

# **CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM**

Review Report

## **PENSION CONTROLS AND MECHANISMS**

*July 1, 2010, through June 30, 2012*



**JOHN CHIANG**  
California State Controller

September 2014



**JOHN CHIANG**  
**California State Controller**

September 9, 2014

Anne Stausboll, Chief Executive Officer  
California Public Employees' Retirement System  
Lincoln Plaza North – 400 P Street  
Sacramento, CA 95811

Dear Ms. Stausboll:

The State Controller's Office (SCO) reviewed the California Public Employees' Retirement System's (CalPERS) established internal controls for preventing and detecting pension spiking for the period of July 1, 2010, through June 30, 2012. Pension spiking, which is based on unusually large or excessive final employee compensation, results in greater-than-earned retirement benefits. We reviewed CalPERS' electronic data processing systems and review efforts to determine CalPERS' ability to prevent and detect pension spiking at its reporting entities, which include state, local, city, and special district governments. In all, CalPERS administers retiree benefits for more than 3,100 reporting entities. We also reviewed 11 reporting entities (three state agencies, two counties, two cities, and four districts) to determine whether these entities also have internal controls in place to prevent and detect pension spiking.

Our review determined the following:

- Although our review of the 11 reporting entities did not identify pension spiking, we observed that CalPERS lacked oversight of the reported payroll information during the review period. A reporting entity submits payroll information for retirement purposes on a monthly basis to CalPERS. However, CalPERS does not review the monthly reported information for accuracy or compliance at the time it is submitted. CalPERS reviews the pay data only when the member employee submits his or her retirement application, to determine retirement benefits. The lack of up-front real-time accuracy verifications could potentially allow employees to inflate their pay until retirement, resulting in an increased pension benefit. A more proactive and preventive approach would dissuade employees from spiking their pay.
- CalPERS' current efforts for reviews of reporting entities include, in part, procedures for detecting pension spiking. The available resources limit its annual reviews to only 45, or 1.5% of the more than 3,000 reporting entities. At this current rate, pension spiking could go undetected for an extended period of time, as each reporting entity would be reviewed, at the earliest, every 66 years.

- CalPERS has a statistically-developed electronic risk assessment tool to aid in its review selection. However, during the period when there were severe local government crises, such as those occurring in the City of Bell, the agency's Board of Administration made overrides to the risk assessment results by focusing on higher-compensated individuals. Although, this may have been an appropriate temporary override, we believe it is now a suitable time to curtail such overrides and utilize the electronic risk assessment tool. This will reduce the focus on higher-compensated individuals, which can create situations where a high-risk entity does not get reviewed.

If you have any questions, please call Mr. Finlayson at (916) 324-6310, or email him at [afinlayson@sco.ca.gov](mailto:afinlayson@sco.ca.gov).

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

JVB/sk

Enclosure

cc: Rob Feckner, President

CalPERS Board of Administration

George Diehr, State Member Representative

CalPERS Board of Administration

Michael Bilbrey, All Member Representative

CalPERS Board of Administration

Richard Gillihan, Acting Director, California Department of Human Resources

Ex Officio Member, CalPERS Board of Administration

John Chiang, California State Controller

Ex Officio Member, CalPERS Board of Administration

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Public Representative, CalPERS Board of Administration

Bill Lockyer, California State Treasurer

Ex Officio Member, CalPERS Board of Administration

Priya Sara Mathur, Vice President

Public Agency Member Representative, CalPERS Board of Administration

Bill Slaton, Local Government Elected Official

CalPERS Board of Administration

Dana Hollinger, Insurance Industry Representative

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# Review Report

## Executive Summary

The State Controller's Office (SCO) has completed a review of the California Public Employees' Retirement System (CalPERS) to determine whether controls are in place to detect and prevent pension payments based on unusually large or excessive final compensation amounts, commonly known as pension spiking. The SCO specifically reviewed the electronic methods used to identify pension spiking and the review processes used by CalPERS to oversee its reporting entities for the period of July 1, 2010, through June 30, 2012.

The SCO also reviewed 11 reporting entities to determine whether controls are in place to prevent and detect pension spiking.

The SCO's review was conducted pursuant to the State Controller's authority under Government Code section 12410.

Our review determined the following:

- Our review of the 11 reporting entities did not identify pension spiking; however, we did observe that CalPERS lacked sufficient oversight of the reported payroll information. A reporting entity submits payroll information for retirement purposes on a monthly basis to CalPERS. CalPERS does perform monthly validations and system edits against incoming payroll files; however, the validations or edits do not normally look for anomalies that would reveal pension spiking. CalPERS typically reviews the pay data only when the member employee submits his or her retirement application to determine retirement benefits. The lack of constant and consistent up-front real-time accuracy verifications could potentially allow employees to inflate their pay until retirement, resulting in an increased pension benefit. A more proactive and preventive approach would dissuade employees from spiking their pay.
- Although our review did not reveal pension spiking, we noted that one type of special compensation existing for certain CalPERS members will require a significant amount of public funds to compute the additional retirement benefits for those member entity employees. This type of additional employee pay is commonly referred to as "Employer Paid Member Contributions" or (EPMC). These public funds have enhanced retirement benefits for participating member entity employees as follows:
  - Under California Government Code section 20692, 97 reporting entities were able to amend their contracts, allowing them to convert these contributions as regular pay instead of special compensation. The pay was increased by approximately \$39.1 million, yielding an additional \$796 million that will be used to compute retirement benefits over 20 years.

- The remainder of the approximately 2,400 member entities did not amend contracts for special compensation to regular pay conversions during the final year. These entities had similar special compensation provisions as the above-mentioned 97 member entities. CalPERS could not determine the increased compensation; however, we have determined that the increased compensation would be significantly higher than for those entities that amended their contracts.
- CalPERS' current efforts for reviews of reporting entities include, in part, procedures for pension spiking. The available resources limit its annual reviews to only 45, or 1.5% of the more than 3,000 reporting entities. At this current rate, pension spiking could go undetected for an extended period of time, as each reporting entity would be reviewed, at the earliest, every 66 years.
- Although CalPERS has a statistically developed electronic risk assessment tool to aid in its review selection, the agency's Board of Administration appears to override such risk assessment selections by focusing on higher-compensated individuals, which can create situations in which a high-risk entity does not get reviewed.

## **Introduction**

This report presents the results of the SCO's review of pension control mechanisms exercised by CalPERS over its reporting entities. With a large number of retirements predicted to occur in the near future, and the fiscal impact on CalPERS' Retirement Funds, the SCO reviewed the adequacy of CalPERS' and its reporting entities' methods to prevent potential pension spiking. Senate Bill (SB) 53, enacted in 1993, instituted tough anti-spiking measures for CalPERS-administered retirement plans.

## **Background**

The California Public Employees' Retirement System (CalPERS) was established by State law in 1932 to provide retirement benefits for State employees. CalPERS manages retirement benefits for more than 1.6 million California public employees, retirees, and their families. As of June 30, 2011, CalPERS provided pension benefits to 1,103,426 active and inactive members and 536,234 retirees, beneficiaries, and survivors. A population made up from 3,103 (1,573 public agencies and 1,530 school districts) CalPERS employers as of May 2012.

CalPERS is managed by the CalPERS Board of Administration (Board). The Board is responsible for the management and control of CalPERS, including the exclusive control of the administration and investment of the Retirement Fund. The Board is composed of 13 members who are elected (6), appointed (3), or who are Ex Officio (4).

Retirements gradually have increased in the past several years due to members of the "baby boom" generation reaching retirement age. After the youngest members of this group retire, retirement rates are expected to decline. Another factor in the rise of retirements is the implementation of furloughs by the State. During fiscal year 2010-11, when furloughs were implemented, approximately 33,000 members retired.

We focused on the adequacy of oversight and audit coverage that CalPERS provides and currently has in place, specifically, in the following areas: 1) automated system reviews and 2) public agency reviews.

CalPERS is responsible for the determination and payment of retirement benefits to members, retirees, and beneficiaries. The amount of retirement benefits is based on the member's age at retirement, the number of service credits at retirement, and the member's final compensation. In the case of this defined benefit program, final compensation is based either on the highest single year or an average of three consecutive years.

Pension spiking is the improper reporting of compensation and, if not detected, can result in increasing a member's final compensation and retirement benefit. This may reflect one-time increases in compensation or increases that became effective shortly before retirement that would not be paid to the member's successor.

## **Objectives, Scope, and Methodology**

The SCO reviewed CalPERS for the period of July 1, 2010, through June 30, 2012. The purpose of the review was to determine whether controls are in place to detect and prevent pension payments based on unusually large or excessive final compensation amounts, commonly known as pension spiking. The SCO specifically reviewed the electronic methods used to identify pension spiking and the review processes used by CalPERS to oversee its reporting entities.

1) For CalPERS automated system reviews we:

- Reviewed and assessed criteria used for flagging salary bumps;
- Determined whether all flagged cases have been reviewed, and if not, why not;
- Assessed the adequacy of review methodology and procedures used by CalPERS for cases reviewed;
- Assessed the timeliness and adequacy of CalPERS in recouping overpayments in identified pension spiking cases; and
- Randomly selected cases reviewed by CalPERS, performed independent testing to ensure proper calculation of retirement benefits, and determined whether CalPERS made the correct conclusions.

2) For public agency reviews we:

- Evaluated audit programs and audit work plans for the current and prior two fiscal years;
- Determined whether reviews were conducted in accordance with the work plan;
- Reviewed criteria used in the selection of public agencies to review and assess the adequacy of coverage;



- Reviewed auditors' working papers to determine whether the reviews were conducted properly; and
- Assessed the adequacy of actions taken in those instances where pension spiking had been identified.

The SCO also reviewed 11 reporting entities to determine whether the reporting entities had controls in place to prevent and detect pension spiking. The objectives of our review were to determine whether CalPERS provides adequate oversight and has in place adequate internal controls to detect and take action in a timely manner against potential pension spiking.

In order to accomplish our objectives, we reviewed:

- Rules and regulations associated with the Public Employees' Retirement Law and other pertinent documents related to public employees' retirement;
- Working papers and reports prepared by CalPERS auditors to determine the procedures performed, their results, and the follow-up for review findings;
- Review reports prepared by CalPERS independent auditors, pursuant to the annual financial and performance audit requirements;
- Internal reports, risk analyses, annual work plans, reports to management, internal audit reports, and contractor's memos and reports related to the oversight of the CalPERS retirement system; and
- Personnel compensation processes, specifically, salary and retirement contribution adjustments for members to determine whether there was adequate oversight and controls to guard against potential pension spiking.

## Conclusion

We reviewed the California Public Employees' Retirement System's established internal controls for preventing and detecting pension spiking for the period of July 1, 2010, through June 30, 2012. We also reviewed 11 reporting entities to determine whether these entities also have internal controls in place to prevent and detect pension spiking.

We found that CalPERS lacks sufficient oversight of its reporting entities and their member employees; an issue that may lead to pension spiking.

We found that, as required, reporting entities submit payroll information for retirement purposes on a monthly basis to CalPERS. CalPERS does perform monthly validations and system edits against incoming payroll files; however, the validations or edits do not normally look for anomalies that would reveal pension spiking. CalPERS typically reviews the pay data only when the member employee submits his or her retirement application to determine retirement benefits. The lack of constant and consistent up-front real-time accuracy verifications could potentially allow employees to inflate their pay until retirement, resulting

in an increased pension benefit. A more proactive and preventive approach would dissuade employees from spiking their pay.

CalPERS' current efforts for reviews of reporting entities include, in part, procedures for pension spiking. The available resources limit its annual reviews to only 45, or 1.5% of the more than 3,000 reporting entities. At this current rate, pension spiking could go undetected for an extended period of time, as each reporting entity would be reviewed, at the earliest, every 66 years.

CalPERS has a statistically developed electronic risk assessment tool to aid in its review selection, however, the agency's Board of Administration appears to override such risk assessment selections by focusing on higher-compensated individuals, which can create situations in which a high-risk entity does not get reviewed.

Although our review did not reveal pension spiking, we noted that one type of special compensation existing for certain CalPERS members will require a significant amount of public funds to compute the additional retirement benefits for those member entity employees. This type of additional employee pay is commonly referred to as "Employer Paid Member Contributions" or (EPMC). These public funds have enhanced retirement benefits for participating member entity employees as follows:

- Pursuant to Government Code section 20692, 97 reporting entities amended their contracts, allowing them to convert these contributions to regular pay. CalPERS determined that these converted payrates increased employees' pay by approximately \$39.1 million in additional compensation, yielding an additional \$796 million in compensation that would be used to compute retirement benefits over 20 years.
- The remainder of the approximately 2,400 member entities did not amend contracts for special compensation to regular pay conversions during the final year. These entities had similar special compensation provisions as the above-mentioned 97 member entities. CalPERS could not determine the increased compensation; however, we have determined that the increased compensation would be significantly higher than for those entities that amended their contracts.

## **Views of Responsible Officials**

We issued a draft report on August 22, 2014, and discussed the result of the draft report on August 25, 2014, with CalPERS. Anne Stausboll, Chief Executive Officer, responded to the finding and observation in a letter dated September 3, 2014. The CalPERS' response is included in this report as an attachment.

**Restricted Use**

This report is intended for the information and use of CalPERS, CalPERS Board of Administration Members, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

September 9, 2014

# Finding and Recommendation

**FINDING—  
CalPERS lacks sufficient  
oversight of reporting  
entities**

Our review determined that CalPERS lacked sufficient oversight of its reporting entities. CalPERS and its Office of Audit Services (OAS) is responsible for the direct oversight of its reporting entities, and performs a number of reviews of its reporting entities, including procedures that cover pension spiking. We found factors that contributed to an overall lack of efficiency and oversight, and a workplan that does not provide adequate coverage of the entities CalPERS is responsible for monitoring.

In addition to the Office of Audit Services (OAS) there is a Compensation Review Unit (CRU), which is responsible for determining accurate retirement benefits. The CRU does not monitor the reported salary amounts of active employees, but works with OAS to aid in employee oversight.

Several factors contributed to the lack of adequate oversight, for both the Office of Audit Services and the Compensation Review Unit:

- As required, reporting entities submit payroll information for retirement purposes on a monthly basis to CalPERS. CalPERS does perform monthly validations and system edits against incoming payroll files; however, the validation or edits do not normally look for anomalies that would reveal pension spiking. CalPERS typically only reviews the pay data when the member employee submits his or her retirement application to determine retirement benefits. The lack of constant and consistent up-front real-time accuracy verifications could potentially allow employees to inflate their pay until retirement, resulting in an increased pension benefit. A more proactive and preventive approach would dissuade employees from spiking their pay.
- Although CalPERS' Audit Services has a statistically developed electronic risk assessment tool to aid in its review selection, the agency's Board of Administration appears to override the risk assessment selections to focus on higher-compensated individuals, which can create situations in which a high-risk entity does not get reviewed.
- The Compensation Review Unit performs procedures to determine proper pay amounts for retiring employees, but no procedures for active employees unless specifically requested to do so.
- CalPERS' current efforts for reviews of reporting entities include, in part, procedures for pension spiking. The available resources limit its annual reviews to only 45, or 1.5% of the more than 3,000 reporting entities. At this current rate, pension spiking could go undetected for an extended period of time, as each reporting entity would be reviewed, at the earliest, every 66 years.
- CalPERS has been in the process of determining the number of additional audit staff needed, as an internal program evaluation noted the need of an additional 25 auditors. However, budget constraints will only allow CalPERS an additional nine positions. These

additional auditors were to specifically aid in conducting additional reviews, which also will include reviews of pension spiking. However, due to a large number of reporting entities, the additional nine audit staff will not immediately provide adequate staffing levels to provide additional oversight of the entities reporting to CalPERS.

### Recommendation

The SCO recommends that CalPERS:

- a. Increase the frequency with which its reporting entities are reviewed by increasing the number of audit staff. With limited resources, CalPERS should enhance pension spiking monitoring through enhanced technology-based analysis.
- b. Continue to use a risk-based analysis and other evidence-based criteria to identify which reporting entities to review. To aid in its annual workplan, CalPERS should include the "high-pay compensation in excess of \$245,000" attribute in its annual risk assessment. This attribute can be given a larger weighting in the risk analysis to satisfy the CalPERS Board's concerns. This analysis should be used to determine the number of entities that should be reviewed each year as well as the resources needed to properly provide program oversight.
- c. Perform an analysis to determine the additional types of resources needed in order to provide more effective and adequate oversight of the entities reporting to CalPERS for active employees.
- d. Require procedures to review active employees' pay amounts for material increases in compensation and special compensation amounts.
- e. Review and analyze the Public Employee's Retirement Law for any necessary clarifications or enhancements to allow CalPERS to provide better oversight of its member entities.
- f. Request additional analytical staff and/or auditors for the Compensation Review Unit to aid in the review of potential spiking by active employees.

### CalPERS' Response 1a

The CalPERS Office of Audit Services (OFAS) presented an agenda item to the CalPERS Board of Administration (Board) in August 2012 that addressed the Public Agency Review Program Expansion Alternatives. In reviewing the expansion alternatives, the Board agreed that additional resources should be provided to increase the number of reviews performed. For the fiscal year ending June 30, 2014, the OFAS reviewed 99 public agencies, consisting of 48 final reports, 34 pending agency responses, and 17 more reports that are significantly complete and going through our internal quality review to ensure accuracy.

We will continue to evaluate and determine if we need to expand our review efforts.

We are most pleased that the SCO's report did not find any issues of pension spiking within the employer community reviewed, including CalPERS. Additionally, the SCO found no material concerns regarding the quality of the work performed, which is of great importance to CalPERS. The OFAS has performed compliance reviews of reporting entities for more than 20 years which demonstrates CalPERS' commitment to effective oversight. CalPERS has also made a commitment to revisit whether resources, in addition to those already approved, are warranted once staffing has fully assimilated and stabilized.

#### SCO's Comment

In response to the low number of reviews performed, CalPERS did seek additional resources subsequent to our review period. However, they were still only able to issue 48 reports during the 2013-14 fiscal year. In response to their ability to accomplish 99 reviews each year currently, if this is correct, they are still only able to cover 3.3% of the reporting entities in any given year. This means pension spiking could still go undetected as each reporting entity would be reviewed every 33 years.

Our office will follow up to evaluate the efficiency of the additional resources and reviews.

#### CalPERS' Response 1b

CalPERS believes that one of the reasons the SCO's report "did not identify pension spiking" among the agencies it reviewed is due, in part, to CalPERS' effective and comprehensive approach to employer education and compliance activities.

When payroll is submitted we apply additional audits and edits as an initial layer of review. In addition, CalPERS performs reviews of employer payroll data, including active and inactive employees.

The need for these reviews might be identified by CalPERS staff during normal monitoring activities, system reviews or impromptu reviews. Reviews might also be identified by members of the public who submit tips or by members of the media.

OFAS historically utilizes a risk-based approach to identify and prioritize which reporting entities to review and will continue to use this and other effective approaches. OFAS has, and continues to use, high compensation (in excess of \$245,000) as one of several risk factors in the risk assessment. Our risk assessment is a dynamic and fluid process that is refined each year as the environment and conditions change. Consequently, risk factors and corresponding weights of these factors are subject to change with each annual assessment completed. That said, it is important to emphasize that the scope of the SCO's review coincided with several high-profile local government pension related cases such as the City of Bell.

In multiple sections of the report, it states that the Board of Administration appears to override the risk assessment selections to focus on higher-compensated individuals. To clarify, in November 2010, the Chief Auditor presented an information agenda item to the Board's Risk and Audit Committee discussing alternatives to achieve optimal targeted coverage of public agencies. After analyzing and considering several alternatives, and with input from the Committee, the Chief Auditor decided to primarily target and review public agencies that have highly-paid employees with reported earnings exceeding \$245,000 per year. As a result of events occurring in the City of Bell and elsewhere, it is incumbent upon the OFAS to review preliminary results of our risk assessment and make appropriate modifications as necessary to adequately respond to changing circumstances.

During fiscal years 2013-14 and 2014-15, OFAS selected a combination of high-risk, high-paid, medium-risk, and low-risk agencies as well as agencies identified through tips from the general public. Selection of agencies during the current year involves consideration of agencies identified as high-risk that have never been reviewed, and selection of both medium- and low-risk agencies. CalPERS is also developing a business intelligence program using technology and data analytics to identify membership and payroll reporting anomalies across its membership.

#### SCO's Comment

CalPERS continues to lack sufficient analytical and audit staff to aid in the execution of an audit tool that utilizes consistent and complete audit edits to identify potential areas of audit risk, along with a thoroughly vetted risk assessment tool to aid in the selection of auditees.

Although CalPERS currently has payroll data submitted for retirement purposes on a monthly basis, the validations are designed to ensure that the file structure is valid and has been formatted and interfaced correctly, and that the data within each record is correct according to program rules and regulations. Errors at either of these levels result in required corrections by the submitting employer before they can be posted as valid to the employees' CalPERS accounts. While these data help provide accurate payroll information, they do not aid in identifying pension spiking.

While we note that CalPERS has a tool in place to select its reviews via the risk assessment process, OFAS allows the Board to circumvent this independent process, allowing high-risk entities to be bypassed for review.

With regard to CalPERS' comments on current activities during FYs 2013-14 and 2014-15, we are unable to determine the accuracy or effectiveness of these reported changes without additional review. Specifically, with respect to the reported design/development of a business intelligence program, this program was discussed during our fieldwork in 2013 and has yet to be implemented. Our office will follow up to evaluate the efficiency of the program once it is designed, implemented, and a data set is available to measure its adequacy and

effectiveness to aid in the oversight of pension spiking.

#### CalPERS' Response 1c

CalPERS believes that one of the reasons the SCO's report "did not identify pension spiking" among the agencies it reviewed is due, at least in part, to CalPERS' effective and comprehensive approach to employer education and compliance activities. CalPERS engages in prevention activities by providing hundreds of classes annually to its employer community detailing information on payroll submission, including statutory and regulatory requirements and prohibitions. Further, we provide individualized education when requested or as needs are identified by CalPERS staff. When payroll is submitted we apply additional audits and edits as an initial layer of review. In addition, CalPERS performs reviews of employer payroll data, including active and inactive employees. The need for these reviews might be identified by CalPERS staff during regular employee or employer reviews, system reviews or impromptu reviews of all data. Reviews might also be identified by members of the public who submit tips, or by members of the media.

While adequate resources are a key part of effective monitoring, it is premature to assume that additional resources are the most effective route to dissuade pension spiking. CalPERS is committed to continuously monitoring our resources to meet our fiduciary responsibilities. To that end, CalPERS will develop and evaluate effective and efficient options for consideration, including the review of the level of payroll oversight at or near submission by entities. These options will include a variety of alternatives, with anticipated costs and potential outcomes. Options will evaluate industry leading practices and innovative approaches, utilizing technology assistance such as Business Intelligence and data reports. It will also take into account any adjustments as a result of changes incorporated as related to the CalPERS response to Recommendation 1.

#### SCO's Comment

The SCO did not state that the most effective route to effective monitoring is additional resources. We indicated CalPERS is lacking effective steps to combat pension spiking. We concur that education is one important proactive step to combat pension spiking, as it helps change the culture. However, the SCO did not observe CalPERS performing highly effective proactive activities such as:

- Consistent ongoing edits that combat pension spiking that require reporting entity feedback and corrections on a monthly basis for active employees
- Ongoing field reviews that utilize analytical tools and data mining efforts on a consistent basis for active employees

Our review found CalPERS is reactive rather than proactive to pension spiking. They primarily use hotlines and media tips as one of their tools for pension spiking detection. Although they have some analytical tools



available to them to detect pension spiking, they don't utilize them on an automated basis. The only thing we could find that is done on an automated basis is that the payroll data submitted for retirement purposes on a monthly basis is validated to ensure that the file structure is valid and has been formatted and interfaced correctly, and that the data within each record is correct according to program rules and regulations. Errors at either of these levels result in required corrections by the submitting employer before they can be posted as valid to the employees' CalPERS accounts. While these help provide accurate payroll information, they do not aid in identifying pension spiking.

#### CalPERS' Response 1d

CalPERS already has procedures in place to review active employees' pay amounts for increases as well as inappropriate reporting, in general. Listed in CalPERS' response to Recommendation 3 are scenarios in which oversight is performed on active employee payroll records. For example, as part of the general maintenance performed on employer records, the Compensation Review Unit has several processes in place that assist in the oversight of reporting entities including active members. The Compensation Review Unit conducts thorough case reviews to verify that the payroll that has been reported in our system is compliant with the Public Employees' Retirement Law (PERL). This includes reviewing documents such as payroll records, memorandums of understanding, written labor policies or agreements, publicly available pay schedules, and Personnel Action Forms. In those instances where reported payroll does not appear to comply with the PERL, appropriate follow-up action is undertaken by the Compensation Review Unit.

The OFAS continues to identify in its risk assessment, agencies that have active employees with high pay and special compensation amounts. Those agencies that have highly-paid employees and high levels of special compensation are provided a risk factor and weight. These two factors are included with other factors to identify and prioritize those agencies to review each year. Further, OFAS' review program includes procedures that test for salary increases, correct reporting of employee pay rates, and correct reporting of employee compensation and earnings.

CalPERS will develop appropriate procedures to support any additional activities for implementation that might arise as a result of CalPERS' response to Recommendation 6.

#### SCO's Comment

CalPERS does have some procedures and analytical tools available to them to detect pension spiking; however, they don't utilize them on an automated basis. Payroll data is submitted for retirement purposes on a monthly basis and is validated to ensure that the file structure is valid and has been formatted and interfaced correctly, and that the data within each record is correct according to program rules and regulations. Errors at either of these levels result in required corrections by the submitting employer before they can be posted as valid to the employees' CalPERS accounts. These may help provide accurate payroll information, however, they do not aid in identifying pension spiking.

In addition, the CRU does perform reviews to detect pension spiking. However, these are only performed on an ad hoc basis for active employees and consistently for retiring employees. The SCO still believes the most effective approach is to be proactive to detect potential pension spiking, as it occurs through automated edits, data mining and focused reviews.

#### CalPERS' Response 1e

Each year, CalPERS sponsors an omnibus bill to make minor non-controversial changes to the PERL, and may sponsor additional legislation to make more substantial changes. Since 2008, CalPERS has sponsored 19 bills, including legislation in 2011 that impacted the definition of pay rate (AB 1028, Ch. 440, St. 2011) and added cost recovery mechanisms for auditing contracting agencies (AB 782, Ch. 107, St. 2011). In addition, CalPERS establishes regulations to implement these and other changes to the PERL, including regulations that require contracting agencies to make their pay schedules publicly available (Title 2, Sec. 570.5, operative 7/11/2011). CalPERS will continue its existing process to review and analyze the PERL for any necessary clarifications or enhancements to allow CalPERS to improve oversight of its member entities. In addition, CalPERS will continue to be available to provide assistance to the Legislature and other state agencies that may pursue changes to the laws that govern public pension systems.

#### SCO's Comment

CalPERS should continue to review and analyze the PERL as needed.

#### CalPERS' Response 1f

As identified in CalPERS' response to Recommendation 3, it is premature to assume that additional resources are the most effective route to dissuade pension spiking. CalPERS is committed to continual monitoring of our resources to adhere to our fiduciary responsibilities. To that end, CalPERS will develop and evaluate effective and efficient alternatives for consideration to review the level of oversight of payroll at or near the time of submission by entities reporting to CalPERS. These alternatives will include a variety of alternatives, with anticipated costs and potential outcomes, evaluating industry leading practices and innovative approaches utilizing technology assistance, such as Business Intelligence and attribute data reports, where possible. It will also take into account any adjustments as a result of changes incorporated from CalPERS' response to Recommendation 1.

These alternatives will include all required resources to ensure that we continue to provide effective and efficient oversight of reporting entities. Staff will move the recommendation into the next annual planning cycle as appropriate. In addition, as mentioned in CalPERS' response to Recommendation 4, CalPERS will develop appropriate procedures to support any additional activities approved for implementation.

**SCO's Comment**

The SCO did not state that the most effective route to effective monitoring is additional resources. The SCO indicated that CalPERS is lacking effective proactive acts to combat pension spiking. We concur that CalPERS should develop and implement effective and efficient payroll oversight to detect pension spiking. The SCO will follow up with CalPERS to verify which alternative it has implemented.

# Observation

## *Statute Authorized publicly-funded enhancement of pension benefits*

We concluded that one type of special compensation existing for certain CalPERS members, pursuant to Government Code section 20692, will require a significant amount of public funds to compute the additional retirement benefits for those member entity employees. This additional type of additional employee pay is commonly referred to as "Employer Paid Member Contributions" or (EPMC).

Enhanced retirement benefits to participating members, such as EPMC, were addressed in the Public Employees' Pension Reform Act (PEPRA) of 2013. As a result, EPMC is no longer available as an optional benefit to new members. However, this optional benefit remains in force for those members for whom it was available prior to December 31, 2013. EPMC will eventually be eliminated as participating member benefits terminate.

In our analysis, we concluded that 97 reporting entities amended their contracts with CalPERS, which will require an additional \$796 million in public funds to compute the additional retirement benefits for those member entity employees. Furthermore there were approximately 2,400 reporting entities that did not amend their contracts. The SCO could not obtain the necessary data from CalPERS to compute the amount of public funds that would be attributable to increased compensation that would be used to compute the additional retirement benefits for these employees. Although we cannot determine the amount, we can conclude that it would be significantly higher than the \$796 million identified above.

Retirement benefits are based on a formula using four attributes: reportable compensation, age, service credit, and a negotiated percentage, usually between 2 and 3 percent based upon the age at retirement. In simple terms, retirement compensation is based upon allowable reportable compensation multiplied by the percentage and service credit.

The EPMC was allowed to be reported as "special compensation" prior to the enactment of Government Code section 20692 (discussed below). The EPMC allowed member entities, such as a local county government, to entirely fund a participating employee's retirement plan. Rather than a participating member entity employee contributing toward his or her retirement fund, the employer member entity withheld a portion of the employee's pay and paid the employee's required retirement contributions.

The 1993 enactment of California Government Code section 20692 has enabled 97 contracting agencies, primarily local governments and special districts, to charge at no cost to their participating employees (members), approximately \$796 million in special compensation over 20 years as reportable income that will be used in computing retirement benefits. This special compensation, EPMC, is one of more than a hundred optional benefit conversions under which local governments and special districts fund their employees' retirement contributions. Under this

EPMC conversion, CalPERS amended contracts for the 97 contracting agencies to amend their retiree contracts. The contract amendment allowed these agencies to reduce members' pay by the amount of their share of the retirement contribution.

Typically, a contracting agency, on behalf of its member, would have contributed approximately 18% of the member's salary toward the retirement contribution, while the member would have paid for the remainder of the contribution, which averaged between 6% and 9% of each member's salary. During the course of this optional benefit conversion, the total retirement contribution for each member remained unchanged. The only difference was that the contracting agency paid the entire contribution along with the incremental contributions based on CalPERS' actuarial valuation for the increased EPMC compensation.

In the final compensation period in cases where the employer has contracted for the enhanced benefit provided by section 20692, payrate is increased by an amount equal to the member's normal contributions that were being paid by the employer. As a result, these members receive a higher retirement benefit and the employer is required to contribute higher amounts throughout the member's career.

However, for those members whose contracting agencies amended their CalPERS contracts to include the special compensation, we have determined that the amendment to the contracts increased members' pay by approximately \$39.1 million in additional compensation, yielding an additional \$796 million in retirement compensation for the next 20 years, as determined below.

The SCO requested data from CalPERS for all EPMC participants, that included the following attributes:

- Contracting agencies that amended their contracts;
- Members who participated in the EPMC;
- Retirement dates of participating members; and
- Pay information on the participants from their retirement dates and 13 months prior.

The SCO then performed the following procedures with this data:

- Computed any increase in monthly pay for each member participating in the EPMC;
- Annualized the monthly pay increase that would be used to compute retirement benefits;
- Determined the number of years each member will have been retired, through September 2023;
- Computed the total amount of increased pay the member would receive through September 5, 2023, that would be used to compute retirement benefits; and

- Summarized the totals for each member, excluding any anomalies we found.

Upon further discussion with CalPERS, we concluded that:

- CalPERS' internal processes did not detect the significant pay increases in the data that was provided to the SCO.
- CalPERS provided documentation to substantiate that four of the 129 pay increases were not used in the members' retirement computations.
- CalPERS could not provide additional data for the EPMC participants, therefore, we only excluded the most unusual anomalies in our calculations.

Similar to the 97 contracting agencies mentioned above, for the remaining 2,400 agencies that did not opt to amend their contract, the retirement benefit structure remained the same and the member's EPMC remained as "special compensation" as was allowed prior to the enactment of Government Code section 20692.

However, due to the large number of participants and retirees, CalPERS was unable to determine the increased compensation amount for these entities. We have determined that the increased compensation of the additional 2,400 entities and its retirees would be significantly higher, although not proportionate, for those agencies that amended their contracts.

#### Recommendation

The California Legislature has amended the existing Government Code section 20692, to terminate this optional benefit. We recommend that, for future optional benefits, CalPERS and contracting agencies thoroughly analyze any pension enhancement programs prior to enactment, to determine the true cost of the program. This information should be made public so that there can be an informative dialogue for discussion on the merits of the program.

#### CalPERS' Response

The Legislature and the Governor are responsible for passing and enacting any optional benefits that become part of the Public Employees Retirement Law (PERL). As part of that legislative process, CalPERS is already required by Government Code section 20236 to provide a cost analysis on any legislative bill that changes the benefit structure of this system. As part of the legislative process, and consistent with the Observation recommendation, CalPERS routinely provides cost information to the legislature that is used as part of the public policy debate and fiscal committee analysis. This information includes the impact to the General Fund for State- and school-related benefit changes. For benefit changes related to public agencies, CalPERS also provides a range of potential cost impacts.

For further clarification and for those who may be unfamiliar with the Employer Paid Member Contributions (EPMC), it is an employment practice routinely utilized by, and included in the laws applicable to, public retirement systems in California. CalPERS administers the EPMC provision of the PERL and has no discretion when an entity has complied with the statutory requirements for EPMC. In addition, the numbers of employers listed in the SCO Review report as utilizing EPMC are higher than the numbers so identified in the CalPERS database. We will continue to work with the SCO to reconcile the differences. For these reasons, CalPERS staff believes that EPMC is outside the stated scope of the audit and that the observation section in this report and all other references to EPMC would be better addressed in a standalone report on that topic.

#### SCO's Comment

CalPERS provided a list of 97 entities on July 26, 2013, which identified those entities that amended their contracts with CalPERS to convert the EPMC to pay rate during a member's final compensation period (GC 20692). We validated this data with CalPERS on several occasions to compute the additional pay that was converted for our computations. We shared these results with CalPERS during our fieldwork, exit conference, and discussion of the draft report. Subsequently on September 3, 2014, a revised list of entities was sent to us. The SCO was unable to validate this data from this new list by the release date of this report. CalPERS did not provide an explanation why the list is now different.

Furthermore, the SCO does not agree that this observation is outside the scope of the review as it does pertain to publicly funded pension enhancement benefits at the public's expense.

**Attachment—  
CalPERS' Response to  
Draft Review Report**

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California Public Employees' Retirement System  
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September 3, 2014

Mr. Andrew Finlayson  
State Agency Audits Bureau  
State Controller's Office, Division of Audits  
PO Box 942850  
Sacramento, CA 94250-5874

Dear Mr. Finlayson:

Thank you for the opportunity to provide formal comments on your August 22, 2014 draft report "Pension Controls and Mechanisms." The California Public Employees' Retirement System (CalPERS) welcomes constructive suggestions to improve controls that will assist our contracting employers with their responsibilities under the Public Employees' Retirement Law (PERL). Attached for your consideration are our full comments to the review.

We are pleased that the review conducted by your staff "did not identify pension spiking" among the nearly dozen public agencies reviewed. We also are pleased that the review offered no material recommended changes to our efforts to audit agencies for pension spiking and that the review found CalPERS has proper processes in place to recoup overpayments from local agencies.

While the review recognized some of the work we do to prevent pension spiking, the report didn't acknowledge the breadth and depth of the actions we have taken in recent years to curb abuse and monitor the compliance of local governments that we believe is important to point out for our stakeholders, including members, employers, and taxpayers.

For the record:

- Since the review time period (July 2010 – June 2012), CalPERS has significantly increased audit staff and, in the last fiscal year alone, CalPERS has doubled its audits of public agencies to 99. We will continue to evaluate and determine if we need to expand our review efforts.

- CalPERS provides comprehensive education for employers and offered more than 600 training courses last fiscal year.
- CalPERS has procedures in place to review compensation of active employees for pay increases and inappropriate reporting by employers.
- CalPERS targets public agencies that have highly paid employees with reported earnings exceeding \$245,000 annually in an effort to optimize its review of agencies.

We are also developing an additional information technology review program using business intelligence and data analytics to identify anomalies regarding membership and payroll reporting across all of our contracting public agencies. This will further optimize our review program.

It is also important to understand that CalPERS shares a partnership with our local government employers who bear the primary responsibility for understanding, complying with and accurately reporting employee compensation in compliance with the law.

We welcome suggestions to improve our oversight role. CalPERS remains committed to preventing pension spiking and protecting our system, and our members, employers and taxpayers.

Please feel free to contact Robert Udall Glazier, Deputy Executive Officer for External Affairs at (916) 795-3850 if you have any questions about our comments or want to further discuss our work.

Sincerely,



Anne Stausboll  
Chief Executive Officer



Response to State Controller's Office Draft Report dated August 22, 2014

**Finding – CalPERS lacks sufficient oversight of reporting entities**

**CalPERS Response:**

The SCO's draft report recommended no material changes to the criteria CalPERS uses for performing audits, had no concerns regarding the quality of the work and had no problems with the adequacy in recouping overpayments for the 11 agencies reviewed, including CalPERS.

CalPERS has a clear commitment to combatting pension spiking. Pension spiking is the improper reporting of compensation, and, if not detected, can result in inappropriate increases in a member's final compensation and to retirement costs. Although not reflected in the report, CalPERS performs many robust reviews in this area and has many processes to combat pension spiking.

**Recommendation 1:**

Increase the frequency with which its reporting entities are reviewed by increasing the number of audit staff. With limited resources, CalPERS should enhance pension spiking monitoring through enhanced technology-based analysis.

**CalPERS Response:**

CalPERS is committed to thorough and appropriate reviews of the public entities that report their payroll data to the pension system. The CalPERS Office of Audit Services (OFAS) presented an agenda item to the CalPERS Board of Administration (Board) in August 2012 that addressed the Public Agency Review Program Expansion Alternatives. In reviewing the expansion alternatives, the Board agreed additional resources should be provided to increase the number of reviews performed. For the fiscal year ending June 30, 2014, the OFAS reviewed 99 public agencies consisting of 48 final reports, 34 pending agency responses, and 17 more reports which are significantly complete and going through our internal quality review to ensure accuracy. It should also be noted, however, that increases in the number of reviews do not solely impact OFAS. It has a ripple effect on staffing in various support functions within CalPERS such as the Customer Account Services Division, Benefit Services Division, and our Legal Office. The expertise and assistance provided by these support functions are critical as the complexity and resource intensive reviews of reporting entities have significantly increased.

We are most pleased that the SCO's report did not find any issues of pension spiking within the employer community reviewed, including CalPERS. Additionally, the SCO found no material concerns regarding the quality of the work performed which is of great importance to CalPERS. The OFAS has performed compliance reviews of reporting



entities for over 20 years which demonstrates CalPERS commitment to effective oversight. CalPERS has also made a commitment to revisit whether resources, in addition to those already approved, are warranted once staffing has fully assimilated and stabilized.

Lastly, it should be noted that during the review period, CalPERS was subject to statewide mandated furloughs that caused a reduction of 26 working days or 208 hours per staff which directly impacted the number of reviews completed. In addition, during this same timeframe CalPERS was subject to statewide hiring freezes and the ability to work overtime was restricted. In spite of these obstacles, CalPERS continued to work diligently with, and provide oversight of, reporting entities.

**Recommendation 2:**

Continue to use a risk-based analysis and other evidence-based criteria to identify which reporting entities to review. To aid in its annual work plan, CalPERS should include the “high-pay compensation in excess of \$245,000” attribute in its annual risk assessment. This attribute can be given a larger weighting in the risk analysis to satisfy the CalPERS Board’s concerns. This analysis should be used to determine the number of entities that should be reviewed each year as well as the resources needed to properly provide program oversight.

**CalPERS Response:**

CalPERS believes that one of the reasons the SCO’s report “did not identify pension spiking” among the agencies it reviewed is due, in part, to CalPERS effective and comprehensive approach to employer education and compliance activities. CalPERS engages in prevention activities by providing hundreds of classes annually to its employer community detailing information on payroll submission, including statutory and regulatory requirements and prohibitions. Further, we provide individualized education when requested or as needs are identified by CalPERS staff. When payroll is submitted we apply additional audits and edits as an initial layer of review. In addition, CalPERS performs reviews of employer payroll data, including active and inactive employees. The need for these reviews might be identified by CalPERS staff during normal monitoring activities, system reviews or impromptu reviews. Reviews might also be identified by members of the public who submit tips or by members of the media.

OFAS historically utilizes a risk-based approach to identify and prioritize which reporting entities to review and will continue to use this and other effective approaches. OFAS has and continues to use high compensation (in excess of \$245,000) as one of several risk factors in the risk assessment. Our risk assessment is a dynamic and fluid process that is refined each year as the environment and conditions change. Consequently, risk factors and corresponding weights of these factors are subject to change with each annual assessment completed. That said, it is important to emphasize that the scope of the SCO’s review coincided with several high profile local government pension related cases such as the City of Bell. Issues that arose from the City of Bell and other high



profile reviews consumed an unprecedented amount of resources. In response, OFAS appropriately deployed existing resources to further investigate these types of abnormalities. Although not mentioned in the report, many resources were being utilized to address the issues raised by these high profile cases.

In multiple sections of the report, it states that the Board of Administration appears to override the risk assessment selections to focus on higher-compensated individuals. To clarify, in November 2010, the Chief Auditor presented an information agenda item to the Board's Risk and Audit Committee discussing alternatives to achieve optimal targeted coverage of public agencies. After analyzing and considering several alternatives, and with input from the Committee, the Chief Auditor decided to primarily target and review public agencies that have highly paid employees with reported earnings exceeding \$245,000 per year. As a result of events occurring in the City of Bell and elsewhere, it is incumbent upon the OFAS to review preliminary results of our risk assessment and make appropriate modifications as necessary to adequately respond to changing circumstances.

During fiscal years 2013-14 and 2014-15, OFAS selected a combination of high risk, high paid, medium risk, and low risk agencies as well as agencies identified through tips from the general public or requests. Selection of agencies during the current year involves consideration of agencies identified as high risk that have never been reviewed and selection of both medium and low risk agencies. CalPERS is also developing a business intelligence program using technology and data analytics to identify membership and payroll reporting anomalies across its membership. This will allow CalPERS to focus its auditing efforts on contracting agencies which are most at-risk for reporting errors. This dynamic risk assessment approach is consistent with leading practices, allows for a diverse sample of our more than 3,000 agencies, and is successful as demonstrated through the results of our reviews. For example, in fiscal year 2013-14, public agency reviews included more than 200 findings related to non-compliance with the California Government Code and California Code of Regulations.

**Recommendation 3:**

Perform an analysis to determine the additional types of resources needed in order to provide more effective and adequate oversight of the entities reporting to CalPERS for active employees.

**CalPERS Response:**

CalPERS believes that one of the reasons the SCO's report "did not identify pension spiking" among the agencies it reviewed is due, at least in part, to CalPERS effective and comprehensive approach to employer education and compliance activities. CalPERS engages in prevention activities by providing hundreds of classes annually to its employer community detailing information on payroll submission, including statutory and regulatory requirements and prohibitions. Further, we provide individualized education when requested or as needs are identified by CalPERS staff. When payroll is



submitted we apply additional audits and edits as an initial layer of review. In addition, CalPERS performs reviews of employer payroll data, including active and inactive employees. The need for these reviews might be identified by CalPERS staff during regular employee or employer reviews, system reviews or impromptu reviews of all data. Reviews might also be identified by members of the public who submit tips or by members of the media.

While adequate resources are a key part of effective monitoring, it is premature to assume additional resources are the most effective route to dissuade pension spiking. CalPERS is committed to continuously monitoring our resources to meet our fiduciary responsibilities. To that end, CalPERS will develop and evaluate effective and efficient options for consideration, including the review of the level of payroll oversight at or near submission by entities. These options will include a variety of alternatives, with anticipated costs and potential outcomes. Options will evaluate industry leading practices and innovative approaches utilizing technology assistance, such as Business Intelligence and data reports. It will also take into account any adjustments as a result of changes incorporated as related to CalPERS Response to Recommendation 1.

**Recommendation 4:**

Require procedures to review active employees' pay amounts for material increases in compensation and special compensation amounts.

**CalPERS Response:**

CalPERS already has procedures in place to review active employees' pay amounts for increases as well as inappropriate reporting, in general. Listed in CalPERS Response to Recommendation 3 are scenarios in which oversight is performed on active employee payroll records. For example, as part of the general maintenance performed on employer records the Compensation Review Unit has several processes in place that assist in the oversight of reporting entities including active members. The Compensation Review Unit conducts thorough case reviews to verify that the payroll that has been reported in our system is compliant with the Public Employees' Retirement Law (PERL). This includes reviewing documents such as payroll records, memorandums of understanding, written labor policies or agreements, publicly available pay schedules, and Personnel Action Forms. In those instances where reported payroll does not appear to comply with the PERL, appropriate follow up action is undertaken by the Compensation Review Unit.

The OFAS continues to identify agencies that have active employees with high pay and special compensation amounts in its risk assessment. Those agencies that have highly paid employees and high levels of special compensation are provided a risk factor and weight. These two factors are included with other factors to identify and prioritize those agencies to review each year. Further, OFAS' review program includes procedures that test for salary increases, correct reporting of employee payrates, and correct reporting of employee compensation and earnings.



CalPERS will develop appropriate procedures to support any additional activities for implementation that might arise as a result of CalPERS Response to Recommendation 6.

**Recommendation 5:**

Review and analyze the Public Employee's Retirement Law for any necessary clarifications or enhancements to allow CalPERS to provide better oversight of its member entities.

**CalPERS Response:**

Each year, CalPERS sponsors an omnibus bill to make minor non-controversial changes to the PERL, and may sponsor additional legislation to make more substantial changes. Since 2008, CalPERS has sponsored 19 bills, including legislation in 2011 that impacted the definition of payrate (AB 1028, Ch. 440, St. 2011) and added cost recovery mechanisms for auditing contracting agencies (AB 782, Ch. 107, St. 2011). In addition, CalPERS establishes regulations to implement these and other changes to the PERL, including regulations that require contracting agencies to make their pay schedules publicly available (Title 2, Sec. 570.5, operative 7/11/2011). CalPERS will continue its existing process to review and analyze the PERL for any necessary clarifications or enhancements to allow CalPERS to improve oversight of its member entities. In addition, CalPERS will continue to be available to provide assistance to the Legislature and other state agencies that may pursue changes to the laws that govern public pension systems.

**Recommendation 6:**

Request additional analytical staff and/or auditors for the Compensation Review Unit to aid in the review of potential spiking by active employees.

**CalPERS Response:**

As identified in CalPERS Response to Recommendation 3, it is premature to assume that additional resources are the most effective route to dissuade pension spiking. CalPERS is committed to continual monitoring of our resources to adhere to our fiduciary responsibilities. To that end, CalPERS will develop and evaluate effective and efficient alternatives for consideration to review the level of oversight of payroll at or near the time of submission by entities reporting to CalPERS. These alternatives will include a variety of alternatives, with anticipated costs and potential outcomes, evaluating industry leading practices and innovative approaches utilizing technology assistance, such as Business Intelligence and attribute data reports, where possible. It will also take into account any adjustments as a result of changes incorporated from CalPERS Response to Recommendation 1.



These alternatives will include all required resources to ensure we continue to provide effective and efficient oversight of reporting entities. Staff will move the recommendation into the next annual planning cycle as appropriate. In addition, as mentioned in CalPERS Response to Recommendation 4, CalPERS will develop appropriate procedures to support any additional activities approved for implementation.

**Observation – The Legislature approved publicly funded enhanced retiree benefits**

**Observation Recommendation:**

The California Legislature has amended existing Government Code section 20692, to terminate this optional benefit. We recommend that, for future optional benefits, CalPERS and contracting agencies thoroughly analyze any pension enhancement programs prior to enactment to determine the true cost of the program. This information should be made public so that there can be an informative dialogue for discussion on the merits of the program.

**CalPERS Response:**

The Legislature and the Governor are responsible for passing and enacting any optional benefits that become part of the Public Employees Retirement Law (PERL). As part of that legislative process, CalPERS is already required by Government Code Section 20236 to provide a cost analysis on any legislative bill that changes the benefit structure of this system. As part of the legislative process, and consistent with the Observation recommendation, CalPERS routinely provides cost information to the legislature that is used as part of the public policy debate and fiscal committee analysis. This information includes the impact to the General Fund for State and School related benefit changes. For benefit changes related to public agencies, CalPERS also provides a range of potential cost impacts.

**CalPERS Comment:**

For those unfamiliar with Employer Paid Member Contributions (EPMC), it is an employment practice routinely utilized by, and included in the laws applicable to, public retirement systems in California. CalPERS administers the EPMC provision of the PERL and has no discretion when an entity has complied with the statutory requirements for EPMC. Indeed, at the exit conference for this review SCO staff acknowledged that EPMC was “not really a CalPERS issue” and found no issue in how CalPERS administered this provision. In addition, the numbers of employers listed in the SCO Review report as utilizing EPMC are higher than the numbers so identified in the CalPERS database. We will continue to work with the SCO to reconcile the differences. For these reasons, CalPERS staff believes that EPMC is outside the stated





scope of the audit and that the observation section in this report and all other references to EPMC would be better addressed in a standalone report on that topic.

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