ATTACHMENT B

STAFF'S ARGUMENT

STAFF'S ARGUMENT TO REJECT THE PROPOSED DECISION AND REQUEST FOR A FULL BOARD HEARING

Classified school employees are CalPERS' largest membership group. Approximately 2,800 school district member agencies report classified employee compensation to CalPERS on an hourly, daily or monthly basis. Government Code section 20636.1[1] (Gov. Code section 20636.1, eff. 2001) governs the reporting of classified school employee compensation to CalPERS.

Prior to the passage of section 20636.1, classified school members were treated differently depending on how the various school districts reported compensation. For instance, compensated work in excess of the hours considered normal for employees employed on a full-time basis was considered overtime. Accordingly, some districts considered work to be overtime only if the employee worked more than 40 hours per week. Other districts considered work in excess of regularly scheduled part-time work to be overtime (such as hours worked over an employee's scheduled 6-hour shift). The result was that employers would report compensation and service credit to CalPERS based on differing practices.

The variances in reporting caused inequitable treatment of CalPERS members. Two CalPERS members working the same positions at the same hourly pay rate for different employers could (and did) have different compensation and service credit reported on their behalf. For example, two school bus drivers working for different employers could be scheduled to drive school buses 25 hours/week and also work 15 hours/week as hall monitors. Because one employer considers all hours over 25 hours/week to be overtime, this employer excludes earnings, compensation and service credit for the 15 hours/week worked as a hall monitor. However, a second employer considers hours in excess of 40 hours/week to be overtime, so the second employer reports both the 25 plus 15 hours of earnings, compensation and service credit. This inequitable reporting led to inequitable retirements. Although both employees in the above example worked the exact same schedules, and earned the same hourly pay rate, one employee will earn more in retirement because his employer reported more service credit on his behalf.

Section 20636.1 was passed in 2001 to fix these inequities and standardize the reporting of compensation and service credit for school employees. Section 20636.1 ensured that only work in excess of 40 hour per week is considered non-reportable overtime. Section 20636.1 also ensured that school employees receive service credit and compensation for work up to 40 hours per week.

[1] All future references are to the Government Code.

Section 20636.1(b) states:

> "Payrate" means the normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group or class of employment for services rendered on a full-time basis during normal working hours, pursuant to publicly available pay schedules. For purposes of this part, for classified members, full-time employment is 40 hours per week, and payments for services rendered, not to exceed 40 hours per week, shall be reported as compensation earnable for all months of the year in which work is performed. "Payrate," for a member who is not in a group or class, means the monthly rate of pay or base pay of the member, paid in cash and pursuant to publicly available pay schedules, for services rendered on a full-time basis during normal working hours, subject to the limitations of paragraph (2) of subdivision (e). (Section 20636.1(b)(1).)

So long as employers report based on a 40-hour week, employers may report payrate on a monthly or hourly basis. All monthly reporting is required to be based on 2,080 hours in a year, or a full-time 40-hour week over an entire year.

Since its 2001 passage, CalPERS has consistently worked to ensure uniform reporting under section 20636.1 through outreach and training. CalPERS also implemented business rules to carry out section 20636.1. Business rules are the CalPERS laws and regulations built into CalPERS' database for reporting and retirement calculation. CalPERS trains its member agencies about the business rules so that the agencies can understand their impact. CalPERS' training given to member agencies includes the annual Employer Forum, school specific training sessions, personal presentations on site, conference presentations, 1-1 phone conversations, Circular Letters, and the Public Agency and School Reference Guide which are all provided to employers for guidance and instruction on how they should reference and enter data.

CalPERS Audit and Determination

CalPERS Office of Audit Service (OAS) performed an audit of 64 public agencies in 2017 and 2018, including Tustin Unified School District (Tustin). On July 18, 2018, CalPERS issued its Draft Audit Report (Draft), which concluded that Tustin was reporting payrate incorrectly. The Draft included six specific findings related to Tustin's reporting of employee compensation to CalPERS. Finding four states:

1) Tustin was incorrectly reporting payrate for its full-time classified employees;
2) the reporting was based on less than a 40-hour workweek; and
3) the reporting was not based on 12 months of the year.

By letter dated August 6, 2018, Tustin disputed finding four of the Draft Audit. Tustin argued that section 20636.1 does not require reporting based on 2,080 hours per year, or 173.33 hours per month.

CalPERS’ Final Audit Report (Audit) dated December 6, 2018 states:

> The Agency did not correctly report full-time payrates for a sampled classified employee who retired in January 2015. Specifically, the reported payrates were not based on a 40-hour workweek for all months of a year as required by section 20636.1. For example, the Agency reported a monthly payrate of $4,022 for the employee in the pay period ended August 31, 2012; however, the reported monthly payrate should have been $3,915.60. The payrates reported for the retired sampled employee reflected a workweek of less than 40 hours and the payrates were not based on all 12 months of the year. The incorrect reporting resulted in decreases to the employee’s reported payrates that were not in compliance with section 20636.1.

CalPERS notified Tustin of the Audit, and Tustin again disputed the Audit findings. CalPERS’ final Determination letter dated December 19, 2019, confirmed the Audit findings, directed Tustin to change its reporting practices, and explained the difference between earnings and payrate:

> Pursuant to section 20636.1(b), the earnings are not considered the same as payrate because the earnings are not equivalent to the normal rate of pay or base pay based on full-time employment of 40 hours per week. Further, for classified school members, CalPERS does not deem employment of less than 40-hours per week as full-time employment for purposes of service credit accrual; therefore, employment of less than 40-hours per week should not yield full-service credit per month worked.

Tustin appealed this determination and exercised its right to a hearing before an Administrative Law Judge (ALJ) with the Office of Administrative Hearings (OAH). A hearing was held on September 2, 2021. Tustin was represented by counsel.

The Administrative Hearing

The issue in the case is whether Tustin incorrectly reported full-time payrates for its classified employees. Payrate affects the calculation of final compensation which in turn affects a member’s retirement benefits. A lower calculation factor results in a lower final compensation figure used to calculate benefits. Here, CalPERS determined that 173.33 is the correct calculation factor, but Tustin uses 168.

PAYRATE

CalPERS' staff testified at hearing. Staff explained that underreporting payrate can negatively impact a member's retirement allowance. If an agency fails to convert the payrate based on a 40-hour workweek, and instead chooses its own conversion based on a 37.5-hour workweek for example, the error results in an approximate $50-$100 decreased monthly amount in that member's retirement allowance.

Tustin calculated the factor as 168 as follows: Assume average number of workdays per month is 21. Assume a full-time employee works 8 hours/day. Tustin multiplies 21 workdays by 8 hours/day to arrive at 168 work hours per month. To convert the hourly rate to a monthly rate, Tustin multiplies the member's pay rate by 168 hours. The audited member received $22.59/hour. Tustin multiplied 168 by $22.59, arriving at $3,795/month.

CalPERS calculated the factor as follows: Assume there are 52 weeks in a year. Assume a 40-hour workweek. Multiply 52 times 40, which equates to 2,080 hours per year. Divide 2,080 by 12 months to arrive at the average of 173.33 work hours per month. Using the $22.59/hour payrate, the monthly payrate for the audited employee should be $3,915/month.

CalPERS argued that the 173.33 conversion factor ensures consistent, accurate, and equitable reporting for all CalPERS members. Both Tustin and CalPERS agreed on the hourly rate of $22.59 as the true base rate of pay. Although monthly employees are paid according to Tustin's monthly pay schedule, the true payrate or base pay for such employees is their hourly rate. To convert to a monthly rate, Tustin should have multiplied by 173.33.

Tustin reported the lower payrate of $3,795/month, rather than the correct payrate of $3,915. CalPERS explained that the erroneous reporting results in an incorrect lower retirement benefit.

Increasing the payrate to $3,915 does not cost Tustin anything. Staff emphasized the difference between payrate and earnings. Correcting Tustin's erroneous reporting will increase payrates and individual retirement benefits, but individual employee earnings remain the same.

SERVICE CREDIT

CalPERS staff also testified that Tustin's calculation results in erroneous service credit calculations. Under section 20962(3), members working 215 days per fiscal year earn one year of service credit. Here, Tustin reported 0.1 service credit each month, so the employee was credited one full year of service credit for the fiscal year in error. The Audit showed that the sampled member actually worked only 209 days in that fiscal year, so she should not have been credited with a full year of service credit. Even accounting for the reduced service credit, the sampled member will still receive an increased retirement allowance once her reported payrate is corrected.

To fix these errors, CalPERS provided Tustin with two options. The first option was to report employee payrate on an hourly basis. If Tustin reports hourly, CalPERS will automatically convert to a monthly payrate based on the 173.33 conversion factor. In the alternative, Tustin could convert their payrate reporting using the 173.33 conversion factor. The evidence was undisputed that neither option costs Tustin any money, but Tustin refused both options.

Tustin employees testified at the hearing. Tustin maintained that they have always reported based on the 168-hour conversion, and that CalPERS never instructed them on the 173.33-hour conversion. CalPERS' training and outreach efforts contradict this testimony.

Tustin's Finance Director testified at the hearing that correcting their payrate reporting would cost Tustin roughly $5 million each year. On cross, he admitted that he did not know how the $5 million was calculated, and he provided the number because somebody had told him that.

Tustin's Director of Human Resources also testified at the hearing. The HR Director explained that Tustin used two different pay schedules for its classified employees: an hourly schedule and a monthly schedule. Hourly employees are paid according to the hourly schedule. Monthly employees are paid according to the monthly pay schedule. However, the hourly schedule is used to determine a monthly employee's overtime rate.

The Proposed Decision

After considering all of the evidence and arguments by the parties, the ALJ granted Tustin's appeal. The ALJ found that both CalPERS' and Tustin's conversion factors were logical.

The ALJ found no statute or regulation requiring employers to use a 173.33 conversion factor. Although section 20636.1 defines full-time employment as 40 hours in a week, the ALJ found nothing requiring 40 hours in a month to be extrapolated over an entire year. The ALJ similarly disagreed with CalPERS' arguments that Tustin's reporting resulted in underreported service credit. Because the 173.33 conversion factor is not expressly specified anywhere in the Public Employees' Retirement Law, the ALJ rejected CalPERS' interpretation and granted Tustin's appeal.

The Board Should Reject the Proposed Decision

As the sole agency charged with the enforcement of the PERL, and specifically membership and benefits, CalPERS' determinations are entitled to great deference. (*City of Pleasanton v. CalPERS Bd. of Admin, supra,* 211 Cal.App.4th at 539, "There is a strong policy favoring statewide uniformity of interpretation as between the PERS and all of its contracting agencies," and PERS cannot be expected to accept different interpretations from different agencies. (*City of Los Altos v. Board of Administration* (1978) 80 Cal.App.3d 1049, 1051, 1052.)

The ultimate goal of statutory interpretation is to ascertain the Legislature's intent. (Code of Civil Procedure section 1959.) The interpretation should harmonize all sections of a statute. (*Huff v. Securitas Security Services USA, Inc*, *supra*, 23 Cal.App.5th at 759*.)* When interpreting statutes, courts "consider the consequences which would flow from our interpretation and avoid constructions which defy common sense, frustrate the apparent intent of the Legislature or which might lead to mischief or absurdity." (*Henry v. Workers' Comp. App. Bd.* (1998) 68 Cal.App.4th 981, 985.)

Legislative history shows that section 20636.1 was passed to standardize the reporting of compensation and service credit for school employees. Its passage ensured that only work in excess of 40 hours per week is considered non-reportable overtime. Moreover, it ensured that school employees receive service credit for work up to 40 hours per week. Finally, it ensures that all compensation for work up to 40 hours is included in the calculation of that employee's final compensation.

The inequitable effects are best illustrated by the sampled member in the audit. Tustin labeled the sampled member as a full-time, 10-month employee. The sampled member worked 40 hours a week for 209 days, and 1672 total hours over 11 months. The sampled member's hourly rate was $22.59, and she earned $3,795 each month. After converting the payrate based on 168 hours in a month, Tustin reported the sampled member's payrate as $3,795, and she earned one full year of service credit.

Consider a member from a different school district working the same schedule (40 hours each week, for 209 days and 1672 hours over 11 months). This other member also earns the same $22.59 hourly wage and earns $3,795 each month. When the payrate is converted using the 173.33 conversion factor from section 20636.1, the other member's payrate is $3,915. Because the other member only worked 1672 hours over 209 days, instead of the 1720 hours and 215 days from section 20962, the other member earns roughly .97 service credit over a year.

The other member, whose payrate is increased because it was converted based on section 20636.1's 173.33 conversion factor, will earn more in retirement than the sampled member. Although both members worked the exact same schedules and earned the exact same amount of money, the sampled member would earn less in retirement solely because her employer chose to report her payrate based on a conversion factor of 168 instead of 173.33. The different retirement benefits, and different service credit, are the inequitable results the Legislature wanted to prevent when it passed section 20636.1. And the increased payrate, resulting in the sampled member's increased retirement, would not cost the District a penny.

Requiring CalPERS to accept Tustin's reporting and calculation factor results in inequity amongst members, and incorrect payment of retirement benefits solely based on how a school district reports compensation. This is an absurd result. CalPERS is the agency charged with implementing the PERL, and its interpretation should not be ignored.

Section 20636.1 standardizes reporting so that all employees' payrates and conversion factors are identical. Regardless of how a district labels its employees, section 20636.1 requires those employers to report payrate using a 40-hour workweek which results in a conversion factor of 173.33. Then, to determine service credit, CalPERS uses the specified time constraints of section 20962 to ensure that all members receive their fully earned service credit. This ensures consistency between all school employers and prevents members from receiving decreased retirement benefits due to an incorrect conversion factor used by one employer.

For all the above reasons, staff argues that the Board reject the Proposed Decision and decide the case upon the record.

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