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January 26, 2011

Employer Code: 5236-5661
Job Number: P09-052

Franchise Tax Board
Joy Burns, Staff Services Manager
P.O. Box 550
Sacramento, CA 95812-0550

Dear Ms. Burns:

Enclosed is our final report on the results of the public agency review completed for the Franchise Tax Board. Your department's written response indicates agreement with the issues noted in the report. The written response is included as an appendix to the report. As part of our resolution process, 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, CPA, CIA, CIDA
Chief, Office of Audit Services

Enclosure

cc: Finance Committee Members, CalPERS
Peter Mixon, General Counsel, CalPERS
Lori McGartland, Chief, ERSD, CalPERS
Mary Lynn Fisher, Chief, BNSD, CalPERS
Holly Fong, Chief, EMHS, CalPERS

Franchise Tax Board State Agency Review



State Agency Review



Office of Audit Services

**Employer Code: 5236-5661
Job Number: P09-052**

January 2011

FRANCHISE TAX BOARD

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FRANCHISE TAX BOARD

RESULTS IN BRIEF

We reviewed the Franchise Tax Board's (Department) enrolled individuals, retirement contributions, member earnings and required health, retirement and Automated Communications Exchange System (ACES) documentation for employees included in our test sample. A detail of the exceptions is noted in the Risk and Mitigation Table. Specifically, the following exceptions were noted during the review:

- Two sampled part-time employees were not enrolled in CalPERS membership.
- Two retired annuitants exceeded the 960 hour threshold in a fiscal year.
- Unused sick leave credit was incorrectly calculated and certified for one sampled employee.
- Required health benefit documentation was not on file for three members in our sample.
- Required ACES Employer User Security Agreements were not on file for eleven ACES users.

BACKGROUND

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 Employer Services Division (ERSD) manages contract coverage for public agencies and receives, processes, and posts payroll information. CalPERS Benefit Services Division (BNSD) provides services for eligible members who apply for service or disability retirement. BNSD sets up retirees' accounts, processes applications, calculates retirement allowances, prepares monthly retirement benefit payment rolls, and makes adjustments to retirement benefits. The Office of Employer and Member Health Services (EMHS), as part of the Health Benefits Branch (HBB), 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.

State members include state miscellaneous, highway patrol, state safety, state industrial and state peace officer/firefighter (POFF) members. California Government Code (GC), §20370 through §20445, provides detailed definitions for these classifications. These classifications denote different retirement benefit

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formulas, which include: 2% at age 55 for state miscellaneous or industrial members (GC §21354.1); 3% at age 50 for state patrol members (GC §21362.2); 2.5% at age 55 for state safety members (GC §21369.1); 3% at age 55 for POFF and local safety members (GC §21363.1); and, 3% at age 50 for POFF members (GC §21363.4 and §21363.8).

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.

Unlike contracting agency retirement benefit program operations, state agencies do not report member enrollment and monthly payroll data to CalPERS. Instead, each state agency inputs membership and payroll information with special designated codes into the Personnel Information Management System (PIMS) through Personnel Action Request forms. PIMS contains official personnel, payroll, and retirement information for state employees. The State Controller's Office (SCO) has the responsibility for maintenance and security of PIMS.

In accordance with the SCO's published Personnel Action Manual and Payroll Procedures Manual, state agencies input necessary personnel and payroll changes into PIMS. The system automatically passes data fields that are necessary for retirement benefit calculations to CalPERS via CalPERS' Transaction Log. The data from PIMS updates the appropriate CalPERS application systems, such as the Contribution Reporting System, Retirement Information Benefit System and CalPERS Online Member and Employer Transaction System. One critical data element passed on from state agencies to CalPERS, via the SCO, is the employee's Retirement Account Code (RAC). The RAC is a one or two digit alpha or numeric code used by PIMS to designate an employee's retirement status. During system updates from SCO to CalPERS, the RAC for each employee is converted to a coverage group code, which is significant for determining retirement contribution levels while the employee is active and the retirement formula when the employee is applying for retirement.

In general, when changes are mandated by law or contract, without the need for state agencies to prepare payroll change documents, payroll changes may be made automatically by the SCO. However, each agency has full responsibility for preparing accurate Personnel Action Request forms, employee attendance reports, and selecting appropriate compensation codes. California State Civil Service Pay Scales are published by the Department of Personnel

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Administration. SCO's Payroll Procedures Manual, at Section G 105, outlines miscellaneous special compensation payment processing methods and whether they are subject to CalPERS for the purpose of retirement calculation.

The SCO also has the responsibility for processing the health care contribution amounts for state employees and state agencies. Based on the information contained in PIMS, the SCO identifies and remits the state's contribution and the amounts authorized by employees and annuitants to be deducted from their salaries or retirement allowances for payment of contributions.

The primary function of the Department is to administer the California Revenue and Taxation Code. In this capacity, the Department administers two major tax programs, Personal Income Tax and Corporation Income Tax, as well as other non-tax programs and delinquent debt collection functions, including delinquent vehicle registration and debts owed to California courts and the Department of Industrial Relations.

SCOPE

As part of the Board approved plan for fiscal year 2009/2010, we reviewed the Department's payroll reporting and enrollment processes as these processes relate to the Department's health and retirement mandates with CalPERS. The objective of this review was limited to the determination that the Department complied with applicable sections of the California Government Code (Sections 20000 et seq.) and Title 2 of the California Code of Regulations and that prescribed reporting and enrollment procedures were followed. The on-site fieldwork for this review was conducted on April 7, 8, 12, 14 and 15, 2010.

The review period was limited to the examination of the records and processes from January 1, 2007, through December 31, 2009. To accomplish the review objectives, we performed the following:

- ✓ Reviewed the mandated requirements the Department had with CalPERS, correspondence files maintained at CalPERS, and employment agreements the Department had with its employees.
- ✓ Interviewed key staff members to obtain an understanding of the Department's personnel and payroll procedures.
- ✓ Reviewed the payroll transactions for sampled employees and compared the Department's payroll information with the data reported to CalPERS to determine whether the Department correctly reported compensation.

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- ✓ Reviewed the Department's payroll information reported to CalPERS for the sampled employees to determine whether payrates were reported pursuant to public salary information.
- ✓ Reviewed the Department's enrollment practices pertaining to temporary employees, retired annuitants, and independent contractors to determine whether the individuals met CalPERS membership requirements.
- ✓ Reviewed the Department's classification of employees to determine whether the Department reported sampled employees in the appropriate coverage groups. The retirement account code (RAC), which is entered by the Department into the SCO system, is converted to the coverage group code when the information is reported to CalPERS.
- ✓ Reviewed the Department's calculation and reporting of unused sick leave balances for a sample of retiring members.
- ✓ Reviewed employees and their dependents to determine whether the Department properly enrolled eligible individuals into CalPERS Health Benefits Program.
- ✓ Determined whether the Department maintained the required user security documents on file and reasonable security procedures were in place for ACES users.

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RISK AND MITIGATION TABLE

In developing our opinions, we considered the following risks and mitigations. We also include our observations and recommendations.

RISK	MITIGATION & OBSERVATION	RECOMMENDATION
1. The Department may not accurately report compensation to CalPERS.	We reviewed payroll records and compensation reported to CalPERS for a sample of 21 employees over two service periods. The service periods reviewed were November 2008 (11/08-0) and November 2009 (11/09-0). We determined the Department accurately reported compensation to CalPERS for the employees in our sample.	None.
2. The Department may not report payrates in accordance with publicly available salary schedules.	We reviewed payrates reported to CalPERS and reconciled the payrates to the Department of Personnel Administration's public salary information to determine whether payrates for the sampled employees were properly authorized and reported to CalPERS. The service periods reviewed were 11/08-0 and 11/09-0. We determined the Department paid and reported salaries pursuant to the authorized published salary information.	None.
3. The Department may not enroll all eligible employees into CalPERS membership.	<p><u>Temporary/Part-time Employees</u></p> <p>We selected a sample of ten temporary/part-time employees and examined the number of hours worked in fiscal years 2007/2008 and 2008/2009 to determine</p>	The Department should review all hours worked in a fiscal year by all temporary/part-time

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>3. The Department may not enroll all eligible employees into CalPERS membership. (continued)</p>	<p>whether they reached or exceeded the 1,000 hour membership eligibility criterion and were timely enrolled, or whether they had prior membership and should have been enrolled upon employment by the Department.</p> <p>We determined that eight of the ten sampled employees were properly enrolled when the 1,000 hour membership eligibility requirement was met; seven in fiscal year 2007/2008 and one in fiscal year 2008/2009. However, the Department did not enroll and report earnings to CalPERS for two employees who met eligibility in fiscal year 2008/2009 by working more than 1,000 hours in a fiscal year. One employee worked a total of 1,264.75 hours, reaching 1,000 hours worked as of April 2009. The other part-time employee worked a total of 1,111.50 hours, reaching 1,000 hours worked as of June 2009.</p> <p>Government Code, § 20305, states, in part, “(a) An employee whose appointment or employment contract does not fix a term of full-time, continuous employment in excess of six months is excluded from this system unless: ...(3) His or her employment is, in the opinion of the board, on a seasonal, limited-term, on-call, emergency, intermittent, substitute, or other irregular basis, and is compensated and meets one of the following conditions:...(B) The person...completes 1,000 hours</p>	<p>employees and enroll those that meet membership eligibility criteria.</p> <p>The Department should work with CalPERS ERSD to assess the impact of the non enrollment of the two sampled employees and determine what adjustments, if any, are needed.</p> <p>A confidential list identifying the employees mentioned in this section of the report has been sent to the Department and CalPERS ERSD as an appendix to our draft report.</p>

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>3. The Department may not enroll all eligible employees into CalPERS membership. (continued)</p>	<p>within the fiscal year, in which case, membership shall be effective not later than the first day of the first pay period of the month following the month in which...1,000 hours of service were completed. For purposes of this subdivision ...membership is effective after he or she has completed 1,000 hours of compensated service in a fiscal year."</p> <p><u>Independent Contractors</u></p> <p>We reviewed the Department's 1099 Miscellaneous Income forms for calendar years 2008 and 2009 in order to identify employees that may be misclassified as independent contractors. We did not identify any individuals who met the minimum criteria for testing.</p>	<p>None.</p>
<p>4. The Department may unlawfully employ retired annuitants.</p>	<p>We reviewed the hours worked for seven retired annuitants in fiscal years 2007/2008 and 2008/2009 to determine whether the retired annuitants worked more than 960 hours in a fiscal year. Our sample testing revealed two retired annuitants exceeded the 960 hour threshold in fiscal year 2007/2008: one working a total of 966 hours and the other a total of 976 hours.</p> <p>We also determined that the Department did not request information as to whether reappointed retired annuitants received unemployment insurance compensation during the 12-month period prior to a second or subsequent</p>	<p>The Department should monitor all hours worked in a fiscal year by all retired annuitants and reinstate those that exceed 960 hours.</p> <p>The Department should work with CalPERS BNSD to assess the impact of this unlawful employment and determine what adjustments, if any, are needed. A confidential list identifying the</p>

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>4. The Department may unlawfully employ retired annuitants. (continued)</p>	<p>appointment. As an informational item, we suggested the Department implement a procedure to obtain this information.</p> <p>Government Code, § 21224, states, in part, "(a) A retired person may serve without reinstatement from retirement or loss or interruption of benefits provided by this system upon appointment by the appointing power of a state agency or public agency employer either during an emergency to prevent stoppage of public business or because the retired employee has skills needed in performing work of limited duration. These appointments shall not exceed a total for all employers of 960 hours in any fiscal year....(b)(1) This section shall not apply to any retired person otherwise eligible if during the 12-month period prior to an appointment described in this section the retired person received any unemployment insurance compensation arising out of prior employment subject to this section with the same employer. (2) A retired person who accepts an appointment after receiving unemployment insurance compensation as described in this subdivision shall terminate that employment on the last day of the current pay period and shall not be eligible for reappointment subject to this section for a period of 12 months following the last day of employment."</p>	<p>retired annuitants mentioned in this section of the report has been sent to the Department and CalPERS BNSD as an appendix to our draft report.</p>

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>4. The Department may unlawfully employ retired annuitants. (continued)</p>	<p><u>Bona Fide Separation</u></p> <p>We determined that a bona fide separation from employment per Government Code, § 21220.5, was not needed as the seven sampled retired annuitants' ages exceeded the normal retirement age at the time they provided services.</p>	<p>None.</p>
<p>5. The Department may not appropriately report members under the proper coverage group code.</p>	<p>We examined the appropriateness and accuracy of the assigned Retirement Account Codes (RACs) by testing a sample of twelve employees representing twelve types of RACs used by the Department. We reviewed each sampled employees' RAC and verified whether the coverage group was consistent with the information in the CalPERS database.</p> <p>We determined the Department accurately assigned RACs in accordance with SCO's Personnel Action Manual and CalPERS' State Handbook for the sampled members.</p>	<p>None.</p>
<p>6. The Department may not accurately report unused sick leave balances for retiring CalPERS members.</p>	<p>We reviewed the unused sick leave balances for a sample of twelve retiring members to determine whether the Department properly computed and reported the balances to CalPERS. We determined the Department did not accurately certify the unused sick leave balance for one retiree. The employee retired with 637 hours of unused sick leave; however, the Department reported the 637</p>	<p>The Department submitted an Amended Employer Certification form to CalPERS and is in the process of working with BNSD to correct the erroneous reporting. The Department should ensure unused sick leave balances are</p>

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>6. The Department may not accurately report unused sick leave balances for retiring CalPERS members. (continued)</p>	<p>hours as days. The Department should have divided the hours by 8 and reported 79.625 days of unused sick leave for additional service credit.</p> <p>Government Code, § 20963(a), states, “A state, school, or school safety member, whose effective date of retirement is within four months of separation from employment with the employer subject to this section that granted the sick leave credit, shall be credited at his or her retirement with 0.004 year of service credit for each unused day of sick leave certified to the board by the employer. The certification shall report only those days of unused sick leave that were accrued by the member during the normal course of his or her employment and shall not include any additional days of sick leave reported for the purpose of increasing the member’s retirement benefit. Reports of unused days of sick leave shall be subject to audit and retirement benefits may be adjusted where improper reporting is found.”</p>	<p>accurately certified for retiring members so that employees receive the appropriate amount of service credit upon retirement.</p> <p>A confidential list identifying the retiree mentioned in this section of the report has been sent to the Department and CalPERS BNSD as an appendix to our draft report.</p>
<p>7. The Department may not properly enroll eligible employees and their dependents in health benefits.</p>	<p>We reviewed a sample of seven employees to assess the health benefits eligibility and enrollment of eligible employees and their dependents. Our sample testing revealed the Department properly enrolled eligible employees and their dependents in CalPERS’ Health Benefits Program, except for the following:</p>	<p>The Department must ensure that the proper member and dependent enrollment documentation is on file at the Department.</p> <p>A confidential list identifying the</p>

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>7. The Department may not properly enroll eligible employees and their dependents in health benefits.</p>	<p>The Department did not have the required Declaration of Health Coverage (HB-12A) form on file for three of the sampled employees. However, during our on-site field visit, the Department completed and filed the HB-12A forms for the three employees.</p> <p>The HB-12A provides information on enrollment options and consequences for non-enrollment and is to ensure compliance with the Health Insurance Portability and Accountability Act (HIPAA). Effective January 1, 1998, each employee must sign the HB-12A when they are first eligible to enroll or when they make any change to their health coverage. This includes open enrollment changes, changing health plans when moving, adding or deleting a dependent, or canceling health benefits. The employer must provide the HB-12A at the time the employee requests enrollment or with the Health Benefit Plan Enrollment (HBD-12) form. The employer must also provide the employee a copy of the signed form and keep the original in the employee's file.</p>	<p>employees mentioned in this section of the report was sent to the Department and CalPERS HBB as an appendix to our draft report.</p>
<p>8. The Department may not maintain appropriate ACES security procedures.</p>	<p>We reviewed the security procedures for the Department's ACES users to determine whether reasonable security precautions were maintained and to determine whether the required security documents were properly completed and filed for ACES users.</p>	<p>The Department should work with CalPERS ERSD to ensure that ACES user security agreements are completed, submitted and maintained.</p>

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RISK	MITIGATION & OBSERVATION	RECOMMENDATION
<p>8. The Department may not maintain appropriate ACES security procedures. (continued)</p>	<p>We determined the Department practiced reasonable security procedures to protect passwords and unauthorized access to ACES. However, the Department did not maintain Employer User Security Agreement (AESD-43) forms for one active ACES user and ten inactive ACES users. During our on-site field visit, the Department completed an AESD-43 for the one active ACES user.</p> <p>CalPERS ACES Security procedures outlined on the CalPERS website at www.calpers.ca.gov require agencies to keep a signed copy of security documents on file for ACES users. An AESD-43 must be completed for each employee using CalPERS on-line access and be available to CalPERS upon request. Forms must be retained in a secure work site location of the employer, for the life of the Agreement and for two years following the deactivation or termination of the Agreement. CalPERS is to be notified immediately in the event that any of its sensitive or confidential information is subjected to unauthorized disclosure, modification or destruction.</p>	<p>A confidential list identifying the individuals mentioned in this section of the report has been sent to the Department and CalPERS ERSD as an appendix to our draft report.</p>

FRANCHISE TAX BOARD

CONCLUSION

We limited this review to the areas specified in the scope section of this report. We limited our test of transactions to samples of the Department' payroll reports and personnel records. The sample testing procedures provide reasonable, but not absolute, assurance that these transactions complied with the California Government Code, except as noted above.

Respectfully submitted,

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

Date: January 2011
Staff: Michael Dutil, CIA, Senior Manager
Diana Thomas, CIDA, Manager
Alan Feblowitz
Emma Shaw

APPENDIX

DEPARTMENT'S WRITTEN RESPONSE



State of California
Franchise Tax Board

Personnel Roster MS A181
PO Box 850
Sacramento, CA 95812-0550

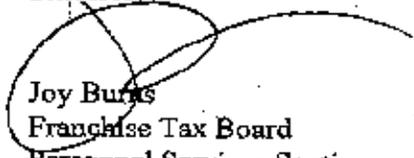
01.07.2011

CalPERS
Office of Audit Services
Emma Shaw
P.O. Box 942701
Sacramento, CA. 94229-2701

Dear Ms. Shaw,

Enclosed is the completion of our written responses to your CalPERS review. If you have any questions, please call me, Michelle Bejarano (916) 845.5546 or Deborah Eddington (916) 845.6708.

Sincerely,


Joy Burns
Franchise Tax Board
Personnel Services Section
(916)845.4174

Personnel Roster

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chair John Chiang
member Betty T. Yee
member Ana. J. Matosantos

January 7, 2011
Franchise Tax Board
Responses to 2010 CalPERS State Agency Review

1. Agree-no comment
2. Agree-no comment
3. Agree- This department has ensured compliance with GC 20305 in the following manner:
 - o A monthly report is generated listing those intermittent employees that have met the 1000 hour eligibility in a fiscal year. The employee's hours are then reviewed to further ensure eligibility and determine which account code to place them in.
 - o A complete review of all intermittent employees is currently in process to ensure that every employee is in the correct retirement code.
 - o On August 18, 2010 all Personnel Specialists and Supervisors attended CalPERS State Handbook training
4. Agree- This department has ensured compliance with GC 21224 in the following manner:
 - o A monthly report is generated listing those Retired Annuitants that have 200 hours or less remaining of their 960 hours available in a fiscal year. The employee's hours are reviewed and an email sent to the employee's Timekeeper. The unit is then made aware and determines how to schedule the employee so that the remaining hours are not exceeded or place them on furlough status. Personnel is also doing a follow-up to ensure compliance.
 - o On August 18, 2010 all Personnel Specialist and Supervisors attended CalPERS State Handbook training
 - o In addition to providing Retired Annuitants forms DE 1181 & DPA 715 upon hire, we now require these forms to be filled out annually.
5. Agree-no comment
6. Agree - This department has ensured compliance when calculating unused sick leave accurately for retiring employees.
7. Agree - This department has ensured compliance with the Health Insurance Portability Accountability Act (HIPAA).
8. Agree - This department has ensured compliance to maintain on file a Employer User Security Agreement (AESD-43) forms for all active and inactive ACES users.