

In the Matter of the Calculation of Final Compensation of:

Bruce Malckenhorst, Sr., Respondent,  
and  
City of Vernon, Respondent

OAH Case No. 2013080917

CalPERS Case No. 2012-0671

**EXHIBIT KKK (24 PAGES)**

**LCW** LIEBERT CASSIDY WHITMORE

6033 WEST CENTURY BOULEVARD, 5<sup>TH</sup> FLOOR  
LOS ANGELES, CALIFORNIA 90045  
T: (310) 981-2000 F: (310) 337-0837

SBERLINER@LCWLEGAL.COM  
(310) 981-2002

January 31, 2012

**VIA OVERNITE EXPRESS AND EMAIL**  
**MARGARET\_JUNKER@CALPERS.CA.GOV**

Margaret Junker, Chief  
Office of Audit Services  
California Public Employees' Retirement System  
400 "Q" Street, Room 2430  
Sacramento, California 95811

Re: *Response By City of Vernon to December 2011 Draft Audit Report*  
*Client-Matter: RI424/001*<sup>1</sup>

Dear Ms. Junker:

The City of Vernon ("City") is in receipt of The Office of Audit Service's (OAS) December 2011 Draft Audit Report ("Draft Report") relating to the City's contract with the California Public Employees' Retirement System ("CalPERS"). The City appreciates OAS's efforts in conducting its compliance review, as well as the opportunity to comment on the Draft Report. Unfortunately, the Draft Report contains a number of factual errors, which we have detailed for you in this response.<sup>2</sup> We hope that this letter will help correct some of these errors. Nonetheless, we agree that there are a number of issues that need correction, as detailed below, and the City looks forward to working together with OAS to remedy any deficiencies in the City's compliance with its CalPERS contract.<sup>3</sup>

It is important to note that unlike many other cities, the City's CalPERS pension plan funds are held in a separate account at CalPERS and are not co-mingled with another jurisdiction. Further, the City is not facing a serious unfunded employee pension problem. According to actuarial studies performed by CalPERS, the Miscellaneous Employee Plan is

<sup>1</sup> **The appendices contain confidential information and should not be reproduced. They are submitted for CalPERS' use only and should not be made a part of any final audit report or other public document.**

<sup>2</sup> The City believes that it is premature to file a formal appeal at this time as no final decision has been made. However, in the event that CalPERS believes that its Draft Report triggers any timeline to file a formal appeal, CalPERS may consider this response the City's formal appeal of its decision and request for an administrative appeal pursuant to Title 2, California Code of Regulations, Section 555.1.

<sup>3</sup> The City was given an extension by \_\_\_\_\_ Associate Program Evaluator, of CalPERS until January 31, 2012, to provide this response.

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86.2% funded and the City's Public Safety Employee Plan is 83% funded (as of the June 30, 2009 valuation date).

**CalPERS Owes Its Primary Fiduciary Duty To Its Members And Must Construe The Evidence In Their Favor Whenever Possible**

Prior to addressing the specific findings and recommendations by CalPERS, it is important to establish the framework under which the law requires that the evidence be reviewed. Proposition 162 was approved by the voters in 1992. Among other things, it amended the California Constitution, Article 16, Section 17(b) by adding the highlighted portion to this section, as follows:

The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto and defraying reasonable expenses of administering the system. **A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.** (Emphasis added).

The amendment made it clear that of all the duties of a public pension retirement board, those owed to its members are paramount. In *City of Oakland v. Public Employees' Retirement System* (2002) 95 Cal.App.4th 29, the Court of Appeal addressed whether the proposition would be applied even if doing so would result in unexpected liabilities to public employers. The court determined that the Constitution's priority of fiduciary duties would be applied even in those situations where it would result in extra expenses to employers. The court relied on statements in the ballot pamphlet sent to voters regarding Proposition 162. The court stated:

The Ballot Pamphlet accompanying Proposition 162 warned "The requirement that pension system boards give highest priority to providing benefits to members and their beneficiaries could result in higher costs to employers. (See Ballot Pamp., Gen. Elect. (Nov. 3, 1992). Analysis of Leg. Analyst, p. 37). This weakens the City's claim that retroactive reclassification unfairly harms local agencies by causing unexpected liabilities. **Instead it reflects a policy in favor of paying employees what they earn. That is not inherently unfair.**" (*Ibid.* at p. 54 [emphasis added].)

**FINDINGS, RECOMMENDATIONS, AND THE CITY'S RESPONSE**

**A. General Comments and Response to OAS's Scope of Review**

As indicated earlier, the City appreciates being given an opportunity to comment on the Draft Report, and looks forward to working together with OAS to remedy any deficiencies in the City's compliance with its CalPERS contract. That said, the Draft Report's introductory

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comments appear somewhat internally inconsistent and contradict OAS's own findings and analysis as well as the factual record.

The Draft Report states that OAS was "hampered by the unavailability of necessary information . . ." (Draft Report 2.) That statement is difficult to reconcile with the fact that the Draft Report is over 80 pages in length and includes roughly 40 pages of findings, in addition to appendices with supporting calculations. More importantly, the City provided over 22,000 pages of documents to OAS, including questionnaires and declarations from employees, focused responses to specific OAS inquiries, summary charts and original documentation, among many other materials.

We recognize that it might have been difficult for OAS to digest and interpret all of the 22,000 pages it requested from the City. (See Draft Report 4 [noting the "thousands of pages of documents" the City provided, but stating that "many . . . were in a form that would require a substantial amount of time for OAS to find relevant requested information"].) The volume of material at issue, however, stemmed solely from the eight-year timeframe OAS selected for its review. Moreover, the City made every effort to facilitate OAS's review. In addition to the documents provided, the City also provided OAS with indices and cross-references. The City also provided OAS with an office at the City, and City staff cooperated with CalPERS auditors throughout this five-month process. The City was, at all times, willing and available to provide OAS with additional assistance; yet, OAS never sought further assistance from the City. In short, while it is unfortunate that OAS appears to have had difficulty interpreting the vast universe of documents and information provided as requested by OAS, it is unfair and inaccurate to suggest that these difficulties stemmed from any action, or inaction, on the part of the City.

In order to facilitate your review of our concerns, we have set forth the proposed findings and corresponding recommendations, followed by the City's response, including the factual amendments necessary to make particular findings accurate.

**B. OAS's Finding 1 is inaccurate and fails to consider the extensive efforts undertaken by the City to respond to the requests made by CalPERS' Associate Program Evaluator.**

**Finding 1:**

The City failed to provide information necessary to determine the accuracy of retirement benefits, reportable compensation, and membership enrollment in the retirement system.

**Recommendation 1:**

The City must provide the specific information upon request by CalPERS in order to determine the accuracy of retirement benefits, reportable compensation, and membership enrollment in the retirement system per Government Code Sections 20221 and 20222.5. Failure to provide requested information can result in termination of the City's contract pursuant to Government Code Section 20572.

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The City must work with CalPERS, CASD and BNSD to provide all supporting documentation that can be located or prepared in the future in order to determine the accuracy of retirement benefits, reportable compensation, and membership enrollment.

**City's Response to Finding and Recommendation 1:**

OAS alleges that the City failed to provide information and documents that were necessary to complete the CalPERS compliance review. (Draft Report 3-4.) The City respectfully disagrees. This conclusion fails to acknowledge the extensive efforts undertaken by the City to respond to the many requests made by CalPERS' Associate Program Evaluator, that include but are not limited to:

- On February 17, 2011, the City submitted to OAS questionnaires containing thirty-six specific inquiries for seven employees. To substantiate the answers included in these questionnaires, the City produced 776 documents. The questionnaires contained citations to the relevant files, and the documents were electronically organized into subfolders corresponding to the employee and the specific inquiry addressed. (See February 17, 2011 Letter ("Appendix A, Feb. 17, 2011 Letter").)<sup>4</sup>
- On February 17, 2011, the City also submitted answers to twenty-one questions posed by (See Appendix A, Feb. 17, 2011 Letter.)
- On February 24, 2011, the City submitted answers to four additional questions posed by . In response to questions, the City produced an additional ten pages of documents. (See February 24, 2011 Letter and Attachments ("Appendix B, Feb. 24, 2011 Letter").)
- On March 14, 2011, the City submitted answers to ten additional questions posed by (See March 14, 2011 Letter and Attachments ("Appendix C, Mar. 14, 2011 Letter").)
- On March 21, 2011, the City submitted a declaration detailing the duties performed by the Chief Deputy City Attorney and Risk Manager for the City of Vernon. ("Appendix D, Declaration").)
- On April 25, 2011, the City submitted questionnaires containing twenty-eight specific inquiries for six independent contractors. To substantiate the answers included in these questionnaires, the City produced twenty-five documents. The questionnaires contained citations to the relevant files, and the documents were electronically organized into subfolders corresponding to the independent contractor and the specific inquiry

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<sup>4</sup> With the February 17, 2011 letter, the City submitted two CDs of documentation, which are not included in the appendix here.

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addressed. (See April 25, 2011 Letter and Attachments ("Appendix E, April 25, 2011 Letter").)<sup>5</sup>

- From December 2010 until April 2011, the City received over fifteen emails from [redacted] and provided detailed answers to more than forty-five additional inquiries and requests. (See Appendix K.)
- In response to [redacted] specific inquiries, the City produced approximately 22,000 pages of documents. The City produced and made thousands of additional documents available for [redacted] review during his visit to the City in January 2011.
- [redacted] spent approximately two weeks reviewing documents and interviewing employees at the City of Vernon. During this time he was given a dedicated office and access to any employees or documents requested. At no point in time during the CalPERS audit did [redacted] inform the City, in writing or orally, that he had not received adequate and accurate documentation.

Despite the City's diligent efforts to compile information and locate documents requested by CalPERS, OAS alleges that the City failed to provide necessary documents. Specifically, OAS claims that many of the documents produced by the City "were in a form that would require a substantial amount of time for OAS to find relevant requested information." (Draft Report 4.) The documents at issue were presented to [redacted] in precisely the form in which they exist. While it may have required more time for [redacted] to go through them, any difficulties he encountered were not attributable to the City. To the contrary, the City went to great lengths to assist [redacted] answering any inquiries with targeted and clear documentation, including citations where appropriate. The City also sent documents attached to original emailed requests or specific CalPERS questionnaires. These documents were sent over a five-month period in response to multiple inquiries. The volume of data provided to CalPERS is solely attributable to the scope of the audit, which covered eight years, and the broad data requests made by [redacted]. The City provided CalPERS with precisely what was requested. Indeed, the City attempted to get [redacted] to narrow the scope of his requests in order to pare down the volume of responsive materials, but he declined to do so. As a result, the City cannot, and should not, be criticized or penalized for complying with [redacted] specific instructions.

Additionally, OAS improperly criticizes the City for redacting certain documents provided to OAS. (*Ibid.*) The City's redaction, however, was entirely appropriate given that [redacted] requested numerous documents that are protected by the attorney-client privilege and/or the attorney work product doctrine. The City is not required to waive its attorney client privileges as a condition of its contract with CalPERS. OAS also protests that certain employee files were taken by the Los Angeles District Attorney's Office, and thus were not provided. The City of Vernon has no control over the District Attorney's actions or files and should not be

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<sup>5</sup> With the April 25, 2011 letter, the City submitted one CD of documentation, which is not included in the appendix here.

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penalized for its inability to produce these documents. Clearly, the City's contract with CalPERS does not require it to produce documents that are neither in its custody nor control.

The OAS also alleges that the City failed to provide documentation to support payrates and earnings reported to CalPERS for employees working in multiple positions. (*Ibid.*) OAS appears to ignore numerous documents created and produced to support wages paid to various employees working multiple jobs, and further ignores the myriad interviews and email communications the City had with [redacted] regarding employees working in multiple positions. Notably, on February 22, 2011, the City submitted a schedule listing all employees who hold, or held, multiple concurrent positions. (February 22, 2011 Employee Schedule ("Appendix J, Employee Schedule").) The schedule referenced the resolutions or authoritative documents approving the compensation for the listed position. Additionally, a table allocating the percentage of time spent per position was provided. Although OAS may disagree with the City's position on multiple employment, it cannot support a claim that the City failed to provide documentation on this topic. We are at a loss to understand how OAS can complain that this information was not provided.

OAS also claims that the City failed to provide documentation to support the additional arrears service credit sought by and provided to certain individuals. (*Ibid.*) OAS also ignores the discussions the City conducted with [redacted] regarding arrears credit on January 27, 2011. Additionally, on February 17, 2011, the City provided numerous documents to [redacted] in response to his inquiries on this subject. (*See Appendix A, Feb. 17, 2011 Letter.*) The questionnaires submitted by the City on February 17, 2011, also include support for the arrears service credit sought by a number of these individuals.

OAS further asserts that the City failed to provide documentation to support the classification of City Attorneys as safety employees. (*Ibid.*) However, the City produced a substantial number of documents on this subject, including correspondence from CalPERS approving the classification. Notably, on February 17, 2011, the City provided documents regarding job descriptions and contracts for City Attorney positions in response to request. (*See Appendix A, Feb. 17, 2011 Letter.*) Additionally, on March 21, 2011, the City submitted a declaration detailing the duties performed by the Chief Deputy City Attorney and Risk Manager for the City. (Appendix D, Declaration.) OAS's finding that the City did not provide documentation on this topic is wrong. The City undertook diligent efforts to locate and produce documents addressing the safety classification.

OAS alleges that the City failed to provide documentation to support the City Council members' payrates subsequent to April 1, 2007. (*See Appendix A, Feb. 17, 2011 Letter*) However, this finding conflicts with the conclusions contained in OAS's report. In Finding Six, OAS quotes Resolution No. 9284, which became effective on April 2, 2007. (*See Appendix I, Resolution No. 9284.*) This resolution clearly provides the council members' payrates subsequent to April 1, 2007. No further documentation is required. We are at a loss to understand how OAS could come to this conclusion given the materials that were provided.

Lastly, OAS's conclusion that the City failed to provide necessary information is contradicted by OAS's later assertion that it was able to "complet[e] th[e] review based on

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information provided by the City." (Draft Report 2). Indeed, OAS's ability to undertake a comprehensive review is evidenced by its compilation of a roughly forty-page report plus appendices. OAS's claims that the City failed to provide documentation necessary to complete the review are contradicted by the sheer volume of documents produced to and the number of documents referenced and analyzed in the Draft Report.

**C. The City's documentation to the CalPERS auditor demonstrated that individuals simultaneously working in multiple positions did not have multiple payrates and were not given additional earnings.**

**Finding 2:**

The City failed to provide documentation in conformance with the Public Employees' Retirement Law (PERL) and the City's contract with CalPERS. As a result, OAS was unable to determine whether payrates and earnings were accurately reported for individuals simultaneously working in multiple positions.

**Recommendation 2:**

Only compensation earnable, as defined under Government Code Section 20636 and the corresponding regulations, can be reported to CalPERS and considered in calculating retirement benefits.

The City should ensure documentation is maintained and provided upon CalPERS' request to verify that payrates and earnings are accurately reported for employees who simultaneously work in multiple positions. Payrates for each position must be clearly set forth in publicly available pay schedules and must be included in public documents available for public scrutiny. Where concurrent service is rendered in two or more positions, one or more of which is full time, service in the part-time position constitutes overtime and should not be reported. If concurrent service occurs in two or more full-time permanent positions, then the position with the highest payrate should be reported and the other would constitute overtime.

The City should work the CalPERS CASD to assess the impact of this incorrect reporting and determine what adjustments are needed to correct any improperly reported compensation amounts and to determine whether any retirement benefit amounts must be corrected pursuant to Government Code Section 20160.

**City's Response to Finding and Recommendation 2:**

OAS alleges that the City failed to provide documentation in conformance with the PERL and the City's contract with CalPERS necessary for OAS to determine whether payrates and earnings were accurately reported for individuals working in multiple positions. (Draft Report 5.) This conclusion is inaccurate and mischaracterizes the extensive efforts undertaken by the City to respond to the requests made by CalPERS' auditor. As discussed in greater detail previously, the City, in fact provided over 20,000 pages of relevant documentation, including a specific schedule of payrates, and remains committed to continue this process in order to assist



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CalPERS in concluding its audit. If there is something more specific that OAS requires, we will work to provide it.

OAS alleges that "for the individuals that worked simultaneously in multiple positions, the City failed to provide documentation to substantiate the number of hours worked per positions and reportable payrates for each position." (*Ibid.*) This statement is not supported by the facts and the information provided. For example, on March 14, 2011, the City provided with a schedule listing all employees with concurrent multiple positions. (*See Appendix C, Mar. 14, 2011 Letter.*) The schedule listed each position and identified whether it received compensation and noted the authoritative document to support it. In the table, each employee was also allocated the percentage of time spent on each position.

OAS also erroneously asserts that the City paid individuals holding multiple positions for each one of their positions. (*See Draft Report 5-6.*) That is not correct. Documents were provided to substantiate the fact that employees with multiple positions would only be compensated for their primary position. In addition to the City's March 14, 2011 schedule, several of the resolutions appointing an employee to another position clearly state that the City would not compensate the employee for holding an additional position. (*See Appendix C, Mar. 14, 2011 Letter.*) The City recognizes that some of its employees wear multiple hats and are nominally granted more than one title. However, that fact should not be confused with the City's practice to pay each individual employee one payrate and *not* multiple payrates. This practice is completely acceptable and common in many cities. OAS is incorrectly allocating these employees' wages among positions, rendering much of their compensation non-reportable as compensation for part-time work.

On Page 6 of the Draft Report, OAS also criticizes the City for purportedly "provid[ing] excessive salary increases" and "pa[y]ing exorbitant amounts of non-employee compensation." OAS is not charged with rendering judgments on the remuneration paid by the City and it is wholly inappropriate for the draft report to contain such a statement. It is well within the City's discretion and authority to pay employees and/or consultants an agreed upon wage and/or rate. The Draft Report's attempt to render a qualitative judgment about compensation levels is unwarranted and improper.

Furthermore, OAS apparently did not accept as "substantial information" the employee contracts or City resolutions that clearly stated the City would not compensate these employees for their added positions. OAS erroneously concluded that this information was lacking and concluded that the employees' payrates were undeterminable. (*Ibid.*) How can that be the case when OAS was provided with the contracts and resolutions? For example, in Appendix D of the Draft Report, OAS identified only one payrate at any point in time throughout the employment for Individuals 2-6, 8 and 9. This is not accurate because that rate was the employees' initial payrate for their primary position. An employee's payrate never significantly increased despite the number of additional titles or responsibilities an employee acquired because employees were not being compensated for the added position. Both the supporting documentation provided by the City and OAS's own schedule to Appendix D prove that at least seven of the nine sampled employees were not compensated for any additional positions or titles they held.

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OAS also generalized its findings to all personnel that held multiple positions. (*See* Draft Report 5-6.) This conclusion is incorrect and inconsistent with the documentation provided by the City and schedules CalPERS included in Appendix D to the Draft Report. Specifically, OAS incorrectly states that the City combined payrates. To support its finding, OAS relies upon information relating to three of the sampled individuals. Although at one time, Individual 1 and Individual 2 were compensated full-time for multiple positions and payrates of each position were combined and reported to CalPERS as one rate, this is not true for the remaining sampled individuals, whom the City demonstrably compensated only for their primary position. Employee contracts and supporting resolutions that were approved by the City Council clearly state that any added positions would not increase an employee's compensation, and that the City did not combine payrates for multiple positions. (*See* Appendix H (including City Ordinance No. 1104; City Resolution No. 6946; City Resolution No. 7785; City Resolution No. 7978; City Resolution No. 8605; City Resolution No. 9189; City Resolution No. 9269; City Resolution No. 9524).) The only payrate reported was for the primary position; all other positions did not have payrates to report.

In addition, in Appendix D of the Draft Report, for Individuals 2-6, 8 and 9, OAS identified only one payrate given to an employee during the duration of their employment. (*See* *ibid.* at pp. 6-7.) This conclusion is incorrect and inconsistent with schedules in Appendix D. Contrary to OAS's interpretation of Appendix D, upon further review of the data, it is clear that only one payrate was included because that rate was the employees' initial payrate for his or her primary position. As discussed above, even if an employee was appointed to additional positions or given new responsibilities, a review of each employee's total compensation demonstrates that his or her payrate did not increase significantly to suggest that they were being compensated for the added position. OAS's schedules prove and confirm the City's position, and the supporting documents that were provided further reveal that employees were not compensated for additional positions; accordingly, there was only one distinguishable and determinable payrate to report.

OAS also alleges that certain Individuals reported W-2 compensation was inconsistent with the total amount of compensation actually received. (*Ibid.* at p. 7.) The City agrees that in certain cases the two figures are not identical. The W-2s can and do include forms of compensation that are not reportable to CalPERS (non-PERSable), such as Auto Benefits, Stand-by pay, and overtime. This is not a "finding," nor is it otherwise a negative fact.

The City also rejects any suggestion that it reported Form 1099 income to CalPERS as compensation. If Form 1099 income was reported as compensation to CalPERS, it was done in error. The City is willing to work with OAS to correct any such erroneous reporting.

Finally, OAS takes issue with how the City paid Individual 3. (*Ibid.* at pp. 10-11.) The monthly payrate of \$27,500 is correct, as is its annual equivalent of \$330,000. OAS's real issue is the total hours worked and how the City processed and reported the income through its payroll system to CalPERS. The City's payroll is processed on a biweekly basis. At the time Individual 3's hourly-rate was being entered into the system, rather than using the \$275/hour at 46.15 hours/biweekly ( $1,200/26 = 46.15$  hours) as stated in his contract, 2,080 hours (80 hours biweekly) was used instead in error to derive an hourly rate of \$158.6538. Although the

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biweekly payrolls reflected 80 hours worked instead of the contracted 46.15 hours, the biweekly pay as well as its annual sum of \$330,000 is correct. The proof is in the math:

Contract	Payroll System
\$275/Hour x 1,200 Annual Hours = \$330,000	\$158.6538/Hour x 2,080 Annual Hours = \$330,000

**D. The City did not submit erroneous information to support the enrollment of ineligible individuals into CalPERS membership.**

**Finding 3:**

The City submitted erroneous information to support the enrollment of ineligible individuals into CalPERS membership. This provided ineligible individuals with excessive service credit and the erroneous purchase of additional service. The City also incorrectly reported individuals who performed services as independent contractors.

**Recommendation 3 (In part):**

The City must provide accurate membership information in order for CalPERS to determine the correctness of retirement benefits per Government Code Sections 20221 and 20222.5.

The City should not enroll employees excluded from membership per Government Code Section 20300(b) and (h).

\* \* \*

CalPERS must insure that its contracts with public agencies provide retirement benefits only to the agencies' common law employees to ensure retirement benefits are properly administered and in order to preserve its tax-qualified status under the Internal Revenue Code Section 401(a). The CalPERS Board of Administration determines who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system.

The City should work with CalPERS CASD to assess the impact of and to correct these membership enrollment and reporting issues.

**City's Response to Finding and Recommendation 3:**

OAS alleges that the City submitted erroneous information to support the enrollment of ineligible individuals into CalPERS membership. (See Draft Report 12.) This statement is inaccurate and fails to consider the process the City undertook with CalPERS eligibility officials

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over many years, especially concerning the extension of retirement benefits to numerous contracting attorneys and consultants.

Beginning in 1979, the City granted retirement benefits to its then City Attorney. The City submitted the appropriate documentation to CalPERS, which clearly set forth the relationship between the parties. The City Attorney was to receive consideration as a salaried employee and, in addition, was to continue to bill the City hourly through his law firm for his City Attorney services. In addition, the City requested CalPERS grant this individual prior service credit from 1977, the date he commenced acting as the City Attorney. The City also, as it has with all its employees, paid for the member's portion of the cost of arrears service credit.

The test to determine whether the individual worker is an employee or consultant is a factual one based upon numerous criteria. The City sought to determine CalPERS eligibility *after the contract consultant in question began his service to the City*. Therefore, much of the criticism OAS is leveling against the City does not logically follow.

The City has in every instance of requesting retirement benefits for its consultants and attorneys carefully compiled a complete transcript of documents for review by CalPERS and arranged interviews with CalPERS eligibility officials *before any membership forms were submitted to CalPERS*.

The very purpose of submitting the contracts and work description of the individuals in question to CalPERS eligibility officials in advance was to receive guidance from CalPERS as to each individual's eligibility. OAS appears to be alleging today that the relationship between the City and the attorneys or consultants concerned is something different than what was represented at the time of the original membership inquiry. Such allegation is incorrect.

The City completely disclosed the relationship with its attorneys and consultants to CalPERS at the time of determining eligibility, submitting then-current and all previous contracts between the City and the attorney or consultant in question. At that time, the City described to CalPERS the work the attorney or consultant undertook for the City, and met with CalPERS eligibility officials in their Sacramento offices.

It was never the City's intent to obtain retirement benefits for individuals that later could be challenged on eligibility grounds.

The City undertook the same process with CalPERS in regard to requesting prior service credit for these same attorneys and consultants. The City submitted to CalPERS all prior agreements with its attorneys and consultants, which detailed the compensation to be paid and the scope of work to be undertaken.

OAS has sampled three individuals and has preliminarily determined that these consultants provided services as independent contractors instead of employees. The City comments to each bullet point below.

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**Individual 1:**

- City officials met with CalPERS actuarial official, \_\_\_\_\_, and eligibility official, \_\_\_\_\_, in March 2002 to discuss extending retirement benefits to its then contract financial consultant. The City discussed what work the individual had undertaken for the City currently and in the past. Copies of all current and past contracts were submitted to \_\_\_\_\_ for his review. The individual worked primarily for the City's Light & Power Department as a finance consultant. The City also disclosed to CalPERS that the individual represented the City as a public finance attorney from 1981 to 1986.
- The individual was acting primarily as a finance consultant to the Light & Power Department, but was at all relevant times, a licensed attorney in California. It is not surprising then that the OAS auditor located correspondence, dated May 6, 1987, from his law firm.
- Early agreements with this individual would logically not have language about his acting as an employee for the City – the entire purpose of the inquiry to CalPERS' eligibility official, \_\_\_\_\_, was to determine, given *the facts* as they existed, whether the individual was eligible for membership despite the wording of his various contracts from 1986 to 2002.
- The June 7, 2002 letter from \_\_\_\_\_ did state that the individual in question would be eligible as an employee, but *not* as an attorney, unless he was in a titled capacity in the City Attorney's office. \_\_\_\_\_ advised the City that the individual would only be eligible if he worked primarily as a finance consultant for the Light & Power Department, which he did. All legal matters for Light & Power were handled by the City Attorney's Office.
- Based upon \_\_\_\_\_ advice, the City submitted the enrollment paperwork to CalPERS, dated as of the date the individual began working as a financial consultant for the Light & Power Department. Since the City first sought CalPERS eligibility advice on the individual in 2002, the City would *not* have reported the individual as an employee to CalPERS *prior* to the request in 2002.
- The City believes OAS audit staff should have reviewed the individual's scope of work with the Light & Power Department before concluding that the individual worked for the finance department. Indeed, for many years, this individual had an office in the Light & Power Department between today's current Director and Assistant Director of Light & Power.
- OAS lists a series of "facts" to support its claim that the City made improper representations to CalPERS regarding this individual. (*See Draft Report 15-16*).

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- The City submitted all relevant documentation to CalPERS in 2002, describing all prior agreements and work relationships to determine eligibility. The documents submitted then are the same documents that OAS reviewed currently.
- The individual participated in interviews with CalPERS eligibility official accompanied by other City officials describing his work as primarily a finance consultant to the Light & Power Department.
- The City would *not* have documentation to show the individual was paid as an employee before July 2002 since the City did not seek CalPERS' advice as to whether the individual would be eligible for CalPERS membership until mid-2002.
- Again, since the City submitted all the individual's prior and current agreements in 2002 to CalPERS to determine eligibility, there would not have been language in these agreements concerning the hiring of the individual.
- The individual was primarily acting as a finance consultant to the City's Light & Power Department. The individual was also an attorney. These agreements were submitted to CalPERS in 2002 for review to determine eligibility.
- The City submitted all agreements concerning this individual to CalPERS eligibility officials.
- Once the City was advised by CalPERS' eligibility official that the individual could enroll in the system, the City went forward with the necessary paperwork.
- Once the City received confirmation that the individual could enroll in the CalPERS retirement system, the City amended the individual's contract accordingly.
- The City believes a more thorough interview with the Director of Personnel, as well as various other past and current Light & Power Department officials, may provide a more accurate understanding of the individual's relationship with the City over the years.
  - Since the City sought advice on whether the individual would qualify for CalPERS in 2002, it would necessarily follow that the individual was not paid through the City's payroll system until after that date.
  - The statements in the bullet point are applicable to the time period when the individual ceased acting primarily as a finance consultant in the Light & Power Department and began representing the City as an attorney in 2003.
  - The City engaged in a different process of evaluation for its attorneys and consultants. They worked directly for top management and the City Council.

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- Since the City did not begin the process to determine eligibility of the individual until 2002, it would logically follow that the individual would not have employee paperwork prior to that date.
- The City began the process of determining eligibility in 2002.
- CalPERS repeatedly advised the City on the eligibility status of its attorneys and consultants. Special care was taken by the City since these individuals' relationships with the City were the subject of agreements and the parties changed their positions based upon their eligibility for CalPERS retirement benefits.

**Individual 2:**

- This individual was the City's Deputy, then Assistant City Attorney, working in the City Attorney's Office from November 1994 to October 1999.
- The City undertook the CalPERS eligibility process with CalPERS' eligibility official in 2002. Therefore, no paperwork would have been previously submitted. The City sought prior service credit for the individual from 1994, and as was its practice for all employees, paid for the member's portion of the cost of the arrears service credit.
- The individual worked under the direction of the City Attorney, who was also a member of the CalPERS system.
- The individual worked for the Office of the City Attorney.
- The individual worked for the Office of the City Attorney and held the titles of Deputy and Assistant City Attorney.
- The City addresses the facts recited by OAS in regard to the individual's employment status below:
  - The City submitted letters describing the individual's relationship with the City to CalPERS' eligibility official in 2002.
  - The individual's role in the City Attorney's Office and his subsequent contract as City Attorney in 1999 were submitted to CalPERS' eligibility official 2002.
  - The individual would not have employee payroll data prior to 2002, as that is when the City reviewed with CalPERS' eligibility official the individual's ability to become a member.

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- The individual was a titled Deputy, then Assistant City Attorney in the City Attorney's Office from 1994 to 1999.
  - All of the agreements concerning this individual's relationship with the City were submitted to CalPERS' eligibility official in 2002, before any membership paperwork was initiated.
  - After receiving eligibility advice from CalPERS eligibility official the City commenced the membership paperwork on this individual.
  - In 2002, the City inquired regarding the individual's eligibility before enrolling the individual and paying a portion of his compensation through the City's payroll system.
  - The City began the process of determining eligibility in 2002.
  - The City commenced paying a portion of the individual's compensation through its payroll system, after it received advice from as to the individual's eligibility.
  - The City had a different evaluation process for its attorneys and consultants.
- The City submitted a complete description of the individual's services to the City as Deputy, then Assistant City Attorney to CalPERS' eligibility official
  - The City acted on the advice it received from CalPERS in 2002, with the document file then as it is today.
  - CalPERS advised the City that the individual qualified for service credit for prior years.

**Individual 3:**

- The City sought retirement benefits for its Chief Assistant City Attorney when his agreement with the City was approved and a portion of his compensation was paid through the City's payroll system.
- The City sought prior service credit for the individual from the date he began representing the City as a member of the City Attorney's Office, to which he was assigned by his law firm.
- To the best of the City's knowledge, the individual was never granted any prior service credit by CalPERS.
- The City is confused as to why OAS is commenting on this individual at this time. The City submitted all the relevant facts concerning this individual to CalPERS official



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Compensation Review Unit, Employer Services Division, in a multi-page document on February 25, 2009. City employees also met with CalPERS officials after that date seeking advice on the eligibility of the individuals in question and what corrective action the City should undertake, if any. (See February 25, 2009 Letter and Attachments, ("Appendix F, Feb. 25, 2009 Letter").)

- To the best of the City's knowledge, CalPERS was already working on this matter with the City and reference to it as a finding in this Draft Report is inappropriate.

Finally, the City and CalPERS advised two of its consultant employees that they were eligible to purchase service credit. The City is uncertain as to what damages these individuals might incur if OAS now determines that they do not qualify. Moreover, there is no indication why the prior audits conducted by OAS in 2005 and subsequent years did not identify these issues.

**E. The City did not track the outcome of a trial of one of its former officials.**

**Finding 4:**

The City failed to notify CalPERS when an "Elective Officer" was convicted of perjury and thus forfeited several years of service.

**Recommendation 4:**

The City must notify CalPERS when an elected officer is convicted of certain enumerated felony crimes specified in statute. Government Code Section 1243 provides in pertinent part that any elected official who takes public office, or is re-elected to public office, on or after January 1, 2006, and who is convicted during or after holding office of any felony involving accepting or giving, or offering to give, any bribe, the embezzlement of public money, extortion or theft of public money, perjury, or conspiracy to commit any of those crimes arising directly out of his or her official duties as an elected public officer, shall forfeit that portion of his rights and benefits that accrued on or after January 1, 2006, on account of his service in the elected public office held when the felony occurred. Section 1243(d) further provides, "[t]he public agency that employs an elected public officer described in subdivision (d) shall notify the public retirement system in which the officer is a member of the officer's conviction."

The City should work with CalPERS BNSD and CASD to assess the impact of this failure to notify CalPERS of a conviction and determine the adjustments to the member's retirement account and allowance.

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**City's Response to Finding and Recommendation 4:**

The City recognizes its error in not tracking the outcome of a trial of its former elected official after leaving office in July 2009 so it would be able to report this fact to CalPERS. The City will work with CalPERS to correct any payroll reporting issues resulting from this omission.

- F. The City acknowledges it received inaccurate legal advice concerning the qualifications of its City Attorney's Office under coverage group 79001, and looks forward to working with CalPERS to correct any inaccurate reporting.**

**Finding 5:**

The City incorrectly reported attorneys under coverage group 79001, a safety classification that provides an enhanced retirement benefit formula of 3% @ 55.

**Recommendation 5:**

The City should report city attorneys under the appropriate member classification and coverage group, based on position's job duties, as required by the PERL. The City should not report attorneys as safety members unless the position's primary duties are to engage in the active enforcement of criminal laws.

The City should work the CalPERS CASD to assess the impact of and to correct this reporting issue.

**City's Response to Finding and Recommendation 5:**

The City hired an attorney to join its City Attorney Office from the Los Angeles City Attorney's Office whose primary duties there were to engage in the active enforcement of criminal laws. The City intended this attorney to primarily undertake the active enforcement of criminal laws in its own jurisdiction.

The City acknowledges it received inaccurate advice concerning the qualifications of its City Attorney Office under coverage group 79001. The City looks forward to working with CalPERS to adjust its account to properly re-classify the City Attorney's Office back to the Miscellaneous category.

- G. The City reported the earnings of some of its attorneys and consultants, consistent with advice received from CalPERS eligibility officials in 1979 and again in 2002, which was based upon the individual's in service date.**

**Finding 6:**

The City reported earnings that exceeded the compensation limit established by the federal Internal Revenue Code.

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**Recommendation 6:**

The City should ensure that reported employee compensation for employees who became members on or after July 1, 1996, does not exceed the annual compensation limits established by the Internal Revenue Code Section 401(a)(17). When an employee reaches the compensation limit, the City should stop reporting member contributions as outlined in the CalPERS Procedures Manual. The City should work with CalPERS CASD to assess the impact of and to correct his reporting issue.

**City's Response to Finding and Recommendation 6:**

The City reported the earnings of some of its attorneys and consultants consistent with advice received from CalPERS eligibility officials in 1979 and again in 2002, which was based on the individual's in service date.

The City first established with CalPERS the individual's qualifications to become a member of the retirement system. Next, the City established with CalPERS the individual's qualifications to obtain prior service credit commencing on the individual's original starting date with the City. Based on these facts, for three individuals, their start dates are prior to the Internal Revenue Code Section 401(a)(17) limits referenced in Finding 6.

Regarding some of the other sampled employees, the City reached out to CalPERS in February 25, 2009, submitting a 70-page transcript of documents and correspondence addressed to the Compensation Review Unit of the Employer Service Division, to examine the compensation of these individuals and their qualifications to be members of CalPERS and to acquire prior service credit. (See Appendix F, Feb. 25, 2009 Letter.) It would have been most helpful to the City if some of the issues OAS is referencing in its Draft Report had been discussed with the City in February 2009. Regardless, the City looks forward to working with CalPERS to resolve these issues.

Moreover, OAS incorrectly cites Government Code Section 21752.5 and CalPERS procedures for its contention that the City over-reported compensation. Neither supports CalPERS' position. Government Code section 21752.5 states,

The amount of compensation that is taken into account in computing benefits payable to any person who first becomes a member of this system on or after July 1, 1996, shall not exceed the limitations in Section 401(a)(17) of Title 26 of the United States Code upon public retirement systems, as that section may be amended from time to time and as that limit may be adjusted by the Commissioner of Internal Revenue for increases in cost of living. The determination of compensation for each 12-month period shall be subject to the annual compensation limit in effect for the calendar year in which the 12-month period begins. In a determination of average annual compensation over more than one 12-month period, the amount of compensation taken into account

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for each 12-month period shall be subject to the applicable annual compensation limit.

This section merely limits benefits. It does not discuss reporting compensation to CalPERS. On the other hand, the CalPERS Procedures Manual specifically requires the City to report the excess compensation and pay contributions on it. It states,

If an employee's compensation reaches the limit, the employer should do the following:

.....

Continue reporting Pay Code, Pay Rate, Member Earnings and a Contribution Code 01, but no member contributions for the periods that remain in the calendar year. Reporting the contribution code 01 allows the employee to continue earning service credit without making contributions on earnings that exceed the limit. If code 11 is used instead of 01, then the member will not receive service credit. While the law limits employee contributions, employer contributions should still be paid on all earnings that are reported. If an employee's pay rate increases after the time you cease reporting contributions, please indicate the higher pay rate and earnings on your payroll transaction in case legislation were to change the original limits established for the year.

Based on the above, the City took the appropriate action.

**H. The City accurately reported compensation earnable.**

**Finding 7:**

The City failed to properly report compensation earnable. The City reported incorrect payrates to CalPERS and improperly reported compensation that was not reportable.

**Recommendation 7:**

The City should ensure that only compensation earnable, as defined under the PERL and corresponding regulations, is reported to CalPERS. The City should also ensure that the payrate reported to CalPERS is the authorized full-time payrate for the position, and that all employees' salaries are properly reviewed, authorized and approved by the City Council. Furthermore, the City should not report pay that fails to meet the definition of compensation earnable and/or constitutes overtime.

The City should work with CalPERS CASD to assess the impact of this incorrect reporting and determine what adjustments are needed.

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**City's Response to Finding and Recommendation 7:**

OAS's Finding is misleading and improperly suggests that the City inflated the amount of compensation earnable reported to CalPERS. OAS's own analysis and the factual record demonstrate that this statement is inaccurate and should be corrected. By and large, OAS's criticisms are technical in nature and relate to instances of over and under reporting compensation earnable, which the City has already corrected or is diligently working to remedy.

For example, OAS criticizes the City's method for calculating the payrate for City Council members, which involved multiplying their bi-weekly payrate by the number of pay periods in a given month. (Draft Report 29.) As OAS notes, this resulted in over reporting in months with three pay periods, and under reporting in months with two pay periods. (*Ibid.*) The overall compensation reported was accurate. Likewise, OAS states that the City correctly did not report disability payments to an unnamed City employee, but the City incorrectly reduced the payrate reported to CalPERS to reflect the employees lower compensation during this time period. (*Ibid.* at p. 31.) OAS also noted that, when the City's Police Captain was promoted to Interim Police Chief, the City incorrectly reported the pay rates together for a single period (two weeks) instead of separately. (*Ibid.* at p. 32.) These oversights, which the City working diligently to correct, are hardly instances of "improperly report[ing] compensation that was not reportable" nor do they justify a separate finding.

The City is also concerned by certain factual inaccuracies and omissions related to this Finding. OAS notes that Resolution No. 9284 increased City Council members' compensation to \$5,500 per month. (*Ibid.* at p. 30.) OAS then speculates that this increase improperly included compensation that was not reportable. (*Ibid.*) The City previously informed OAS that it disputed this interpretation of Resolution No. 9284, and the City continues to dispute this interpretation now. OAS cannot unilaterally dictate the salary the City pays its elected officials by refusing to recognize the City's duly enacted legislation. If OAS does not change its view, the City wishes to have its objection accurately noted in the Final Report. Similarly, OAS incorrectly claims that the City "was not able to identify the cause" of certain errors in reporting the Fire Chief's payrate in some pay periods from 2007 to 2008. The City explained to OAS, however, that these errors resulted from transitioning the Fire Chief from a fire-suppression schedule to a 40-hour work-week.

As for OAS's remaining items noted under this Finding, the City appreciates OAS's efforts and will work diligently to address these issues. At the same time, the City reiterates its position that OAS's own findings belie its claim that the City failed to provide information or was uncooperative.

**I. The City did not intentionally misreport payroll element information to CalPERS.**

**Finding 8:**

The City incorrectly reported payroll element information to CalPERS.

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**Recommendation 8:**

- a) The City should report items of compensation using the correct pay codes. Special compensation should be reported separately from payrate and regular earnings using the pay code 09.
- b) The City should review its records and correct erroneous payroll reporting to reflect the correct payroll adjustments. The City should follow the procedures outlined in the CalPERS manual.
- c) The City should ensure that the correct work schedule code is reported for employees who work an average of 173 hours per month.

The City should work with CalPERS CASD to assess the impact of these incorrect payroll reporting elements and determine what adjustments, if any, are needed.

**City's Response to Finding and Recommendation 8:**

This Finding concerns technical errors that the City has proactively worked to address. The City will proactively work with OAS to remedy any prior reporting discrepancies.

OAS also notes that for one sampled employee, the City correctly identified that the employee's compensation was over-reported and proceeded to remedy this error by reporting a reduced payrate for the subsequent four pay periods. OAS's sole concern regarding this issue is procedural, not substantive, as the City should have remedied the overpayment through a payroll adjustment as outlined in the CalPERS Procedures Manual. Similarly, OAS's remaining concern under this Finding involves an incorrect work-schedule code for a single sampled employee. The City, of course, will work with OAS to remedy these errors, but notes that they belie the OAS's insinuation that the City inflated reported compensation earnable.

- J. **The City properly reported special compensation; OAS's Finding 9 is based on both legal and factual inaccuracies.**

**Finding 9:**

The City failed to properly report special compensation. Two statutory items of special compensation were not contained in a written labor policy or agreement and one of the items was not reported to CalPERS.

- a) Value of uniforms and uniform maintenance were not reported and were not contained in a written labor policy or agreement.
- b) The City's FLSA policy was not in a written labor policy or agreement.

**Recommendation 9:**

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a) The City should ensure that the values of uniforms and uniform maintenance are reported for all employees required to wear a uniform and that the uniform allowance policy is contained in a written labor policy or agreement.

b) The City should ensure that all items of special compensation, including FLSA, are contained in a written labor policy or agreement.

The City should work with CalPERS CASD to assess the impact of and to correct this issue.

#### City's Response to Finding and Recommendation 9:

This Finding is based on both legal and factual inaccuracies.

First, OAS asserts that the City should have reported uniform remuneration as special compensation for employees who received uniforms outside of a written labor agreement. This assertion is based on an erroneous interpretation of Title 2, Section 571 of the California Code of Regulations, which provides that remuneration for uniforms "must be reported to CalPERS" as special compensation only "if [it is] contained in a written labor policy or agreement." (Cal. Code Regs., tit. 2, § 571, subd. (a); see *id.*, § 571, subd. (a)(5) [emphasis added].) Contrary to OAS's Finding, the plain meaning of Section 571 does not require all remuneration for uniforms be made pursuant to a written labor agreement, or in turn to be reported to CalPERS as special compensation. CalPERS' own Procedures Manual repeatedly makes this point plain:

#### Special Compensation

Special compensation shall be limited to that which is received by a member pursuant to a labor policy or agreement.

....

\* \* \*

Only those items listed in the CCR 571 (a) [items qualifying as special compensation, such as uniforms] and meeting the criteria listed in CCR 571 (b) [written labor policy or agreement and numerous other requirements] are reportable.

....

Special compensation items must meet definitions listed in 571 (a) as well as the criteria outlined in 571(b) to be reported to CalPERS.

....

If an item of special compensation reported for a member is not listed in CCR 571 (a) or is out of compliance with any of the standards in CCR 571 (b) as reported for an individual, then it shall not be used to calculate the final compensation for that individual.

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(CalPERS Public Agency & Schools Procedures Manual 70-71, 79 [emphasis added].)

The second aspect of this Finding is similarly without merit. Because OAS received a "memo dated April 8, 1986" that incorrectly stated "the FLSA cycle for fire department employees was 27 days," OAS has taken the extreme position that, because of "conflicting information," the City effectively "did not have documentation supporting the current FLSA policy." (Draft Report 35-36.) Article 8 of the current Memorandum of Understanding between the City and its Fire Association clearly states that the length of the work period is 24 days, which, as OAS recognizes, is an appropriate work period under the FLSA that the City has consistently used for reporting purposes. (*Ibid.* at p. 35.); (*see* Appendix G, Memorandum of Understanding at 3). The City's current FLSA policy is correct and documented. OAS's Finding should be revised to reflect this fact.

**K. The City will work with CalPERS to correct any alleged overreporting of special compensation to CalPERS.**

**Finding 10:**

The City over-reported special compensation to CalPERS.

**Recommendation 10 (In part):**

The City should ensure that only compensation earnable, as defined under Government Code Section 20636 and corresponding regulations, is reported to CalPERS.

**City's Response to Finding and Recommendation 10:**

The City will work with CalPERS to correct any erroneous reporting of special compensation. It should be noted that while the Finding implies that there is a widespread problem, this is untrue. The Finding addressed one item of special compensation for one former employee for pay periods at least six years ago.

**CONCLUSION**

As noted above, the City agrees with some of the criticism set forth in the draft report but strenuously objects to any finding that the City failed to fully cooperate in the review or did not provide the requested information and documents. The City remains committed to working with CalPERS to provide any documentation or data it may still need to complete its audit and to correct any erroneous payroll reporting.



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Please contact the undersigned if you have any questions.

Very truly yours,

LIEBERT CASSIDY WHITMORE

  
Steven M. Berliner

SMB/tp

Enclosures

cc: Mark Whitworth  
Hema Patel  
Chris Wall