

Office of Audit Services



CalPERS

Public Agency Review

City of Mission Viejo

**Employer Code: 1476
CalPERS ID: 4532062373
Job Number: P13-082**

September 2014



California Public Employees' Retirement System
Office of Audit Services
P.O. Box 942701
Sacramento, CA 94229-2701
TTY: (877) 249-7442
(916) 795-0802 phone, (916) 795-7836 fax
www.calpers.ca.gov

September 29, 2014

Employer Code: 1476
CalPERS ID: 4532062373
Job Number: P13-082

Patricia Brunell, Accounting Supervisor
City of Mission Viejo
200 Civic Center
Mission Viejo, CA 92691

Dear Ms. Brunell:

Enclosed is our final report on the results of the public agency review completed for the City of Mission Viejo (Agency). Your written response, included as an appendix to the report, indicates agreement with the issues noted in the report except for Finding 3. We appreciate the additional information regarding Finding 3 that you provided in your response. After consideration of this information, we removed the finding from our report.

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 Phyllis Miller
PHYLLIS MILLER, Acting Chief
Office of Audit Services

Enclosure

cc: Board, City of Mission Viejo
Risk and Audit Committee Members, CalPERS
Matthew G. Jacobs, General Counsel, CalPERS
Anthony Suine, Chief, BNSD, CalPERS
Renee Ostrander, Assistant Chief, CASD, CalPERS

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RESULTS IN BRIEF

The primary objective of our review was to determine whether the City of Mission Viejo (Agency) complied with applicable sections of the California Government Code, California Code of Regulations (CCR) and its contract with the California Public Employees' Retirement System (CalPERS).

The Office of Audit Services (OAS) noted the following findings during the review. Details are noted in the Results section beginning on page two of this report.

- Payrates were incorrectly reported.
- Special compensation was not reported as required by CCR Section 571.

There were no issues identified related to employees subject to the Public Employees' Pension Reform Act of 2013 (PEPRA).

OAS recommends the Agency comply with applicable sections of the California Government Code, CCR and its contract with CalPERS. We also recommend the Agency work with the appropriate CalPERS divisions to resolve issues identified in this report.

SCOPE

The Agency contracted with CalPERS effective April 1, 1989, to provide retirement benefits for miscellaneous employees. By way of the Agency's contract with CalPERS, the Agency agreed to be bound by the terms of the contract and by the Public Employees' Retirement Law (PERL). The Agency also agreed to make its employees members of CalPERS subject to all provisions of the PERL.

As part of the Board approved plan for fiscal year 2013-14, the OAS reviewed the Agency's payroll reporting and member enrollment processes related to the Agency's retirement contract with CalPERS. The review period was limited to the examination of sampled employees, records, and pay periods from January 1, 2011 through December 31, 2013. The on-site fieldwork for this review was conducted from May 5-8, 2014. The review objectives and a summary of the procedures performed are listed in Appendix A.

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OFFICE OF AUDIT SERVICES REVIEW RESULTS

1: The Agency reported incorrect payrates.

Condition:

The Agency incorrectly reported monthly rate of pay as hourly for an employee in the pay period ending December 6, 2013. Specifically, the Agency reported an employee's hourly payrate as \$3,312.40 which was the employee's monthly payrate. In addition, the employee received two pay increases in August 2013, but the Agency did not report the correct payrate. Specifically, the employee's payrate was increased to \$19.78, but the Agency continued to report the payrate for the employee as \$19.11. Payrate is an important factor in computing a member's retirement allowance because service credit and final compensation are directly related to the payrate and earnings reported for a member.

Recommendation:

The Agency should ensure payrates are correctly reported.

The Agency should work with CalPERS Customer Account Services Division (CASD) to make any necessary adjustments to active and retired member accounts pursuant to Government Code Section 20160.

Criteria:

Government Codes: § 20120, § 20121, § 20160, § 20630, § 20636

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2: The Agency did not report special compensation as required by the CCR.

Condition:

- A. The Agency did not report special compensation of Holiday Pay earned by an employee who worked on a holiday during the pay period ending December 6, 2013. The employee was required to work without regard to holidays and received additional compensation. However, the additional compensation of Holiday Pay was not reported to CalPERS. Pursuant to CCR Section 571, Holiday Pay is a statutory item and should have been reported to CalPERS as special compensation.

- B. The Agency did not report the monetary value for the purchase of uniforms as special compensation for employees who were provided uniforms. Specifically, the Agency indicated it provides uniforms to Animal Service employees. CCR Section 571 requires that the monetary value for the purchase, rental and/or maintenance of required clothing, a statutory item, be reported as special compensation. However, the Agency did not report the value of uniforms provided as special compensation.

Recommendation:

The Agency should report Holiday Pay and the monetary value of uniforms purchased, rented, and/or maintained for employees as special compensation.

The Agency should work with CASD to make the necessary adjustments to active and retired member accounts pursuant to Government Code Section 20160.

Criteria:

Government Codes: § 20160, § 20630, § 20636
CCR: § 571

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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 A. OAS limited the test of transactions to employee samples selected from the Agency'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. 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 30 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 Phyllis Miller
PHYLLIS MILLER
Acting Chief, Office of Audit Services

Staff: Cheryl Dietz, CPA, Assistant Division Chief
Alan Feblowitz, CFE, Manager
Chris Wall, Auditor
Dennis Szeto, Auditor

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APPENDIX A

OBJECTIVES

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OBJECTIVES

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

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

This review covers the period of January 1, 2011 through December 31, 2013.

SUMMARY

To accomplish the review objectives, OAS interviewed key staff members to obtain an understanding of the Agency's personnel and payroll procedures, reviewed documents, and performed the following procedures.

- ✓ Reviewed:
 - Provisions of the contract and contract amendments between the Agency and CalPERS
 - Correspondence files maintained at CalPERS
 - Agency Board minutes and Agency Board resolutions
 - Agency written labor policies and agreements
 - Agency salary, wage and benefit agreements including applicable resolutions
 - Agency personnel records and employee hours worked records
 - Agency payroll information including Contribution Detail Transaction History reports
 - Other documents used to specify payrate, special compensation, and benefits for employees
 - Various other documents as necessary
- ✓ Reviewed Agency payroll records and compared the records to data reported to CalPERS to determine whether the Agency correctly reported compensation.
- ✓ Reviewed payrates reported to CalPERS and reconciled the payrates to Agency 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 Agency's governing body in accordance with requirements of applicable public meeting laws.
- ✓ Reviewed CalPERS reports to determine whether the payroll reporting elements were reported correctly.

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- ✓ Reviewed the Agency's enrollment practices for temporary and part-time employees to determine whether individuals met CalPERS membership requirements.
- ✓ Reviewed the Agency's employment practices for retired annuitants to determine if retirees were lawfully employed and reinstated when 960 hours were worked in a fiscal year.
- ✓ Reviewed the Agency's independent contractors to determine whether the individuals were either eligible or correctly excluded from CalPERS membership.
- ✓ Reviewed the Agency's affiliated entities to determine if the Agency shared employees with an affiliated entity and if the employees were CalPERS members and whether their earnings were reported by the Agency or by the affiliated entity.
- ✓ Reviewed the Agency's calculation and reporting of unused sick leave balances, if contracted to provide for additional service credits for unused sick leave.

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APPENDIX B

AGENCY RESPONSE

NOTE: The Agency provided additional informational attachments to the response which have been intentionally omitted from this appendix.



City of Mission Viejo

Administrative Services Department

Trish Kelley
Mayor

Dave Leckness
Mayor Pro Tem

Rhonda Reardon
Council Member

Cathy Schlicht
Council Member

Frank Ury
Council Member

Transmitted via E-mail and Certified Mail

August 28, 2014

Ms. Margaret Junker, CPA, CIA, CIDA
Chief, Office of Audit Services
California Public Employees' Retirement System
Office of Audit Services
Lincoln Plaza South
400 Q Street, Suite 140
Sacramento, CA 94229-2715

Re: Public Agency Review Report, Employer Code 1476; CalPERS ID: 4532062373; Job Number P13-082

Dear Ms. Junker,

This letter serves as our response for the City of Mission Viejo ("City") in regards to the draft City of Mission Viejo Public Agency Review Report ("Report") made available to City management by the California Public Employees' Retirement System ("CalPERS") on August 4, 2014. In your transmittal of the Report, you provided the City until August 29, 2014 to respond to findings and conclusions outlined in the Report.

The Report documents four separate conditions under three separate findings requiring response by the City.

Finding 1: The Agency reported incorrect payrates

Condition:

The Agency incorrectly reported monthly rate of pay as hourly for an employee in the pay period ending December 6, 2013. Specifically, the Agency reported an employee's hourly payrate as \$3,312.40 which was the employee's monthly payrate. In addition, the employee received two pay increases in August 2013 but the Agency did not report the correct payrate. Specifically, the employee's payrate was increased to \$19.78 but the Agency continued to report the payrate for the employee as \$19.11. Payrate is an

important factor in computing a member's retirement allowance because service credit and final compensation are directly related to the payrate and earnings reported for a member.

Recommendation:

The Agency should ensure payrates are correctly reported.

The Agency should work with CalPERS Customer Account Services Division ("CASD") to make any necessary adjustments to active and retired member accounts pursuant to Government Code Section 20160.

Agency Response:

The City agrees with this finding. The employee's pay rate type was inadvertently entered as hourly and should have been entered as monthly in the my|CalPERS compensation reporting module. The employee's pay rate was also incorrectly reported in the my|CalPERS module. The City corrected the pay rate type and the pay rate in the employee's record for the service period 5/10/2014 to 5/23/2014 and prospectively. The City will work with CalPERS CASD as recommended in the Report to make any necessary adjustments to the member's account prior to the service period ending 5/23/2014.

Finding 2: The Agency did not report special compensation as required by the CCR

Condition A:

The Agency did not report special compensation of Holiday Pay earned by an employee who worked on a holiday during the pay period ending December 6, 2013. The employee was required to work without regard to holidays and received additional compensation. However, the additional compensation of Holiday Pay was not reported to CalPERS. Pursuant to CCR Section 571, Holiday Pay is a statutory item and should have been reported to CalPERS as special compensation.

Condition B:

The Agency did not report the monetary value for the purchase of uniforms as special compensation for employees who were provided uniforms. Specifically, the Agency indicated it provides uniforms to Animal Service employees. CCR Section 571 requires that the monetary value for the purchase, rental and/or maintenance of required clothing, a statutory item, be reported as special compensation. However, the Agency did not report the value of uniforms provided as special compensation.

Recommendation:

The Agency should report Holiday Pay and the monetary value of uniforms purchased, rented, and/or maintained for employees as special compensation.

The Agency should work with CASD to make the necessary adjustments to active and retired member accounts pursuant to Government Code Section 20160.

Agency Response:

The City agrees with this finding. Under the California Code of Regulations (“CCR”) Section 571, holiday pay for employees who are required to work without regard to holidays and the monetary value for the purchase of uniforms are statutory items that should be reported as special compensation. The review performed by CalPERS identified that the City does in fact have certain employee job positions applicable to these special compensation categories. The City will work with the CalPERS CASD as recommended in the Report to identify all job positions eligible for special compensation and make the necessary adjustments to the applicable member’s accounts retrospectively.

Finding 3: The Agency unlawfully employed retired annuitants

Condition:

The Agency paid two retired annuitants payrates that exceeded the maximum payrates of employees performing comparable duties. The Agency hired a retired annuitant to perform a variety of duties related to multiple Agency positions. OAS determined the retired annuitant performed duties that were comparable to the Director of Administrative Services. The retired annuitant’s payrate as of September 2, 2011 was \$90.00 an hour. The payrate exceeded maximum hourly payrate for the Director of Administrative Services position listed on the pay schedule effective July 1, 2011 as \$77.97.

In addition, the Agency hired another retired annuitant who performed a variety of duties related to multiple Agency positions. OAS determined the retired annuitant performed duties that were comparable to the Director of Public Works. The retired annuitant’s payrate as of December 31, 2011 was \$75.00 an hour. The payrate exceed the maximum hourly payrate for the Director of Public Works position listed on the pay schedule effective July 1, 2011 as \$71.27.

Government Code Section 21224 in effect during this period specified that the rate of pay for the employment of a retired annuitant shall not be less than the minimum, nor exceed that paid by the employer to other employees performing comparable duties.

Recommendation:

The Agency should monitor the payrate of retired annuitants in order to ensure the Agency complies with applicable Government Codes.

The Agency should work with CalPERS Benefit Services Division to determine the appropriate course of action.

Agency Response:

The City disagrees with this finding and denies having unlawfully employed two retired annuitants according to Government Code Section 21224. Further, the City believes it was

in compliance with all applicable sections of the California Government Code during the CalPERS audit review period of January 1, 2011 through December 31, 2013.

As of January 1, 2011, Government Code Section 21224, subdivision (a) provided, in pertinent part:

“... the rate of pay for the employment shall not be less than the minimum, nor exceed that paid by the employer to other employees performing comparable duties.” (Gov. Code § 21224(a), amended by Stats. 2005, c.328 (A.B. 1166), § 10.)

This language remained unaltered until Section 21224 was amended by Assembly Bill (“AB”) 1021 in June of 2012, and the term “rate of pay” was replaced by the term “pay rate.” Notably, “rate of pay” was never defined in earlier iterations of Section 21224, and is not the same as “payrate”, which is defined elsewhere in the Public Employees Retirement Law (“PERL”) (Gov. Code §§ 20636(b)(1).) Therefore, prior to enactment of AB 1021, interpretation and application of the term “rate of pay” was left to the agency.

Accordingly, as permitted by the applicable language of Section 21224 in effect at the time, the City applied its usual and customary total compensation formulas when determining the rate of pay for the two retired annuitants mentioned in the CalPERS audit. Specifically, the City’s practice is to use total compensation formulas and worksheets which place a monetary value on all of the benefits received by employees performing comparable duties. Since 2006, the direction of the City Council has been to compensate employees on a “total compensation” basis and the Council routinely refers to total compensation when negotiating and setting employee salary and benefit levels. Under the City’s usual and customary total compensation formulas, the rate of pay for the Director of Administrative Services on January 1, 2011 was actually \$108.80 and on July 1, 2011 it was \$97.58. The Director of Public Works rate of pay for the entire calendar year of 2011 was \$89.99. A copy of the City’s worksheets detailing each of the components comprising total compensation is attached for CalPERS review as Attachment 1.

The statute must stand as the controlling authority in this matter, as there is no regulation on point and any other non-regulatory direction would constitute “underground rulemaking” in violation of the California Administrative Procedure Act (“APA”) (Gov. Code § 11340 *et seq.*). Thus, in conducting its audit, CalPERS cannot rely on rules of its own creation that are not found in the statute or in properly adopted regulations and cannot argue that, at the time the City set the compensation for the two retired annuitants at issue, it was obligated to construe “rate of pay” to mean the same as the later-defined term “payrate.” In fact, the City complied with the then-current requirements of Section 21224, in determining the rate of pay for the two retirees.

Alternatively, assuming *arguendo* that the two retired annuitants were hired pursuant to Government Code Section 21221, rather than Section 21224, the City again asserts that it

August 28, 2014

Ms. Margaret Junker

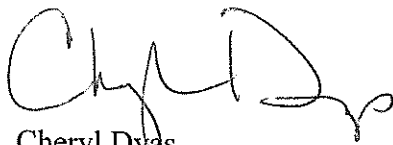
was acting within its authority when it based the compensation of the two retired annuitants on its usual and customary total compensation formulas.

As chaptered in 1995, Section 21221, subsection (h) imposed no limitations on payrate or compensation for retired annuitants. It was not until enactment of AB 1028 in January 2012—after both retired annuitants were no longer City employees—that language was added to the statute providing, among other things, that compensation “shall not exceed the maximum published pay schedule for the vacant position.” (Gov. Code § 21221, amended by Stats.2011, c.440 (A.B. 1028) § 8.) Because the statute in effect at the time the City hired the two retired annuitants did not include any maximum or minimum or salary requirements, the City acted in accordance with the law when it applied its usual and customary total compensation formulas in fixing the compensation for the two retired annuitants.

In sum, the City was in compliance with the provisions of Government Code sections 21224 and 21221 in effect at the time when it applied its total compensation formulas, which take into account the value of the benefits the retirees relinquished in setting their rate of pay.

Government Code Section 20636 and California Code Title 2 Section 571, which together define payrate and special compensation, outline limitations to items that can be included by employers in compensation earnable. However, the purpose of “compensation earnable” is to address how a member’s retirement contributions and benefits shall be calculated. These sections should not be relied upon to determine comparable compensation between different employees under a total compensation system. This is especially true when the statutes in effect at the time (Sections 21221 and 21224) made no mention of “payrate” and did not limit employers to the Section 20636 definition.

Respectfully,



Cheryl Dyas
Director of Administrative Services

Attachment 1