



California Public Employees' Retirement System
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March 30, 2012

Employer Code: 1716
Job Number: P10- 036

League of California Cities
Chris McKenzie, Executive Director
1400 K Street, Suite 400
Sacramento, CA 95814

Dear Mr. McKenzie:

Enclosed is our final report on the results of the public agency review completed for the League of California Cities. Your agency's written response, included as an appendix to the report, indicates agreement with the issues noted in the 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 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
Honorable Board Members, League of California Cities

Office of Audit Services



Public Agency Review League of California Cities

Employer Code: 1716
Job Number: P10-036

March 2012

LEAGUE OF CALIFORNIA CITIES

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RESULTS IN BRIEF

The Office of Audit Services (OAS) reviewed the League of California Cities' (League) enrolled individuals, member compensation, required retirement documentation and other documentation for individuals included in test samples. This review did not include a determination as to whether the League 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 League 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:

- Payrates were not reported in accordance with public salary schedules.
- Commissions were incorrectly reported as special compensation.
- Compensation reported to CalPERS exceeded the Internal Revenue Code (IRC) 401(a)(17) limit.
- Unused sick leave balances were incorrectly reported.

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

LEAGUE BACKGROUND

The League is a California nonprofit mutual benefit corporation. Founded in 1898, the League has grown to include voluntary membership of all or nearly all California cities. The League's purpose is to strengthen and protect local control for cities through education and advocacy to enhance the quality of life for all Californians. The League's principal office is located in Sacramento, California.

The League contracted with CalPERS effective August 1, 1997, to provide retirement benefits for local miscellaneous employees. The League's current contract amendment identifies the length of the final compensation period as three years for the local miscellaneous employees. The League did not contract with CalPERS to provide health benefits to its employees during our review period.

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SCOPE

As part of the Board approved plan for fiscal year 2010/2011, OAS reviewed the League's payroll reporting and member enrollment processes as these processes relate to the League's retirement contract with CalPERS.

The review period was limited to the examination of sampled records and processes from January 1, 2008, through December 31, 2010. The on-site fieldwork for this review was conducted from March 21, 2011, through March 25, 2011. 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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OFFICE OF AUDIT SERVICES REVIEW RESULTS

Finding 1: Payrates were not reported in accordance with salary schedules.

Recommendations:

The League should ensure that payrates are reported in accordance with its publicly available salary schedules.

The League should work with CalPERS CASD to assess the impact of reporting payrates different than those presented in its publicly available salary schedules and determine what adjustments are needed.

Condition:

OAS reviewed payrates reported to CalPERS for a sample of 11 employees. OAS determined that payrates for two of the sampled employees were not reported in accordance with the League's public salary information.

Payrate Over-Reported – Director of Administrative Services

The Director of Administrative Services received an \$8,400 salary adjustment, increasing his annual salary from \$180,470 in 2009 to \$188,870 in 2010. However, according to the League's salary schedule, the highest salary listed for the Director classification in 2010 was \$187,264. Therefore, the Director's 2010 salary exceeded the salary schedule by \$1,606.

Incorrect Payrate Reported – Manager II

OAS reviewed the payrates reported for an advertising sales manager working in the classification of Manager II. It was found that the League incorrectly reported a base monthly payrate of \$2,704 during 2008, and \$2,787.22 during 2009 and 2010. The League's salary schedule listed an entry level salary for the Manager II position at \$78,927 for calendar year 2008, and \$82,755 for calendar years 2009 and 2010. The salaries converted to monthly payrates of \$6,577.25 in 2008, and \$6,896.25 in 2009 and 2010. According to the compensation plan established between the League and the sampled Manager II, the employee was compensated with a base salary plus commissions. OAS determined that the payrates reported to CalPERS were incorrect and not in accordance with the

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League's salary schedule. OAS also determined that the commissions were incorrectly reported as special compensation. This issue is discussed under Finding 2.

Criteria:

Government Code § 20636(b)(1)

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Finding 2: Commissions were incorrectly reported as special compensation.

Recommendations:

The League should discontinue reporting commissions to CalPERS.

The League should work with CalPERS CASD to assess the impact of the incorrect reporting and determine what adjustments are needed.

Condition:

The League incorrectly reported a sampled employee's sales commission as special compensation. The compensation plan for an advertising sales manager, classified as a Manager II, called for an annual salary based on qualifications and background. The employee also received sales commission based on the amount of advertising sold. The League paid and reported \$1,831, the employee's sale commission in sampled service period 10/10-2, as special compensation. Commissions do not meet the definition of reportable compensation and should not be reported to CalPERS as special compensation.

Criteria:

Government Code: § 20636(c)(5), § 20636(c)(6)
California Code of Regulations: § 571(a), § 571(c)

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Finding 3: Reported compensation limits were exceeded.

Recommendations:

The League should comply with IRC section 401(a)(17) and CalPERS' policies and procedures regarding the maximum compensation limits.

The League should work with CalPERS CASD to assess the impact of over-reporting compensation and determine what adjustments are needed.

Condition:

Annual compensation amounts reported to CalPERS are limited by IRC section 401(a)(17) for persons who first became members or participants of CalPERS on or after July 1, 1996. The compensation limit does not limit the salary an employer can pay an employee who is a CalPERS member, but rather limits the amount of compensation that can be used when calculating a member's retirement allowance. The IRC compensation limits established for calendar years 2008, 2009, and 2010 were \$230,000, \$245,000 and \$245,000 respectively.

OAS found that the League paid one employee, the League Executive Director, total compensation that exceeded the compensation limits established for calendar years 2008, 2009 and 2010. The League reported the appropriate, limited amounts of compensation for the League Director in 2008 and 2010; however, the League over-reported compensation in 2009. Specifically, the League reported \$266,171.22 in 2009, which exceeded the \$245,000 compensation limit set by the IRC by \$21,171.22.

Criteria:

Government Code: § 21752.5
CalPERS Procedures Manual, page 94

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Finding 4: Unused sick leave was reported incorrectly.

Recommendations:

The League should divide the accumulated hours of a member's unused sick leave balance by eight when certifying unused sick days for additional service credit.

The League should work with CalPERS BNSD to assess the impact of incorrectly reporting unused sick leave and determine what adjustments are needed.

Condition:

The League certified the incorrect number of unused sick days for five sampled employees. The League converted the employees' accumulated unused sick leave hours into days using a divisor of seven and one half instead of eight. As a result, the number of days certified to CalPERS overstated the employees' retirement benefit. The excessive number of unused sick days ranged from .59 to 20.63 days.

Criteria:

Government Code: § 20965
CalPERS Procedures Manual: Page 189

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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 League'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. Because OAS did not review whether the League 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 League is a public agency or whether its employees are employed by a public agency.

Respectfully submitted,

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

Date: March 2012

Staff: Michael Dutil, CIA, Senior Manager

Alan Feblowitz, Manager

Richard Parsons CFE, CIA

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APPENDIX A

BACKGROUND

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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. 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. The Health Account Services section, as part of the 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.

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 employers' 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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OBJECTIVES

The objectives of this review were limited to determination of:

- Whether the League 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 League's retirement contract with CalPERS were followed.

This review covers the period of period January 1, 2008, through December 31, 2010.

SUMMARY

Procedures, Sample Sizes, Sample Periods, and Findings

To accomplish the review objectives, OAS interviewed key staff members to obtain an understanding of the League's personnel and payroll procedures. OAS also reviewed the following documentation:

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

OAS performed the following procedures. A description and the related sample sizes, sample periods and applicable findings for each procedure are included.

- ✓ Reviewed payrates reported to CalPERS and reconciled the payrates to League public salary schedule 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 League's governing body in accordance with requirements of applicable public meeting laws.

Sample Size and Period: Reviewed 11 sampled employees covering the review period.

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See Finding 1: Payrates were not in accordance with salary schedules.

- ✓ Reviewed League payroll records and compared the records to data reported to CalPERS to determine whether the League correctly reported employees' compensation.

Sample Size and Period: Reviewed 11 employees covering two sampled service period – the first service period in July 2010 (7/10-1), and the second service period in October 2010 (10/10-2). Employees were paid semi-monthly.

See Finding 2: The League reported commissions as special compensation.

- ✓ Reviewed employees' annual reported compensation amounts.

Sample Size and Period: Reviewed one employee covering calendar years 2008, 2009 and 2010.

See Finding 3: The League reported contributions in excess of IRC(a)(17) limits.

- ✓ 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 11 sampled employees in the second service period in October 2010 (10/10-2).

No Finding

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

Sample Size and Period: Reviewed seven temporary/part-time employees in fiscal years 2007/2008, 2008/2009, and 2009/2010.

No Finding

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

Sample Size and Period: There were no retired annuitants working for the League during the review period.

No Finding

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- ✓ Reviewed the City's enrollment practices pertaining to independent contractors to determine whether the individuals met CalPERS membership requirements.

Sample Size and Period: Reviewed nine independent contractors in review period.

No Finding

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

Sample Size and Period: Reviewed nine retiring members covering the review period.

See Finding 4: Unused sick leave was reported incorrectly.

APPENDIX C

CRITERIA

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CRITERIA

Government Code § 20636, subdivision (c)(5), states:

The monetary value of a service or noncash advantage furnished by the employer to the member, except as expressly and specifically provided in this part, is not special compensation unless regulations promulgated by the board specifically determine that value to be "special compensation."

Government Code § 20636, subdivision (c)(6), states, in part:

The board shall promulgate regulations that delineate more specifically and exclusively what constitutes "special compensation" as used in this section.

Government Code § 20636, subsection (b)(1) states, in part:

"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.

Government Code § 20965 states, in part:

A local miscellaneous member and a local safety member, whose effective date of retirement is within four months of separation from employment with the employer which granted the sick leave credit, shall be credited be credited at his or her retirement with 0.0004 year of service credit for each unused day of sick leave certified to the board by his or her employer.

Government Code § 21752.5 states, in part:

The amount of compensation that is taken into account in computing benefits payable to any person who first becomes a member of this system on or after July 1, 1996, shall not exceed the limitations in Section 401(a)(17) of Title 26 of the United States Code upon public retirement systems, as that section may be amended from time to time and as that limit may be adjusted by the Commissioner of Internal Revenue for increases in cost of living. The determination of compensation for each 12-month period shall be subject to the annual compensation limit in effect for the calendar year in which the 12-month period begins.

California Code of Regulations § 571, subdivision (a), states:

The following list exclusively identifies and defines special compensation items for members employed by contracting agencies and school employers that must be reported to CalPERS if they are contained in a written labor policy or agreement.

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California Code of Regulations § 571, subdivision (c), states, in part:

Only items listed in subsection (a) have been affirmatively determined to be special compensation.

CalPERS Procedures Manual, page 94 states, in part:

Section 401(a)(17) of the Internal Revenue Service Code provides dollar limitations on benefits and contributions under qualified retirement plans....For those members who are subject to the limit, their compensation will be capped at the limit in effect for each twelve consecutive-month period that is used to calculate their allowance if they were to retire. For example, the compensation limit for 2008 is \$230,000. Therefore, the member should not make contributions on earnings that exceed the \$230,000 limit within the 2008 calendar year. The earnings that are mentioned are those earnings that are reportable to CalPERS, which exclude earnings for overtime, automobile allowances, lump sum payouts, etc. The compensation limit does not limit the salary an employer can pay an employee who is a member of CalPERS.

CalPERS Procedures Manual, page 189, explains that all employees, regardless of their work schedule, will have any accumulated unused hours of sick leave divided by eight to determine the number of days to report to CalPERS for the purposes of enhancing the retirement benefit and there are no exceptions.

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APPENDIX D

LEAGUE'S WRITTEN RESPONSE

March 19, 2012

California Public Employees' Retirement System
Office of Audit Services
Margaret Junker, Chief
P.O. Box 942701
Sacramento, CA 94229-2701

RE: Response to CalPERS Audit Report
Employer Code: 1716, Job Number: P-10-036

Dear Ms. Junker:

Thank you for the audit report covering the California Public Employees' Retirement System (CalPERS) compliance findings in relation to the League of California Cities' (League) contract with CalPERS. The League welcomes CalPERS' audit and findings.

Founded in 1898, the League is a nonprofit mutual benefit corporation whose membership is confined to and comprised exclusively of California cities. The League contracted with CalPERS in August 1997, following a CalPERS determination indicating the League is eligible to participate in CalPERS as a public agency under Government Code Section 20057(e).

Audit Report Findings

The League appreciates the professional and thorough approach CalPERS has taken during the audit. The League would also like to thank CalPERS' field auditor Richard Parsons for his positive approach while working with the League to complete the audit.

The League has reviewed and agrees with each of the four audit report findings. Except for Finding 2 (Commissions were incorrectly reported as special compensation), and its interaction with Finding 1 (Pay rates were not reported in accordance with salary schedules), the findings stem from administrative errors resulting from unintentional oversights by the League. The League has taken steps internally to avoid such oversights in the future. The League's Human Resources Director is in contact with CalPERS in an effort to work with the Customer Account Services Division and Benefit Services Division to assess the impact of and to correct each of the reporting errors identified during the audit.

Finding 1: Pay rates were not reported in accordance with salary schedules.

Pay rate over reported – Director of Administrative Services: The League acknowledges the administrative error that resulted in the Director of Administrative Services' 2010 salary exceeding the top of his salary schedule by \$1,606. In January 2011, independent of the

CalPERS audit the League identified this oversight and proceeded to re-establish the Director of Administrative Services' salary within the salary schedule.

Incorrect pay rate reported – Manager II: The League acknowledges this issue relates to Finding 2 and how the League reported the Advertising Sales Manager compensation to CalPERS. The League reported the Advertising Sales Manager's compensation to CalPERS as a monthly pay rate plus special compensation. Combined, the reported monthly pay rate and special compensation accurately reflects the advertising sales manager's compensation, which falls within the Manager II salary schedule. However, since the League reported a portion of the Advertising Sales Manager's compensation as special compensation, the monthly pay rate reported to CalPERS fell below the Manager II salary schedule. As noted in Finding 2, the League is committed to correcting its reporting to properly reflect the Advertising Sales Manager's full compensation.

Finding 2: Commissions were incorrectly reported as special compensation.

The League acknowledges it has been reporting the Advertising Sales Manager's compensation as a monthly pay rate plus special compensation. When the League contracted with CalPERS in 1997, the League and CalPERS worked together to address a number of transition issues. Some of the issues were handled via written correspondence; others were handled via oral communications.

The issue of how to report the Advertising Sales Manager's compensation was addressed orally in 1997 with a CalPERS representative from the Actuarial and Employer Services Division, Training and Assistance Unit. Written correspondence addressed to Gloria Crimmins, RPS II, with the Member Services Division Compensation Review Section was also prepared by the League. However, there is no indication CalPERS received or responded to the written correspondence. The League based its reporting of the Advertising Sales Manager's compensation on the oral information received from the Training and Assistance Unit.

The League accepts the finding that either through miscommunication or misunderstanding the Advertising Sales Manager compensation should not have been reported as special compensation. In response to this finding, the League has restructured the Advertising Sales Manager compensation, thereby eliminating the issue of commission and how it should be reported. The League is fully committed to working with the Customer Account Services Division to correct previously submitted payroll reports so that they properly account for the Advertising Sales Manager's full compensation.

Finding 3: Reported compensation limits were exceeded.

The League acknowledges the administrative error that resulted in the reporting to CalPERS of compensation beyond the IRS 401(a)(17) limitation for 2009. In November 2009, the

League notified CalPERS via written communication that the affected employee had reached the IRS limitation and correctly reported in its CalPERS payroll report the employee's permissible compensation only. However, through an oversight, the League failed to properly adjust the subsequent December 2009 CalPERS payroll reports to accurately reflect that the employee's compensation for those pay periods also exceeded the IRS limitation.

The League has reviewed its internal payroll procedures and is in contact with the Customer Account Services Division to correct this error.

Finding 4: Unused sick leave was reported incorrectly.

The League acknowledges an error occurred when the League used its 7.5 hour workday to calculate and report to CalPERS a retiring employee's sick leave balance. The League has corrected its reporting process and will work with the Benefit Services Division to determine what adjustments are needed.

In closing, on behalf of the League's Board of Directors, management, and employees, the League appreciates the time CalPERS has invested in ensuring the League is compliant with California Public Employees Retirement Law statutes, regulations, and its contract with CalPERS.

Respectfully,



Christopher McKenzie
Executive Director
League of California Cities