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August 13, 2012

Employer Code: 1525  
CalPERS ID: 7951940706  
Job Number: P11-019

Special District Risk Management Authority  
Gregory S. Hall, Chief Executive Officer  
1112 I Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hall:

Enclosed is our final report on the results of the public agency review completed for the Special District Risk Management Authority. Your agency's written response, included as an appendix to the report, indicates agreement with Finding 3 noted in the report, but disagreement with Finding 1 and Finding 2. We reviewed the information contained in your agency's response pertaining to Finding 1 and Finding 2 and did not identify any information to cause us to withdraw the findings. Our recommendations remain as stated in the report. However, we expanded Finding 1 and Finding 2 to further clarify the issues. In accordance with our resolution policy, we have referred the issues identified in the report to the appropriate divisions at CalPERS. Please work with these divisions to address the recommendations specified in our report. It was our pleasure to work with your agency and we appreciate the time and assistance of you and your staff during this review.

Sincerely,

Original Signed by Margaret Junker  
MARGARET JUNKER, Chief  
Office of Audit Services

Enclosure

cc: Risk and Audit Committee Members, CalPERS  
Peter Mixon, General Counsel, CalPERS  
Karen DeFrank, Chief, CASD, CalPERS  
Mary Lynn Fisher, Chief, BNSD, CalPERS  
Paul C. Frydendal, Chief Financial Officer, Authority  
Nicole Rushing, Finance Manager, Authority

# **Office of Audit Services**



## **Public Agency Review**

### **Special District Risk Management Authority**

**Employer Code: 1525  
Job Number: P11-019**

**August 2012**

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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# **SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY**

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## **RESULTS IN BRIEF**

The Office of Audit Services (OAS) reviewed the Special District Risk Management Authority's (Authority) enrolled individuals, member compensation, and required documentation for individuals included in test samples. This review did not include a determination as to whether the Authority is a "public agency" (as that term is used in the California Public Employees' Retirement Law), and OAS therefore expresses no opinion or finding with respect to whether the Authority is a public agency or whether its employees are employed by a public agency.

A detail of the findings is noted in the Results section beginning on page three of this report. Specifically, the following findings were noted during the review:

- An increase in compensation earnable was not received by other employees in the same or next closest group or class of employment.
- Payrates were not contained in publicly available pay schedules.
- Payrate and earnings were not properly reported for an employee who received an increase in the middle of a pay period.

The pertinent sections of the California Government Code and California Code of Regulations for each finding are listed in Appendix C.

## **AUTHORITY BACKGROUND**

The Special District Risk Management Authority is a Joint Powers Authority formed in 1986, under Section 6500 et seq. of the California Government Code for the purpose of providing risk management services including risk financing, risk control and loss prevention services for California's local government agencies. The Authority provides property, liability, and auto as well as Workers' Compensation coverage, loss prevention services and training for its members. In addition, the Authority offers and administers a small group Medical Benefits Program, dental, vision, life long-term disability and an employee assistance program to public agencies with 250 employees or less through a partnership with California State Association of Counties Excess Insurance Authority. The entities participating in these programs are generally special districts and joint power authorities, but also include one city in the Property/Liability Program, three cities in the Workers' Compensation program and six cities, one county and nine Superior Courts of California in the Health Benefits Program. The Authority is governed by a seven-member Board of Directors. The Employee Handbook and employment agreements outline Authority employees' salaries and benefits

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# **SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY**

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and state the terms of employment agreed upon between the Authority and its employees.

The Authority contracted with CalPERS effective January 14, 1991, to provide retirement benefits for local miscellaneous employees. The Authority's current contract amendment identifies the length of the final compensation period as thirty-six months.

All contracting public agencies, including the Authority, are responsible for the following:

- Determining CalPERS membership eligibility for its employees.
- Enrolling employees into CalPERS upon meeting membership eligibility criteria.
- Enrolling employees in the appropriate membership category.
- Establishing the payrates for its employees.
- Approving and adopting all compensation through its governing body in accordance with requirements of applicable public meeting laws.
- Publishing all employees' payrates in a publicly available pay schedule.
- Identifying and reporting compensation during the period it was earned.
- Ensuring special compensation is properly identified and reported.
- Reporting payroll accurately.
- Notifying CalPERS when employees meet Internal Revenue Code annual compensation limits.
- Ensuring the employment of a retired annuitant is lawful and reinstating retired annuitants that work more than 960 hours in a fiscal year.

## **SCOPE**

As part of the Board approved plan for fiscal year 2011/2012, the OAS reviewed the Authority's payroll reporting and member enrollment processes as these processes relate to the Authority's retirement contract with CalPERS.

The review period was limited to the examination of sampled records and processes from July 1, 2008, through June 30, 2011. The on-site fieldwork for this review was conducted on January 4, 2012, and January 5, 2012. The review objectives and a summary of the procedures performed, sample sizes, sample periods and findings are listed in Appendix B.

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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## OFFICE OF AUDIT SERVICES REVIEW RESULTS

**Finding 1:** Increase in compensation earnable was not received by other employees in the same or closest group or class of employment.

***Recommendation:***

Only compensation earnable, as defined under Government Code Section 20636 and corresponding regulations, can be reported to CalPERS and considered in calculating retirement benefits. The Authority must ensure that reported payrates are set forth in a publicly available pay schedule and meet the definition of payrate under the Public Employees' Retirement Law (PERL). The Authority also should ensure that only compensation meeting the definition of compensation earnable in Section 20636 and related regulations is reported to CalPERS. Additionally, the Authority must ensure that all employees' payrates are properly reviewed, authorized and approved by the Authority's Board of Directors in accordance with applicable public meeting laws and that pay amounts and pay scales are available for public scrutiny. Furthermore, calculation of retirement benefits should be limited to a member's last authorized payrate listed in a publicly available pay schedule.

OAS recommends CASD work with the Authority to determine the impact of any incorrect reporting and determine what adjustments are needed to correct any improperly reported amounts. To the extent that amounts of pay were improperly included in the calculation of any retirement allowance afforded individuals who have already retired, a correction must be made pursuant to Government Code Section 20160.

***Condition:***

OAS found that the former Chief Executive Officer (CEO) received a salary increase that exceeded the average increases received by employees in a similar group or class. In June 2006, the individual received a 67.41 percent salary increase to a new payrate of \$20,833.33 retroactively to July 2005. Prior to the retroactive salary increase, the individual's monthly payrate was \$12,444.50. The individual's salary increase exceeded the salary increases received by the Chief Officers' group, which was the closest group or class of employment to the CEO position. Specifically, the Chief Officers group and the former CEO received a 2.7 percent increase effective July 2005. In addition, in July 2006, one Chief Officer received a 3.4 percent increase and another Chief

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# **SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY**

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Officer received an 8.57 percent increase. The Chief Risk Officer did not receive a salary increase.

The former CEO retired on December 31, 2009. The retirement law limits increases in compensation earnable for employees not in a group or class during the final compensation period (here thirty six months) and the two years immediately preceding the final compensation period to the average increase in compensation earnable for employees in the same membership classification. Here, this means that any increases in pay provided an individual not in a group or class within the 5 years prior to retirement would need to be compared against the raises provided to other miscellaneous members over that same time frame.

In this case, it appears that the former CEO received an increase of 67.41 percent in June of 2006 that was made retroactive to July of 2005. Since an increase in this amount was not provided to the next closest group or class of employees, the increase should not have been reported nor used to calculate retirement benefits.

The City's response to CalPERS draft audit report concedes that the pay change occurred three and one half years before retirement and was made retroactive to four and one half years before retirement, both of which fall within the time frame referenced in the retirement law. Therefore, it appears that the June 2006 increase that was made retroactive to July of 2005 should not have been reported or used in the calculation of retirement benefits for the former CEO because the amounts failed to meet the definition of payrate under Section 20636.

In addition, the former CEO's \$20,833.33 payrate was not listed on a publicly available pay schedule, as noted in Finding 2. Per section 20636, an employee's payrate is the base pay pursuant to publicly available pay schedules.

***Criteria:***

Government Code § 20160, § 20630(b), § 20636(b)(1), § 20636(d),  
§20636(e)(1), § 20636(e)(2)  
California Code of Regulations § 570.5, § 572

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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**Finding 2:** Payrates were not properly authorized and were not contained in a publicly available pay schedule.

***Recommendation:***

Only compensation earnable, as defined under Government Code Section 20636 and corresponding regulations, can be reported to CalPERS and considered in calculating retirement benefits. The Authority must ensure that reported payrates are set forth in a publicly available pay schedule and meet the definition of payrate under the PERL. Additionally, the Authority must ensure that all pay schedules are properly reviewed, authorized and approved by the Authority's Board of Directors in accordance with requirements of applicable public meeting laws. Furthermore, calculation of retirement benefits should be limited to a member's last authorized payrate listed in a publicly available pay schedule and must be available for public scrutiny.

OAS recommends CASD deny payrates that were not properly authorized, listed in a publicly available pay schedule, and available for public scrutiny. To the extent that amounts of pay did not meet the definition of compensation earnable and were improperly reported and/or included in the retirement allowance afforded individuals who have already retired, a correction must be made pursuant to Government Code Section 20160. The Authority should work with CASD to determine the impact of any incorrect reporting and to determine what adjustments are needed to correct any improperly reported compensation amounts. In addition, the Authority should work with CASD to ensure that all pay schedules are public records and identify the position title for every employee position.

***Condition:***

The Authority had a salary worksheet which contained columns indicating Cost of Living Allowance (COLA) increases and also promotional and step increases. The worksheet was organized by level of classification, date of increase, and employee initials. However, the salary worksheet was not a pay schedule and was not publicly available. It was an internal document utilized to track employees' payrates subsequent to salary increases and COLAs. The most recent salary worksheet provided was approved by the Authority's Board on July 1, 2007, but it had not been updated since and was not current. Multiple COLAs and several employee promotional and step increases had occurred since 2007 making the July 2007 salary worksheet out of date.

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## **SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY**

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In addition, the salary worksheet did not include the salary range for the Chief Executive Officer classification. The only document that referenced the amount of pay to be received by the CEO was a separate employment agreement. The former CEO's rate of pay does not appear to have been included in a publicly available pay schedule as required by the definition of payrate in section 20636(b). If amounts of pay do not meet the definition of compensation earnable under section 20636, they should not be reported to CalPERS and cannot be used to calculate retirement benefits. All employees' payrates must be contained in a publicly available pay schedule.

***Criteria:***

Government Code § 20160, § 20049, § 20636(b)(1), § 20636(d)  
California Code of Regulations § 570.5(a)

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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**Finding 3:** The Authority incorrectly reported payroll information for an employee who received a payrate increase in the middle of a pay period.

***Recommendation:***

The Authority should report two payroll entries for employees who receive a pay increase in the middle of a pay period.

OAS recommends CASD ensure the Authority implement the recommendation noted in Finding 2 prior to working with the Authority to correct this payrate increase reporting error.

***Condition:***

A payrate increase was incorrectly reported in the 1/10-3 service period for a sampled employee who received a promotion in the middle of the corresponding pay period. On January 1, 2010, the employee was promoted to the Chief Executive Officer position and received a payrate increase from \$12,130.02 to \$15,416.61. However, the Authority reported a payrate of \$14,102.03 in service period 1/10-3, which was a combination of the four days of the old payrate and six days at the new payrate. The Authority should have reported two payroll entries for the employee in service period 1/10-3; one payroll entry indicating the old payrate of \$12,130.02 and the earnings received under the old payrate, and a second entry indicating the new payrate of \$15,416.61 and the earnings received under the new payrate. As noted in Findings 1 and 2, the payrate for the Chief Executive Officer's position was not listed in a publicly available pay schedule and may not meet the definition of payrate in this case.

***Criteria:***

Government Code § 20630(b), § 20636(a), § 20636(b)(1)  
CalPERS Procedures Manual, Page 104

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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## CONCLUSION

OAS limited this review to the areas specified in the scope section of this report and in the objectives as outlined in Appendix B. OAS limited the test of transactions to employee samples selected from the Authority's payroll records. Sample testing procedures provide reasonable, but not absolute, assurance that these transactions complied with the California Government Code except as noted.

The findings and conclusions outlined in this report are based on information made available or otherwise obtained at the time this report was prepared. Since OAS did not review whether the Authority is a "public agency" (as that term is used in the California Public Employees' Retirement Law), this report expresses no opinion or finding with respect to whether the Authority is a public agency or whether its employees are employed by a public agency.

This report does not constitute a final determination in regard to the findings noted within the report. The appropriate CalPERS divisions will notify the agency of the final determinations on the report findings and provide appeal rights, if applicable, at that time. All appeals must be made to the appropriate CalPERS division by filing a written appeal with CalPERS, in Sacramento, within thirty days of the date of the mailing of the determination letter, in accordance with Government Code Section 20134 and Sections 555-555.4, Title 2, California Code of Regulations.

Respectfully submitted,

Original Signed by Margaret Junker  
MARGARET JUNKER, CPA, CIA, CIDA  
Chief, Office of Audit Services

Date: August 2012  
Staff: Michael Dutil, CIA, Senior Manager  
Alan Feblowitz, CFE, Manager  
Kelly Dotters-Rodriguez

# APPENDIX A

## BACKGROUND

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# **SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY**

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## **BACKGROUND**

### **California Public Employees' Retirement System**

The California Public Employees' Retirement System (CalPERS) provides a variety of programs serving members employed by more than 2,500 local public agencies as well as state agencies and state universities. The agencies contract with CalPERS for retirement benefits, with CalPERS providing actuarial services necessary for the agencies to fund their benefit structure. In addition, CalPERS provides services which facilitate the retirement process.

CalPERS Customer Account Services Division (CASD) manages contract coverage for public agencies and receives, processes, and posts payroll information. In addition, CASD provides services for eligible members who apply for service or disability retirement. In addition, CASD provides eligibility and enrollment services to the members and employers that participate in the CalPERS Health Benefits Program, including state agencies, public agencies, and school districts. CalPERS Benefit Services Division (BNSD) sets up retirees' accounts, processes applications, calculates retirement allowances, prepares monthly retirement benefit payment rolls, and makes adjustments to retirement benefits.

Retirement allowances are computed using three factors: years of service, age at retirement and final compensation. Final compensation is defined as the highest average annual compensation earnable by a member during the last one or three consecutive years of employment, unless the member elects a different period with a higher average. State and school members use the one-year period. Local public agency members' final compensation period is three years unless the agency contracts with CalPERS for a one-year period.

The employer's knowledge of the laws relating to membership and payroll reporting facilitates the employer in providing CalPERS with appropriate employee information. Appropriately enrolling eligible employees and correctly reporting payroll information is necessary to accurately compute a member's retirement allowance.

# APPENDIX B

## OBJECTIVES

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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## OBJECTIVES

The objectives of this review were limited to the determination of:

- Whether the Authority complied with applicable sections of the California Government Code (Sections 20000 et seq.) and Title 2 of the California Code of Regulations.
- Whether prescribed reporting and enrollment procedures as they relate to the Authority's retirement contract with CalPERS were followed.

This review covers the period of July 1, 2008, through June 30, 2011. OAS completed a prior review covering the period of July 1, 2000, to June 30, 2003. This review did not include a determination as to whether the Authority is a "public agency", and expresses no opinion or finding with respect to whether the Authority is a public agency or whether its employees are employed by a public agency.

## SUMMARY

### **Procedures, Sample Sizes, Sample Periods, and Findings**

To accomplish the review objectives, OAS interviewed key staff members to obtain an understanding of the Authority's personnel and payroll procedures, reviewed documents, and performed the following procedures. Related sample sizes, sample periods and findings are listed.

- ✓ Reviewed:
  - Provisions of the Contract and contract amendments between the Authority and CalPERS
  - Correspondence files maintained at CalPERS
  - Authority Board minutes and Authority Board resolutions
  - Authority written labor policies and agreements
  - Authority salary, wage and benefit agreements including applicable resolutions
  - Authority personnel records and employee hours worked records
  - Authority payroll information including Summary Reports and PERS listings
  - Other documents used to specify payrate, special compensation and benefits for all employees
  - Authority ordinances as necessary
  - Various other documents as necessary

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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- ✓ Reviewed Authority payroll records and compared the records to data reported to CalPERS to determine whether the Authority properly reported compensation.

Sample Size and Period: Reviewed eight employees covering two sampled service periods - the second service period in December 2010 (12/10-4), and the second service period in June 2011 (6/11-4).

## **No Finding**

- ✓ Reviewed payrates reported to CalPERS and reconciled the payrates to Authority public salary records to determine whether base payrates reported were accurate, pursuant to publicly available pay schedules that identify the position title, payrate and time base for each position, and duly approved by the Authority's governing body in accordance with requirements of applicable public meeting laws.

Sample Size and Period: Reviewed eight sampled employees in the second service period in December 2010 (12/10-4) and two sampled employees during the review period (July 1, 2008 – June 30, 2011).

**See Finding 1:** The Authority reported an excessive payrate increase for the former Chief Executive Officer.

**See Finding 2:** Payrates were not properly authorized and contained in publicly available pay schedule.

- ✓ Reviewed PERS listing reports to determine whether the following payroll reporting elements were reported correctly: contribution code, pay code, work schedule code, service period, and member contributions.

Sample Size and Period: Reviewed eight sampled employees in the second service period in December 2010 (12/10-4).

**See Finding 3:** The Authority incorrectly reported payroll information for an employee who received a salary increase in the middle of a pay period.

- ✓ Reviewed the Authority's enrollment practices for temporary and part-time employees to determine whether individuals met CalPERS membership requirements.

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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Sample Size and Period: The Authority employed one part time employee; however, the employee was an existing CalPERS member, whom the Authority correctly enrolled into CalPERS upon hire date. The Authority did not employ any other part time or temporary employees in fiscal years 2009/2010 and 2010/2011.

**No Finding**

- ✓ Reviewed the Authority's enrollment practices for retired annuitants to determine if retirees were reinstated when 960 hours were worked in a fiscal year.

The Authority did not employ retired annuitants in fiscal years 2009/2010 and 2010/2011.

**No Finding**

- ✓ Reviewed independent contractors to ensure they were properly classified.

Sample Size and Period: Two independent contractors were sampled in calendar years 2009 and 2010.

**No Finding**

- ✓ Reviewed employees related to affiliated parties.

Sample Size and Period: The Authority did not employ employees related to affiliated parties.

**No Finding**

- ✓ Reviewed the Authority's calculation and reporting of unused sick leave balances.

Sample Size and Period: One retiring member covering the review period (July 1, 2008 – June 30, 2011).

**No Finding**

# APPENDIX C

## CRITERIA

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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## CRITERIA

Government Code § 20049, defines labor policy or agreement as:

Any written policy, agreement, memorandum of understanding, legislative action of the elected or appointed body governing the employer, or any other document used by the employer to specify the payrate, special compensation, and benefits of represented and unrepresented employees.

Government Code § 20160, states:

a) Subject to subdivisions (c) and (d), the board may, in its discretion and upon any terms it deems just, correct the errors or omissions of any active or retired member, or any beneficiary of an active or retired member, provided that all of the following facts exist:

(1) The request, claim, or demand to correct the error or omission is made by the party seeking correction within a reasonable time after discovery of the right to make the correction, which in no case shall exceed six months after discovery of this right.

(2) The error or omission was the result of mistake, inadvertence, surprise, or excusable neglect, as each of those terms is used in Section 473 of the Code of Civil Procedure.

3) The correction will not provide the party seeking correction with a status, right, or obligation not otherwise available under this part.

Failure by a member or beneficiary to make the inquiry that would be made by a reasonable person in like or similar circumstances does not constitute an "error or omission" correctable under this section.

(b) Subject to subdivisions (c) and (d), the board shall correct all actions taken as a result of errors or omissions of the university, any contracting agency, any state agency or department, or this system.

(c) The duty and power of the board to correct mistakes, as provided in this section, shall terminate upon the expiration of obligations of this system to the party seeking correction of the error or omission, as those obligations are defined by Section 20164.

(d) The party seeking correction of an error or omission pursuant to this section has the burden of presenting documentation or other evidence to the board establishing the right to correction pursuant to subdivisions (a) and (b).

(e) Corrections of errors or omissions pursuant to this section shall be such that the status, rights, and obligations of all parties described in subdivisions (a) and (b) are adjusted to be the same that they would have been if the act that would have been taken, but for the error or omission, was taken at the proper time. However, notwithstanding any of the other provisions of this

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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section, corrections made pursuant to this section shall adjust the status, rights, and obligations of all parties described in subdivisions (a) and (b) as of the time that the correction actually takes place if the board finds any of the following:

- (1) That the correction cannot be performed in a retroactive manner.
- (2) That even if the correction can be performed in a retroactive manner, the status, rights, and obligations of all of the parties described in subdivisions (a) and (b) cannot be adjusted to be the same that they would have been if the error or omission had not occurred.
- (3) That the purposes of this part will not be effectuated if the correction is performed in a retroactive manner.

Government Code § 20630, subdivision (b), states, in part:

Compensation shall be reported in accordance with Section 20636 and shall not exceed compensation earnable, as defined in Section 20636.

Government Code § 20636, subdivision (a), states, in part:

Compensation earnable by a member means the payrate and special compensation of the member....

Government Code § 20636, subdivision (b)(1), 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. Payrate for a member who is not in a group or class, means the normal 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).

Government Code § 20636, subdivision (d), states:

Notwithstanding any other provision of law, payrate and special compensation schedules, ordinances, or similar documents shall be public records available for public scrutiny.

Government Code § 20636, subdivision (e)(1), states:

As used in this part, 'group or class of employment' means a number of employees considered together because they share similarities in job duties, work location, collective bargaining unit, or other logical work related grouping. One employee may not be considered a group or class.

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# SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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Government Code § 20636, subdivision (e)(2), states:

Increases in compensation earnable granted to an employee who is not in a group or class shall be limited during the final compensation period applicable to the employees, as well as the two years immediately preceding the final compensation period, to the average increase in compensation earnable during the same period reported by the employer for all employees who are in the same membership classification...

California Code of Regulations § 570.5, subdivision (a), states:

For purposes of determining the amount of "compensation earnable" pursuant to Government Code Sections 20630, 20636, and 20636.1, payrate shall be limited to the amount 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 payrate 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 payrate.

California Code of Regulations § 572, states, in part:

An employee who is not in a "group or class of employment" within the meaning of the Public Employees' Retirement Law, may request an exception from the "average increase" procedure set forth in Sections 20636 and 20636.1. The local employer may request this exception on the employees behalf...

CalPERS Procedures Manual, Page 70, states,

Pay rate and special compensation must be in written schedules, ordinances, or similar documents that are available for public scrutiny.

The CalPERS Procedure Manual, page 104, states,

If a person receives a salary increase or decrease during the current service period, both pay rates must be reported. This will require two line entries, reporting the proper amount earned under each pay rate.

# APPENDIX D

## AUTHORITY RESPONSE



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June 29, 2012

**VIA OVERNIGHT COURIER AND E-MAIL**  
**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 Special District Risk Management Authority to June 4, 2012 Draft Audit Report*

Dear Ms. Junker:

We submit the following on behalf of our client, Special District Risk Management Authority ("Authority"). The Authority is in receipt of the Office of Audit Service's ("OAS") June 4, 2012 draft audit report ("Draft Report") related to the Authority's contract with the California Public Employees' Retirement System ("CalPERS"). The Authority appreciates OAS' efforts in conducting its compliance review, as well as the opportunity to comment on the Draft Report.

The Authority does not dispute Finding 3. However, we respectfully disagree with Finding 2. In addition, while we do not dispute the facts as stated in the Condition to Finding 1, except the statement that the payrate of the former CEO was not properly authorized or paid pursuant to a publicly available pay schedule as that term was defined during the period subject to the audit, we respectfully disagree with the proposed recommendation to Finding 1.

It is our hope that this response will provide you with additional information that will change OAS' determinations with respect to Finding 1 and Finding 2. Although our written response was due June 22, 2012, the Authority was graciously given an extension by Kelly Dotters-Rodriguez until June 29, 2012 to provide this response. We thank you for granting us this additional time to prepare our response.



**BEST BEST & KRIEGER**  
ATTORNEYS AT LAW

Margaret Junker, Chief  
June 29, 2012  
Page 2

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

In order to facilitate your review of the Authority's position with respect to each of the three findings noted in the Draft Report, we have set forth below the proposed findings and corresponding recommendations, followed by the Authority's response.

**A. Finalizing the proposed recommendation to Finding 1 and thereafter implementing the recommendation is not only inequitable but also contrary to the authority granted to CalPERS to make corrections of errors or omissions under Section 20160(b).**

**Finding 1:**

Increase in compensation earnable was not received by other employees in the same or closest group or class of employment.

**Recommendation to Finding 1:**

Only compensation earnable, as defined under Government Code Section 20636 and corresponding regulations, can be reported to CalPERS and considered in calculating retirement benefits. The Authority must ensure that reported payrates are set forth in a publicly available pay schedule and meet the definition of payrate under the Public Employees' Retirement Law (PERL). Additionally, the Authority must ensure that all employees' payrates are properly reviewed, authorized and approved by the Authority's Board of Directors in accordance with public meeting laws. Furthermore, calculation of retirement benefits should be limited to a member's last authorized payrate listed in a publicly available pay schedule.

OAS recommends that CASD work with the Authority to determine the impact of this incorrect reporting and determine what adjustments are needed. To the extent that amounts of pay were improperly included in the retirement allowance afforded individuals who have already retired, a correction must be made pursuant to Government Code Section 20160.

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

As stated earlier, we do not dispute the facts as stated in the Condition to Finding 1, except the statement that the payrate of the former CEO was not properly authorized or paid pursuant to a publicly available pay schedule as that term was defined during the period subject



**BEST BEST & KRIEGER**  
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to the audit.<sup>1</sup> However, we respectfully disagree with the proposed recommendation to Finding 1 because any proposed adjustments to the former CEO's retirement allowance would be neither equitable nor permissible under Section 20160.

The underlying principle behind denying certain elements of an employee's compensation as reportable for purposes of calculating a retirement allowance is the prevention of pension spiking. This is a laudable and necessary endeavor. However, the increase in the former CEO's base payrate was not done for the purpose of pension spiking. Rather, it was approved by the Board of Directors ("Board") in recognition of the former CEO's outstanding performance as CEO of the Authority. This performance was reflected in the substantial increase in membership and annual revenues enjoyed by the Authority during the period immediately preceding the 67.41% increase in the former CEO's compensation. Specifically, the Authority's total assets grew from \$14.0M as of June 30, 2001 to more than \$52.4M as of June 30, 2006 – a 274% increase. In addition, the Authority's retained earnings grew from \$9.1M as of June 30, 2001 to more than \$18.6M as of June 30, 2006 – a 104.4% increase. Further, during this period, the Authority evolved from a single coverage program with 170 public agency members to one with expanded coverage providing services to over 600 public agency members. This was hardly an attempt to unjustly compensate the former CEO. Rather, the increase in compensation was a reflection of the enormous benefit that the former CEO had created for the Authority throughout this period.

Further, the contested increase in compensation was not granted to the former CEO during his final compensation period which occurred between January 1, 2006 through December 31, 2009. While the increase in compensation was approved by the Board on December 7, 2005, it was applied retroactively to July 1, 2005. The retroactive effective date was agreed to by the Board because the Board had unofficially agreed to increase the former CEO's compensation in recognition of his outstanding performance during a board meeting in July of 2005. However, a final decision was postponed while the Board formed a committee to investigate and negotiate the former CEO's proposed increase in compensation. Those negotiations spanned a period of five months. Determining that the delay in arriving at an agreed upon increase in compensation was no fault of the former CEO, the Board agreed it was appropriate to make the increase in compensation retroactive.

Thus, the increased compensation was in effect for four and a half years before the former CEO retired. In fact, as of July 1, 2005, both the Authority and the former CEO paid the required employer and normal member contributions calculated on the increased

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<sup>1</sup> We address the properly authorized and publicly available pay schedule portion of Finding 1 in our discussion pertaining to Finding 2.



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compensation in effect on July 1, 2005. In addition, it is our understanding that the former CEO purchased five additional years of service credit at this increased payrate.

It cannot be emphasized enough that at no point did the Authority or the former CEO intend to or attempt to artificially inflate the former CEO's payrate for the purpose of increasing his pension benefit. Rather, the increase in compensation was arrived at by the Board after consideration of the former CEO's outstanding performance and the compensation paid to similarly situated chief executives in other similar agencies. Further, at all times, the increase in the former CEO's payrate was transparent to CalPERS and at no time, until receipt of this Draft Audit, was the increase brought into question.

The foregoing considerations coupled with the amount of time that has expired since the former CEO retired on December 31, 2009 and the time that the Draft Audit was issued on June 4, 2012, i.e., *almost 2 and 1/2 years later*, suggest that the proposed adjustment to the retirement allowance currently paid to the former CEO would not only be inequitable, but also is not permissible under Section 20160. First, at no time after the former CEO submitted his retirement application but before his retirement allowance commenced, when according to Ms. Angelina T. Ray, CalPERS staff evaluates a retiree's compensation to determine whether all elements thereof are reportable under the law, did any CalPERS staff member call the former CEO's compensation into question.<sup>2</sup> Rather, not only did the CEO's final compensation get approved by CalPERS staff but, in addition, the former CEO's purchase of five years of additional service credit was based on said final compensation. Thus, it would seem patently unfair to penalize the former CEO for an oversight of CalPERS staff particularly when the increased compensation had been in effect since July 1, 2005 and contributions on that increased compensation were paid not only up to the former CEO's retirement on December 31, 2009, but through the former CEO's purchase of additional service credit. We understand that the former CEO completed payments of approximately \$294,575.02 to pay for the cost of the five years of additional service credit.

Second, CalPERS is authorized to modify a retirement allowance at the request of CalPERS staff if the corrective action is necessary "as a result of errors or omissions of . . . any contracting agency . . ." <sup>3</sup> However, at the time that the former CEO's compensation was increased by 67.41% pursuant to Board approval and in compliance with the requirements of a publicly available pay schedule in effect at the time, as discussed in detail below in reference to Finding 2, the inclusion of the 67.41% increase in compensation was not an error or omission of

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<sup>2</sup> On June 28, 2012, the CEO and CFO of the Authority and general counsel of the Authority had a telephone conference with Ms. Angelina T. Ray whereby the referenced statement was made by Ms. Ray.

<sup>3</sup> California Government Code §20160(b) (2012).



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the Authority. In fact, at the time that the increase in compensation was approved on December 7, 2005 to be retroactively effective July 1, 2005, the 'payrate' component of reportable compensation merely required that it be a "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 (3)."<sup>4</sup> Since the provisions of Regulation Section 570.5 had not yet been adopted, as discussed in detail below, the Board's approval of the increase in compensation during a meeting held in compliance with the Brown Act and the availability of the former CEO's compensation upon request by the public, were sufficient to meet the requirement that the payrate be paid pursuant to a publicly available pay schedule. Thus, a correction to the former CEO's retirement allowance is not appropriate under the provisions of Section 20160(b), because no error or omission occurred when the action, i.e., the Board's approval of the 67.41% in compensation, was taken.

On the basis of the foregoing, we respectfully request that CalPERS revise Finding 1 of the Draft Report to provide that no adjustment to the retirement allowance of the former CEO is appropriate in these circumstances.

**B. Contrary to Finding 2, the Authority properly authorized payrates by approval of the Board in meetings held in compliance with the Brown Act and said payrates were contained in a publicly available pay schedule, as that term was defined during the period subject to the audit.**

**Finding 2:**

Payrates were not properly authorized and were not contained in a publicly available pay schedule.

**Recommendation to Finding 2:**

Only compensation earnable, as defined under Government Code Section 20636 and corresponding regulations, can be reported to CalPERS and considered in calculating retirement benefits. The Authority must ensure that reported payrates are set forth in a publicly available pay schedule and meet the definition of payrate under the PERL. Additionally, the Authority must ensure that all employees' salaries are properly reviewed, authorized and approved by the Authority's Board of Directors in accordance with public meeting laws. Furthermore, calculation of retirement benefits should be limited to a member's last authorized payrate listed in a publicly available pay schedule.

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<sup>4</sup> Section 20636(e)(2) was not applicable at that time because the former CEO was employed by the Authority.



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OAS recommends that CASD deny payrates that were not properly authorized and publically [sic] available. To the extent that amounts of pay were improperly included in the retirement allowance afforded individuals who have already retired, a correction must be made pursuant to Government Code Section 20160.

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

The Authority disagrees with this finding. The analysis contained in the "Condition" section of Finding 2 erroneously observes that the Authority's salary schedule, approved by the Board and effective July 1, 2007, was an internal document and thus was not publicly available. It further suggests that the Chief Executive Officer's salary "range" should have been included in the salary schedule which, only lines earlier in the Draft Audit, the field examiner suggests was not "publicly available." Setting aside the fact that the preceding is contradictory, not only is CalPERS unfairly and incorrectly attempting to impose requirements that became effective August 1, 2011, it also incorrectly concludes that the Board failed to review, authorize and approve payrates.

In order to effectively respond to the preceding proposed finding, it is important to articulate the rules not only as they apply in this instance but as they existed during the period subject to the audit. As it applies to a CalPERS member that is "not in a group or class," as is the case with the CEO of the Authority, the term "publicly available pay schedule" appears in the definition of the term "payrate" at Section 20636(b)(1). Said provision defines "payrate" as 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 (3)."<sup>5</sup> As it applies to a CalPERS member that is in a group or class, Section 20636(b)(1) defines the term 'payrate' as "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." (Emphasis added). Thus, the difference between the definition of payrate for an employee that is in a group or class and one that is not is the requirement that the payrate for an employee that is in a group or class must be paid to similarly situated members of the same group or class. This is not case for an employee that is not in a group or class such as the CEO.

During the period subject to the audit, the term "publicly available pay schedule" was not defined anywhere in the PERL. In fact, said definition did not exist until Regulation Section 570.5 became effective on August 10, 2011. Regulation Section 570.5 was adopted by

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<sup>5</sup> Section 20636(e)(2) is not applicable to the *current* CEO as he is still employed by the Authority.



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the Board of Administration at the behest of the Actuarial & Employer Services Branch for the purpose of specifically identifying the elements necessary to satisfy the requirement that a payrate be paid pursuant to a “publicly available pay schedule.”

Prior to the adoption of Regulation Section 570.5, CalPERS employers had no guidance available to them indicating that any particular requirements needed to be satisfied in order to demonstrate that a payrate was paid pursuant to a publicly available pay schedule. In fact, all that was available was the legislative history to SB 53 (Russell) which added the definition of payrate, including that said payrate be paid pursuant to a “publicly available pay schedule,” as it applied to a CalPERS member not in a group or class.<sup>6</sup> In the section-by-section analysis of SB 53, provided to the Senate Public Employment & Retirement Committee by CalPERS staff, it was explained that “payrates would have to be publicly noticed by the governing body.”<sup>7</sup> No further guidance of what constituted a “publicly available pay schedule” was provided in that analysis.

Thus, it appears that all the guidance that was available to CalPERS employers, including the Authority, with respect to what it meant to have a rate of pay paid pursuant to a “publicly available pay schedule,” was that such rate of pay was to be publicly noticed by the governing body. In fact, as stated earlier, Regulation Section 570.5 did not become operative until August 10, 2011, more than a month after the close of the period subject to the audit. As such, we respectfully submit that it would be patently unfair to hold the Authority and its employees, including the former and current CEO, accountable for a requirement that was not defined during the period subject to the audit.

Based on the preceding, the Authority strongly disagrees with the assertion in Finding 2 that the payrate amounts paid by the Authority to its employees, including the former and current CEO, were not publicly available. The Authority also disagrees with the statement that the payrates of Authority employees, including the former and current CEO, were not properly authorized by the Board.

As indicated above, at best, the pre-Regulation Section 570.5 standard for a “publicly available pay schedule” was that it be publicly noticed by the governing body. As noted in Finding 2, the salary schedule reviewed by the field auditor was approved by the Board

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<sup>6</sup> The legislative history to AB 2244 (2006), the Assembly Bill that amended Section 20636(b)(1) to add the requirement that the payrate of a member in a class or group be paid pursuant to a publicly available pay schedule, contained no guidance on how the term “publicly available pay schedule” was to be construed.

<sup>7</sup> Senate Bill 53, 1993-1994 Reg. Sess., Senate Public Employment & Retirement Committee (March 29, 1993), pg. 3 available at [http://www.leginfo.ca.gov/pub/93-94/bill/sen/sb\\_0051-0100/sb\\_53\\_cfu\\_930316\\_155531\\_sen\\_comm](http://www.leginfo.ca.gov/pub/93-94/bill/sen/sb_0051-0100/sb_53_cfu_930316_155531_sen_comm) (last visited June 29, 2012).



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with an effective date of July 1, 2007. Subsequent increases in the payrates referenced in the salary schedule were similarly approved by the Board. All said meetings at which payrates and increases in payrates were approved by the Board were conducted in accordance with the Brown Act, and thus the payrates and adjustments thereto were publicly noticed by the Board as required during the period that is subject to the audit. Furthermore, all agendas and minutes of these meetings were and are public records available to the public on request. While there seems to be an implication in the Draft Report that the total payrate, and not just the percentage of the increase in the payrate, needed to be disclosed at a public meeting of the Board, there was no such requirement at the time.

Similarly, the Board not only considered the matter of approving the employment contract of the former CEO in accordance with the Brown Act but reported the approval of such contract in a public meeting held on December 7, 2005. The former CEO's contract, which was at all times a public record available for public scrutiny, clearly provided that the CEO's annual payrate was \$250,000 effective July 1, 2005. While Finding 1 suggests that the former CEO's payrate was required to be on the same pay schedule as the payrates of other Authority employees, there was no such requirement in place then and there is no such requirement now. Rather, per the requirements in place then, it was sufficient that the payrates be publicly available and publicly noticed. The Board's approval of the contract at its meeting in December 7, 2005 made the payrate as stated in the contract publicly noticed and the payrate was publicly available, as the former CEO's contract was never marked or kept confidential but was always available for public review. The same has been the case with respect to the current CEO. Not only has his contract and subsequent increases been approved by the Board at meetings held in accordance with the Brown Act but said contract, as amended, is available for public scrutiny. Further, the current CEO remains an employee of the Authority and there is no expectation that he will be retiring anytime soon. In addition, the Authority is now in compliance with the requirements of Regulation Section 570.5 having approved a pay schedule that complies with Regulation Section 570.5. As a result, it is highly probable that the current CEO's retirement benefits and those of current employees will be based on their respective payrates in effect at some future date.

More importantly, all of the Authority's payrate data has been available to the public upon request dating back to at least January 29, 2002. For example, on that date and on at least three other occasions, the Authority responded to requests made both by private firms and public agencies for salary paid to all Authority employees for survey purposes. The disclosed data included the position, department, base monthly salary and benefits. Thus, the fact that these requests were granted further supports our position that the Authority's payrates were a public record available for public scrutiny.



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Further, there appears to be no dispute that Authority employees earned all the payrate components of their reported compensation earnable, and that the employer and normal member contributions were paid on the full amounts reported. Thus, it would appear that CalPERS would be inadvertently acting against its own interest if the Authority were placed in the position of having to retroactively adjust its pay records, triggering an obligation by CalPERS to refund the employer and normal member contributions related to those adjustments.

Lastly, we certainly understand and agree with the importance of reviewing the Authority's records to verify compliance with Regulation Section 570.5 as of August 10, 2011. Nonetheless, it would be unfair to impose the requirements of Regulation Section 570.5 retroactively when such rules were not delineated at such time, particularly when it is clear that the Authority was not hiding anything and that the Authority made its payrates publicly available at all times during the period subject to the audit and subsequently.

On the basis of the foregoing, we respectfully request that CalPERS eliminate Finding 2 of the Draft Report.

**C. Subject to the Authority's position with respect to Finding 2, the Authority agrees with Finding 3**

**Finding 3:**

The Authority incorrectly reported payroll information for an employee who received a payrate increase in the middle of a pay period

**Recommendation to Finding 3:**

The Authority should report two payroll entries for employees who receive a pay increase in the middle of a pay period.

OAS recommends CASD ensure the Authority implement the recommendation noted in Finding 2 prior to working with the Authority to correct this payrate increase reporting error.

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

Subject to the Authority's position with respect to Finding 2 as stated above, the Authority agrees with Finding 3. During the first pay period of January 2010, the subject employee was promoted to CEO and his payrate increased as of January 1, 2010. The CEO was paid for four days at his old payrate for 2009 wages and six days at the new payrate. However,



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his wages were reported to CalPERS at the blended rate for this bi-weekly pay period instead of in two separate transactions, one for each rate of pay. In the future, we will report employee wages to CalPERS with separate transactions for each change in pay rate. We note that this finding has no fiscal impact to the Authority, to CalPERS or to the CEO.

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In closing and on the basis of the preceding, we respectfully request that CalPERS reconsider its findings and recommendations with respect to Finding 1 and Finding 2. We thank you for the opportunity to submit this written response and we look forward to working with OAS and CASD to ensure that the final recommendations and the implementation of said recommendations are not only appropriate but equitable.

Respectfully submitted,

A handwritten signature in cursive script that reads 'Isabel C. Safie'.

Isabel C. Safie  
for BEST BEST & KRIEGER LLP

cc: Gregory S. Hall, CEO  
C. Paul Frydendal, CFO  
Ann Siprelle, General Counsel