



August 17, 2016

CALPERS AUDIT FINDINGS HIGHLIGHT NEED TO MAKE CLASSIFIED SALARY SCHEDULES PUBLICLY AVAILABLE

In July of this year, the California Public Employees Retirement System issued guidance in the form of Circular Letter 200-025-16 relating to audit procedures, highlighting the common finding that districts routinely fail to observe legal requirements concerning the posting of pay schedules. A copy of the Circular is attached.¹

Specifically, CalPERS regulations contain requirements relating to pay schedules which must be observed for the pay to be considered “compensation earnable” counting toward the defined retirement benefit. The Government Code defines compensation earnable to include the employee's pay rate “pursuant to publicly available pay schedules.”

Title 2, California Code of Regulations, section 570.5 (adopted in 2011) provides that the pay rate is limited to amounts listed on a pay schedule that meets all of the following requirements:

- (1) Has been duly approved and adopted by the employer's governing body in accordance with requirements of applicable public meetings laws;
- (2) Identifies the position title for every employee position;
- (3) Shows the pay rate for each identified position, which may be stated as a single amount or as multiple amounts within a range;
- (4) Indicates the time base, including, but not limited to, whether the time base is hourly, daily, bi-weekly, monthly, bi-monthly, or annually;
- (5) Is posted at the office of the employer or immediately accessible and available for public review from the employer during normal business hours or posted on the employer's Internet website;
- (6) Indicates an effective date and date of any revisions;
- (7) Is retained by the employer and available for public inspection for not less than five years; and
- (8) Does not reference another document in lieu of disclosing the pay rate.

¹ The Circular highlights other common compliance review findings in addition to the issues around pay schedules, such as failure to observe requirements relating to retired annuitants and incorrect reporting of unused sick leave. See also, CalPERS Circular Letter 200-050-12 (Oct. 25, 2012).

When these requirements are not met, CalPERS may establish the pay rate using any information it deems relevant. In one recent case, the California Court of Appeal upheld CalPERS' significant reduction of benefits where the pay rate did not appear on a publicly available pay schedule.

In *Tanner v. California Public Employees' Retirement System* (2016) 248 Cal.App.4th 743, a city official entered into a written employment agreement with the City of Vallejo with a base salary of \$216,000 along with other compensation (auto allowance, deferred compensation contributions, etc.) totaling \$89,844. The City submitted the agreement to CalPERS, with CalPERS responding that the law would not permit the additional compensation to be converted to base salary for retirement purposes. The City drafted a new contract for a base salary of \$305,844, without the elements of additional compensation, "to comply with [CalPERS] regulations without changing the total cost of the original employment agreement." When the official retired, CalPERS informed him that it would compute his retirement benefit based on the original base salary of \$216,000.

The California Court of Appeal concluded that the higher base salary did not qualify as the pay rate because it was not paid pursuant to a publicly available pay schedule. The court did not accept the argument that the employment agreement or a cost analysis document were the equivalent of a pay schedule, even though both documents were publicly available. The Court defined a schedule to mean a "written or printed list, catalog or inventory" and concluded that the employment agreement and cost analysis did not isolate the pay rate, but rather contained significant additional information, making it hard for the public to locate the base salary among the other figures and information. The court opined that the Legislature's purpose in enacting the anti-spiking legislation in question was to ensure that pay rates would be stable, predictable and publicly noticed by the governing body.²

We recommend that districts review their practices to ensure that classified pay schedules (for unit members as well as supervisory/confidential/management employees) reflect the actual pay rates for people in the job classification and are properly available for public inspection - whether by posting the information at the district office, making it immediately accessible for public inspection during business hours, or by posting it on the district website. CalPERS will not accept a reference to the base salary in an employment contract or budgetary documents as sufficient to comply with Regulation 570.5.

If you have any questions concerning this or related issues, do not hesitate to contact our office.

— Grant Herndon

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² The *Tanner* court cited a 2007 decision in *Prentice v. Board of Administration, CalPERS* (2007) 157 Cal.App.4th 983, in which a city employee was given a 10.49 percent raise which resulted in a pay rate higher than the salary range for the position. The court found that although the pay raise was included in the city budget, it was never incorporated into a published pay schedule and differed from the raise given to other employees in the classification, with the result that it was not included in the computation of the retirement benefit.



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Circular Letter: 200-025-16
Distribution: IV, V, VI, X, XII, XVI

Circular Letter

July 12, 2016

TO: **ALL CALPERS EMPLOYERS**

SUBJECT: **ADMINISTRATION OF CALPERS EMPLOYER COMPLIANCE REVIEWS**

The purpose of this Circular Letter is to provide information on the CalPERS compliance review process, finding resolution, and the most common findings.

Employer as Defined by Government Code Section 20030:

The state, university, school employer, and any contracting agency employing an employee.

Background:

CalPERS Office of Audit Services (OFAS) has conducted employer (agency) compliance reviews since 1991 to determine whether agencies comply with applicable sections of the California Government Code (GC), California Public Employees' Pension Reform Act of 2013, California Code of Regulations (CCR), and CalPERS contracts. OFAS performs these reviews to provide assurance to both CalPERS and contracting agencies of compliance with the Public Employees' Retirement Law and agencies' retirement contracts with CalPERS.

Authority to Review:

CalPERS' authority to review agencies for compliance is stipulated in each agency's contract and in GC sections 20222.5, 22797, 7522.34(c)(11,12), 7522.72(g), and 7522.74(g).

Selection of Agencies to Review:

CalPERS may select agencies to review based on the following factors:

- Annual risk assessments
- Direction from CalPERS management
- Anonymous tips
- Requests from the CalPERS Board
- Agency requests
- Other indications of non-compliance

Scope of Reviews:

The scope of the compliance review is defined in the beginning of each review and identifies the specific compliance areas to be examined.

Compliance Review Process – What to Expect:

1. Initial contact: OFAS auditor informs the agency staff of an upcoming review via telephone call.
2. Engagement letter: Within a few days of the initial contact, OFAS provides an engagement letter officially notifying the agency of the review, and detailing information expected to be available for the review.
3. Entrance conference: After sending the engagement letter, the auditor schedules an in-person or conference call meeting with OFAS and agency management to discuss the review objectives, process, and timeframes. The auditor asks questions about the agency and answers any agency questions about the review.
4. Planning: In this phase, the auditor gathers relevant information about the agency to prepare for review.
5. Fieldwork: The auditor interviews agency staff members to understand the agency's business processes and reviews selected records. The auditor then tests various transactions/records to achieve the review objectives.
6. Post-Fieldwork: The auditor may contact agency staff to seek further clarification, obtain additional information/documentation, or provide updates on audit findings.
7. Exit conference: At the completion of the review, the auditor summarizes the issues identified during the review. This is an opportunity for the agency to provide additional documentation or clarification that may have an impact on the compliance report.
8. Quality review: OFAS management performs a quality review to ensure all the issues identified during the review are supported. If issues are revised or added during this phase, the auditor contacts the agency to provide clarification and to explain those changes.

Examples of information required to be provided either before or during the on-site visit:

- Memorandum of Understanding, employment contracts, salary agreements
- Governing body meeting minutes
- Resolutions related to employee benefits
- Publicly available pay schedules
- Roster of employees who are CalPERS members, temporary/part-time employees, temporary agency employees, independent contractors, and retired annuitants
- IRS forms, 1099-Misc
- Audited financial statements and management letters
- Payroll registers
- Health benefit enrollment documents such as birth and marriage certificates and divorce decrees

The compliance review program varies based on the type of assignment, and can include, but is not limited to, the following compliance areas:

- Pay schedule
- Salary and compensation
- Contributions
- Excluded and optional positions
- Temporary and/or part-time employees
- Retired annuitants
- Employees of affiliated entities
- Retiring member unused sick leave certifications
- Health benefits
- Accuracy of data reported in my|CalPERS
- Processes related to disability retirement determinations

Reporting of Findings:

OFAS prepares a formal draft report, taking into account any revisions resulting from the exit conference and quality review. The draft report is considered confidential and provides the agency an opportunity to respond in writing prior to issuance of the final report. Once OFAS issues the draft report, the agency has 15 days to provide a written response.

The final report includes the agency's response and is issued to the agency's governing body and staff as well as relevant CalPERS divisions. The final report is publicly available and posted on www.calpers.ca.gov.

Compliance Review Follow-up and Finding Resolution:

In accordance with the International Standards for the Professional Practice of Internal Auditing Standards, OFAS has a follow-up process to monitor findings and ensure management actions have been implemented effectively. The appropriate CalPERS division will contact the agency after the final report has been issued to ensure resolution of the findings.

Common Compliance Review Findings:

- Pay schedule does not meet all of the California GC and/or CCR requirements.
- Special compensation is not reported in accordance with the GC and CCR.
- Non-reportable compensation is reported or included in pay rate and earnings.
- Payroll information, such as number of work week hours, is incorrectly reported.
- Earnings and pay rates are reported incorrectly or exceed the maximum listed on a publicly available pay schedule.
- Retroactive adjustments are reported incorrectly.
- Retirement contributions are paid or reported incorrectly.
- Part-time employees or temporary agency staff deemed to be agency employees are not enrolled into membership when eligible.
- Eligible employees are not enrolled into CalPERS membership as required.
- Member reciprocal self-certification is not maintained by the agency.

- Elected officials as defined by retirement law are not offered optional membership.
- Unused sick leave is not reported or reported incorrectly.
- Retired annuitant employment does not comply with all legal requirements, such as the requirements for bona fide separation, the limit of 960 hours allowed per fiscal year, or payrate exceeding the maximum rate on the agency's pay schedule.
- Retired annuitant information is not reported as required.

Additional Resources:

For additional information regarding **Common Membership Findings found in CalPERS Public Employer Reviews**, refer to Circular Letter: **200-065-14**, October 27, 2014.

For additional information regarding **Common Misreported Items of Compensation**, refer to Circular Letter: **200-064-14**, October 27, 2014.

Log in to your my|CalPERS account and select the Education Tab for Business Rules and my|CalPERS Employer Training, including Student Guides. You can attend training at our Regional Offices or through Online Classes.

For more information on these topics, please refer to the 'Public Agency & Schools Reference Guide' or the 'State Reference Guide' which are located on the CalPERS website.

If you have questions that are not addressed within the resources provided, please call our CalPERS Customer Contact Center at **888 CalPERS** or **(888-225-7377)**.

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