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Special Compensation Circular Letter

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To: All CalPERS Public Agency and School Employers
Subject: Common Issues on Special Compensation Reporting and Labor Agreement Conditions

Purpose

The purpose of this Circular Letter is to provide information and increase awareness of commonly misreported items of special compensation for public agencies and schools based on language in their Memoranda of Understanding (MOU)/Labor Agreements. This information is to ensure stakeholder understanding and accurate benefit payments, eliminate errors, and provide guidance on correctly reporting special pay items according to a compliant MOU/Labor Agreement. The information is intended to also ensure reporting of special compensation complies with the Public Employees' Retirement Law (PERL), Public Employees' Pension Reform Act of 2013 (PEPRA), and Title 2 of the California Code of Regulations (CCR).

Defining Compensation for Classic Members and PEPRA Members

Compensation Earnable for Classic Members

Pursuant to Government (Gov.) Code sections 20636 and 20636.1, compensation earnable is defined as the pay rate and special compensation of the member, as further clarified by those statutes.

Gov. Code sections 20636(c) and 20636.1(c) further specify that special compensation includes any payment received for special skills, knowledge, abilities, work assignment, workdays or hours, or other work conditions. Pursuant to CCR section 571, a list of special compensation items is identified along with the requirements under subsection (b).

Pensionable Compensation for PEPRA Members

Gov. Code section 7522.34 and CCR section 571.1 state that pensionable compensation of a PEPRA member of any public retirement system is defined as the normal monthly rate of pay or base pay for normally required duties that must be historically consistent for the job classification.

CCR section 571.1(b) further identifies, clarifies, and defines the types of pay that meet the criteria of pensionable compensation according to each subsequent criterion set forth in subdivision (a) which must also be met.

Common Reporting Errors

- **Lump-Sum Reporting**

Lump-sum reporting occurs when special compensation items, such as holiday pay and bonus pay, are reported as a single lump-sum amount when paid. Pursuant to Gov. Code sections 20636, 20636.1, and 7522.34, special compensation items shall be reported in the pay period in which they were earned, regardless of when paid.

Special compensation is a component of final compensation and must be accurately reported to correctly calculate a member's retirement benefits. Lump-sum reporting issues may cause members to receive inflated retirement benefits, because a member's final compensation may include more than one lump-sum special compensation based on the reporting frequency.

For example, an employer may pay and report holiday pay at the end of the year in December as a lump-sum amount for the entire year; then, the following year, the member retires in November and receives the holiday pay reported in November as a lump-sum for the current year. This may cause the final compensation period to include two holiday pay lump-sums that span two calendar years. Alternately, a member with a 12-month final compensation may reflect 24-months of holiday pay reported within the 12-month final compensation period; this would be inaccurate reporting and is not compliant with the PERL.

- **Top Step Requirements**

Employers most commonly set eligibility based on a top-step requirement to receive special compensation such as longevity pay. A top-step requirement will create a group or class disparity, as it separates work-related grouping from other members, which makes the special compensation no longer available to all members in the group or class of logical grouping. Special compensation items are further defined under the CCR sections 571 and 571.1.

Longevity pay is a common example of special compensation for members who have been employed with an employer, or in a specified job classification, for a minimum of five years. When a non-compliant top-step requirement is included with longevity pay in the MOU/Labor Agreement terms and conditions, it will place further restrictions on the longevity pay and create a group or class issue.

- **Bonus Pay for Classic Members**

Bonus pay is compensation paid to members based on superior performance within a guideline and system in place; however, it is commonly misreported as special compensation when paid. Bonus pay is **only** reportable for classic members based on superior performance; however, employers often do not clearly define and/or outline clear and objective criteria, terms, and conditions for compliance in the MOU/Labor Agreement regarding how and when to measure the defined superior performance. For a member to clearly or objectively obtain reportable bonus pay, it should be in accordance with the employer's performance goals and/or objectives and properly documented as the member's evaluation criteria that deems the member's performance as superior for performance measures.

Note: Bonus pay is not reportable for PEPRA members.

- **Temporary Upgrade Pay for Classic Members**

Temporary upgrade pay (TUP) is often inaccurately reported due to noncompliant MOU/Labor Agreement language related to ambiguous terms and/or conditions for how the TUP shall be reported. It is most frequently misreported for members who are only taking on additional duties of an upgraded position, while continuing to perform their current duties.

Pursuant to CCR section 571(a)(3), TUP is defined as compensation to members who are required by their employer or governing board or body to work in an upgraded position/classification of limited duration. When a member maintains their current duties while concurrently assuming additional duties of an upgraded position, the additional duties do not meet the definition of TUP. They meet the definition of overtime as set forth in Gov. Code section 20635; overtime is not reportable for pensionable purposes to CalPERS.

To validate TUP, supporting documents, such as personnel action forms and related personnel documents, are commonly requested to verify the nature of the TUP and to determine if the member was performing additional duties or full duties of the upgraded position.

Note: Temporary upgrade pay is not reportable for PEPRA Members.

- **Categories & Types**

Employers often report special compensation items under an inaccurate category and/or type. This poses significant financial, contractual, and operational risks for the employer and its members.

Inaccurately reporting special compensation will also delay a member's retirement process until the compliant reportable information is obtained, verified, and accurately re-reported. Employers should properly identify special compensation items for transparency and reduce inaccurate data to be reported to the system.

Common Errors on MOU/Labor Agreement

- **Group or Class**

Employers may create a group or class disparity when a special compensation item is excluded due to a member's salary placement, including additional requirement(s) outside of the item's definition, and tenure. Although longevity pay is tenure-based at a minimum of five years (in most cases), additional requirements (i.e., performance-based) would create a group or class disparity. A group or class of employment is several members considered together because they share similarities in job duties, work location, collective bargaining unit, and/or other logical work-related grouping. A single member is not a group or class.

- **Condition(s) for Payments**

Employers commonly provide and report special compensation items consistently. To maintain compliance, all special compensation items must meet the definition of CCR sections 571 for classic members and 571.1 for PEPRAs members.

Often, a special compensation item does not have a condition for payments contained within a labor policy and/or agreement. In addition, employers may compound other additional benefits in the calculation of a special compensation item, and it must be specified within the labor policy and/or agreement. For example, many employers include educational incentive and longevity pay when calculating holiday pay; therefore, the MOU/Labor Agreement shall include such terms within the condition for payments.

- **Combination of Eligibility Requirements**

Like the top-step requirements in reporting, employers may include additional requirements for members to qualify for special compensation items. Each special compensation item is defined under the exclusive list within CCR sections 571 and 571.1.

Although there are conditional eligibilities to qualify for the special compensation items, two definitions should not be combined into one. For example, the educational incentive's requirements are generally tied to completion of courses and/or obtaining a certification or degree. Adding a performance component would disqualify the educational incentive to be reportable.

- **Final Settlement Pay**

Employers may misreport compensation when they report amounts in the form of severance packages or "golden parachutes" that are typically paid in the member's final year of service prior to retirement. In other instances, employers may report vacation cash-outs and separation bonuses. This compensation meets the definition of final settlement pay set forth in CCR section 570. Final settlement pay in any form is not reportable to CalPERS for classic or PEPRAs members. Additionally, even if an employer's MOU/Labor Agreement specifically states that the compensation is not final settlement pay, the compensation will still be excluded in calculating a retirement benefit.

Impacts for Employers & Members

Special compensation items are one of the factors in calculating a member's retirement benefit. Therefore, misreported special compensation can create financial hardships for members. When a member's retirement benefit is calculated with inaccurate special compensation items, an overpayment is owed to CalPERS. This overpayment must be paid by the member and/or the respective employer to accurately account for funding contributions and benefits, ensure compliance with law, and reduce risk to the pension fund.

In addition to the impact these errors cause for your employee, failure to comply may also result in:

- Enforcement of an administrative hold on a member's account, which may result in loss of benefits and/or delay of a member's retirement date due to additional review required
- Notification to the employer's impacted members or bargaining groups to inform them of the employer's inability to make the necessary corrections and how it may impact their retirement and/or benefits
- A reoccurring administrative fee for delinquent resolution and erroneous payroll until compliance is obtained
- Escalation of the employer's Employer Compliance Review to the CalPERS Board of Administration's Risk & Audit Committee for further action
- Revocation of the employer's contract and/or pursuing all available remedies to enforce the PERL

To ensure consistent, transparent, and compliant employer compensation reporting and MOU/Labor Agreements requirements, employers may contact CalPERS' Compensation Compliance & Audit Resolution team via email at MOU_Review@calpers.ca.gov. This team is designated to collaborate with stakeholders to provide additional information, recommendations, and guidance.

We also offer [employer training classes](#) and resources on the CalPERS website to assist you with your CalPERS-related business. To gain a better understanding of myCalPERS business rules and procedures for reporting, view our [Business Rules Employer Education Schedule \(PDF\)](#) for virtual instructor led classes and/or explore our self-led [Online Classes for Employers \(PDF\)](#).

Questions

It is the employer's responsibility to comply with all terms and conditions set forth in the employer's contract with CalPERS and to ensure all reportable information is compliant with the PERL, PEPR, and the CCR.

For questions or concerns, contact the CalPERS Customer Contact Center at **888 CalPERS** (or **888-225-7377**).

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