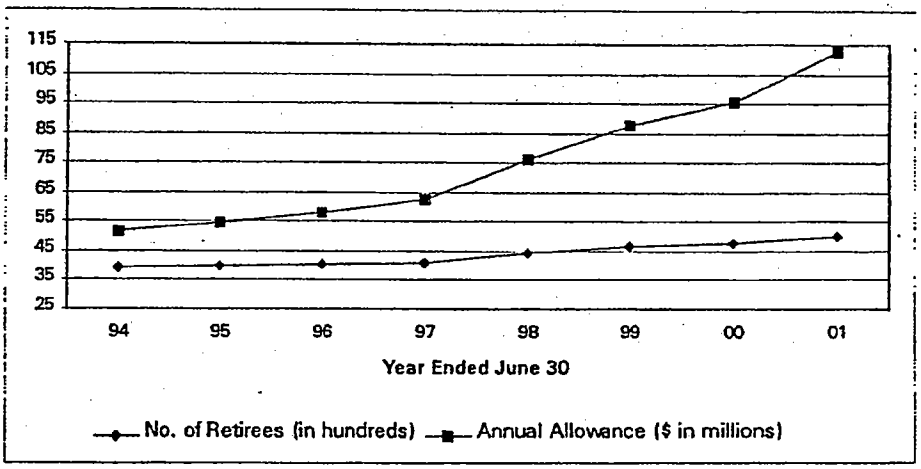
Type of Allowance	Annual No.	Annual Allowances
Service Retirement		
Life Annuity Only	131	$4,956,650
Cash Refund Annuity	25	1,069,467
Joint & 100% Survivor	82	4,071,228
Joint & 50% Survivor		
Automatic	740	33,375,939
Elected	4	247,456
Option 4[1]	9	380,148
Social Security Option	0	0
Total Service Retirement	991	$44,100,888
Disability Retirement		
Life Annuity Only	158	3,183,595
Cash Refund Annuity	4	155,925
Joint & 100% Survivor		
Automatic	37	267,872
Elected	20	766,860
Joint & 50% Survivor		
Automatic	579	15,275,482
Elected	1	32,508
Option 4[1]	3	111,809
Social Security Option	0	0
Total Disability Retirement	802	$19,794,051
Death Before Retirement	32	460,281
Death After Retirement		
Service Retirement	148	1,523,073
Disability Retirement	102	1,030,224
Total Death After Retirement	250	$2,553,297
Total Allowances Being Paid	2,075	$66,908,517

[1] §24.0607 of the San Diego Municipal Code allows, upon approval of the Board, other benefits that are the actuarial equivalent of the retirement allowance.

San Diego City Employees' Retirement System
Retirants and Beneficiaries - Comparative Statement

Valuation Date	No.	Annual Allowances	Average Allowance	Percent Increase	Present Value of Allowances	Percent Increase
6/30/94 [1]	3,920	$51,503,636	$13,139	3.4%	$565,913,075	5.2%
6/30/95	3,966	$54,404,975	$13,718	4.4%	$605,776,749	7.0%
6/30/96	4,052	$58,224,674	$14,369	4.7%	$647,228,431	6.8%
6/30/97	4,123	$62,672,105	$15,201	5.8%	$699,534,837	8.1%
6/30/98 [1,2]	4,419	$76,507,181	$17,313	13.9%	$885,585,652	26.6%
6/30/99 [2]	4,657	$87,823,437	$18,858	8.9%	$1,026,394,505	15.9%
6/30/00	4,789	$95,348,751	$19,910	5.6%	$1,114,872,745	8.6%
6/30/00	4,789	$95,348,751	$19,910	5.6%	$1,170,074,966 [3]	14.0%
6/30/01	5,012	$112,686,465	$22,483	12.9%	$1,337,799,454	14.3%

[1] Reflects revised actuarial assumptions
[2] Reflects increased activity due to DROP program
[3] Reflects non-contingent Corbett benefit increase and estimated value of retroactive payments and increased DROP payments



COSD 01029

San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 2001
Tabulated by Attained Ages and Year of Retirement

General Members

	Age Groups								
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	Totals
Before 1982	0	24	21	26	38	112	457	94	772
1982	0	3	1	2	6	27	42	0	81
1983	1	2	2	1	8	26	48	1	89
1984	2	4	2	3	7	34	47	0	99
1985	2	3	0	8	17	41	25	0	96
1986	1	3	1	5	18	30	23	0	81
1987	1	3	2	3	32	25	24	0	90
1988	1	3	4	10	27	40	8	0	93
1989	2	2	2	16	30	46	5	0	103
1990	0	6	3	14	39	32	6	0	100
1991	5	2	3	22	48	13	0	0	93
1992	4	4	3	22	26	19	4	0	82
1993	9	6	14	41	56	24	2	1	153
1994	9	10	14	9	19	3	1	0	65
1995	13	7	12	32	23	1	2	0	90
1996	9	10	21	24	13	3	1	0	81
1997	11	16	32	29	15	1	1	0	105
1998	13	27	47	34	7	2	0	0	130
1999	11	49	53	36	7	3	1	0	160
2000	14	69	44	24	6	1	0	0	158
2001	11	97	72	30	5	1	0	0	216
TOTALS	119	350	353	391	447	484	697	96	2,937

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement: 58.1
Attained Age: 70.8
Annual Pension: $15,580

COSD 01030

San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 2001
Tabulated by Attained Ages and Year of Retirement

Safety Members

	Age Groups								
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	Totals
Before 1982	9	107	50	46	86	120	220	44	682
1982	1	4	7	1	11	5	1	0	30
1983	2	8	1	9	15	8	2	0	45
1984	0	4	3	10	15	3	1	0	36
1985	4	8	6	4	12	1	0	0	35
1986	2	7	8	10	14	2	0	0	43
1987	3	7	2	10	7	5	0	0	34
1988	3	4	11	11	3	1	0	0	33
1989	4	14	19	15	3	1	1	0	57
1990	9	11	14	15	1	0	0	0	50
1991	11	9	9	20	2	0	0	0	51
1992	9	11	15	8	0	0	0	0	43
1993	14	25	70	43	2	1	0	0	155
1994	17	14	8	1	0	0	0	0	40
1995	13	19	12	1	0	0	0	0	45
1996	16	23	9	5	0	0	0	0	53
1997	16	45	42	3	2	0	0	0	108
1998	11	68	14	0	0	0	0	0	93
1999	23	115	21	2	0	0	0	0	161
2000	13	129	11	0	0	0	0	1	154
2001	13	105	8	0	0	0	0	1	127
TOTALS	193	737	340	214	173	147	225	46	2,075

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement: 48.9
Attained Age: 62.8
Annual Pension: $32,231

COSD 01031

Diego City Employees' Retirement S[illegible]n
Retirants and Beneficiaries June 30, 2001
Tabulated by Attained Ages and Year of Retirement

Total Members

	Age Groups								
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	Totals
Before 1982	9	131	71	72	124	232	677	138	1,454
1982	1	7	8	3	17	32	43	0	111
1983	3	10	3	10	23	34	50	1	134
1984	2	8	5	13	22	37	48	0	135
1985	6	11	6	12	29	42	25	0	131
1986	3	10	9	15	32	32	23	0	124
1987	4	10	4	13	39	30	24	0	124
1988	4	7	15	21	30	41	8	0	126
1989	6	16	21	31	33	47	6	0	160
1990	9	17	17	29	40	32	6	0	150
1991	16	11	12	42	50	13	0	0	144
1992	13	15	18	30	26	19	4	0	125
1993	23	31	84	84	58	25	2	1	308
1994	26	24	22	10	19	3	1	0	105
1995	26	26	24	33	23	1	2	0	135
1996	25	33	30	29	13	3	1	0	134
1997	27	61	74	32	17	1	1	0	213
1998	24	95	61	34	7	2	0	0	223
1999	34	164	74	38	7	3	1	0	321
2000	27	198	55	24	6	1	0	1	312
2001	24	202	80	30	5	1	0	1	343
TOTALS	312	1,087	693	605	620	631	922	142	5,012

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement: 54.2
Attained Age: 67.5
Annual Pension: $22,474

COSD 01032

San Diego City Employ Retirement System
Active Members June 30, 2001
By Attained Ages and Years of Service

GENERAL MEMBERS

Age Group	Years of Accrued Service 0-1	1-2	2-3	3-4	4-5	5-9	10-14	15-19	20-24	25-29	30-34	35 & Up	Totals
15-19 NO	1	0	0	0	0	0	0	0	0	0	0	0	1
TOT PAY	13,198	0	0	0	0	0	0	0	0	0	0	0	13,198
AVG PAY	13,198	0	0	0	0	0	0	0	0	0	0	0	13,198
20-24 NO	77	25	13	5	1	1	0	0	0	0	0	0	122
TOT PAY	2,115,390	774,394	359,981	136,644	25,085	35,776	0	0	0	0	0	0	3,447,271
AVG PAY	27,473	30,976	27,691	27,329	25,085	35,776	0	0	0	0	0	0	28,256
25-29 NO.	131	87	70	57	19	56	1	0	0	0	0	0	421
TOT PAY	4,132,054	2,998,069	2,764,324	2,336,025	749,228	2,054,404	51,147	0	0	0	0	0	15,085,251
AVG PAY	31,542	34,461	39,490	40,983	39,433	36,686	51,147	0	0	0	0	0	35,832
30-34 NO.	132	113	107	64	63	262	101	0	0	0	0	0	842
TOT PAY	4,779,969	4,276,203	4,248,034	2,747,559	2,708,553	10,929,071	4,026,092	0	0	0	0	0	33,715,481
AVG PAY	36,212	37,843	39,701	42,931	42,993	41,714	39,862	0	0	0	0	0	40,042
35-39 NO	112	107	57	61	53	343	415	73	3	0	0	0	1,224
TOT PAY	3,872,539	3,958,381	2,322,299	2,662,828	2,430,956	15,211,577	19,724,285	3,193,093	131,186	0	0	0	53,507,143
AVG PAY	34,576	36,994	40,742	43,653	45,867	44,349	47,528	43,741	43,729	0	0	0	43,715
40-44 NO.	96	71	53	64	45	291	497	208	48	1	0	0	1,374
TOT PAY	3,288,120	2,808,068	2,044,230	2,560,881	1,875,667	12,651,650	24,150,447	9,715,925	2,342,984	49,217	0	0	61,487,189
AVG PAY	34,251	39,550	38,570	40,014	41,681	43,476	48,592	46,711	48,812	49,217	0	0	44,751
45-49 NO	76	55	48	30	34	245	390	238	139	67	3	0	1,325
TOT PAY	2,673,457	2,130,202	2,109,101	1,133,698	1,502,238	10,791,292	18,280,741	11,790,172	7,359,783	3,433,034	167,149	0	61,370,867
AVG PAY	35,177	38,731	43,940	37,790	44,183	44,046	46,874	49,539	52,948	51,239	55,716	0	46,318
50-54 NO	45	40	27	20	20	157	284	179	152	136	48	0	1,108
TOT PAY	1,559,211	1,578,868	1,071,826	783,051	806,661	6,890,001	13,220,550	8,950,594	7,789,086	7,772,904	2,375,601	0	52,798,354
AVG PAY	34,649	39,472	39,697	39,153	40,333	43,885	46,551	50,003	51,244	57,154	49,492	0	47,652
55-59 NO.	19	23	14	13	11	87	155	63	44	54	37	5	525
TOT PAY	643,032	1,068,949	574,419	599,980	510,058	4,002,269	7,396,840	3,285,905	2,310,984	3,435,763	2,148,800	270,125	26,247,124
AVG PAY	33,844	46,476	41,030	46,152	46,369	46,003	47,722	52,157	52,522	63,625	58,076	54,025	49,995
60-64 NO	3	5	6	5	5	28	66	32	16	8	6	2	182
TOT PAY	252,616	152,246	166,598	195,414	155,958	1,115,053	2,840,619	1,469,865	786,892	448,255	385,072	89,149	8,057,736
AVG PAY	84,205	30,449	27,766	39,083	31,192	39,823	43,040	45,933	49,181	56,032	64,179	44,574	44,273
65-99 NO	0	2	3	2	0	20	13	8	2	4	2	3	59
TOT PAY	0	81,640	121,566	63,242	0	771,258	562,603	231,202	69,285	167,752	79,186	185,006	2,332,739
AVG PAY	0	40,820	40,522	31,621	0	38,563	43,277	28,900	34,642	41,938	39,593	61,669	39,538
TOT NO.	692	528	398	321	251	1,490	1,922	801	404	270	96	10	7,183
TOT AMT	23,329,586	19,827,020	15,782,378	13,219,323	10,764,406	64,452,349	90,253,322	38,636,757	20,790,199	15,306,924	5,155,808	544,280	318,062,353
AVG AMT	33,713	37,551	39,654	41,182	42,886	43,257	46,958	48,236	51,461	56,692	53,706	54,428	44,280

COSD 01033

San Diego City Emp. .es' Retirement System
Active Members June 30, 2001
By Attained Ages and Years of Service

SAFETY MEMBERS (Excludes DROP members)

Age Group	Years of Accrued Service												Totals
	0-1	1-2	2-3	3-4	4-5	5-9	10-14	15-19	20-24	25-29	30-34	35 & Up	
20 24 NO.	23	10	3	1	0	0	0	0	0	0	0	0	37
TOT PAY	820,358	393,713	156,930	51,557	0	0	0	0	0	0	0	0	1,422,558
AVG PAY	35,668	39,371	52,310	51,557	0	0	0	0	0	0	0	0	38,448
25 29 NO.	53	55	36	21	22	19	0	0	0	0	0	0	206
TOT PAY	1,927,447	2,292,934	1,828,322	1,145,550	1,252,796	1,121,492	0	0	0	0	0	0	9,568,541
AVG PAY	36,367	41,690	50,787	54,550	56,945	59,026	0	0	0	0	0	0	46,449
30 34 NO.	37	41	45	51	45	175	57	0	0	0	0	0	451
TOT PAY	1,383,885	1,732,875	2,230,374	2,874,165	2,645,870	10,488,460	3,524,079	0	0	0	0	0	24,879,708
AVG PAY	37,402	42,265	49,564	56,356	58,797	59,934	61,826	0	0	0	0	0	55,166
35 39 NO.	14	10	18	27	27	131	360	75	1	0	0	0	663
TOT PAY	519,769	421,437	941,391	1,539,339	1,514,810	7,849,556	22,243,254	4,842,425	63,819	0	0	0	39,935,800
AVG PAY	37,126	42,144	52,300	57,013	56,104	59,920	61,787	64,566	63,819	0	0	0	60,235
40 44 NO.	7	11	6	9	6	55	217	222	77	0	0	0	610
TOT PAY	265,656	434,674	310,552	510,700	344,479	3,323,568	13,503,208	14,682,755	5,358,404	0	0	0	38,733,997
AVG PAY	37,951	39,516	51,759	56,744	57,413	60,429	62,227	66,139	69,590	0	0	0	63,498
45 49 NO.	6	2	1	6	3	19	58	140	214	23	1	0	473
TOT PAY	230,560	86,615	55,411	337,216	170,281	1,122,909	3,539,311	9,045,054	14,713,914	1,638,514	74,098	0	31,013,883
AVG PAY	38,427	43,308	55,411	56,203	56,760	59,100	61,023	64,608	68,757	71,240	74,098	0	65,568
50 54 NO.	2	0	0	2	0	3	19	45	73	70	4	0	218
TOT PAY	60,000	0	0	118,918	0	179,856	1,166,081	3,033,351	5,033,549	5,047,981	281,218	0	14,920,954
AVG PAY	30,000	0	0	59,459	0	59,952	61,373	67,408	68,953	72,114	70,305	0	68,445
55 59 NO.	0	0	0	0	0	2	6	12	15	11	1	0	47
TOT PAY	0	0	0	0	0	121,129	363,782	768,572	1,005,692	779,128	76,507	0	3,114,810
AVG PAY	0	0	0	0	0	60,564	60,630	64,048	67,046	70,830	76,507	0	66,273
60 64 NO.	0	0	0	0	0	1	1	1	0	0	0	0	3
TOT PAY	0	0	0	0	0	60,183	61,410	59,122	0	0	0	0	180,715
AVG PAY	0	0	0	0	0	60,183	61,410	59,122	0	0	0	0	60,238
65 99 NO.	0	0	0	0	0	0	0	0	1	0	0	0	1
TOT PAY	0	0	0	0	0	0	0	0	30,000	0	0	0	30,000
AVG PAY	0	0	0	0	0	0	0	0	30,000	0	0	0	30,000
TOT NO.	142	129	109	117	103	405	718	495	381	104	6	0	2,709
TOT AMT	5,207,675	5,362,248	5,522,980	6,577,445	5,928,237	24,267,152	44,401,125	32,431,280	26,205,377	7,465,623	431,823	0	163,800,966
AVG AMT	36,674	41,568	50,670	56,217	57,556	59,919	61,840	65,518	68,781	71,785	71,970	0	60,465

COSD 01034

San Diego City Empl s' Retirement System
Active Memb. June 30, 2001
By Attained Ages and Years of Service

TOTAL MEMBERS (Excludes DROP members)

Age Group	Years of Accrued Service												
	0-1	1-2	2-3	3-4	4-5	5-9	10-14	15-19	20-24	25-29	30-34	35 & Up	Totals
15-19 NO.	1	0	0	0	0	0	0	0	0	0	0	0	1
TOT PAY	13,198	0	0	0	0	0	0	0	0	0	0	0	13,198
AVG PAY	13,198	0	0	0	0	0	0	0	0	0	0	0	13,198
20-24 NO.	100	35	16	6	1	1	0	0	0	0	0	0	159
TOT PAY	2,935,749	1,168,107	516,911	188,200	25,085	35,776	0	0	0	0	0	0	4,869,828
AVG PAY	29,357	33,374	32,307	31,367	25,085	35,776	0	0	0	0	0	0	30,628
25-29 NO.	184	142	106	78	41	75	1	0	0	0	0	0	62[illegible]
TOT PAY	6,059,501	5,291,003	4,592,646	3,481,574	2,002,025	3,175,896	51,147	0	0	0	0	0	24,653,792
AVG PAY	32,932	37,261	43,327	44,636	48,830	42,345	51,147	0	0	0	0	0	39,320
30-34 NO.	169	154	152	115	108	437	158	0	0	0	0	0	1,293
TOT PAY	6,163,853	6,009,079	6,478,408	5,621,724	5,354,424	21,417,531	7,550,171	0	0	0	0	0	58,595,189
AVG PAY	36,473	39,020	42,621	48,885	49,578	49,010	47,786	0	0	0	0	0	45,317
35-39 NO.	126	117	75	88	80	474	775	148	4	0	0	0	1,887
TOT PAY	4,392,308	4,379,818	3,263,691	4,202,168	3,945,766	23,061,133	41,967,538	8,035,518	195,004	0	0	0	93,442,944
AVG PAY	34,860	37,434	43,516	47,752	49,322	48,652	54,152	54,294	48,751	0	0	0	49,519
40-44 NO.	103	82	59	73	51	346	714	430	125	1	0	0	1,984
TOT PAY	3,553,776	3,242,742	2,354,783	3,071,582	2,220,146	15,975,217	37,653,655	24,398,681	7,701,388	49,217	0	0	100,221,186
AVG PAY	34,503	39,546	39,912	42,076	43,532	46,171	52,736	56,741	61,611	49,217	0	0	50,515
45-49 NO.	82	57	49	36	37	264	448	378	353	90	4	0	1,798
TOT PAY	2,904,017	2,216,817	2,164,512	1,470,914	1,672,520	11,914,200	21,820,053	20,835,226	22,073,696	5,071,548	241,247	0	92,384,750
AVG PAY	35,415	38,892	44,174	40,859	45,203	45,130	48,705	55,120	62,532	56,351	60,312	0	51,382
50-54 NO.	47	40	27	22	20	160	303	224	225	206	52	0	1,326
TOT PAY	1,619,211	1,578,868	1,071,826	901,969	806,661	7,069,857	14,386,631	11,983,945	12,822,635	12,820,885	2,656,819	0	67,719,307
AVG PAY	34,451	39,472	39,697	40,999	40,333	44,187	47,481	53,500	56,989	62,237	51,093	0	51,070
55-59 NO.	19	23	14	13	11	89	161	75	59	65	38	5	572
TOT PAY	643,032	1,058,949	574,419	599,980	510,058	4,123,397	7,760,622	4,054,477	3,316,676	4,214,891	2,225,307	270,125	29,361,935
AVG PAY	33,844	46,476	41,030	46,152	46,369	46,330	48,203	54,060	56,215	64,844	58,561	54,025	51,332
60-64 NO.	3	5	6	5	5	29	67	33	16	8	6	2	185
TOT PAY	252,616	152,246	166,598	195,414	155,958	1,175,235	2,902,028	1,528,987	786,892	448,255	385,072	89,149	8,238,450
AVG PAY	84,205	30,449	27,766	39,083	31,192	40,525	43,314	46,333	49,181	56,032	64,179	44,574	44,532
65-99 NO.	0	2	3	2	0	20	13	8	3	4	2	3	60
TOT PAY	0	81,640	121,566	63,242	0	771,258	562,603	231,202	99,285	167,752	79,186	185,006	2,362,739
AVG PAY	0	40,820	40,522	31,621	0	38,563	43,277	28,900	33,095	41,938	39,593	61,669	39,379
TOT NO.	834	657	507	438	354	1,895	2,640	1,296	785	374	102	10	9,892
TOT AMT	28,537,261	25,189,269	21,305,359	19,796,768	16,692,643	88,719,501	134,654,448	71,068,037	46,995,576	22,772,547	5,587,631	544,280	481,863,318
AVG AMT	34,217	38,340	42,022	45,198	47,154	46,818	51,005	54,836	59,867	60,889	54,781	54,428	48,712

COSD 01035

n Diego City Employees' Retirem ystem
Summary of Active Members
in the June 30, 2001 Actuarial Valuation

	No.	Annual Salary	Averages Annual Salary	Age	Service
GENERAL MEMBERS					
General					
6/30/01	7,175	$317,556,435	$44,259	43.0	10.1
6/30/00	7,148	289,281,380	40,470	43.0	10.0
Percent Increase	0.4%	9.8%	9.4%		
Legislative					
6/30/01	8	505,918	63,240	45.3	5.3
6/30/00	8	466,338	58,292	55.6	7.3
Percent Increase	0.0%	8.5%	8.5%		
Total					
6/30/01	7,183	$318,062,353	$44,280	43.0	10.1
6/30/00	7,156	289,747,718	40,490	43.1	10.0
Percent Increase	0.4%	9.8%	9.4%		

COSD 01036

San Diego City Employees' Retirement System
Summary of Active Members
in the June 30, 2001 Actuarial Valuation

(continued)

	No.	Annual Salary	Averages Annual Salary	Age	Service
SAFETY MEMBERS					
Police					
6/30/01	1,882	$114,353,080	$60,761	39.1	12.0
6/30/00	1,930	112,527,472	58,304	39.1	11.8
Percent Increase	-2.5%	1.6%	4.2%		
Fire					
6/30/01	747	45,265,809	60,597	41.3	13.6
6/30/00	749	42,437,444	56,659	42.1	14.2
Percent Increase	-0.3%	6.7%	6.9%		
Lifeguard					
6/30/01	80	4,182,077	52,276	36.7	7.9
6/30/00	78	3,789,193	48,579	37.0	8.1
Percent Increase	2.6%	10.4%	7.6%		
Total					
6/30/01	2,709	163,800,966	60,465	39.6	12.3
6/30/00	2,757	158,754,109	57,582	39.8	12.3
Percent Increase	-1.7%	3.2%	5.0%		
Grand Total					
6/30/01	9,892	$481,863,319	$48,712	42.1	10.7
6/30/00	9,913	448,501,827	45,244	42.2	10.7
Percent Increase	-0.2%	7.4%	7.7%		

San Diego City Employees' Retirement System
Summary of Inactive Members
in the June 30, 2001 Actuarial Valuation

	Inactive Members	Member Contribution Balance	Averages Contribution Balance	Age	Service	Age at Termination
General Members						
6/30/01	1,271 [1]	$18,443,339	$14,511	43.2	6.6	38.6
6/30/00	893	14,745,635	16,512	44.2	7.4	39.6
Percent Increase	42.3%	25.1%	-12.1%			
Safety Members						
6/30/01	167 [1]	5,058,289	30,289	40.8	8.0	35.5
6/30/00	123	3,875,192	31,506	45.2	8.6	39.2
Percent Increase	35.8%	30.5%	-3.9%			
Grand Total						
6/30/01	1,438	$23,501,628	$16,343	42.9	6.8	38.2
6/30/00	1,016	18,620,827	18,328	44.3	7.5	39.6
Percent Increase	41.5%	26.2%	-10.8%			

[1] 947 General and 101 Safety Inactives have less than 10 years of service. These members' liabilities are valued as the balance of their employee contributions with interest.

COSD 01038

San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
in the June 30, 2001 Actuarial Valuation
(City Only)

The following include DROP Retirements

				Averages			New Retirees		
	No.	Annual Allowance	Annual Allowance	Attained Age	Age at[1] Retirement	Service at[1] Retirement	No.	Age	Allowance
General Members									
6/30/01	2,937	$45,757,397	$15,580	70.8	58.1	21.1	232	58.6	$29,943
6/30/00	2,849	39,540,787	13,879	71.5	58.3	20.9	152	58.6	25,259
Percent Increase	3.1%	15.7%	12.3%						
Safety Members									
6/30/01	2,075	66,880,161	32,231	62.8	48.9	21.3	154	52.5	56,261
6/30/00	1,940	55,807,964	28,767	63.0	48.6	21.0	99	52.8	50,094
Percent Increase	7.0%	19.8%	12.0%						
Grand Total 6/30/01	5,012	$112,637,558	$22,474	67.5	54.2	21.2	386	56.1	$40,443
Grand Total 6/30/00	4,789	95,348,751	19,910	68.1	54.4	20.9	251	56.3	35,054
Percent Increase	4.7%	18.1%	12.9%						

[1] Retirees only; beneficiaries excluded

COSD 01039

San Diego City Employees' Retirement System
Summary of DROP Members
in the June 30, 2001 Actuarial Valuation

			DROP Averages				New DROPS	
	No.	Annual Allowance	Annual Allowance	Attained Age	Age at[1] Retirement	Service at[1] Retirement	No.	Annual Allowance
DROP General								
6/30/01	198	$6,474,794	$32,701	60.7	59.1	27.7	82	$33,529
6/30/00	155[2]	4,551,932	29,367	60.2	58.9	28.4	69	26,238
Percent Increase	27.7%	42.2%	11.4%					
DROP Police								
6/30/01	189	10,869,509	57,511	55.2	53.3	26.0	51	61,261
6/30/00	124	6,118,858	49,346	55.3	53.7	26.4	28	52,536
Percent Increase	52.4%	77.6%	16.5%					
DROP Fire								
6/30/01	160	9,850,661	61,567	55.8	53.7	28.2	37	63,831
6/30/00	133	7,143,428	53,710	55.7	53.8	28.4	26	53,338
Percent Increase	20.3%	37.9%	14.6%					
DROP Grand Total								
6/30/01	547	$27,194,964	$49,717	57.3	55.5	27.3	170	$48,443
6/30/00	412	17,814,217	43,238	57.3	55.7	27.8	123	37,953
Percent Increase	32.8%	52.7%	15.0%					

[1] Retirees only; beneficiaries excluded
[2] Includes one legislative member

COSD 01040

ACTUARIAL COST METHODS, ACTUARIAL ASSUMPTIONS

AND

DEFINITIONS OF TECHNICAL TERMS

COSD 01041

Normal cost and the allocation of benefit values between service rendered before and after the valuation date were determined using the Projected Unit Credit actuarial cost method.

Financing of Unfunded Actuarial Accrued Liability. The balance of unfunded actuarial accrued liabilities was amortized by level (principal & interest combined) percent of payroll contributions over the 30-year period beginning July 1, 1991 (20 years remaining).

Active member payroll in aggregate was assumed to increase 4.25% a year for the purpose of determining the level percent contributions, although individual annual compensation increase rates will increase by at least 4.75% per year for the purpose of projecting individual benefits.

Deferred Member Actuarial Accrued Liability. Typically, data provided includes date of hire, date of birth, date of termination, and last pay. Based on the data reported, service credit, highest average salary, and deferred retirement age were estimated. The estimates were used to compute the retirement benefit, upon which the liabilities are based. For those members without sufficient data, accumulated member contribution balances, with interest, were used as the actuarial accrued liability.

The contribution requirements and benefit values of the Fund are calculated by applying actuarial assumptions to the benefit provisions and member information furnished, using the actuarial cost methods described on the previous page.

The principal areas of financial risk which require assumptions about future experiences are:

(i) long-term rates of investment return to be generated by the assets of the Fund.
(ii) patterns of pay increases to members.
(iii) rates of mortality among members, retirants, and beneficiaries.
(iv) rates of withdrawal of active members (without entitlement to a retirement benefit).
(v) rates of disability among members.
(vi) the age patterns of actual retirements.

In making a valuation, the monetary effect of each assumption is calculated for as long as a present covered person survives -- a period of time which can be as long as a century.

~ ~ ~ ~ ~ ~

Actual experience of the system will not coincide exactly with assumed experience, regardless of the choice of the assumptions, the skill of the actuary and the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments to the computed contribution rate. From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends (but not random year-to-year fluctuations).

COSD 01043

(Continued on Next Page)

San Diego City Employees' Retirement System

Actuarial Assumptions Used for the June 30, 2001 Valuation

The investment return rate used for the actuarial valuation calculations was 8.0% a year, net of administrative expenses, compounded annually. This assumption is used to equate the value of payments due at different points in time. The rate is comprised of two elements:

Inflation	4.25%
Real Rate of Return	3.75%
Total	8.00%

Administrative expenses have averaged 0.2% over the last three valuations. Since the 8.0% assumed rate of return is currently net of administrative expenses, the comparable gross rate would be 8.2%. Currently, no administrative expenses are explicitly recognized in the valuation.

The Inflation rate used for the actuarial valuation calculations was 4.25% per year compounded annually. It represents the difference between the investment return rate and the assumed real rate of return.

Inflation actually experienced, as measured by the Consumer Price Index for urban wage earners, has been as follows:

Consumer Price Index
Urban Wage Earner and Clerical Workers Before 1978
All Urban Consumers After 1977
10 Year Moving Averages

June 30, 1961	1.4%
June 30, 1971	3.1
June 30, 1981	8.4
June 30, 1991	4.1
June 30, 2001	2.7
50-Year Average	**3.9%**

Interest credited to member contributions is 8.0%, compounded annually.

Salary increase rates used to project current pays to those upon which a benefit will be based are represented by the following table. Rates do not vary by age, but do reflect an added merit component, starting with the 1998 valuation, for those with 0-4 years of service at the valuation date.

Inflation	4.25%
Merit and Longevity	0.50%
Total	4.75%

COSD 01044

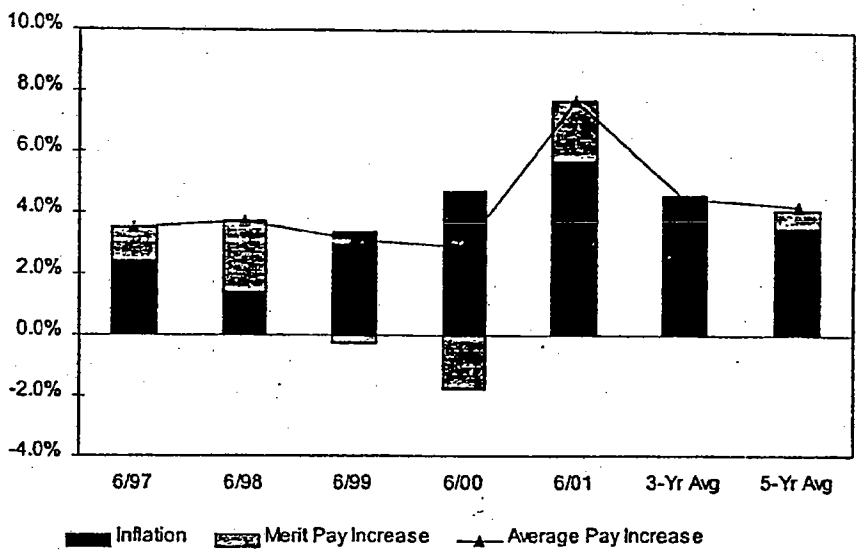
(Continued)

The additional merit component is:

Years of Service at Valuation Date	General	Safety
0	4.5%	6.5%
1	3.5%	5.5%
2	2.5%	4.5%
3	1.5%	3.0%
4	0.5%	1.5%

The assumed, annual cost-of-living adjustment is generally 2% per annum, compounded. There is a closed group of 159 special safety officers whom we assume an annual adjustment equal to inflation (4.25% per year).

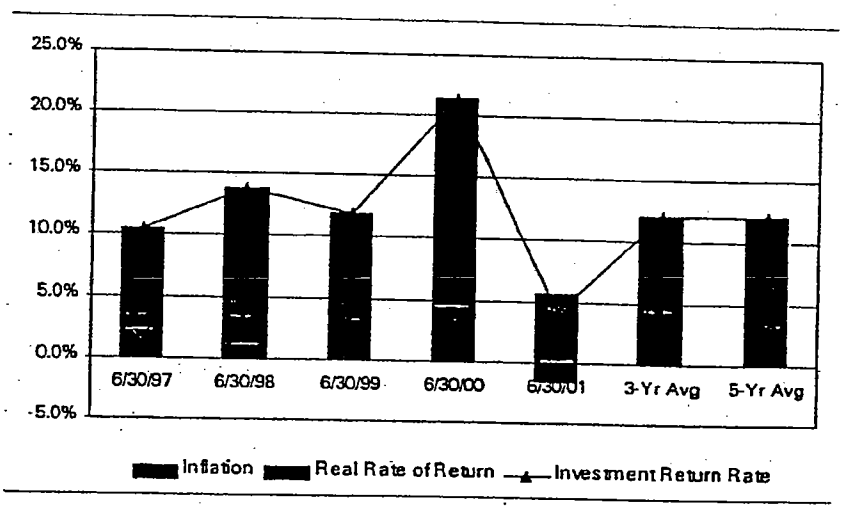
Salary Increase Analysis



Valuation Date	No.	Total Payroll	Percent Increase	Average Salary	Percent Increase
6/30/92	8,991	$312,490,764	9.2%	$34,756	3.9%
6/30/93	8,615	$320,623,685	2.6%	$37,217	7.1%
6/30/94	8,893	$338,440,247	5.6%	$38,057	2.2%
6/30/95	9,060	$350,583,835	3.6%	$38,696	1.7%
6/30/96	9,198	$365,088,750	4.1%	$39,692	2.6%
6/30/97	9,312	$382,715,084	4.8%	$41,099	3.5%
6/30/98	9,359	$399,035,094	4.3%	$42,637	3.7%
6/30/99	9,654	$424,515,969	6.4%	$43,973	3.1%
6/30/00	9,913	$448,501,827	5.7%	$45,244	2.9%
6/30/01	9,892	$481,863,319	7.4%	$48,712	7.7%

COSD 01046

n Diego City Employees' Retirem ystem
Actu Assumptions Used for the June 3 001 Valuation



COSD 01047

Diego City Employees' Retiremer ociation

Comparis f Selected Actuarial Assumptions Actual Experience

(Continued)

The salary increase assumptions project annual increases in total member payroll of 4.25%, the inflation portion of the individual pay increase assumptions. In effect, this assumes no change in the number of active members. Changes actually experienced in areas related to these assumptions have been as follows:

	Year Ended					3-year	5-year
	6/30/01	6/30/00	6/30/99	6/30/98	6/30/97	Average	Average
Inflation[1]	5.7%	4.7%	3.4%	1.4%	2.4%	4.6%	3.5%
Assumed						4.25[2]	4.25[2]
Average Pay Increase	7.7	2.9	3.1	3.7	3.5	4.5	4.2
Assumed						4.25[2]	4.25[2]
Merit & Longevity Increase	2.0	(1.8)	(0.3)	2.3	1.1	0.0	0.6
Assumed						0.5	0.5
Total Payroll	7.4	5.7	6.4	4.3	4.8	6.5	5.7
Assumed						4.25[2]	4.25[2]
Investment Return Rate[4]	4.1	21.4	11.8	13.8	10.5	12.2	12.2
Assumed						8.0	8.0
Real Rate of Investment Return	(1.6)	16.7	8.4	12.4	8.1	7.6	8.6
Assumed						3.75[3]	3.75[3]
Administrative Expenses[5] (Percentage of assets)	0.2	0.2	0.1	0.2	0.3	0.2	0.2
Assumed						0.0	0.0

1 Based on Consumer Price Index for San Diego, All Items, 1982-84 = 100.

2 Reduced from 4.5% for 1998 valuation.

3 Increased from 3.5% for 1998 valuation.

4 Based on actuarial value of assets NOT market value or book value.

5 Excluding Investment Fees.

COSD 01048

(Continued)

Rates of separation from active membership are shown below (rates do not include separation on account of retirement or death). This assumption measures the probabilities of members remaining in employment.

		% of Active Members Separating Within Next Year						
		Disability[1]		Other				
				General				
Sample Ages	Years of Service	General	Safety	Male	Female	Safety	Years of Service	Sample Ages
All	0			4.3%	7.3%	4.4%	0	All
	1			4.3	7.2	4.4	1	
	2			4.3	7.0	4.3	2	
	3			4.3	6.9	4.1	3	
	4			4.2	6.3	4.0	4	
20	5 & Over	0.6%	.54%	4.0	5.6	3.2	5 & Over	20
25		0.8	.60	4.0	5.6	3.2		25
30		.10	.65	3.7	4.2	2.2		30
35		.16	.71	3.2	2.6	1.4		35
40		.22	.90	2.1	2.0	0.6		40
45		.33	1.15	1.7	1.6	0.3		45
50		.50	1.25	1.3	1.3	0.1		50
55		.75	1.50	0.9	1.0	0.0		55

[1] 70% (40% used in previous valuation) of the General Disabilities and 100% of the Safety Disabilities are assumed to be Industrial. Non-industrial disability is subject to service requirement.

[2] 20% of terminating employees, with 10+ years of service at termination, are assumed to subsequently work for a reciprocal employer.

(Continued on Next Page)

(Continued)

The post-retirement mortality table used was the 1994 Uninsured Pension Mortality Table, set back 2 years for retirees and set forward 5 years for disability retirees. This assumption is used to measure the probabilities of members dying after retirement and the probabilities of each benefit payment being made after retirement. Related values are shown below.

	Future Life Expectancy (Years)		
	Retirants		
Sample Ages	Men	Women	Disabilitants
45	36.07	40.44	30.01
50	31.37	35.64	25.49
55	26.78	30.90	21.20
60	22.38	26.27	17.26
65	18.28	21.86	13.77
70	14.61	17.80	10.66
75	11.35	14.03	7.97
80	8.48	10.61	5.86

The active member mortality assumption measures the probability of mortality before retirement. The rates include probability of ordinary death, service death, and death while eligible for retirement or disability.

	Members Dying Within the Next Year					
	Active Members				Service Retirants & Beneficiaries	
	General					
Sample Ages	Men	Women	Safety	Sample Ages	Men	Women
30	.07%	.03%	.07%	45	0.15%	0.09%
35	.09	.04	.09	50	0.23	0.13
40	.09	.05	.09	55	0.39	0.21
45	.12	.08	.12	60	0.68	0.36
50	.17	.10	.17	65	1.23	0.72
55	.28	.15	.28	70	2.14	1.26

All active member deaths are assumed to be duty-related for Safety members and not duty-related for other members.

(Continued on Next Page)

(Continued)

The rates of retirement used to measure the probability of eligible active members retiring during the next year.

Retirement Ages	Percent of Members Retiring Within the Next Year			
	Safety Members	General Members	Legislative Members Men	Legislative Members Women
50	10%	--%	--%	--%
51	10	--	--	--
52	10	--	--	--
53	10	--	15	15
54	20	--	1	1
55	40	20	5	6
56	40	10	3	3
57	40	10	4	4
58	50	15	5	4
59	80	15	6	5
60	85	20	60	60
61	90	25	25	25
62	100	50	39	29
63	100	40	23	25
64	100	25	34	35
65	100	50	70	60
66	100	40	70	65
67	100	40	75	70
68	100	40	80	80
69	100	40	90	90
70	100	100	100	100

For vested deferred members, we assume that retirement will occur on the later of attained age or:

General members: Earlier of age 62 or age 55 and 20+ years of service

Legislative members: Earlier of age 55 or age 53 and 8+ years of service

Safety members: Earlier of age 55 or age 50 and 20+ years of service

(Concluded)

Member refunds. All or part of the employee contribution rate is subject to potential "pick up" by the employer. Such pick up and related accumulated interest are not to be refunded to employees at termination. The City's liability for potential refunds is reduced to reflect this.

Rates provided in the census apply to salary amounts over $400 per month in the case of employees with integrated benefits. Rates applicable to the first $400 per month of salary are not provided. Due to the small portion of salary to which a different rate is applied and the substantial portion of total member contributions subject to employer pick up, rates provided were assumed, for simplicity, to apply to total salary.

Survivor Benefits. Marital status and spouses' census data were imputed with respect to active and deferred members.

Marital Status:	80% of men and 50% of women were assumed married at retirement.
Spouse Census:	Women were assumed to be 4 years younger than men.

Member Contributions for Spousal Continuance. Municipal Code §24.0521 dictates that all active members contribute towards a 50% survivor continuance. However, it also provides that members unmarried at retirement may either be refunded that specific part of their contributions, or they may leave such contributions on account and receive an incremental benefit that is the actuarial equivalent of such contributions.

Actuarial Accrued Liability. The difference between the actuarial present value of system benefits and the actuarial value of future normal costs. Also referred to as "accrued liability" or "actuarial liability".

Actuarial Assumptions. Estimates of future experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Actuarial assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.

Accrued Service. Service credited under the system which was rendered before the date of the actuarial valuation.

Actuarial Equivalent. A single amount or series of amounts of equal actuarial value to another single amount or series of amounts, computed on the basis of appropriate actuarial assumptions.

Actuarial Cost Method. A mathematical budgeting procedure for allocating the dollar amount of the actuarial present value of retirement system benefits between future normal cost and actuarial accrued liability. Sometimes referred to as the "actuarial funding method".

Actuarial Gain (Loss). The difference between actual experience and actuarial assumption anticipated experience during the period between two actuarial valuation dates.

Actuarial Present Value. The amount of funds currently required to provide a payment or series of payments in the future. It is determined by discounting future payments at predetermined rates of interest, and by probabilities of payment.

Amortization. Paying off an interest-discounted amount with periodic payments of interest and principal – as opposed to paying off with lump sum payment.

COSD 01053

Normal Cost. The actuarial present value of retirement system benefits allocated to the current year by the actuarial cost method.

Pension Benefit Obligation. A standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date.

Unfunded Actuarial Accrued Liability. The difference between actuarial accrued liability and valuation assets. Sometimes referred to as "unfunded actuarial liability" or "unfunded accrued liability".

Most retirement systems have unfunded actuarial accrued liability. They arise each time new benefits are added and each time an actuarial loss is realized.

The existence of unfunded actuarial accrued liability is not in itself bad, any more than a mortgage on a house is bad. Unfunded actuarial accrued liability does not represent a debt that is payable today. What is important is the ability to amortize the unfunded actuarial accrued liability and the trend in its amount (after due allowance for devaluation of the dollar). Unfunded actuarial accrued liability must be controlled.

COSD 01054

APPENDIX A:

MEMBER CONTRIBUTION RATES

San Diego City Employees' Retir[illegible]t System
June 30, 2001 Actuarial Va[illegible]tion
General Member Contribution Rates

Entry Age	Normal Plus Cost-Of-Living Rates	Entry Age	Normal Plus Cost-Of-Living Rates
16	8.61%	37	10.65%
17	8.61	38	10.78
18	8.61	39	10.91
19	8.61	40	11.05
20	8.61	41	11.19
21	8.71	42	11.32
22	8.82	43	11.46
23	8.93	44	11.61
24	9.03	45	11.75
25	9.16	46	11.89
26	9.28	47	12.04
27	9.39	48	12.19
28	9.51	49	12.34
29	9.63	50	12.48
30	9.75	51	12.65
31	9.88	52	12.80
32	10.00	53	12.96
33	10.12	54	13.12
34	10.24	55	13.28
35	10.38	56	13.44
36	10.51	57	13.64

Interest: 8.00%
Salary: 5.00%
Mortality: 83 GAM male (X-2, X-8)

Rates include cost of providing spouse's continuance and cost of funding final one-year average salary in lieu of final three-year average. Changes to the salary scale and mortality table effective with the June 30, 1994 valuation were applied to the then existing member rates.

Members of the legislature contribute 9.05% of total salary, regardless of entry age.

The rates above include 0.61% for General and 0.16% for Legislature currently paid from the Employee Contribution Rate Increase Reserve (See Comment H).

COSD 01056

San Diego City Employees' Retire System

June 30, 2001 Actuarial Valuation

Safety Member Contribution Rates

Entry Age	Normal Plus Cost-of-Living Rates		
	Police	Fire	Lifeguard
20	11.88%	11.53%	11.26%
21	12.04	11.69	11.42
22	12.18	11.83	11.56
23	12.34	11.99	11.72
24	12.49	12.14	11.87
25	12.66	12.31	12.04
26	12.81	12.46	12.19
27	12.98	12.63	12.36
28	13.14	12.79	12.52
29	13.31	12.96	12.69
30	13.47	13.12	12.85
31	13.64	13.29	13.02
32	13.80	13.45	13.18
33	13.97	13.62	13.35
34	14.15	13.80	13.53
35	14.33	13.98	13.71
36	14.50	14.15	13.88
37	14.68	14.33	14.06
38	14.87	14.52	14.25
39	15.05	14.70	14.43
40	15.24	14.89	14.62
41	15.43	15.08	14.81
42	15.61	15.26	14.99
43	15.81	15.46	15.19
44	16.01	15.66	15.39
45	16.19	15.84	15.57
46	16.42	16.05	15.78
47	16.60	16.25	15.98
48	16.79	16.44	16.17
49	16.99	16.64	16.37

Interest: 8.00%
Salary: 5.00%
Mortality: 83 GAM male (X-2, X-8)

Rates include cost of providing spouse's continuance and cost of funding final one-year average salary in lieu of final three-year average. Changes to the salary scale and mortality table effective with the June 30, 1994 valuation were applied to the then existing member rates.

The rates above include 0.67% for Police, 0.63% for Fire, and 0.71% for Lifeguard currently paid from the Employee Contribution Rate Increase Reserve (See Comment H).

APPENDIX B:

RETIREMENT AGE FACTORS

EXHIBIT 33

THE COMMITTEE ON
RULES, FINANCE AND INTERGOVERNMENTA L RELATIONS
OF THE CITY COUNCIL OF THE CITY OF SAN DIEGO
(MAYOR DICK MURPHY, CHAIRPERSON)

Action Items for meeting of Wednesday, February 27, 2002

ITEM-1: Discussion re: Report from the Mayor's Blue Ribbon Committee on Budget and Finance.

The Committee voted 4-0 to accept the report and to direct the City Manager to prepare a response and to return to the Rules Committee on March 20, 2002. (Motion: Madaffer; Second: Atkins; Not Present: Stevens)

ITEM-2: Discussion re: San Diego's Proposed Urban Forest.

The Committee voted 4-0 to accept the Tree Advisory Board's "Community Roots" report and to refer all recommendations contained therein to the City Manager to prepare a response and to return to the Rules Committee on April 10, 2002. (Note: The Tree Advisory Board was invited to return on April 10, 2002, to present their funding recommendations.) (Motion: Wear; Second: Atkins; Not Present: Stevens)

ITEM-3: Discussion re: Proposal to amend Municipal Code Section 35.0111 to reflect an increase in the room rental charge amount exempt from Transient Occupancy Tax (TOT) from $20 per night to $25 per night.

The Committee voted 4-0 to approve the City Manager's recommendation contained in City Manager's Report 02-041. (Motion: Wear; Second: Atkins; Not Present: Stevens)

THE COMMITTEE ON
RULES, FINANCE AND INTERGOVERNMENTA L RELATIONS
OF THE CITY COUNCIL OF THE CITY OF SAN DIEGO
(MAYOR DICK MURPHY, CHAIRPERSON)

Action Items for meeting of Wednesday, March 20, 2002

ITEM-1: **Discussion re: City Manager's Response to the recommendations made by the Mayor's Blue Ribbon Committee on Budget and Finance.**

The Committee voted 4-0 to accept the City Manager's Report (#02-061) and adopt the items in the Mayor's March 20, 2002, memo with the following two changes to the Mayor's memo:

a) Line 5, add "Would include a discussion of limiting City employee growth to the rate of population growth except when we add a new program."

b) Line 6, add "Would include a discussion of the 2/3 vote requirement to make a mid-year budget modification."

(Motion: Wear; Second: Atkins; Not Present: Madaffer)

ITEM-2: **Discussion re: City Manager's Energy Conservation and Management Status Report No. 10 (including but not limited to a discussion of the U.S. Green Building Council's Leadership in Energy and Environmental Design Standard).**

The Committee voted 4-0 to adopt the City Manager's recommendation s contained in City Manager Report #02-060. (Motion: Atkins; Second: Wear; Not Present: Madaffer)

ITEM-3: **Discussion re: Airport Authority Legislation.**

The Committee voted 4-0 to: a) Oppose the provision in SB 1896 which requires the date of the ballot initiative to be November 2004; and b) continue the item to the Rules Committee meeting of April 24, 2002. (Motion: Wear; Second: Atkins; Not Present: Madaffer)

Herring/DVW

Aud. Cert. 2200854.

FILE LOCATION: MEET

COUNCIL ACTION: (Tape location: A338-469.)

CONSENT MOTION BY STEVENS TO ADOPT. Second by Madaffer. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-150: Recommendations Made by the Mayor's Blue Ribbon Committee on Budget and Finance.

(See City Manager Report CMR-02-061 and Mayor Murphy's 3/20/2002 memo.)

TODAY'S ACTION IS:

Adoption of the following resolution:

(R-2002-1385 Cor. Copy) ADOPTED AS RESOLUTION R-296354

Accepting the Blue Ribbon Committee Report on City of San Diego Finances, dated February 2002;

Accepting City Manager's Report CMR-02-061, dated March 18, 2002;

Adopting the schedule in the Mayor's April 4, 2002 memo.

RULES, FINANCE AND INTERGOVERNMENTAL RELATIONS COMMITTEE'S RECOMMENDATION:

On 3/20/2002, RULES voted 4-0 to accept City Manager's Report CMR-02-061 and adopt the items in the Mayor's March 20, 2002 memo with the following two changes to the Mayor's memo: a) Line 5, add "Would include a discussion of limiting City employee growth to the rate of population growth except when we add a program.", b) Line 6, add "Would include a discussion of the 2/3 vote requirement to make a mid-year budget modification."

(Councilmembers Wear, Atkins, Stevens and Mayor Murphy voted yea. Councilmember Madaffer not present.)

FILE LOCATION: MEET

COUNCIL ACTION: (Tape location: B145-E056.)

MOTION BY FRYE TO ADOPT THE RESOLUTION, ACCEPTING THE BLUE RIBBON COMMITTEE'S REPORT EXCEPT FOR SECTION V, WITH DIRECTIONS TO THE CITY MANAGER THAT SECTION V CONCERNING STORM WATER BE RETURNED TO THE RULES COMMITTEE FOR DISCUSSION, RATHER THAN ADOPTING IT AS PART OF THE REPORT. AND TO PROVIDE A REPORT OF A LARGER ANALYSIS FOR EACH OF THE FOUR SECTIONS, CITING SPECIFICALLY THE LANGUAGE ON PAGES 33 AND 34. IN ADDITION, ADOPT ALL OF THE RULES COMMITTEE'S RECOMMENDATIONS AS SET FORTH IN THE MAYOR'S MEMO. AS TO RECOMMENDATION 1, ADOPT THE RULES COMMITTEE'S ACTION TO APPROVE THE FIRST SENTENCE ONLY. FOR RECOMMENDATIONS 2 AND 3, REFER THESE TO THE RETIREMENT BOARD BY JUNE 30, 2002. ADOPT RECOMMENDATION 7 WITH THE CITY MANAGER'S PROPOSAL TO GO TO THE RULES COMMITTEE BY SEPTEMBER 30, 2002, TO INCLUDE A DISCUSSION OF THE RIGHT-OF-WAY FEES. CONCERNING RECOMMENDATION 8, THE CITY MANAGER'S PROPOSAL SHOULD GO TO THE RULES COMMITTEE BY OCTOBER 31, 2002, TO INCLUDE THE DISCUSSION OF LIMITING CITY EMPLOYEE GROWTH TO THE RATE OF POPULATION GROWTH EXCEPT WHEN PROGRAMS ARE ADDED AND AFTER A BASE IS DETERMINED. THE PHRASE "AND AFTER A BASE IS DETERMINED" SHOULD BE ADDED ON LINE 5 AFTER THE PHRASE "WHICH WOULD INCLUDE A DISCUSSION OF LIMITING THE CITY EMPLOYEE GROWTH TO THE RATE OF POPULATION GROWTH EXCEPT WHEN WE HAD A PROGRAM." AS TO RECOMMENDATION 9, REQUEST THAT THE CITY MANAGER'S PROPOSAL GO TO THE RULES COMMITTEE BY NOVEMBER 30, 2002, WHICH SHOULD INCLUDE A DISCUSSION OF A TWO-THIRDS VOTE THAT WOULD BE REQUIRED TO PROVIDE A MID-YEAR BUDGET MODIFICATION.

ACCEPT COUNCIL MEMBER WEAR'S RECOMMENDATION THAT AN EXAMINATION OF THE ISSUE OF CHARGING FEES AND COLLECTING A FAIR SHARE FROM CITIZENS OF OTHER CITIES FOR CITY SERVICES BE SPECIFICALLY ADDED TO THE RULES COMMITTEE ACTION IN SECTION VII UNDER REVENUES. THIS SHOULD INCLUDE A DISCUSSION OF HOW NEW

GROWTH MAY OR MAY NOT BE SUBSIDIZED BY THE EXISTING USERS, PARTICULARLY AS IT RELATES TO WASTE WATER AND WATER SUPPLY.

ACCEPT COUNCIL MEMBER PETERS' RECOMMENDATION THAT THE ISSUE OF REFINANCING THE CITY'S DEBT BE EXAMINED WITH A VIEW TO POTENTIAL SAVINGS IN DEBT SERVICE. IN ADDITION, THERE SHOULD BE AN EXAMINATION OF TOBACCO FUNDS WITH A VIEW TO RECEIVING UP-FRONT PAYMENT. Second by Peters. Passed by the following vote: Peters-yea, Wear-yea, Atkins-yea, Stevens-yea, Maienschein-yea, Frye-yea, Madaffer-yea, Inzunza-yea, Mayor Murphy-yea.

ITEM-250: Settlement of Property Damage Claim of CFD Mesa Ridge Partners Claim.

(R-2002-1228)

Adopted as Resolution R-296254.

A Resolution approved by the City Council in Closed Session on Tuesday, April 2, 2002, by the following vote: Peters-not present; Wear-yea; Atkins-yea; Stevens-not present; Maienschein-yea; Frye-yea; Madaffer-yea; Inzunza-yea; Mayor-yea.

Authorizing the City Manager to pay the total sum of $95,989.04 in the settlement of each and every claim against the City, its agents and employees, resulting from property damage to CFD Mesa Ridge Partners on June 28, 2001;

Authorizing the City Auditor and Comptroller to issue one check for the balance of $46,692.04 made payable to Luth & Turley, Inc. in full settlement of all claims.

Aud. Cert. 2200917.

NOTE: This item is placed on a Council docket, so that the official and public record will reflect the adoption of this Resolution. It does not require any further Council action.

EXHIBIT 34

Office of
The City Attorney
City of San Diego

MEMORANDUM

DATE: January 13, 2005

TO: Michael J. Aguirre, City Attorney

FROM: Dan Andrews, City Attorney Investigator

SUBJECT: Rules Committee Meetings on 2-27-02 and 3-20-02

CONFIDENTIAL ATTORNEY WORK PRODUCT

On 1-13-05 a review was conducted of the tape recordings of the Rules Committee Meetings on February 27, 2002, and March 20, 2002. Only the portions of the tapes pertaining to the Retirement System were reviewed. The following is a summary from the discussions:

February 27, 2002

This meeting was attended by all of the Blue Ribbon Committee Members, Mayor Dick Murphy, several City Council Persons, Ed Ryan, and others.

Blue Ribbon Committee Member Dick Vortman presented the section of the Blue Ribbon Committee Report pertaining to the retirement benefits and unfunded pension liabilities. They concluded that the City was not paying, from its current year budget, the full benefit cost incurred by its current year workforce. He noted that this was a concern. He stated that the non-discretionary pension expense as a budget item has been steadily growing and would continue to grow. He provided information on pension expense expressed as a percentage of the City's payroll base. This has also been steadily increasing. The budget line itself has grown at 9% compounded rate. Currently this is $68 million. He noted that this was very troublesome, as it was increasing by ½% per year.

He provided two recommendations: To change the City's funding strategy, and to fully fund the pension fund and increased benefits; and, to make sure all on the City Council fully understand the cost of retirement benefits, and that the present value of retiree health benefits be obtained.

Ed Ryan provided that annual liability shortfall was $6 million to $8 million per year. He noted that the system was intentionally "back-loading the funding. Ryan urged the Council to try and fix this.

Byron Ware commented that it sounded, "Like our own little version of a Social Security scandal." Ryan noted that the City intentionally under-funded the system with a "non-standard" method of funding that the SDCERS Board and actuary accepted. Ware stated, "It looks like someone is going to pick up the tab later." Ryan agreed, noting that expectations did not meet with the plan (presumably high investment returns).

Mayor Murphy noted that this issue merited its own lengthy discussion. He stated that they previously let the SDCERS Board handle the issue while they (the Council) put their "heads in the sand."

Vortman stated that even with the record stock market boom, the City is in arrears and this is of "grave concern." Most pension plans are flush.

Jim Madaffer stated that he was extremely troubled by this report. He stated, "We are in deep trouble here as a City…as we are not meeting the definition of fiscal health provided by the Blue Ribbon Committee."

Mayor Murphy stated that he expected the City Manger to return in three weeks with his comments on the Blue Ribbon Report. It was suggested that this issue be discussed with the entire Council; and, that perhaps a workshop be conducted on the Blue Ribbon Committee Report in April.

There was no discussion during this meeting of funding ratios expressed as a percentage of full funding.

There were no additional discussions on this issue.

March 20, 2002

This meeting was attended by several City Council Persons, Mayor Dick Murphy, City Manager Mike Uberuaga, several members of the Blue Ribbon Committee including Dick Vortman, and others.

City Manager Mike Uberuaga was tasked to provide a response to the Blue Ribbon Committee Report provided at the Rules Committee Meeting on 2-27-02. He was to provide his comments on the report with some recommendations.

Uberuaga began his discussion with the caveat that his comments were by no means a comprehensive analysis. He submitted a five page report summarizing his thoughts. Mayor Murphy tasked Uberuaga to return on 7-31-02 with a comprehensive response to the Blue Ribbon Committee Report.

Uberuaga discussed the portion of the Blue Ribbon Committee Report pertaining to the Unfunded Pension Liability and Benefits. He noted that the Blue Ribbon Committee suggested

that the Pension Fund be immediately fully funded and that the City conduct a comprehensive study as to the future costs of the increased benefits.

Uberuaga noted that the unfunded pension liability is growing at 9% per year. He noted that the pension funding issue is a complicated one that requires extensive study in order for council members to understand the system enough to make sound recommendations. He suggested that the City Council participate in a workshop. In addition he recommended that Larry Grissom obtain comprehensive information on other public sector retirement systems so that the Council would be able to compare the City of San Diego's system with other similar systems.

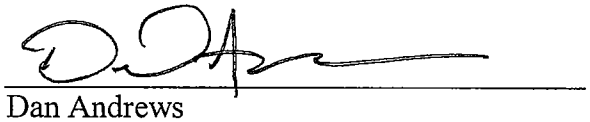
Mayor Murphy interjected that he felt it was more appropriate for the SDCERS Board to evaluate the Blue Ribbon Report and to provide a response prior to the Council attending a workshop. He recommended that the Board provide a response to Council by 6-30-02. he noted that the Board by Charter controls the retirement system. He felt that it may be inappropriate for Council to involve themselves too deeply in the issues of retirement system funding. He stated that the workshop may violate "protocol." He noted that it was a prior City Council that under funded the system to cover their deficit, and that it is a serious, but not crisis situation.

Dick Vortman was asked for his comments on the Mayor's suggestions. Vortman stated that he agreed with the Mayor, however he "urged speed" in resolving this issue. He suggested that decisions be made prior to the current fiscal year's budget being approved.

Mayor Murphy responded that it would be difficult to make changes prior to budget approval. He noted that they were currently involved in meet and confer sessions with the Unions and he felt that addressing this issue at this time may compromise these sessions. Murphy requested the City Attorney to provide guidance on the relationship between the SDCERS Board and Council in terms of making funding decisions.

Byron Ware interjected that he was no longer as concerned about the funding as he was during the February 27th meeting. He stated that the funding was not a crisis and that the July schedule was fine. Mayor Murphy noted that they may even need more time to properly address the issue. He stated that he was comfortable that it was not a crisis issue as the report showed funding in excess of 90%.

There were no additional comments or discussion.



Dan Andrews
City Attorney Investigator

:da
cc: Robert Abel, Principal City Attorney Investigator
Christopher S. Morris, Head Deputy City Attorney

EXHIBIT 37

Report on Investigation

The City of San Diego, California's

Disclosures of Obligation to Fund the

San Diego City Employees' Retirement System

and Related Disclosure Practices

1996-2004

with

Recommended Procedures and Changes to the Municipal Code

September 16, 2004

Paul S. Maco
Richard C. Sauer
Vinson & Elkins L.L.P.
Washington, D.C.

the immediate restoration of actuarial funding. He estimated that this iteration of the proposal reduced by 75% the additional contribution shortfall that would have resulted from the initial version. He also noted: "the modified proposal will provide added contributions after 2009 in an effort to attain Entry Age Normal Funding levels."

Mr. Roeder also provided projections of the System's funded ratios and the City's contribution rates under earnings scenarios other than the 8% assumed rate of return. He calculated that with a 4% rate of return, the SDCERS funded ratio would decline to approximately 60% by June 30, 2009, whether or not SDCERS adopted MP2. With a 12% rate of return, the funded ratio would increase to approximately 100%. This exercise, whatever the intention at the time, illustrates that the difference in City contributions between MP1 and MP2 rates, as it affected the SDCERS funded level, would likely be far less significant than the role of market forces over the same years.

Thus, the SDCERS Board was faced with a difficult question of judgment. Depending on whether the 82.3% floor was breached and, if so, when and by how much – as well as which interpretation of MP1's trigger provision would then be applied – MP2 could result in greater or lesser payments by the City than the existing agreement. Although the SDCERS actuary declined to predict whether the funded level would fall below the 82.3% floor during the next two years,[280] the substantial decline in the System's funded ratio between FY 2000 and 2001, and the continued bear market through FY 2002, made that appear likely. Indeed, that was the very reason the City sought relief from the "hard floor" provided by MP1.[281] It was, therefore, probable that the proposed modification to the 1996 agreement would result in at least a modest reduction in City contributions over a several year period. Weighed against this, however, were the problems that would result should the City become liable to its retirement system for an enormous balloon payment as early as July 1, 2003. The layoffs and other expense reduction measures that would follow a City budgetary crisis would negatively affect many elements of SDCERS' membership.[282]

After fiduciary counsel Robert Blum indicated that he could not support reducing the trigger level to 75%, but might find acceptable a proposal that would leave the 82.3% floor in place while allowing the City a ramp-up period to achieve that level, Board member Ronald Saathoff, as anticipated by the Manager's Office, made a motion to approve MP2 contingent upon it being so

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280 Minutes of SDCERS Board Meeting, at 19 (July 11, 2002).

281 As Ms. Lexin stated: "her understanding is that the City is before the Board with this request because... there was a good chance we would hit the floor, and that the City would be faced with a $25 million hit to next year's budget." *Id.* at 25. *See also id.* at 26 (remarks of Mr. Blum) ("He believes there is a high probability that the 82.3% trigger will be hit in a couple of years....").

282 It is notable that the City's municipal unions supported MP2. *Id.* at 22.

EXHIBIT 38

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The City of San Diego, California's

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> ... provided the Board with a history of the System and discussed realized gains. He reported that the System has historically utilized earnings as a means to pay certain benefits within the System. However, the Board is now faced with a situation where the projected earnings for this fiscal year are far short of what they have been over the past ten years. He reported that the System's high mark was in June of 1999, when the System achieved $468 million in realized earnings. This year, Staff projects the earnings will be somewhere between $40 million and $50 million.[254]

During the spring of 2002, the City concluded labor negotiations with three of its municipal unions. In the meet and confer process, the City agreed to increase the basic multiplier for retirement benefits for general employees to 2.5% at age 55. Combined with the increase from 2.0 to 2.25% from the FY 2000 negotiations, this meant that the cost of the basic retirement benefit would increase 25% over a two-year period. Labor and management also agreed that the City Manager would propose to the SDCERS Board that it transfer $25 million from surplus earnings into a reserve to fund the healthcare benefit in future years in which earnings were insufficient for this purpose.

These new benefits were explicitly contingent upon the willingness of the SDCERS Board to grant the City additional breathing room with respect to the MP1 funding floor. Specifically, for the benefits to be implemented, the Board was required to lower the trigger level from 82.3% to 75% of actuarial assets. In the event that the new floor was breached, furthermore, the City would have five years to ramp up to the full actuarial rate. Although in other contexts it attributed the need for these concessions primarily to investment losses,[255] in its communications with the municipal unions, the Manager's Office emphasized the cost of pension benefits previously granted as necessitating the proposed modification of the trigger provision. In a "Summary of the City's Final Position" sent to its municipal unions on May 9, 2002, the City stated:

> Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996 (Manager's Proposal) have created additional unfunded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions. Significant improvements in benefits are contained in this three-year proposal. Consequently, the "trigger" provisions must be adjusted as a condition of the City's three-year proposal[;] therefore, this three-year proposal is contingent upon, and subject to, approval by the SDCERS Board of

---

abrupt changes in asset levels and, consequently, volatile contribution rates. Because the years that were about to fall out of this calculation had provided strong returns, the burden on the next years would be that much greater. At the time the Board was considering the second Manager's proposal, the market value of System assets trailed their actuarial value by approximately $230 million. *Id.* at 18 (remarks of Mr. Roeder).

[254] Minutes of SDCERS Special Board Meeting, at 1 (May 29, 2002).

[255] Memorandum from Cathy Lexin and Elmer Heap to Mayor and City Council (June 14, 2002), *supra*; and Memorandum from P. Lamont Ewell, Assistant City Manager, City of San Diego, to Mayor and City Council, Re: San Diego City Employees' Retirement System Benefit Enhancements (Dec. 6, 2002).

Report on Investigation

The City of San Diego, California's

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EXHIBIT 39

City of San Diego
OFFICE OF THE CITY AUDITOR AND COMPTROLLER
MEMORANDUM

Date: September 16, 2002
To: Larry Grissom, Retirement Administrator
From: Terri Aja Webster, Assistant City Auditor and Comptroller
Subject: 1472 for 13th Check

Please revise the 2002 13th Check 1472 or attach a report to the Mayor and Council to include the items below. Mayor and Council need to know the fiscal issues of spending City Employee Retirement System (CERS) Trust fund assets that would otherwise be available to fund future pension liabilities. As currently written, the extensive discussion on the 13th check reserve fund could mislead the reader to believe that those assets can only be used for the 13th check.

1. SDMC 25.1501 requires the Auditor and Comptroller to determine annual Surplus Undistributed Earnings. Earnings provide funding for the mandatory crediting of interest to member's accounts and funding the CERS operating budget. If earnings are available after crediting interest to accounts and funding the budget then earnings are distributed to the health reserve, as needed, the 13th Check, Corbett settlement payment and crediting interest to two reserves.

The Earnings available for 2002 distribution is approximately **$51 million.** The mandatory crediting interest to members' accounts and funding the CERS budget is approximately **$90 million,** which results in a **shortfall of approximately $38 million.** The $38 million shortfall will be funded from the CERS Trust Fund Employer Reserve, which decreases assets available for future liabilities of the fund.

Therefore 2002 Earnings are depleted and not available for the Health Reserve or to Fund the 13th Check.

2. Since the Earnings are depleted and not available for the 13th check, if paid, it would have to be funded from Trust Fund assets that otherwise would be available to fund future pension liabilities.

3. CERS Trust fund is liable for the 2002 Corbett payment of at least $5.2 million even though earnings are insufficient to pay it in 2002. As terms of the settlement agreement it must be paid out of future earnings. The amount owed to each retiree keeps accumulating until paid.

4. The funding ratio is the major indicator of the fund's financial position and was at 89.9% as of 6-30-01. If the ratio falls below 82.3% the City's contribution rates will increase in an accelerated manner in accordance with a recent agreement. The 6-30-02 ratio is expected to decrease due to very low FY 02 earnings but at this time the exact ratio is unknown and is

in the process of being calculated by an actuary.

5. Earnings in FY 03 as of July 31, 2002 are at a **net loss of approximately ($40 million)** and could be insufficient to pay the 2003 13th check.

Please call if you have any questions.

Terri Aja Webster
Assistant Auditor and Comptroller

EXHIBIT 40

SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM
ANNUAL ACTUARIAL VALUATION
June 30, 2002

Submitted to

THE RETIREMENT BOARD

San Diego City Employees' Retirement System

San Diego, California

San Diego City Employees' Retirement System

June 30, 2002 Actuarial Valuation

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December 26, 2002

Retirement Board
San Diego City Employees' Retirement System
401 "B" Street, Suite 400
San Diego, CA 92101

Dear Members of the Board:

Submitted in this report are results of the regular Annual Actuarial Valuation as of June 30, 2002 of the San Diego City Employees' Retirement System. The valuation is intended to provide a measure of the funding status of the retirement system and actuarially computed contribution rates. These rates are higher than rates specified by the Manager's Proposal, and will be superceded by Manager's Proposal Rates, as long as certain parameters are met. This valuation forms part of the basis for the employer contribution rates for the year beginning July 1, 2003.

Beginning of Year Contributions	June 30, 2002	June 30, 2001
General Members	15.50%	11.03%
Safety Members	32.55%	24.48%
Weighted City Total	21.13%	15.59%

The member statistical data on which the valuation was based was furnished by the Retirement Office, together with pertinent data on financial operations. Data was reviewed for reasonableness, but was not audited by the actuary.

Valuation results indicate that there was a large experience loss of $364.8 million. This loss represents 13.0% of actuarial accrued liabilities as of the previous valuation date of June 30, 2001. Losses were primarily due to lower investment returns than anticipated.

The cooperation of the Retirement Office in furnishing materials requested for this valuation is deeply acknowledged with appreciation.

Respectfully submitted,

GABRIEL, ROEDER, SMITH & COMPANY

Rick A. Roeder, E.A., F.S.A., M.A.A.A.

FINANCIAL PRINCIPLES
AND
OPERATIONAL TECHNIQUES

San Diego City Employees' Retirement System

Financial Principles and Operational Techniques

of the Retirement System

Promises Made, and To Be Paid For. As each year is completed, the Retirement System, in effect, hands an "IOU" to each member then acquiring a year of service credit -- the "IOU" says: "The San Diego City Employees' Retirement System owes you one year's worth of retirement benefits, payments in cash commencing when you qualify for retirement."

The related key financial questions are:

Which generation of taxpayers contributes the money to cover the IOU?

The present taxpayers, who receive the benefit of the member's present year of service?

Or the future taxpayers, who happen to be in San Diego at the time the IOU becomes a cash demand, years and decades later?

The principle of level percent of payroll financing intends that this year's taxpayers contribute the money to cover the IOUs being handed out this year. By following this principle, the employer contribution rate will remain approximately level from generation to generation -- our children and our grandchildren will contribute the same percents of active payroll we contribute now.

(There are systems which have a design for deferring contributions to future taxpayers, lured by a lower contribution rate now and putting aside the consequence that the contribution rate must then relentlessly grow much greater over decades of time.)

An inevitable by-product of the level-cost design is the accumulation of reserve assets, for decades, and income produced when the assets are invested. Invested assets are a by-product and not the objective. Investment income becomes the 3rd contributor for benefits to employees, and is interlocked with the contribution amounts required from employees and employer.

(Concluded on next page)

(Concluded)

Translated to actuarial terminology, this level-cost objective means that the contribution rates must total at least the following:

Current Cost (the cost of members' service being rendered this year)

. . . plus. . .

Interest on Unfunded Accrued Liabilities (unfunded accrued liabilities are the difference between liabilities for service already rendered, and the accrued assets of the Retirement System).

Computing Contributions To Support System Benefits. From a given schedule of benefits and from the employee data and asset data furnished, the actuary determines the contribution rates to support the benefits, by means of an actuarial valuation and a funding method.

An actuarial valuation has a number of ingredients such as: the rate of investment return which plan assets will earn; rates of withdrawal of active members who leave covered employment; rates of mortality; rates of disability; rates of pay increases; and the assumed age or ages at actual retirement.

In an actuarial valuation the actuary must assume what the above rates will be for the next year and for decades in the future. Only the subsequent actual experience of the plan can indicate the degree of accuracy of the assumptions.

Reconciling Differences Between Assumed Experience and Actual Experience. Once actual experience has occurred and been observed, it will not coincide exactly with assumed experience, regardless of the skill of the actuary and the many calculations made. Most retirement systems cope with such differences by having annual actuarial valuations. Each actuarial valuation is a complete recalculation of assumed future experience, taking into account all past differences between assumed and actual experience. The result is continuing adjustments in financial position.

THE ACTUARIAL VALUATION PROCESS

The financing diagram on the opposite page shows the relationship between the two fundamentally different philosophies of paying for retirement benefits: the method where contributions match cash benefit payments (or barely exceed cash benefit payments, as in the Federal Social Security program) which is an increasing contribution method; and the level contribution method which equalizes contributions between the generations.

~ ~ ~ ~ ~ ~

The actuarial valuation is the mathematical process by which the level contribution rate is determined. The flow of activity constituting the valuation may be summarized as follows:

A. Covered people data, furnished by plan administrator, including:

Retired lives now receiving benefits

Former employees with vested benefits not yet payable

Active employees

B. + Asset data (cash & investments), furnished by plan administrator

C. + Assumptions concerning future experience in various risk areas, which are established by the Retirement Board after consulting with the actuary

D. + The funding method for employer contributions (the long-term, planned pattern for employer contributions)

E. + Mathematically combining the assumptions, the funding method, and the data

F. = Determination of:

Plan Financial Position and/or

New Employer Contribution Rate

VALUATION RESULTS

&

COMMENTS

FUNDING OBJECTIVE

The funding objective of the Retirement System is to establish and receive contributions, expressed as percents of active member payroll, which will remain approximately level from year to year and will not have to be increased for future generations of citizens.

CONTRIBUTION RATES

The Retirement System is supported by member contributions, City contributions, and investment income from Retirement System assets.

Contributions which satisfy the funding objective are determined by the annual actuarial valuation and are sufficient to:

(1) cover the actuarial present value of benefits allocated to the current year by the actuarial cost method (the normal cost); and

(2) finance over a period of future years the actuarial present value of benefits not covered by valuation assets and anticipated future normal costs (unfunded actuarial accrued liability).

Computed contributions as of June 30, 2002 apply to fiscal year beginning July 1, 2003.

San Diego City Employees' Retirement System

Computed City Contribution Rates

(Expressed as Percents of Active Payroll)

June 30, 2002

GENERAL

General Contributions Based on Valuation of	June 30, 2002			June 30, 2001		
	General	Legislative	Weighted Totals	General	Legislative	Weighted Totals
Normal Cost *	9.26%	21.01%	9.28%	9.12%	21.65%	9.14%
Amortization Payment *	6.75%	43.01%	6.83%	2.25%	44.95%	2.32%
SUBTOTAL	16.01%	64.02%	16.11%	11.37	66.60%	11.46%
Adjusted for payment at beginning of year	15.41%	61.61%	15.50%	10.94%	64.09%	11.03%

SAFETY

Safety Contributions Based on Valuation of	June 30, 2002	June 30, 2001
	Weighted Totals	Weighted Totals
Normal Cost *	17.60%	17.61%
Amortization Payment *	16.23%	7.83%
SUBTOTAL	33.83%	25.44%
Adjusted for payment at beginning of year	32.55%	24.48%

For Safety members, the 2002, beginning-of-year contribution rates are 32.08% for Police, 33.82% for Fire and 31.60% for Lifeguards.

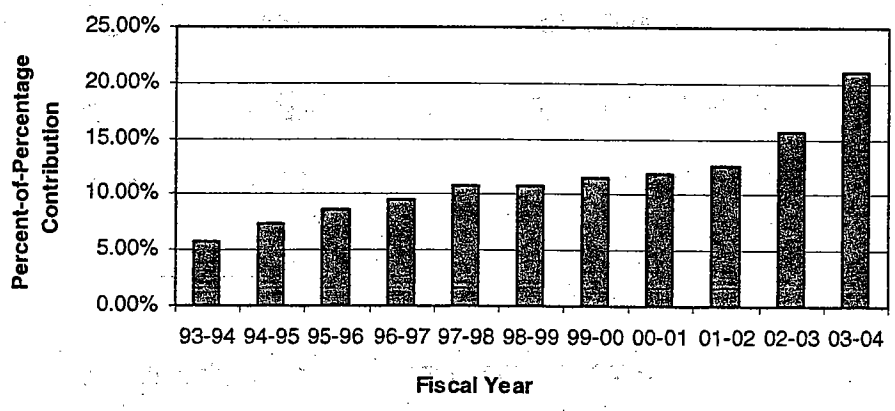
* Rates assume that contributions are made uniformly during the plan year.

San Diego City Employees' Retirement System
Computed City Contributions - Historic Comparison

Expressed as Percents of Payroll[1]

Fiscal Year	Valuation Date	General Members	Safety Members	Weighted Total	Valuation Payroll
93-94	6/30/92[2]	2.08%	11.37%	5.67%	$313,176,024
94-95	6/30/93[3]	3.15%	14.19%	7.39%	$320,623,685
95-96	6/30/94[4]	4.34%	15.42%	8.60%	$338,440,247
96-97	6/30/95	5.28%	16.42%	9.55%	$350,583,835
97-98	6/30/96	4.81%	15.20%	8.71%	$365,088,750
97-98	6/30/96[5]	7.35%	16.74%	10.87%	$365,088,750
98-99	6/30/97	7.52%	16.46%	10.86%	$382,715,084
99-00	6/30/98[4]	7.87%	17.75%	11.48%	$399,035,094
00-01	6/30/99	8.06%	19.05%	11.96%	$424,515,968
01-02	6/30/00	5.65%	13.30%	8.35%	$448,501,827
01-02[6]	6/30/00	8.62%	19.83%	12.58%	$448,501,827
02-03	6/30/01	11.03%	24.48%	15.59%	$481,863,318
03-04	6/30/02	15.50%	32.55%	21.13%	$535,156,545

Weighted Average Rate for All Groups



[1] Rates shown are adjusted for payment at the beginning of the year and exclude negotiated "pick ups"

[2] Reflects change in benefits for certain member groups

[3] Reflects changes in member contribution rates for certain member groups, early retirement incentive program activity, and methodology with regard to member refunds and employer pickup

[4] Reflects revised actuarial and economic assumptions

[5] After Manager's Proposal

[6] Reflects non-contingent benefit increases

San Diego City Employees' Retirement System

June 30, 2002

Elements of Normal Cost

(Expressed as Percents of Active Payroll)

	General	Safety	Total
Service Retirement	15.05%	23.50%	17.83%
Vested Deferred Retirement	1.41%	0.61%	1.15%
Death-in-Service	0.23%	0.48%	0.31%
Disability	2.12%	5.60%	3.27%
Contribution Refunds	0.49%	0.26%	0.41%
Total Normal Costs	19.30%	30.45%	22.97%
Employee Contributions	10.02%	12.85%	10.95%
Normal Costs	9.28%	17.60%	12.02%

(Mid-year contributions assumed for this illustration)

NOTES: In this presentation, Disability costs could be viewed as "overstated" and Service Retirement costs correspondingly "understated" since ALL costs for accrued benefit service are included and encompass those eligible to service retire at date of disability grant.

Member Contributions as of June 30, 2002

In addition to City contributions, the system is also funded by employee contributions. The rate at which members contribute is expressed as a percent of pay and varies according to age of entry into the system. Please refer to Appendix A for a detailed list of these rates by member group.

Average, long-term employee contribution rates for each member group are shown below, and reflect Corbett increases.

	June 30, 2002	June 30, 2001
General Members	10.02%	10.01%
Safety Members	12.85%	12.84%

All or part of the employee rate is subject to potential "offset" ("pick up") by the employer. The rates above are shown prior to any applicable offset. Please refer to page 50 for other relevant assumptions. Assumed offset amounts by member group are shown for information purposes ONLY.

Estimated Average Offsets

Group	Offset
General	
Represented	5.40%
Non-Represented	6.40
Legislative	8.89
Safety	
Lifeguards	7.30
Police/Fire	7.30

Such offset and related accumulated interest are not to be refunded to employees at termination. The City pick up, contributed to the System, is reduced by anticipated savings for reduced employee refunds prior to being contributed. See Comment J in this regard.

Unfunded Actuarial Accrued Liability
June 30, 2002

(City Only)

Derivation of Experience Gain (Loss)

The actuarial gains or losses realized in the operation of the Retirement Association provide an experience test. Gains and losses are expected to cancel each other over a period of years (in the absence of double-digit inflation) and sizable year-to-year fluctuations are common. Detail on the derivation of the actuarial gain(loss) is shown below.

1)	UAAL* at beginning of year	$283,892,737
2)	Expected beginning of year accrued liability payment	(13,172,997)
3)	Interest accrual ((1) - (2)) x .08	23,765,259
4)	Increase in Excludable Reserves	35,066,722
5)	Expected UAAL at end of year (1) - (2) + (3) + (4)	355,897,715
6)	Actual UAAL at end of year	720,712,870
7)	Gain(loss): (5) - (6)	(364,815,155)
8)	Gain(loss) as percentage of actuarial accrued Liabilities at beginning of year ($2,809,537,745)	(13.0)%

* Unfunded Actuarial Accrued Liability

San Diego City Employees' Retirement System

Unfunded Actuarial Accrued Liability

June 30, 2002

Unfunded Actuarial Accrued Liability

Total actuarial liabilities	$3,168,921,175
Assets allocated to funding	$2,448,208,305
Unfunded Actuarial Accrued Liability	$720,712,870

Elements of Experience Gain (Loss)

Estimated Gain(Loss) attributed to pay increases	($25,000,000)
Estimated Gain(Loss) attributed to investment experience	(312,953,654)
Estimated Gain(Loss) attributed to post-retirement mortality	(203,000)
Estimated Gain(Loss) attributed to data refinement to include the "permissive" purchase service for active and vested deferred members	(56,404,000)**
Estimated Gain(Loss) attributed to data refinements for inactive members who were refunded their contributions prior to June 30, 2001	6,000,000
Estimated Gain(Loss) from employee turnover, pre-retirement mortality and miscellaneous factors	23,745,499
Total Estimated Experience Gain(Loss)	($364,815,155)

Experience Gain(Loss) - Comparative Schedule

Valuation Date	Gain (Loss)	Beginning-of-Year Accrued Liabilities	Gain (Loss) Percentage
6/30/92	$57,952,320	$1,006,299,729	5.8%
6/30/93	(42,605,778)	1,057,238,917	(4.0)
6/30/94	(6,744,850)	1,220,830,059	(0.6)
6/30/95	(11,370,990)	1,338,279,541	(0.8)
6/30/96	59,592,960	1,476,710,662	4.0
6/30/97	38,473,993	1,682,604,532	2.3
6/30/98	31,086,010	1,822,432,018	1.7
6/30/99*	29,750,299	1,979,668,038	1.5
6/30/00	286,639,160	2,181,547,453	13.1
6/30/01	(193,168,984)	2,528,773,900	(7.6)
6/30/02	(364,815,155)	2,809,537,745	(13.0)

* Beginning with June 30, 1999 valuation, experience schedule is City only.

** The total permissive service liability of $77,705,000 less $21,301,000 in new contributions after June 30, 2001

San Diego City Employees' Retirement System
Actuarial Balance Sheet – June 30, 2002

($ in Millions)

PRESENT VALUE AND EXPECTED FUTURE RESOURCES

	General	Safety	Total
A. Actuarial value of system assets	1,163.6	1,284.6	2,448.2
B. Present value of expected future contributions			
1. For normal costs	333.9	300.3	634.2
2. For unfunded actuarial accrued liability	332.0	388.7	720.7
3. Totals	665.9	689.0	1,354.9
C. Present value of expected future member contributions	360.5	219.3	579.8
D. Total Present and Expected Future Resources	2,190.0	2,192.9	4,382.9

PRESENT VALUE OF EXPECTED FUTURE BENEFIT PAYMENTS AND RESERVE

	General	Safety	Total
A. To retirants and beneficiaries	541.1	899.3	1,440.4[1]
B. To vested and terminated members	50.2	16.4	66.6
C. To present active members			
1. Allocated to service rendered prior To valuation date	904.3	757.6	1,661.9
2. Allocated to service likely to be rendered after valuation date	694.4	519.6	1,214.0
3. Totals	1,598.7	1,277.2	2,875.9
D. Total Present Value of Expected Future Benefit Payments	2,190.0	2,192.9	4,382.9

[1] 2001 total, on this page only, was not updated to $1,337.8 but was correctly valued.

San Diego City Employees' Retirement System

Funding Progress Indicators

June 30, 2002

There is no single all-encompassing indicator which measures a retirement system's funding progress and current funded status. A traditional measure has been the relationship of valuation assets to unfunded actuarial accrued liability -- a measure that is influenced by the choice of actuarial cost method.

We believe a better understanding of funding progress and status can be achieved using the following indicators which are independent of the actuarial cost method.

(1) The ratio of assets to the actuarial present value of credited projected benefits allocated in the proportion accrued service is to projected total service -- a plan continuation indicator. The ratio is expected to increase in the absence of benefit improvements or strengthening of actuarial assumptions.

(2) The ratio of the unfunded actuarial present value of credited projected benefits to member payroll -- a plan continuation indicator. In a soundly financed retirement system, the amount of the unfunded actuarial present value of credited projected benefits will be controlled and prevented from increasing in the absence of benefit improvements or strengthening of actuarial assumptions. However, in an inflationary environment, it is seldom practical to impose this control on dollar amounts which are depreciating in value. The ratio is a relative index of condition where inflation is present in both items. The ratio is expected to decrease in the absence of benefit improvements or strengthening of actuarial assumptions.

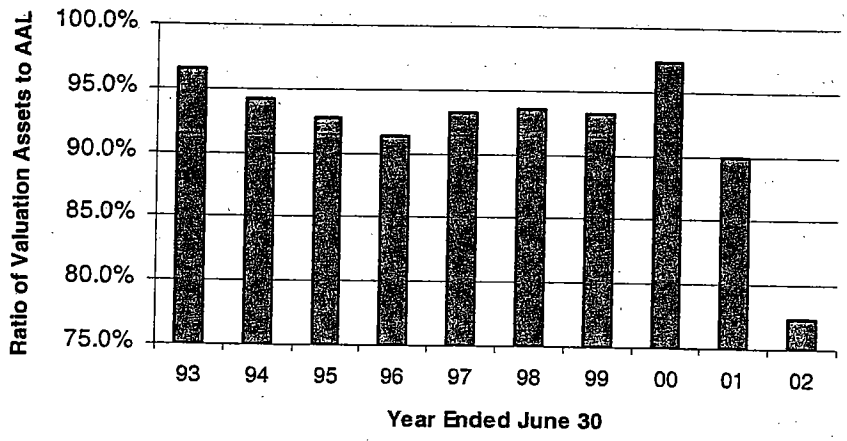
San Diego City Employees' Retirement System
Funding Process Indicators - Historic Comparison

($ in Thousands)

Valuation Date	Valuation Assets	Continuation Indicators				
		AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
6/30/93	$1,137,019	$1,178,311	96.5%	$41,292	$320,624	12.9%
6/30/94[1]	$1,216,063	$1,290,927	94.2%	$74,864	$338,440	22.1%
6/30/95	$1,316,903	$1,421,150	92.7%	$104,247	$350,584	29.7%
6/30/96[2]	$1,480,772	$1,620,373	91.4%	$139,602	$365,089	38.2%
6/30/97	$1,632,361	$1,748,868	93.3%	$116,507	$382,715	30.4%
6/30/98[1]	$1,852,151	$1,979,668	93.6%	$127,517	$399,035	32.0%
6/30/99	$2,033,153	$2,181,547	93.2%	$148,394	$424,516	35.0%
6/30/00	$2,459,815	$2,343,400	105.0%	($116,414)	$448,502	(26.0)%
6/30/00[3]	$2,459,815	$2,528,774	97.3%	$68,959	$448,502	15.4%
6/30/01	$2,525,645	$2,809,538	89.9%	$283,893	$481,864	58.9%
6/30/02	$2,448,208	$3,168,921	77.3%	$720,713	$535,157	134.7%

AAL - Actuarial Accrued Liability
UAAL - Unfunded Actuarial Accrued Liability

Historic Comparison of Funding Value



[1] Reflects revised actuarial and economic assumptions
[2] Reflects Manager's Proposal
[3] Reflects Corbett non-contingent benefit increases

San Diego City Employees' Retirement System

Comments & Recommendations

(Preliminary and Subject to Change and Internal Review!)

June 30, 2002

COMMENT A: The computed actuarial rate increased from 15.59% to 21.13%, primarily due to significant investment losses. The aggregate actuarial loss was $365 million dollars, which reflects 13.0% of accrued liabilities as of June 30, 2001. The funded ratio decreased from 89.9% to 77.3%.

There were no benefit changes or assumption changes incorporated into this valuation. As indicated in Comment I in last year's valuation report, the 89.9% funded ratio was an overstatement since we did not have service purchase data for this increasingly popular program. This year, data improvements were made and permissive service credit service was provided. Without such data improvements, the funded ratio would have been 79.2%.

COMMENT B: Using the actuarial value of assets, there were investment losses of $312.9 million. For this purpose, losses are calculated relative to the 8% investment assumption NOT zero. On an actuarial basis, the City's investment return was negative 4.14%.

Without the 5-year smoothing of the actuarial value of assets, contribution rates would be higher and the funded ratio lower.

However, the use of smoothing strongly suggests there will be additional investment losses on an actuarial basis next year since all of the impact of recent low returns is not yet explicitly reflected in this year's numbers. The City's actuarial value of assets exceeds the City's apportioned share of market value (assets are commingled with Unified Port District) by $248 million dollars. The funded ratio would be 69.4% on the basis of market value.

COMMENT C: There were additional benefits conferred as a result of the amended Manager's Proposal which was recently ratified. Because both the ratification date and the effective date of such increases were after June 30, 2002, we have not incorporated the latest benefit enhancements in this valuation. However, this will serve to put upward pressure on the computed rate and downward pressure on the funded ratio when such increases commence to be reflected.

The analysis we completed in February 2002 indicated an increase in the normal cost of 1.06% and an increase in the accrued liability of $42 million based on 2001 census data. Such increases will initially be reflected in the 2003 valuation.

A third factor, in addition to benefit enhancements and deferred investment losses, will put upward pressure on the 21.13% rate in the 2003 valuation. The 21.13% contribution rate is calculated using principles of "level" funding. However, since the Manager's Proposal rate for the current fiscal year is

(continued)

10.33%, the 21.13% rate is predicated on roughly $59 million dollars more in funding in fiscal year end 2003 than will occur under the Manager's Proposal. If every actuarial assumption is exactly met this year, this funding differential would cause the computed rate to increase by 0.75%-0.85%.

COMMENT D: There continues to be large increases in the average allowance granted new retirees. There were 292 new retirants (which includes those initially electing DROP) with an average annual allowance of $44,581. The average new retirant allowance for the previous two years was $35,054 and $40,443, respectively. The average allowance for new retirees is close to double that of new retirants in the 1996 valuation ($24,460) – just prior to the implementation of the original Manager's Proposal.

COMMENT E: At direction from the Retirement Board, we continue to NOT include any Corbett contingent liabilities in the valuation. If we had included the value of such liabilities, estimated to be in the $70-76 million range, the funded ratio would drop roughly 2%.

We offer a comment related to disposition of Surplus Undistributed Earnings. Suppose that your System earns 0% in the current fiscal year and 16% next year. Our understanding is that a contribution to Surplus Undistributed Earnings will be made for the 16% year even though there will be no net gain from investments over the two-year period. If extra benefits are conferred during the "good" years, then the median, "after the fact" investment return to finance all other benefits should theoretically be correspondingly lower. We have addressed this issue in the experience investigation.

COMMENT F: As anticipated, the number of current DROP program participants declined slightly. City membership declined from 547 to 522. There is a maximum DROP period of five years and there was much initial participation when the program became effective in April 1997. There are also 3 UPD members in DROP. The annual amounts credited to the 87 new City DROP members averaged $50,252, compared to $48,443 average in the 2001 valuation.

Advocates of the 1996 Manager's Proposal felt that there would be cost savings due to an anticipated reduction of the average age of the non-DROP active member work force. For funding, DROPs have been treated as retirants at the date they initiate their DROP period. Such decrease has clearly not come to pass. The average age of actives was 41.3 years as of the 1996 valuation. In this valuation, the average age of the non-DROP actives continued to increase -- 42.4 years compared to 42.1 years in the 2001 valuation. This is evidence of ongoing low employee turnover, not surprising in view of the high level of pension benefits.

(continued)

COMMENT G: Pursuant to the amended Manager's Proposal, the City has agreed to pay the following minimum rates (exclusive of pick up):

Fiscal Year End	City-Paid Rate
2003	10.33%
2004	11.89%
2005	12.89%
2006	13.89%
2007	14.89%
2008	15.89%

Part of the updated Manager's Proposal stipulates that additional contributions will be made for Fiscal Year Ends 2004-2008 if the funded ratio falls below 82.3% as has occurred in the 2002 valuation. Under the agreement, the full Projected Unit Credit contribution rate will be paid for the 2009 Fiscal Year End, with further increases thereafter to get to the Entry Age Normal rate as soon as possible.

The gap between the City-Paid rate and the computed rate has significantly increased in each of the past two valuations. The gap is large enough that even if all assumptions are exactly met, other factors equal, the computed rate will increase each year as long as a contribution shortfall from the computed actuarial rate exists.

The actual contribution rate for fiscal year end 2004, pursuant to the updated Manager's Proposal, will be between 13%-14%, depending on final interpretation of two contractual points.

COMMENT H: One of the many complexities of the System is that there is a reserve for an Employee Contribution Rate Increase pursuant to the Manager's Proposal, currently $40.65 million. As such, a small part of this reserve account should be transferred into the Member Deposit Reserve each year to pay for such increase. Our calculations reflect the entire employee contribution amount and are also reflected in the member rates included in the back of the report. As such, we add the following amounts to the rates on data provided us, based on our understanding as to negotiations, pursuant to the Manager's Proposal and Corbett:

	Manager's Proposal	Corbett	Total
General	+0.45%	+0.16%	+0.61%
Police	+0.51%	+0.16%	+0.67%
Lifeguard	+0.55%	+0.16%	+0.71%
Fire	+0.47%	+0.16%	+0.63%
Legislative	-0-	+0.16%	+0.16%

(continued)

COMMENT I: As in recent years, we continue to work with Retirement Staff to help resolve certain data issues. We appreciate the clear improvements this year. To date, 994 General members purchased 4,601 years of "permissive" service. The total average years of service for the General group increased from 10.2 to 10.8 due to this data refinement. 192 Safety members purchased 618 years of service. The total average years of service for the Safety Group increased from 12.4 to 12.6 due to this data refinement.

The added liabilities associated with the service purchase was $77.7 million. This data improvement produced a 2% reduction in the funded ratio and resulted in a computed rate increase of 1.00%.

COMMENT J: The City is phasing in, over a four-year period, a reduction in the discounts applied to offsets for anticipated saved refunds. Over the four years, the discount will be reduced from 22% to 5% for General members and 7% to 1% for Safety members.

COMMENT K: We have been requested to complete an Entry Age Normal valuation annually. This year's Entry Age rate is 23.16%.

COMMENT L: Overall, the financial condition of the retirement system is in adequate condition in accordance with actuarial principles of level-cost financing. However, all parties should be acutely aware that the current practice of paying less than the computed rate of contribution will help foster an environment of additional declines in the funding ratios in absence of healthy investment returns.

SUMMARY OF BENEFIT PROVISIONS

AND

VALUATION DATA SUBMITTED BY RETIREMENT SYSTEM

San Diego City Employees' Retirement System

Brief Summary of Benefit Provisions Evaluated

June 30, 2002

Section references refer to Article 4 of the Municipal Code, unless otherwise noted

1. Membership Requirements
   Salaried Employees - immediate eligibility upon employment (compulsory). (§24.0105)

2. Monthly Salary Base for Benefits
   Highest one-year average. (§24.0103), subject to a 10% increase, if the General or Safety Member elects such increase in lieu of an increased benefit formula. (Such change is effective as of July 1, 2000 and is being valued in the 2000 valuation). For Legislative Members, there shall be an increase of 10% in this average, effective as of July 1, 2000.

3. Service Requirement
   A. Eligibility
      1) General Members - Age 62 with 10 years of service, or age 55 with 20 years of service. (§141 of City Charter)
      2) Safety Members - Age 55 with 10 years of service, or age 50 with 20 years of service. (§141 of City Charter)
      3) Legislative Members - Age 55 with 4 years of service. Reduced retirement with 8 years of service regardless of age. (§24.0545)

   B. Benefit Formula Per Year of Service
      1) General and Safety Members
         Member choice of formula in place of June 30, 2000 or "Corbett" formula effective as of July 1, 2000. (§24.0402). See Appendix B.

      2) Legislative Members – 3.5% (§24.0546). A 2% annual reduction factor applies to benefits for Legislative members retiring prior to age 55.

   C. Maximum Benefit

      1) Safety Members,
         90% of Final Average Compensation (subject to 10% increase).

      2) General and Legislative Members - None

   D. Unmodified Form of Payment - Monthly payments continued for the life of the member, with 50% continuance to the eligible spouse upon member's death. (§24.0521)

Note: City employees withdrew from Social Security January 1, 1982 (§24.0104). We are assuming that all future benefits for active members will be determined on a non-integrated basis.

Note: Effective July 1, 1991, credited service earned under the 1981 Pension System will be considered equivalent to CERS service for the purpose of benefit calculation (i.e., the above formulas will apply to 1981 Pension System service).

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4. Non-industrial Disability
   A. Eligibility - Ten years of service. (§24.0501)

   B. Benefit Formula Per Year of Service
      1) General Members - Greater of 1.5% per year of service, one-third of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §34.0505.1)
      2) Safety Members - Greater of 1.8% per year of service, one-third of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §24.0503.1)

5. Industrial Disability
   A. Eligibility - No age or service requirement. (§24.0501)

   B. Benefit
      1) General Members - Greater of one-half of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §24.0504.1)
      2) Safety Members - Greater of one-half of final compensation (subject to 10% compensation increase), or the earned service retirement benefit. (§24.0502, §24.0503)
      3) Legislative members - Earned service retirement benefit (§24.0547)

6. Non-industrial Death Before Eligible to Retire
   Refund of employee contributions with interest plus one month's salary for each completed year of service to a maximum of six month's salary. (§24.0703)

7. Non-industrial Death After Eligible to Retire for Service
   50% of earned benefit payable to surviving eligible spouse. (§24.0704.2)

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(Continued)

8. Industrial Death - 50% of the final average compensation preceding death payable to eligible spouse. (§24.0710.2, §24.0706)

9. Death After Retirement
   50% of member's unmodified allowance continued to eligible spouse. (§24.0521)
   $2,000 payable in lump sum to the beneficiary or the estate of the retiree.

10. Withdrawal Benefits (§24.0206, §24.0306)
    A. Pre-12/8/76 Hires - If contributions left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.
    B. Post-12/7/76 Hires
       1) Less than ten years of service - Refund of accumulated employee contributions with interest, or may keep deposits in the System and earn additional interest.
       2) Ten or more years of service - If contributions left on deposit, entitled to earned benefits, commencing anytime after eligible to retire.

11. Post-retirement Cost-of-Living Benefits
    A. General Members and Safety - Based on changes in Consumer Price Index, to a maximum of 2% per year. (§24.0531)

12. Computed Contribution Rate
    Determined by the Projected Unit Credit Funding Method with a 30-year amortization (§24.0801) of Unfunded Actuarial Accrued Liability beginning on July 1, 1991.

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(Concluded)

13. Member Contributions - Vary by age at time of entrance into the system. (§24.0201, §24.0301). While a significant portion of these contributions are "picked up", such pickups are not directly reflected in either the employee contributions or related refund calculations.

14. Internal Revenue Code Compliance
Benefits provided by the Plan are subject to the limitations set forth in Section 415 in accordance with the "grandfather" election in Section 415(b)(10) of the Internal Revenue Code.

NOTE: The summary of major plan provisions is designed to outline principal plan benefits. If the City should find the plan summary not in accordance with the actual provisions, the City should alert the actuary IMMEDIATELY so all parties can be sure the proper provisions are valued.

San Diego City Employees' Retirement System

Summary of Reported Asset Information

Submitted for the June 30, 2002 Valuation

Market Value of Reported Assets	
Cash/Short-term	$243,596,793
Domestic Stocks	935,859,657
International Stocks	379,798,539
Bonds	687,237,643
Mortgages	1,515,530
Real Estate	267,360,092
Receivables	71,249,804
Miscellaneous	23,005,214
Total Market Value	$2,609,623,272

Reserves	
Member Deposit Reserve	$372,129,066
DROP Reserve	97,430,035
Employer Reserve	459,073,155
Retired Members Reserve	1,289,713,478
General Reserve	109,160,143
Undistributed Reserve	(18,748,424)
Encumbrance Reserve	3,910,512
Supplemental Benefit Reserve	3,714,211
Receivables Reserve	6,577,586
Fixed Assets Reserve	290,737
Retiree Health Insurance Reserve	14,317,073
401(h) Reserve	17,873,395
Supplemental COLA Reserve	29,944,109
City Changes Reserve	82,498,325
UPD Changes Reserve	4,272,283
Employee Cont. Rate Inc.	40,650,714
NPO Reserve	39,230,748
Payables	79,519,306
Total Reserves	$2,631,556,452
Unrealized Appreciation	(21,933,180)
Total Market Value	$2,609,623,272

(Continued on Next Page)

San Diego City Employees' Retirement System

Summary of Reported Asset Information

Submitted for the June 30, 2002 Valuation

(Continued)

Revenues and Disbursements in Fund Balances

Total Reserves - Beginning of year	$2,715,636,690
Revenues	
Employees' contributions	$53,546,085
Employees' DROP contributions	1,094,832
Employer contributions	49,962,365
Employer DROP contributions	1,095,653
Offset contributions	28,794,143
DROP Monthly Pension Allowances	27,234,698
DROP Supplemental Benefit	467,587
Income - Investment	49,082,292
Income - Other	459,087
To Liability Reserve	(126,114,144)
Total Revenues to Liability Reserve	$85,622,598
Disbursements	
Monthly Retirement Allowances	$93,298,959
Monthly Retirement Allowances - DROP	27,234,698
Monthly Ret. Allowances - Supp. COLA	4,434,946
Health Insurance Payments	8,882,138
Supplemental Benefit Payments	3,627,495
Corbett Retro Payment (6/01-7% contingent payment)	5,265,570
Andrecht Retro Payments	1,547,472
DROP Payments to Members	5,134,456
DROP Payments to Beneficiaries	126,495
Death Benefits	367,682
Refunds of Member contributions	994,740
Administrative Expenses	18,752,807
Depreciation Expense	35,378
Total Disbursements	$169,702,836
Total Reserves - End of Year	$2,631,556,452
Net Unrealized Appreciation	(21,933,180)
Total Market Value	$2,609,623,272

Valuation assets are developed on the following page.

San Diego City Employees' Retirement System

Development of Actuarial Value of Assets

Year Ending June 30, 2002

The actuarial valuation of the System as of June 30, 2002 was based on the unaudited Statement of Assets and Liabilities and additional reconciliations provided by the Retirement Office.

The total book value of applicable assets for the valuation of the System as of June 30, 2002 was determined as follows:

1) Total book value of assets	$2,631,556,452
2) Less reserves and liabilities excluded from valuation	
a. Liabilities (other than PPE Conversion Liability)	79,276,420
b. Reserve for supplemental payments	3,714,211
c. Reserve for Retiree Health Insurance	14,317,073
d. Reserve for Post Retirement Health Care	17,873,395
e. Reserve for DROP contributions	97,430,035
f. Reserve for Employee Contribution Rate Increase	40,650,714
g. Reserve for Supplemental COLA	29,944,109
h. Total Excludables: Sum of a. through g.	283,205,957
Net applicable assets as of June 30, 2002: 1)-2)h.	$2,348,350,495

The net applicable assets (book value) along with the corresponding market value was used to determine an actuarial value of assets, as shown on the following page.

(Concluded on Next Page)

San Diego City Employees' Retirement System

Development of Actuarial Value of Assets

Year Ending June 30, 2002

(Concluded)

	(a) Net Market Value	(b) Net Book Value	(a) / (b)
1. Market Value as a percentage of book value of assets:			
a. June 30, 2002	$2,326,417,315	$2,348,350,495	99.07%
b. June 30, 2001	2,433,217,521	2,341,407,593	103.92%
c. June 30, 2000	2,514,858,618	2,245,019,575	112.02%
d. June 30, 1999	2,196,756,520	1,868,267,506	117.58%
e. June 30, 1998	2,069,293,140	1,744,483,835	118.62%
2. Average percentage for most recent 5-year period			110.24%
3. Current net book value of assets			$2,348,350,495
4. Preliminary actuarial value of assets: (2) * (3)			2,588,821,586
5. Actuarial value of assets: item 4, adjusted to be within 20% of market value			2,588,821,586

Valuation assets, for purposes of cost development, were allocated among groups in accordance with their relative proportions of applicable reserves reported at book value.

Member Group	Book Value of Reserves	Valuation Assets Used
General	$999,206,004	$1,160,693,938
Legislative	2,525,096	2,933,193
Safety	1,105,856,747	1,284,581,174
Unified Port District	121,049,684	140,613,281
Total	$2,228,637,531	$2,588,821,586

San Diego City Employees' Retirement System

Retirants and Beneficiaries June 30, 2002

General Members

Allowances Being Paid as of July 1, 2002

Type of Allowance	Annual No.	Annual Allowances
Service Retirement		
Life Annuity Only	494	$9,782,328
Cash Refund Annuity	78	1,321,050
Joint & 100% Survivor	99	2,959,611
Joint & 50% Survivor		
Automatic	1,293	26,087,303
Elected	7	162,149
Option 4[1]	2	90,056
Social Security Option	22	344,660
Total Service Retirement	1,995	$40,747,157
Disability Retirement		
Life Annuity Only	155	1,703,381
Cash Refund Annuity	5	64,692
Joint & 100% Survivor		
Automatic	0	0
Elected	12	163,472
Joint & 50% Survivor		
Automatic	256	3,064,004
Elected	1	8,751
Option 4[1]	2	29,516
Social Security Option	1	3,712
Total Disability Retirement	432	$5,037,528
Death Before Retirement	9	93,690
Death After Retirement		
Service Retirement	444	2,606,699
Disability Retirement	119	698,182
Total Death After Retirement	563	$3,304,881
Total Allowances Being Paid	2,999	$49,183,256

[1] §24.0607 of the San Diego Municipal Code allows, upon approval of the Board, other benefits that are the actuarial equivalent of the retirement allowance.

San Diego City Employees' Retirement System

Retirants and Beneficiaries June 30, 2002

Safety Members

Allowances Being Paid as of July 1, 2002

Type of Allowance	Annual No.	Annual Allowances
Service Retirement		
Life Annuity Only	144	5,694,138
Cash Refund Annuity	24	1,040,707
Joint & 100% Survivor	91	4,602,878
Joint & 50% Survivor		
Automatic	776	36,632,408
Elected	4	233,585
Option 4[1]	9	379,325
Social Security Option	0	0
Total Service Retirement	1,048	48,583,041
Disability Retirement		
Life Annuity Only	163	3,405,180
Cash Refund Annuity	5	196,808
Joint & 100% Survivor		
Automatic	37	271,840
Elected	23	871,388
Joint & 50% Survivor		
Automatic	584	15,828,491
Elected	1	33,158
Option 4[1]	2	72,564
Social Security Option	0	0
Total Disability Retirement	815	20,679,429
Death Before Retirement	33	505,391
Death After Retirement		
Service Retirement	150	1,612,424
Disability Retirement	98	991,035
Total Death After Retirement	248	2,603,459
Total Allowances Being Paid	2,144	72,371,320

[1] §24.0607 of the San Diego Municipal Code allows, upon approval of the Board, other benefits that are the actuarial equivalent of the retirement allowance.

San Diego City Employees' Retirement System

Retirants and Beneficiaries June 30, 2002

Total Members

Allowances Being Paid as of July 1, 2002

Type of Allowance	Annual No.	Annual Allowances
Service Retirement		
Life Annuity Only	638	$15,476,466
Cash Refund Annuity	102	2,361,757
Joint & 100% Survivor	190	7,562,489
Joint & 50% Survivor		
Automatic	2,069	62,719,711
Elected	11	395,734
Option 4[1]	11	469,381
Social Security Option	22	344,660
Total Service Retirement	3,043	$89,330,198
Disability Retirement		
Life Annuity Only	318	5,108,561
Cash Refund Annuity	10	261,500
Joint & 100% Survivor		
Automatic	37	271,840
Elected	35	1,034,860
Joint & 50% Survivor		
Automatic	840	18,892,495
Elected	2	41,909
Option 4[1]	4	102,080
Social Security Option	1	3,712
Total Disability Retirement	1,247	$25,716,957
Death Before Retirement	42	599,081
Death After Retirement		
Service Retirement	594	4,219,123
Disability Retirement	217	1,689,217
Total Death After Retirement	811	$5,908,340
Total Allowances Being Paid	5,143	$121,554,576

[1] §24.0607 of the San Diego Municipal Code allows, upon approval of the Board, other benefits that are the actuarial equivalent of the retirement allowance.

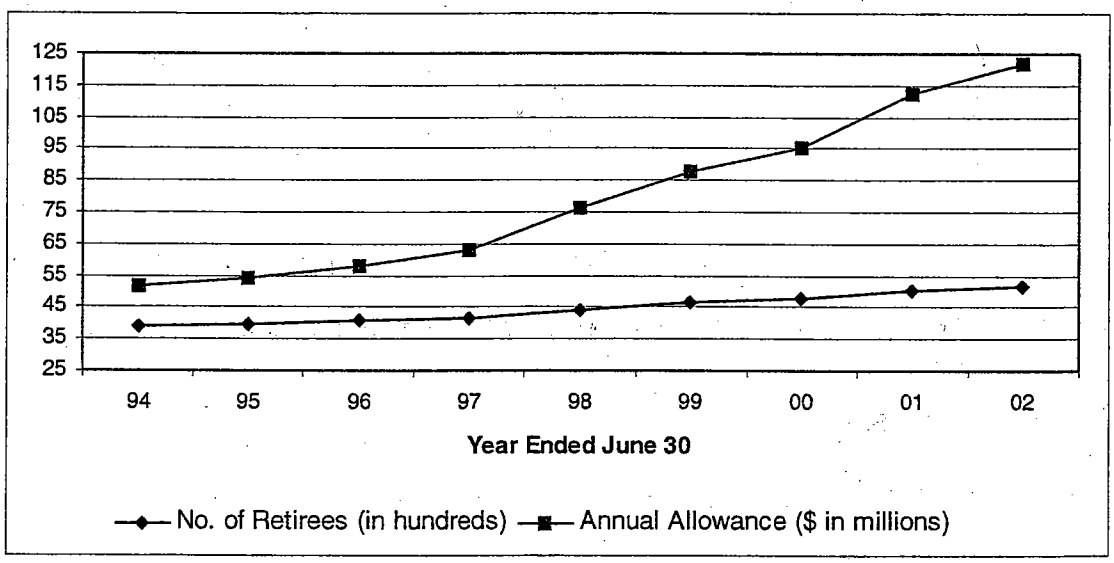
San Diego City Employees' Retirement System
Retirants and Beneficiaries - Comparative Statement

Valuation Date		No.	Annual Allowances	Average Allowance	Percent Increase	Present Value of Allowances		Percent Increase
6/30/94	[1]	3,920	$51,503,636	$13,139	3.4%	$565,913,075		5.2%
6/30/95		3,966	$54,404,975	$13,718	4.4%	$605,776,749		7.0%
6/30/96		4,052	$58,224,674	$14,369	4.7%	$647,228,431		6.8%
6/30/97		4,123	$62,672,105	$15,201	5.8%	$699,534,837		8.1%
6/30/98	[1,2]	4,419	$76,507,181	$17,313	13.9%	$885,585,652		26.6%
6/30/99	[2]	4,657	$87,823,437	$18,858	8.9%	$1,026,394,505		15.9%
6/30/00		4,789	$95,348,751	$19,910	5.6%	$1,114,872,745		8.6%
6/30/00		4,789	$95,348,751	$19,910	5.6%	$1,170,074,966	[3]	14.0%
6/30/01		5,012	$112,637,558	$22,474	12.9%	$1,337,799,454		14.3%
6/30/02		5,143	$121,554,577	$23,635	5.2%	$1,440,392,422		7.7%

[1] Reflects revised actuarial assumptions

[2] Reflects increased activity due to DROP program

[3] Reflects non-contingent Corbett benefit increase and estimated value of retroactive payments and increased DROP payments



San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 2002
Tabulated by Attained Ages and Year of Retirement

General Members

	Age Groups								
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	Totals
Before 1983	0	23	22	22	40	109	485	117	818
1983	0	2	2	1	3	26	52	1	87
1984	1	5	1	4	6	26	52	1	96
1985	2	3	0	7	12	28	44	0	96
1986	1	3	3	2	14	30	28	0	81
1987	1	3	3	2	29	28	24	0	90
1988	0	4	4	3	28	39	15	0	93
1989	2	3	1	13	26	49	9	0	103
1990	0	5	1	13	28	43	8	0	98
1991	5	2	2	16	43	25	0	0	93
1992	4	4	3	19	29	19	4	0	82
1993	8	5	7	42	50	35	4	0	151
1994	5	14	6	13	20	6	1	0	65
1995	13	4	11	22	36	2	2	0	90
1996	9	10	16	24	16	4	1	0	80
1997	12	13	22	29	16	2	1	0	95
1998	12	13	49	32	16	0	0	0	122
1999	10	37	43	43	11	4	0	0	148
2000	14	59	30	35	10	0	0	0	148
2001	15	93	77	33	7	2	0	0	227
2002	1	51	58	21	4	1	0	0	136
TOTALS	115	356	361	396	444	478	730	119	2,999

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement:	58.0
Attained Age:	71.1
Annual Pension:	$16,400

San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 2002
Tabulated by Attained Ages and Year of Retirement

Safety Members

	Age Groups								
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	Totals
Before 1983	7	97	60	57	82	121	222	51	697
1983	2	8	1	3	17	12	2	0	45
1984	0	4	3	6	19	3	1	0	36
1985	3	9	4	5	12	2	0	0	35
1986	1	8	5	12	15	2	0	0	43
1987	3	7	3	9	7	3	2	0	34
1988	3	4	5	11	9	0	1	0	33
1989	3	11	18	17	4	2	1	0	56
1990	9	10	11	17	3	0	0	0	50
1991	11	9	5	22	4	0	0	0	51
1992	8	11	13	11	0	0	0	0	43
1993	13	19	55	64	3	1	0	0	155
1994	17	13	8	2	0	0	0	0	40
1995	11	15	18	1	0	0	0	0	45
1996	16	19	12	5	0	0	0	0	52
1997	16	25	25	6	2	0	0	0	74
1998	11	43	26	0	0	0	0	0	80
1999	20	100	29	4	1	0	0	0	154
2000	12	111	20	0	0	0	0	1	144
2001	14	106	14	0	0	0	0	0	134
2002	7	104	29	3	0	0	0	0	143
TOTALS	187	733	364	255	178	146	229	52	2,144

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement:	49.2
Attained Age:	63.1
Annual Pension:	$33,755

San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 2002
Tabulated by Attained Ages and Year of Retirement

Total Members

	Age Groups								
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	Totals
Before 1983	7	120	82	79	122	230	707	168	1,515
1983	2	10	3	4	20	38	54	1	132
1984	1	9	4	10	25	29	53	1	132
1985	5	12	4	12	24	30	44	0	131
1986	2	11	8	14	29	32	28	0	124
1987	4	10	6	11	36	31	26	0	124
1988	3	8	9	14	37	39	16	0	126
1989	5	14	19	30	30	51	10	0	159
1990	9	15	12	30	31	43	8	0	148
1991	16	11	7	38	47	25	0	0	144
1992	12	15	16	30	29	19	4	0	125
1993	21	24	62	106	53	36	4	0	306
1994	22	27	14	15	20	6	1	0	105
1995	24	19	29	23	36	2	2	0	135
1996	25	29	28	29	16	4	1	0	132
1997	28	38	47	35	18	2	1	0	169
1998	23	56	75	32	16	0	0	0	202
1999	30	137	72	47	12	4	0	0	302
2000	26	170	50	35	10	0	0	1	292
2001	29	199	91	33	7	2	0	0	361
2002	8	155	87	24	4	1	0	0	279
TOTALS	302	1,089	725	651	622	624	959	171	5,143

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement:	54.2
Attained Age:	67.7
Annual Pension:	$23,635

Active Me. rs June 30, 2002
By Attained Ages and Years of Service

GENERAL MEMBERS (Excludes DROP members)

Age Group	Years of Accrued Service												
	0-1	1-2	2-3	3-4	4-5	5-9	10-14	15-19	20-24	25-29	30-34	35 & Up	Totals
15-19 NO.	3	0	0	0	0	0	0	0	0	0	0	0	3
TOT PAY	74,256	0	0	0	0	0	0	0	0	0	0	0	74,256
AVG PAY	24,752	0	0	0	0	0	0	0	0	0	0	0	24,752
20-24 NO.	71	45	12	6	1	2	0	0	0	0	0	0	137
TOT PAY	1,958,726	1,405,945	375,669	170,666	32,074	39,562	0	0	0	0	0	0	3,982,640
AVG PAY	27,588	31,243	31,306	28,444	32,074	19,781	0	0	0	0	0	0	29,070
25-29 NO.	117	126	83	53	35	47	1	0	0	0	0	0	462
TOT PAY	3,956,683	4,793,865	3,321,029	2,293,283	1,547,933	1,837,487	49,629	0	0	0	0	0	17,799,909
AVG PAY	33,818	38,047	40,012	43,269	44,227	39,095	49,629	0	0	0	0	0	38,528
30-34 NO.	122	128	98	105	69	217	120	1	1	0	0	0	861
TOT PAY	4,361,688	5,189,166	4,085,596	4,605,118	3,223,565	9,689,673	5,088,966	32,698	48,880	0	0	0	36,325,350
AVG PAY	35,752	40,540	41,690	43,858	46,718	44,653	42,408	32,698	48,880	0	0	0	42,190
35-39 NO.	97	107	98	72	54	305	404	85	8	0	0	0	1,230
TOT PAY	3,323,779	4,056,550	4,056,834	3,179,557	2,495,852	14,849,409	20,240,292	4,178,754	347,341	0	0	0	56,728,369
AVG PAY	34,266	37,912	41,396	44,161	46,219	48,687	50,100	49,162	43,418	0	0	0	46,121
40-44 NO.	84	98	73	57	67	250	484	235	76	10	0	0	1,434
TOT PAY	3,145,388	3,934,534	3,233,222	2,394,092	2,956,360	11,230,263	24,462,994	12,121,397	3,960,545	549,994	0	0	67,988,788
AVG PAY	37,445	40,148	44,291	42,002	44,125	44,921	50,543	51,580	52,112	54,999	0	0	47,412
45-49 NO.	64	79	58	44	35	204	371	285	185	72	17	1	1,415
TOT PAY	2,584,136	3,170,625	2,391,530	2,152,358	1,398,288	9,478,115	18,203,950	14,925,755	10,195,140	4,071,644	906,144	54,746	69,532,430
AVG PAY	40,377	40,134	41,233	48,917	39,951	46,461	49,067	52,371	55,109	56,551	53,303	54,746	49,140
50-54 NO.	48	47	45	30	21	134	220	225	162	144	81	17	1,174
TOT PAY	1,827,817	1,812,069	1,952,766	1,328,581	846,200	6,235,126	10,407,426	11,593,330	8,981,566	8,179,500	4,687,155	947,827	58,799,364
AVG PAY	38,080	38,555	43,395	44,286	40,295	46,531	47,306	51,526	55,442	56,802	57,866	55,755	50,085
55-59 NO.	24	24	19	15	13	69	150	91	74	55	53	42	629
TOT PAY	1,263,787	936,917	1,000,126	601,297	566,141	3,080,064	7,305,692	4,667,464	4,718,097	2,952,412	3,347,506	2,851,083	33,290,587
AVG PAY	52,658	39,038	52,638	40,086	43,549	44,639	48,705	51,291	63,758	53,680	63,160	67,883	52,926
60-64 NO.	2	4	8	8	9	31	57	55	26	13	11	7	231
TOT PAY	102,045	165,408	290,742	317,972	401,559	1,436,779	2,438,451	2,708,794	1,548,487	769,236	710,784	425,129	11,315,385
AVG PAY	51,022	41,352	36,343	39,746	44,618	46,348	42,780	49,251	59,557	59,172	64,617	60,733	48,984
65-99 NO.	4	0	1	3	2	9	19	10	5	5	3	5	66
TOT PAY	112,278	0	55,203	129,095	65,177	264,170	846,371	467,016	162,323	138,108	127,899	285,563	2,653,204
AVG PAY	28,070	0	55,203	43,032	32,588	29,352	44,546	46,702	32,465	27,622	42,633	57,113	40,200
TOT NO.	636	658	495	393	306	1,268	1,826	987	537	299	165	72	7,642
TOT AMT	22,710,585	25,465,079	20,762,718	17,172,020	13,533,149	58,140,648	89,043,770	50,695,208	29,962,379	16,660,894	9,779,488	4,564,348	358,490,284
AVG AMT	35,708	38,701	41,945	43,695	44,226	45,852	48,764	51,363	55,796	55,722	59,270	63,394	46,911

San Diego City Employees' Retirement System
Active Members June 30, 2002
By Attained Ages and Years of Service

SAFETY MEMBERS (Excludes DROP members)

Age Group	Years of Accrued Service												
	0-1	1-2	2-3	3-4	4-5	5-9	10-14	15-19	20-24	25-29	30-34	35 & Up	Totals
20-24 NO.	22	11	3	1	0	0	0	0	0	0	0	0	37
TOT PAY	887,440	531,382	145,954	56,807	0	0	0	0	0	0	0	0	1,621,583
AVG PAY	40,338	48,307	48,651	56,807	0	0	0	0	0	0	0	0	43,827
25-29 NO.	48	57	51	25	18	21	0	0	0	0	0	0	220
TOT PAY	1,949,106	2,614,666	2,831,648	1,419,744	1,056,521	1,252,364	0	0	0	0	0	0	11,124,048
AVG PAY	40,606	45,871	55,523	56,790	58,696	59,636	0	0	0	0	0	0	50,564
30-34 NO.	33	41	43	54	48	180	42	0	0	0	0	0	441
TOT PAY	1,296,818	1,915,788	2,370,029	3,119,370	2,950,126	11,203,866	2,760,655	0	0	0	0	0	25,616,652
AVG PAY	39,298	46,727	55,117	57,766	61,461	62,244	65,730	0	0	0	0	0	58,088
35-39 NO.	13	15	15	20	31	142	316	110	0	0	0	0	662
TOT PAY	548,912	703,019	823,980	1,178,956	1,905,894	8,871,533	20,364,682	7,504,898	0	0	0	0	41,901,873
AVG PAY	42,224	46,868	54,932	58,948	61,480	62,476	64,445	68,226	0	0	0	0	63,296
40-44 NO.	8	6	10	5	9	36	204	253	82	1	0	0	614
TOT PAY	308,514	272,740	559,570	298,515	554,330	2,230,382	13,274,681	17,469,648	5,877,007	98,981	0	0	40,944,367
AVG PAY	38,564	45,457	55,957	59,703	61,592	61,955	65,072	69,050	71,671	98,981	0	0	66,685
45-49 NO.	2	5	3	2	7	20	57	139	241	40	0	0	516
TOT PAY	78,374	222,227	148,456	120,567	416,341	1,246,007	3,679,108	9,374,671	17,341,230	3,125,924	0	0	35,752,905
AVG PAY	39,187	44,445	49,485	60,284	59,477	62,300	64,546	67,444	71,955	78,148	0	0	69,289
50-54 NO.	1	1	0	0	1	6	12	42	78	74	9	0	224
TOT PAY	152,000	62,650	0	0	63,900	377,243	768,473	2,933,308	5,509,951	5,476,424	775,137	0	16,119,085
AVG PAY	152,000	62,650	0	0	63,900	62,874	64,039	69,841	70,640	74,006	86,126	0	71,960
55-59 NO.	1	0	0	0	0	1	6	13	12	10	3	1	47
TOT PAY	40,893	0	0	0	0	63,134	373,755	859,134	908,078	692,411	185,001	67,313	3,189,720
AVG PAY	40,893	0	0	0	0	63,134	62,293	66,087	75,673	69,241	61,667	67,313	67,866
60-64 NO.	0	0	0	0	0	1	0	4	0	0	1	0	6
TOT PAY	0	0	0	0	0	63,111	0	265,604	0	0	67,313	0	396,028
AVG PAY	0	0	0	0	0	63,111	0	66,401	0	0	67,313	0	66,005
65-99 NO.	0	0	0	0	0	0	0	0	0	0	0	0	0
TOT PAY	0	0	0	0	0	0	0	0	0	0	0	0	0
AVG PAY	0	0	0	0	0	0	0	0	0	0	0	0	0
TOT NO.	128	136	125	107	114	407	637	561	413	125	13	1	2,767
TOT AMT	5,262,057	6,322,472	6,879,635	6,193,959	6,947,113	25,307,641	41,221,353	38,407,261	29,636,266	9,393,740	1,027,451	67,313	176,666,261
AVG AMT	41,110	46,489	55,037	57,887	60,940	62,181	64,712	68,462	71,759	75,150	79,035	67,313	63,848

San Diego City E yees' Retirement System
Active Members June 30, 2002
By Attained Ages and Years of Service

TOTAL MEMBERS (Excludes DROP members)

Age Group	Years of Accrued Service 0-1	1-2	2-3	3-4	4-5	5-9	10-14	15-19	20-24	25-29	30-34	35 & Up	Totals
15-19 NO.	3	0	0	0	0	0	0	0	0	0	0	0	3
TOT PAY	74,256	0	0	0	0	0	0	0	0	0	0	0	74,256
AVG PAY	24,752	0	0	0	0	0	0	0	0	0	0	0	24,752
20-24 NO.	93	56	15	7	1	2	0	0	0	0	0	0	174
TOT PAY	2,846,166	1,937,327	521,622	227,473	32,074	39,562	0	0	0	0	0	0	5,604,223
AVG PAY	30,604	34,595	34,775	32,496	32,074	19,781	0	0	0	0	0	0	32,208
25-29 NO.	165	183	134	78	53	68	1	0	0	0	0	0	682
TOT PAY	5,905,789	7,408,531	6,152,676	3,713,027	2,604,455	3,089,850	49,629	0	0	0	0	0	28,923,957
AVG PAY	35,793	40,484	45,915	47,603	49,141	45,439	49,629	0	0	0	0	0	42,410
30-34 NO.	155	169	141	159	117	397	162	1	1	0	0	0	1,302
TOT PAY	5,658,506	7,104,954	6,455,625	7,724,488	6,173,691	20,893,539	7,849,622	32,698	48,880	0	0	0	61,942,002
AVG PAY	36,506	42,041	45,785	48,582	52,767	52,629	48,454	32,698	48,880	0	0	0	47,575
35-39 NO.	110	122	113	92	85	447	720	195	8	0	0	0	1,892
TOT PAY	3,872,691	4,759,569	4,880,814	4,358,513	4,401,746	23,720,942	40,604,974	11,683,652	347,341	0	0	0	98,630,242
AVG PAY	35,206	39,013	43,193	47,375	51,785	53,067	56,396	59,916	43,418	0	0	0	52,130
40-44 NO.	92	104	83	62	76	286	688	488	158	11	0	0	2,048
TOT PAY	3,453,902	4,207,274	3,792,792	2,692,608	3,510,691	13,460,645	37,737,675	29,591,044	9,837,551	648,975	0	0	108,933,156
AVG PAY	37,542	40,455	45,696	43,429	46,193	47,065	54,851	60,637	62,263	58,998	0	0	53,190
45-49 NO.	66	84	61	46	42	224	428	424	426	112	17	1	1,931
TOT PAY	2,662,511	3,392,852	2,539,986	2,272,925	1,814,629	10,724,122	21,883,058	24,300,426	27,536,370	7,197,567	906,144	54,746	105,285,336
AVG PAY	40,341	40,391	41,639	49,411	43,205	47,876	51,129	57,312	64,639	64,264	53,303	54,746	54,524
50-54 NO.	49	48	45	30	22	140	232	267	240	218	90	17	1,398
TOT PAY	1,979,818	1,874,719	1,952,766	1,328,581	910,100	6,612,370	11,175,898	14,526,638	14,491,517	13,655,924	5,462,292	947,827	74,918,449
AVG PAY	40,404	39,057	43,395	44,286	41,368	47,231	48,172	54,407	60,381	62,642	60,692	55,755	53,590
55-59 NO.	25	24	19	15	13	70	156	104	86	65	56	43	676
TOT PAY	1,304,680	936,917	1,000,126	601,297	566,141	3,143,198	7,679,447	5,526,597	5,626,175	3,644,824	3,532,508	2,918,396	36,480,307
AVG PAY	52,187	39,038	52,638	40,086	43,549	44,903	49,227	53,140	65,421	56,074	63,080	67,870	53,965
60-64 NO.	2	4	8	8	9	32	57	59	26	13	12	7	237
TOT PAY	102,045	165,408	290,742	317,972	401,559	1,499,890	2,438,451	2,974,398	1,548,487	769,236	778,097	425,129	11,711,413
AVG PAY	51,022	41,352	36,343	39,746	44,618	46,872	42,780	50,414	59,557	59,172	64,841	60,733	49,415
65-99 NO.	4	0	1	3	2	9	19	10	5	5	3	5	66
TOT PAY	112,278	0	55,203	129,095	65,177	264,170	846,371	467,016	162,323	138,108	127,899	285,563	2,653,204
AVG PAY	28,070	0	55,203	43,032	32,588	29,352	44,546	46,702	32,465	27,622	42,633	57,113	40,200
TOT NO.	764	794	620	500	420	1,675	2,463	1,548	950	424	178	73	10,409
TOT AMT	27,972,642	31,787,551	27,642,353	23,365,979	20,480,261	83,448,288	130,265,124	89,102,469	59,598,645	26,054,633	10,806,939	4,631,661	535,156,545
AVG AMT	36,613	40,035	44,584	46,732	48,763	49,820	52,889	57,560	62,735	61,450	60,713	63,447	51,413

San Diego City Employees' Retirement System
Summary of Active Members
in the June 30, 2002 Actuarial Valuation

			Averages			
	No.	Annual Compensation	Annual Compensation	Age	Service	Including Purchased Service
GENERAL MEMBERS						
General						
6/30/02	7,632	$357,715,723	$46,871	43.3	10.2	10.8
6/30/01	7,175	317,556,435	44,259	43.0	10.1	
Percent Increase	6.4%	12.6%	5.9%			
Legislative						
6/30/02	10	774,561	77,456	46.2	6.8	8.9
6/30/01	8	505,918	63,240	45.3	5.3	
Percent Increase	25.0%	53.1%	22.5%			
Total General						
6/30/02	7,642	358,490,284	46,911	43.3	10.2	10.8
6/30/01	7,183	318,062,353	44,280	43.0	10.1	
Percent Increase	6.4%	12.7%	5.9%			

994 General members purchased 4,601 years of service

San Diego City Employees' Retirement System
Summary of Active Members
in the June 30, 2002 Actuarial Valuation

			Averages			
	No.	Annual Compensation	Annual Compensation	Age	Service	Including Purchased Service
SAFETY MEMBERS						
Police						
6/30/02	1,914	$122,117,880	$63,802	39.3	12.2	12.3
6/30/01	1,882	114,353,080	60,761	39.1	12.0	
Percent Increase	1.7%	6.8%	5.0%			
Fire						
6/30/02	766	49,722,904	64,912	41.2	13.5	14.0
6/30/01	747	45,265,809	60,597	41.3	13.6	
Percent Increase	2.5%	9.8%	7.1%			
Lifeguard						
6/30/02	87	4,825,477	55,465	36.9	7.9	7.9
6/30/01	80	4,182,077	52,276	36.7	7.9	
Percent Increase	8.7%	15.4%	6.1%			
Total Safety						
6/30/02	2,767	176,666,261	63,848	39.8	12.4	12.6
6/30/01	2,709	163,800,966	60,465	39.6	12.3	
Percent Increase	2.1%	7.9%	5.6%			
Grand Total						
6/30/02	10,409	$535,156,545	$51,413	42.4	10.8	11.3
6/30/01	9,892	481,863,319	48,712	42.1	10.7	
Percent Increase	5.2%	11.1%	5.5%			

192 Safety members purchased 618 years of service

San Diego City Employees' Retirement System
Summary of Inactive Members
in the June 30, 2002 Actuarial Valuation

	Inactive Members	Inactives - < 10 years of service	Member Contribution Balance	Averages Contribution Balance	Age	Service	Age at Termination
General Members							
6/30/02	1,328	1,000	$20,624,978	$15,531	43.4	6.3 [1]	38.4
6/30/01	1,271	947	18,443,339	14,511	43.2	6.6	38.6
Percent Increase	4.5%	5.6%	11.8%	7.0%			
Safety Members							
6/30/02	171	107	5,183,571	30,313	40.9	7.5 [2]	34.9
6/30/01	167	101	5,058,289	30,289	40.8	8.0	35.5
Percent Increase	2.4%	5.9%	2.5%	0.1%			
Total City							
6/30/02	1,499	1,107	$25,808,549	$17,217	43.1	6.4 [3]	38.0
6/30/01	1,438	1,048	23,501,628	16,343	42.9	6.8	38.2
Percent Increase	4.2%	5.6%	9.8%	5.3%			

There are 59 inactive members with 243 years of service purchased

[1] 6.5 with purchased service included
[2] 7.6 with purchased service included
[3] 6.6 with purchased service included

San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
in the June 30, 2002 Actuarial Valuation
(City Only)

The following include DROP Retirements

				Averages			New Retirees		
	No.	Annual Allowance	Annual Allowance	Attained Age	Age at[1] Retirement	Service at[1] Retirement	No.	Age	Allowance
General Members									
6/30/02	2,999	$49,183,256	$16,400	71.1	58.0	21.7	147	59.7	$31,617
6/30/01	2,937	45,757,397	15,580	70.8	58.1	21.1	232	58.6	29,943
Percent Increase	2.1%	7.5%	5.3%						
Safety Members									
6/30/02	2,144	72,371,321	33,755	63.1	49.2	21.8	145	54.8	57,724
6/30/01	2,075	66,880,161	32,231	62.8	48.9	21.3	154	52.5	56,261
Percent Increase	3.3%	8.2%	4.7%						
6/30/02 Grand Total	5,143	$121,554,577	$23,635	67.7	54.2	21.7	292	57.3	$44,581
6/30/01 Grand Total	5,012	112,637,558	22,474	67.5	54.2	21.2	386	56.1	$40,443
Percent Increase	2.6%	7.9%	5.2%						

[1] Retirees only; beneficiaries excluded

San Diego City Employees' Retirement System
Summary of DROP Members
in the June 30, 2002 Actuarial Valuation

			DROP Averages				New DROPS		
	No.	Annual Allowance	Annual Allowance	Attained Age	Age At Drop	Service at Drop	No.	Age	Annual Allowance
DROP General									
6/30/02	186	$6,068,627	$32,627	60.6	58.7	28.0	36	58.5	$29,858
6/30/01	198	6,474,794	32,701	60.7	59.1	27.7	82	58.8	33,529
Percent Increase	-6.1%	-6.3%	-0.2%						
DROP Lifeguard									
6/30/02	1	48,883	48,883	50.6	50.0	30.9	1	50.0	48,883
6/30/01	0	0	0	0.0	0.0	0.0	0	0.0	0
Percent Increase	N/A	N/A	N/A						
DROP Police									
6/30/02	192	11,356,319	59,147	55.5	53.2	26.2	33	52.9	63,417
6/30/01	189	10,869,509	57,511	55.2	53.3	26.0	51	52.1	61,261
Percent Increase	1.6%	4.5%	2.8%						
DROP Fire									
6/30/02	143	9,091,921	63,580	55.8	53.5	28.5	17	53.8	67,968
6/30/01	160	9,850,661	61,567	55.8	53.7	28.2	37	53.5	63,831
Percent Increase	-10.6%	-7.7%	3.3%						
DROP Grand Total									
6/30/02	522	$26,565,750	$50,892	57.4	55.2	27.5	87	55.3	$50,253
6/30/01	547	27,194,964	49,717	57.3	55.5	27.3	170	55.6	48,443
Percent Increase	-4.6%	-2.3%	2.4%						

ACTUARIAL COST METHODS, ACTUARIAL ASSUMPTIONS

AND

DEFINITIONS OF TECHNICAL TERMS

Normal cost and the allocation of benefit values between service rendered before and after the valuation date were determined using the Projected Unit Credit actuarial cost method.

Financing of Unfunded Actuarial Accrued Liability. The balance of unfunded actuarial accrued liabilities was amortized by level (principal & interest combined) percent of payroll contributions over the 30-year period beginning July 1, 1991 (19 years remaining).

Active member payroll in aggregate was assumed to increase 4.25% a year for the purpose of determining the level percent contributions, although individual annual compensation increase rates will increase by at least 4.75% per year for the purpose of projecting individual benefits.

Deferred Member Actuarial Accrued Liability. Typically, data provided includes date of hire, date of birth, date of termination, and last pay. Based on the data reported, service credit, highest average salary, and deferred retirement age were estimated. The estimates were used to compute the retirement benefit, upon which the liabilities are based. For those members without sufficient data, accumulated member contribution balances, with interest, were used as the actuarial accrued liability.

Actuarial Assumptions Used for the June 30, 2002 Valuation

The contribution requirements and benefit values of the Fund are calculated by applying actuarial assumptions to the benefit provisions and member information furnished, using the actuarial cost methods described on the previous page.

The principal areas of financial risk which require assumptions about future experiences are:

(i) long-term rates of investment return to be generated by the assets of the Fund.
(ii) patterns of pay increases to members.
(iii) rates of mortality among members, retirants, and beneficiaries.
(iv) rates of withdrawal of active members (without entitlement to a retirement benefit).
(v) rates of disability among members.
(vi) the age patterns of actual retirements.

In making a valuation, the monetary effect of each assumption is calculated for as long as a present covered person survives -- a period of time which can be as long as a century.

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Actual experience of the system will not coincide exactly with assumed experience, regardless of the choice of the assumptions, the skill of the actuary and the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments to the computed contribution rate. From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends (but not random year-to-year fluctuations).

(Continued on Next Page)

Actuarial Assumptions Used for the June 30, 2002 Valuation

The investment return rate used for the actuarial valuation calculations was 8.0% a year, net of administrative expenses, compounded annually. This assumption is used to equate the value of payments due at different points in time. The rate is comprised of two elements:

Inflation	4.25%
Real Rate of Return	3.75%
Total	8.00%

Administrative expenses have averaged 0.2% over the last three valuations. Since the 8.0% assumed rate of return is currently net of administrative expenses, the comparable gross rate would be 8.2%. Currently, no administrative expenses are explicitly recognized in the valuation.

The Inflation rate used for the actuarial valuation calculations was 4.25% per year compounded annually. It represents the difference between the investment return rate and the assumed real rate of return.

Inflation actually experienced, as measured by the Consumer Price Index for urban wage earners, has been as follows:

Consumer Price Index
Urban Wage Earner and Clerical Workers Before 1978
All Urban Consumers After 1977
10 Year Moving Averages

June 30, 1962	1.3%
June 30, 1972	3.3%
June 30, 1982	8.8%
June 30, 1992	3.8%
June 30, 2002	2.5%
50-Year Average	**3.9%**

Interest credited to member contributions is 8.0%, compounded annually.

Salary increase rates used to project current pays to those upon which a benefit will be based are represented by the following table. Rates do not vary by age, but do reflect an added merit component, starting with the 1998 valuation, for those with 0-4 years of service at the valuation date.

Inflation	4.25%
Merit and Longevity	0.50%
Total	4.75%

(Continued)

The additional merit component is:

Years of Service at Valuation Date	General	Safety
0	4.5%	6.5%
1	3.5%	5.5%
2	2.5%	4.5%
3	1.5%	3.0%
4	0.5%	1.5%

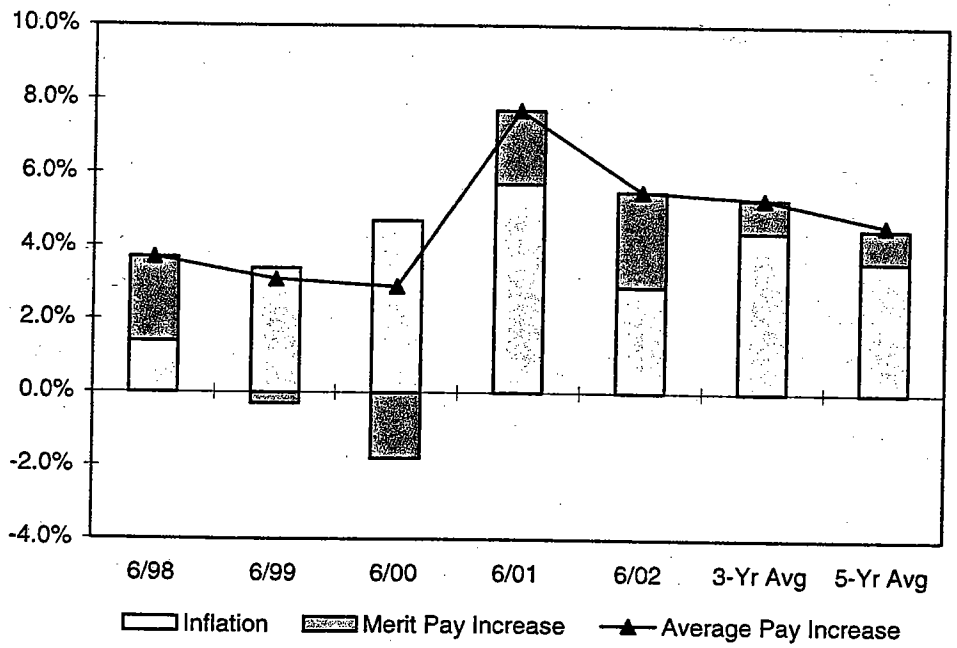
The assumed, annual cost-of-living adjustment is generally 2% per annum, compounded. There is a closed group of 147 special safety officers whom we assume an annual adjustment equal to inflation (4.25% per year).

San Diego City Employees' Retirement System

Actuarial Assumptions Used for the June 30, 2002 Valuation

(Continued)

Salary Increase Analysis

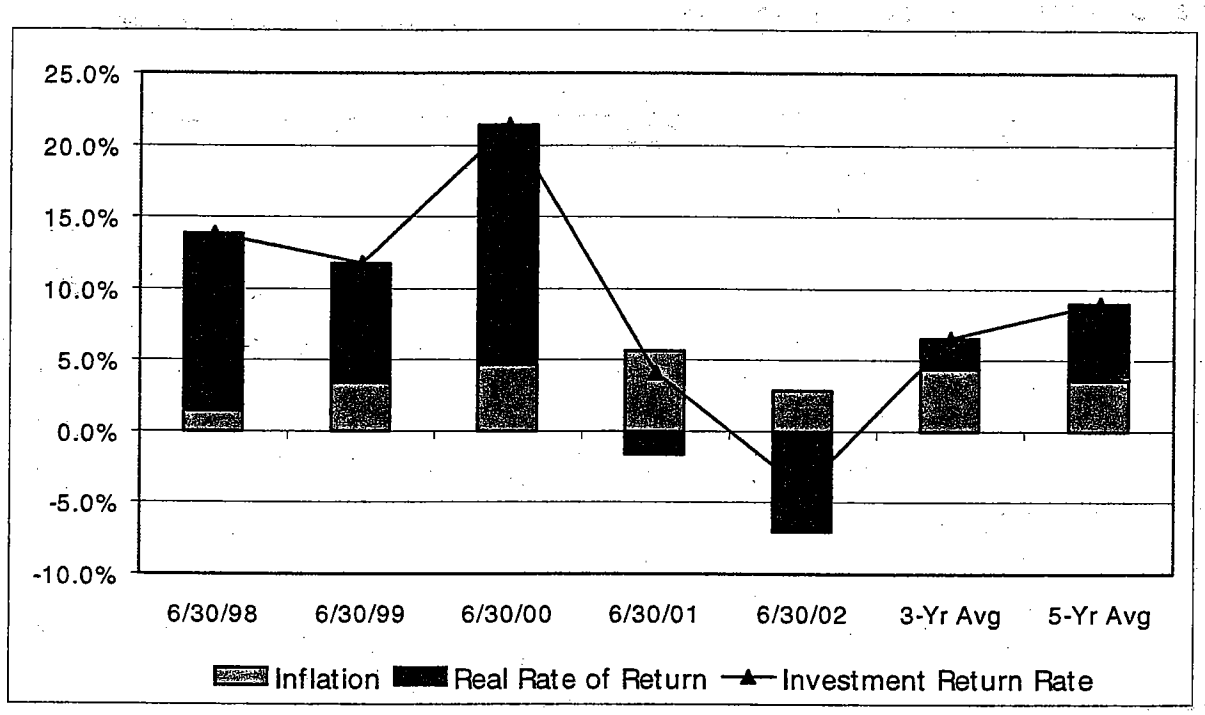


Valuation Date	No.	Total Payroll	Percent Increase	Average Salary	Percent Increase
6/30/92	8,991	$312,490,764	9.2%	$34,756	3.9%
6/30/93	8,615	$320,623,685	2.6%	$37,217	7.1%
6/30/94	8,893	$338,440,247	5.6%	$38,057	2.2%
6/30/95	9,060	$350,583,835	3.6%	$38,696	1.7%
6/30/96	9,198	$365,088,750	4.1%	$39,692	2.6%
6/30/97	9,312	$382,715,084	4.8%	$41,099	3.5%
6/30/98	9,359	$399,035,094	4.3%	$42,637	3.7%
6/30/99	9,654	$424,515,969	6.4%	$43,973	3.1%
6/30/00	9,913	$448,501,827	5.7%	$45,244	2.9%
6/30/01	9,892	$481,863,319	7.4%	$48,712	7.7%
6/30/02	10,409	$535,156,545	11.1%	$51,413	5.5%

San Diego City Employees' Retirement System

Actuarial Assumptions Used for the June 30, 2002 Valuation

(Continued)



San Diego City Employees' Retirement Association

Comparison of Selected Actuarial Assumptions To Actual Experience

(Continued)

The salary increase assumptions project annual increases in total member payroll of 4.25%, the inflation portion of the individual pay increase assumptions. In effect, this assumes no change in the number of active members. Changes actually experienced in areas related to these assumptions have been as follows:

	Year Ended					3-year	5-year
	6/30/02	6/30/01	6/30/00	6/30/99	6/30/98	Average	Average
Inflation[1]	2.9%	5.7%	4.7%	3.4%	1.4%	4.4%	3.6%
Assumed						4.25[2]	4.25[2]
Average Pay Increase	5.5	7.7	2.9	3.1	3.7	5.3	4.6
Assumed						4.25[2]	4.25[2]
Merit & Longevity Increase	2.6	2.0	(1.8)	(0.3)	2.3	0.9	0.9
Assumed						0.5	0.5
Total Payroll	11.1	7.4	5.7	6.4	4.3	8.0	7.0
Assumed						4.25[2]	4.25[2]
Investment Return Rate[4]	(4.1)	4.1	21.4	11.8	13.8	6.6	9.0
Assumed						8.0	8.0
Real Rate of Investment Return	(7.0)	(1.6)	16.7	8.4	12.4	2.2	5.4
Assumed						3.75[3]	3.75[3]
Administrative Expenses[5] (Percentage of assets)	0.3	0.2	0.2	0.1	0.2	0.2	0.2
Assumed						0.0	0.0

1 Based on Consumer Price Index for San Diego, All Items, 1982-84=100.

2 Reduced from 4.5% for 1998 valuation.

3 Increased from 3.5% for 1998 valuation.

4 Based on actuarial value of assets NOT market value or book value.

5 Excluding Investment Fees.

Actuarial Assumptions Used for the June 30, 2002 Valuation

(Continued)

Rates of separation from active membership are shown below (rates do not include separation on account of retirement or death). This assumption measures the probabilities of members remaining in employment.

		% of Active Members Separating Within Next Year						
		Disability[1]		Other[2]				
				General				
Sample Ages	Years of Service	General	Safety	Male	Female	Safety	Years of Service	Sample Ages
All	0			4.3%	7.3%	4.4%	0	All
	1			4.3	7.2	4.4	1	
	2			4.3	7.0	4.3	2	
	3			4.3	6.9	4.1	3	
	4			4.2	6.3	4.0	4	
20	5 & Over	0.6%	.54%	4.0	5.6	3.2	5 & Over	20
25		0.8	.60	4.0	5.6	3.2		25
30		.10	.65	3.7	4.2	2.2		30
35		.16	.71	3.2	2.6	1.4		35
40		.22	.90	2.1	2.0	0.6		40
45		.33	1.15	1.7	1.6	0.3		45
50		.50	1.25	1.3	1.3	0.1		50
55		.75	1.50	0.9	1.0	0.0		55
60		.97	0.00	0.0	0.0	0.0		60

[1] 70% of the General Disabilities and 100% of the Safety Disabilities are assumed to be Industrial. Non-industrial disability is subject to service requirement.

[2] 20% of terminating employees, with 10+ years of service at termination, are assumed to subsequently work for a reciprocal employer and receive 4.75% pay increases per year.

(Continued on Next Page)

(Continued)

The post-retirement mortality table used was the 1994 Uninsured Pension Mortality Table, set back 2 years for retirees and set forward 5 years for disability retirees. This assumption is used to measure the probabilities of members dying after retirement and the probabilities of each benefit payment being made after retirement. Related values are shown below.

	Future Life Expectancy (Years)		
	Retirants		
Sample Ages	Men	Women	Disabilitants
45	36.07	40.44	30.01
50	31.37	35.64	25.49
55	26.78	30.90	21.20
60	22.38	26.27	17.26
65	18.28	21.86	13.77
70	14.61	17.80	10.66
75	11.35	14.03	7.97
80	8.48	10.61	5.86

The active member mortality assumption measures the probability of mortality before retirement. The rates include probability of ordinary death, service death, and death while eligible for retirement or disability.

	Members Dying Within the Next Year					
	Active Members				Service Retirants & Beneficiaries	
	General					
Sample Ages	Men	Women	Safety	Sample Ages	Men	Women
30	.07%	.03%	.07%	45	0.15%	0.09%
35	.09	.04	.09	50	0.23	0.13
40	.09	.05	.09	55	0.39	0.21
45	.12	.08	.12	60	0.68	0.36
50	.17	.10	.17	65	1.23	0.72
55	.28	.15	.28	70	2.14	1.26

All active member deaths are assumed to be duty-related for Safety members and not duty-related for other members.

(Continued on Next Page)

(Continued)

The rates of retirement used to measure the probability of eligible active members retiring during the next year.

Retirement Ages	Percent of Members Retiring Within the Next Year			
	Safety Members	General Members	Legislative Members Men	Legislative Members Women
50	10%	--%	--%	--%
51	10	--	--	--
52	10	--	--	--
53	10	--	15	15
54	20	--	1	1
55	40	20	5	6
56	40	10	3	3
57	40	10	4	4
58	50	15	5	4
59	80	15	6	5
60	85	20	60	60
61	90	25	25	25
62	100	50	39	29
63	100	40	23	25
64	100	25	34	35
65	100	50	70	60
66	100	40	70	65
67	100	40	75	70
68	100	40	80	80
69	100	40	90	90
70	100	100	100	100

For vested deferred members, we assume that retirement will occur provided they have 10 years of service (4 for Legislative members) on the later of attained age or:

General members: Earlier of age 62 or age 55 and 20+ years of service

Legislative members: Earlier of age 55 or age 53 and 8+ years of service

Safety members: Earlier of age 55 or age 50 and 20+ years of service

If the inactive member is not vested, the liability is the return of the member's employee contributions with interest.

Actuarial Assumptions Used for the June 30, 2002 Valuation

(Concluded)

Member refunds. All or part of the employee contribution rate is subject to potential "pick up" by the employer. Such pick up and related accumulated interest are not to be refunded to employees at termination. The City's liability for potential refunds is reduced to reflect this.

Rates provided in the census apply to salary amounts over $400 per month in the case of employees with integrated benefits. Rates applicable to the first $400 per month of salary are not provided. Due to the small portion of salary to which a different rate is applied and the substantial portion of total member contributions subject to employer pick up, rates provided were assumed, for simplicity, to apply to total salary.

Survivor Benefits. Marital status and spouses' census data were imputed with respect to active and deferred members.

Marital Status:	80% of men and 50% of women were assumed married at retirement.
Spouse Census:	Women were assumed to be 4 years younger than men.

Member Contributions for Spousal Continuance. Municipal Code §24.0521 dictates that all active members contribute towards a 50% survivor continuance. However, it also provides that members unmarried at retirement may either be refunded that specific part of their contributions, or they may leave such contributions on account and receive an incremental benefit that is the actuarial equivalent of such contributions.

DEFINITIONS OF TECHNICAL TERMS

Actuarial Accrued Liability. The difference between the actuarial present value of system benefits and the actuarial value of future normal costs. Also referred to as "accrued liability" or "actuarial liability".

Actuarial Assumptions. Estimates of future experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Actuarial assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.

Accrued Service. Service credited under the system which was rendered before the date of the actuarial valuation.

Actuarial Equivalent. A single amount or series of amounts of equal actuarial value to another single amount or series of amounts, computed on the basis of appropriate actuarial assumptions.

Actuarial Cost Method. A mathematical budgeting procedure for allocating the dollar amount of the actuarial present value of retirement system benefits between future normal cost and actuarial accrued liability. Sometimes referred to as the "actuarial funding method".

Actuarial Gain (Loss). The difference between actual experience and actuarial assumption anticipated experience during the period between two actuarial valuation dates.

Actuarial Present Value. The amount of funds currently required to provide a payment or series of payments in the future. It is determined by discounting future payments at predetermined rates of interest, and by probabilities of payment.

Amortization. Paying off an interest-discounted amount with periodic payments of interest and principal -- as opposed to paying off with lump sum payment.

DEFINITIONS OF TECHNICAL TERMS

(Continued)

Normal Cost. The actuarial present value of retirement system benefits allocated to the current year by the actuarial cost method.

Pension Benefit Obligation. A standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date.

Unfunded Actuarial Accrued Liability. The difference between actuarial accrued liability and valuation assets. Sometimes referred to as "unfunded actuarial liability" or "unfunded accrued liability".

Most retirement systems have unfunded actuarial accrued liability. They arise each time new benefits are added and each time an actuarial loss is realized.

The existence of unfunded actuarial accrued liability is not in itself bad, any more than a mortgage on a house is bad. Unfunded actuarial accrued liability does not represent a debt that is payable today. What is important is the ability to amortize the unfunded actuarial accrued liability and the trend in its amount (after due allowance for devaluation of the dollar). Unfunded actuarial accrued liability must be controlled.

APPENDIX A:

MEMBER CONTRIBUTION RATES

San Diego City Employees' Retirement System
June 30, 2002 Actuarial Valuation
General Member Contribution Rates

Entry Age	Normal Plus Cost-Of-Living Rates	Entry Age	Normal Plus Cost-Of-Living Rates
16	8.61%	37	10.65%
17	8.61	38	10.78
18	8.61	39	10.91
19	8.61	40	11.05
20	8.61	41	11.19
21	8.71	42	11.32
22	8.82	43	11.46
23	8.93	44	11.61
24	9.03	45	11.75
25	9.16	46	11.89
26	9.28	47	12.04
27	9.39	48	12.19
28	9.51	49	12.34
29	9.63	50	12.48
30	9.75	51	12.65
31	9.88	52	12.80
32	10.00	53	12.96
33	10.12	54	13.12
34	10.24	55	13.28
35	10.38	56	13.44
36	10.51	57	13.64

Interest: 8.00%
Salary: 5.00%
Mortality: 83 GAM male (X-2, X-8)

Rates include cost of providing spouse's continuance and cost of funding final one-year average salary in lieu of final three-year average. Changes to the salary scale and mortality table effective with the June 30, 1994 valuation were applied to the then existing member rates.

Members of the legislature contribute 9.05% of total salary, regardless of entry age.

The rates above include 0.61% for General and 0.16% for Legislature currently paid from the Employee Contribution Rate Increase Reserve (See Comment H).

San Diego City Employees' Retirement System

June 30, 2002 Actuarial Valuation

Safety Member Contribution Rates

	Normal Plus Cost-of-Living Rates		
Entry Age	Police	Fire	Lifeguard
20	11.88%	11.53%	11.26%
21	12.04	11.69	11.42
22	12.18	11.83	11.56
23	12.34	11.99	11.72
24	12.49	12.14	11.87
25	12.66	12.31	12.04
26	12.81	12.46	12.19
27	12.98	12.63	12.36
28	13.14	12.79	12.52
29	13.31	12.96	12.69
30	13.47	13.12	12.85
31	13.64	13.29	13.02
32	13.80	13.45	13.18
33	13.97	13.62	13.35
34	14.15	13.80	13.53
35	14.33	13.98	13.71
36	14.50	14.15	13.88
37	14.68	14.33	14.06
38	14.87	14.52	14.25
39	15.05	14.70	14.43
40	15.24	14.89	14.62
41	15.43	15.08	14.81
42	15.61	15.26	14.99
43	15.81	15.46	15.19
44	16.01	15.66	15.39
45	16.19	15.84	15.57
46	16.42	16.05	15.78
47	16.60	16.25	15.98
48	16.79	16.44	16.17
49	16.99	16.64	16.37

Interest: 8.00%
Salary: 5.00%
Mortality: 83 GAM male (X-2, X-8)

Rates include cost of providing spouse's continuance and cost of funding final one-year average salary in lieu of final three-year average. Changes to the salary scale and mortality table effective with the June 30, 1994 valuation were applied to the then existing member rates.

The rates above include 0.67% for Police, 0.63% for Fire, and 0.71% for Lifeguard currently paid from the Employee Contribution Rate Increase Reserve (See Comment H).

APPENDIX B:

RETIREMENT AGE FACTORS