ATTACHMENT A

STAFF'S ARGUMENT

STAFF'S ARGUMENT TO DECLINE TO ADOPT THE PROPOSED DECISION

As the agency charged with the enforcement of the Public Employees' Retirement Law (PERL), CalPERS' interpretations of the PERL are entitled to deference. Additionally, the Board is responsible for the management and control of the system. To administer the system equitably across all members and contracting agencies, the Board must ensure uniformity and standardization in its interpretations.

To avoid disparity among similarly situated members and for consistent administration of the system, CalPERS requires that all school employers report time and pay on a uniform basis based on an average of 40 hours per week, 52 weeks, and 12 months in a year. Incorrect payrate reporting can ultimately affect final compensation, which in turn may impact a member's retirement allowance.

In this case, the Administrative Law Judge (ALJ) granted Tustin Unified School District's (Tustin) use of an **incorrect** calculation factor when reporting full-time payrates for its classified employees. As explained more fully below, requiring CalPERS to use different reporting standards from different school districts would lead to two members who worked the same number of hours at the same rate of pay potentially receiving two different retirement benefit amounts. Further, the disparity and inequity among these similarly situated members can be eliminated, without additional cost to the school districts, by using CalPERS' calculation factor.

Because Tustin's reporting causes disparity and inequity among similarly situated members, the Board should decline to adopt the Proposed Decision, and deny the appeal submitted by Tustin.

Government Code Section 20636.1[1]

Classified school employees are CalPERS' largest membership group. Approximately 2,800 school district contracting agencies report classified employee compensation to CalPERS on an hourly, daily or monthly basis. Government Code section 20636.1 governs the reporting of classified school employee compensation to CalPERS.

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

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

shift). The result was that employers would report compensation and service credit to CalPERS based on differing practices.

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

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

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

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

Since its 2001 passage, CalPERS has consistently worked to ensure uniform reporting under section 20636.1 through outreach and training. CalPERS' training given to member agencies includes the annual Employer Forum, school specific training sessions, personal presentations on site, conference presentations, 1-1 phone conversations, Circular Letters, and the Public Agency and School Reference Guide which are all provided to employers for guidance and instruction on how they should reference and enter data.

CalPERS Audit and Determination

CalPERS Office of Audit Service (OFAS) performed an audit of 64 public agencies in 2017 and 2018, including Tustin. Tustin is a school district operating under the Orange County Office of Education (OCOE). On July 18, 2018, CalPERS issued its Draft Audit Report (Draft), which concluded that Tustin was reporting payrate incorrectly. The Draft included six specific findings related to Tustin's reporting of employee compensation to CalPERS. Finding four states:

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

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

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

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

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

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

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

The Administrative Hearing

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

Payrate

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

Tustin calculated the factor as 168 as follows: First, Tustin assumes a total of 260.85 average weekdays in a year, and subtracts 11 holidays to reach 249.85 workdays in an average year. Divided by 12 months is 20.82 average workdays each month, which Tustin then rounds up to 21. Next, assume a full-time employee works 8 hours/day. Tustin multiplies 21 workdays by 8 hours/day to arrive at 168 work hours per month. To convert the hourly rate to a monthly rate, Tustin multiplies the member's pay rate by 168 hours. The audited member received $22.59/hour. Tustin multiplied 168 by $22.59, arriving at $3,795/month.

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

CalPERS argued that the 173.33 conversion factor ensures consistent, accurate, and equitable reporting for all CalPERS members. Both Tustin and CalPERS agreed on the hourly rate of $22.59 as the true base rate of pay. Although monthly employees are paid according to Tustin's monthly pay schedule, the true payrate or base pay for such employees is their hourly rate. To convert an hourly rate to a monthly rate, Tustin should have multiplied by 173.33 and not 168.

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

Increasing the payrate to $3,915 does not increase the amount Tustin pays to its employees on a regular basis. Staff emphasized the difference between payrate and earnings. Correcting Tustin's erroneous reporting will increase payrates and individual retirement benefits, but individual employee earnings remain the same.

Service Credit

CalPERS staff also testified that Tustin's calculation results in erroneous service credit calculations. Under section 20962(a), members need to meet certain thresholds, per fiscal year to earn one year of service credit. Here, Tustin reported 0.1 service credit each month, so the employee erroneously earned one full year of service credit for the fiscal year. But, the Audit showed that the sampled member actually worked less than the requisite thresholds, so she should not have been credited with a full year of service credit.

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

Tustin's Testimony

Tustin employees testified at the hearing. Tustin maintained that they have always reported based on the 168-hour conversion, and that CalPERS never instructed them on the 173.33-hour conversion. CalPERS' training and outreach efforts dispute this testimony. In addition, the California Association of School Business Professionals (CASBO) recommends reporting based on the 173.33-hour conversion.

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

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

The Proposed Decision

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

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

The Board Should Reject the Proposed Decision

As the sole agency charged with the enforcement of the PERL, CalPERS' determinations are entitled to great deference. (*City of Pleasanton v. CalPERS Bd. of Admin*, (2012) 211 Cal.App.4th 522, 539.) Moreover, "[t]here is a strong policy favoring statewide uniformity of interpretation as between the PERS and all of its contracting agencies." (*City of Los Altos v. CalPERS Bd. of Admin*., 80 Cal.App.3d 1049, 1051.) Further, CalPERS cannot be expected to accept different interpretations from different agencies. (*Ibid*.)

The ultimate goal of statutory interpretation is to ascertain the Legislature's intent. (Code of Civ. Proc., § 1959.) The interpretation should harmonize all sections of a statute. (*Huff v. Securitas Security Services USA, Inc*, (2018) 23 Cal.App.5th 745, 759.) When interpreting statutes, courts "consider the consequences which would flow from our interpretation and avoid constructions which defy common sense, frustrate the apparent intent of the Legislature or which might lead to mischief or absurdity." (*Henry v. Workers' Comp. App. Bd.* (1998) 68 Cal.App.4th 981, 985.)

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

The inequitable effects of Tustin's calculation are best illustrated by the sampled member in the audit. Tustin labeled the sampled member as a full-time, 10-month employee. The sampled member worked 40 hours a week for 209 days, and 1,672 total hours over 11 months. The sampled member's hourly wage was $22.59, and she earned $3,795 each month. After converting the payrate based on 168 hours in a month, Tustin reported the sampled member's payrate as $3,795, and she earned one full year of service credit.

Consider a member from a different school district working the same schedule (40 hours each week, for 209 days and 1,672 hours over 11 months). This second member also earns the same $22.59 hourly wage and earns $3,795 each month. When the employer correctly converts payrate using the 173.33 conversion factor from section 20636.1, the second member's payrate should be $3,915. The second member will earn slightly less than one full year of service credit when applying Section 20962 to her correctly reported payrate

The second member, whose payrate is increased because it was calculated based on section 20636.1's 173.33 conversion factor, will likely earn more in retirement than the Tustin employee.[2] Although both members worked the exact same schedules and earned the exact same pay, the Tustin employee earns less in retirement solely because her employer chose to report her payrate based on a conversion factor of 168 instead of 173.33. The different retirement benefits, and different service credit, are the inequitable results the Legislature wanted to prevent when it passed section 20636.1. It is important to note that had Tustin used the correct conversion factor, Tustin would not have experienced any increased payroll costs.

Requiring CalPERS to accept Tustin's reporting and calculation factor results in inequity amongst members, and incorrect payment of retirement benefits solely based on how a school district chooses to report compensation. This also conflicts with section 20120, which vests the management and control of the system in the board.

There are 2,800 CalPERS contracting agencies. Classified school members are CalPERS' largest, but generally the lowest paid, membership group. CalPERS cannot allow each contracting agency to calculate its own conversion based upon its own assumptions. CalPERS must ensure uniformity and standardization to enable CalPERS to administer the system equitably across all members and contracting agencies.

Section 20636.1 standardizes reporting so that all employees' payrates and conversion factors are identical. Regardless of how a district labels its employees, section 20636.1 requires those employers to report payrate using a 40-hour workweek and conversion factor of 173.33. When determining service credit, CalPERS must use the specified time

---

[2] Based solely on the factors in this example, the retirement calculations are more or less even. However, classified school members working 10-month schedules often pickup additional part-time work for their school employers, which then offsets the slight service credit reductions, So, the small annual reduction in service credit will not reduce the retirement allowance, but the increased payrate will ultimately increase the retirement allowance.

constraints of section 20962 to ensure that all members receive their correct fully earned service credit. CalPERS' approach ensures consistency between all school employers and prevents members from receiving lower retirement benefits due to an incorrect conversion factor used by one employer.

For all the above reasons, staff respectfully submits that the Board should reject the Proposed Decision and adopt a modified Decision denying the District's appeal.

April 18, 2022

____
Charles H. Glauberman
Senior Attorney