

TEACHERS' RETIREMENT BOARD

REGULAR MEETING

Item Number: **9**

SUBJECT: Proposed Regulations on Direct Reporting by Employers

CONSENT: ___

ATTACHMENT(S): 1

ACTION: X

MEETING DATE: April 1, 2015 / 30 mins.

INFORMATION: ___

PRESENTER: Ed Derman

PURPOSE

The purpose of this item is to secure direction from the board to begin the formal rulemaking process, pursuant to the Administrative Procedure Act, to promulgate standards for a district to report directly to CalSTRS rather than through its county office of education.

BACKGROUND

School district employers report member and pension contribution data and remit contributions to CalSTRS using a hierarchical reporting model wherein, generally, each community college or school district reports retirement information and remits contributions to its respective county office of education. The county then compiles and submits the information and remits the contributions to CalSTRS. Penalties and interest for late reporting and contributions are similarly coordinated through the county, adding a layer of complexity to an already complex business process. Beginning in 2014, the Governmental Accounting Standards Board Statements 67 and 68 caused CalSTRS to record, track and report contributions, service credit and employer accounts receivable at the district level; however, the related transaction activities generally occur at the county level (as the direct report source).

Section 23004 of the Education Code provides that “[t]he county superintendent of schools shall, or a *school district or community district may, with approval of the board,* submit a report monthly to the system containing such information as the board may require in the administration of the plan.” The Legislature amended this law to reflect the preexisting practice of receiving data and contributions from a few large districts, bypassing the county office of education. Since the 2012–13 fiscal year, CalSTRS has piloted the direct reporting process with other districts. During that time, CalSTRS has refined its considerations in evaluating candidates for direct reporting.

In 2014, staff conducted an informal readiness assessment of districts whose payroll operations are managed in-house. Staff identified 59 fiscally independent or accountable districts with independent payroll systems. Based on reporting competency and self-reported employer interest, of these 59, approximately 40 districts are potential candidates. In each of the last three years, between 10 and 15 districts have contacted CalSTRS to express an interest in direct reporting, and between one and three have actually been approved each year. CalSTRS expects these regulations, when compared to the current case-by-case processing of applications, will allow for widespread understanding of the qualification criteria in the employer community and, therefore, a lower

application rate and a higher approval rate. Based on these factors, staff is anticipating no more than five districts to be admitted as direct reports each year, with that population tapering off after the first five or so years.

Permitting these employers to directly report allows for direct communication between CalSTRS and the district and absolves the county of any reporting responsibility for its independent districts. When districts report directly to CalSTRS, process efficiencies—including the direct flow of data and contributions, elimination of potential introduction of errors at the county level, reduced time to receive deposits, improved ease of matching funds with report data, and ability to address issues directly with employers—result, benefiting all parties.

Regulations provide CalSTRS a means to administer standards that districts must meet in order to be approved by the board to report directly. In [November 2013](#), the Legislative Committee directed staff to proceed with the drafting of regulations that would establish criteria that CalSTRS will use to assess whether an employer can be accepted as a direct report.

DISCUSSION

The primary objective in creating the evaluation criteria contained in these regulations is to establish permanent relationships with districts as direct reports that have the ability to report without undue intervention and instruction by CalSTRS staff. After it has begun, the relationship would be administratively complex to reverse. Through the standards laid out in these regulations, CalSTRS seeks to avoid circumstances that could lead to termination of the direct reporting relationship. These regulations would:

- Ensure districts accepted as direct reports are compliant with state and federal law.
- Require that an audit of the applying district during the prior 36 months had demonstrated full compliance with specified issues, such as proper reporting to the Defined Benefit Supplement Program and mandatory membership, and that an additional CalSTRS review during the prior 12 months has demonstrated compliance with, among other issues, reporting full-time minimum standards consistent with a written agreement with an exclusive representative.
- Require counties and districts to mutually agree to the division of responsibilities.
- Require districts to demonstrate that they have the authority to act independently and the tools and knowledge to report accurately.
- Validate a history of stable accreditation status, as loss of accreditation would affect a district's status as a CalSTRS-covered employer.
- Ensure potential direct reports are timely and responsive in reporting and responding to CalSTRS requests.

In addition, these regulations set limits as to when and how the direct reporting relationship may be terminated and subsequently reestablished. Administrative complexity would result if school employers were able to terminate and reinstate the direct reporting relationship at will, with responsibility shifting between the district and county and back again. Once the direct reporting relationship is established, the district will be CalSTRS' sole point of contact for data and contributions, including data previously maintained by the county. In the event the relationship is

subsequently terminated, responsibility for all reporting would return to the county. These regulations seek to ensure that there is a clear acceptance of that division of responsibilities on the part of the district and the county.

Staff also recognized a need to retain a degree of flexibility in order to balance workload. The application and approval process requires administration by staff. Through these regulations, staff aims to absorb this administration with existing resources. Having the flexibility to limit the number of direct reports who may be approved in a given time period and to limit re-application from recently rejected applicants enables staff to manage that workload.

Benefits Anticipated

Anticipated benefits of these regulations include improved process efficiencies for school districts, county offices of education and CalSTRS. These regulations ensure employers who have the minimum enabling technology and have demonstrated knowledge and ability to execute the laws and regulations related to reporting will be allowed to become direct reports. Further, these regulations set a high bar for compliance so that the direct report does not require the expenditure of additional staff time or other resources by CalSTRS, thereby promoting a stable and permanent direct reporting relationship. Restricting the ability to become a direct report to districts who have met the standards laid out in these regulations will maximize the likelihood that direct reporting employers will comply with reporting standards and governing laws and will not require an undue level of intervention by CalSTRS staff.

In addition, these regulations promote an efficient use of staff time in reviewing applications by encouraging a high rate of successful application submissions as opposed to repeat rejections of applicants following staff analysis. Initial training and support needs will be met using existing resources, providing a seamless transition for applicants.

NEXT STEPS

With the board's approval, staff will initiate the rulemaking process. Publication in the California Regulatory Notice Register (coinciding with the beginning of the 45-day comment period) can occur on April 24, with the comment period ending on June 8, 2015.

The board has discretion as to whether or not to conduct a public hearing, but CalSTRS will be required to hold one if it is requested by the public no later than 15 days before the close of the written comment period. The board may choose to preschedule a hearing or wait to see whether one is requested and schedule it at that point.

The board may elect to conduct a hearing in person to coincide with its June 2015 meeting, which is scheduled to begin two days after the end of the 45-day comment period. Alternatively, the board may delegate the hearing to staff, which would allow greater flexibility in the June board agenda. The board has tried each approach in the past. In the case of the creditable compensation regulations and regulations implementing penalties and interest, the board conducted the hearings.

When the board was proposing regulations on campaign contributions and the appeals process, the hearings were conducted by the Chief Executive Officer.

The final proposed regulations will be brought before the board for adoption before they are submitted to the Office of Administrative Law for approval. If there are no additional comment periods, the board can consider adoption of the regulations in September 2015, with an effective date of January 1, 2016. If an additional comment period is required, staff would return instead with a revised draft in September, and the effective date would be delayed.

RECOMMENDATION

Staff recommends that the board direct staff to initiate the rulemaking process and delegate authority to schedule and hold the related hearing to the Chief Executive Officer.

Title 5. Education. Division 3. Teachers' Retirement System.

All new text to be added to the California Code of Regulations follows, under new Article 1 in new Chapter 3.

Chapter 3. Employer Reporting

Article 1. Employer Direct Reporting

§ 27700. Definitions.

(a) As used in this chapter:

- (1) Unless otherwise specifically named, “board” means the Teachers’ Retirement Board.
- (2) “County” means the county superintendent of schools.
- (3) “County governing authority” means the county board of education, or, if in possession of the relevant authority to perform the activities specified in this Article, the county superintendent of schools.
- (4) “Direct report” means an elementary, high school, or unified school district, or a community college district, that is approved to report directly to the system such information as that the Teachers’ Retirement Board may require in the administration of the State Teachers’ Retirement Plan.
- (5) “District” means an elementary, high school, or unified school district, or a community college district.
- (6) “System” means the California State Teachers’ Retirement System.

Note: Authority cited: Sections 22207, 22213 and 22305, Education Code. Reference: Section 23004, Education Code.

§ 27701. Effective date.

- (a) The regulations shall be effective for districts that are currently approved as direct reports and to those that apply or are in the process of applying to become direct reports to the Defined Benefit Program on or after January 1, 2016.
- (b) The effective date of becoming a new direct report shall be July 1 of the year specified in the resolution adopted by the district governing board.

Note: Authority cited: Sections 22207, 22213 and 22305, Education Code. Reference: Section 23004, Education Code.

§ 27702. Prerequisites to approval.

- (a) A district may apply to be a direct report to the system. The Teachers’ Retirement Board may approve or may deny a district as a direct report based on the criteria in subdivisions (b) and (c).
- (b) An applicant to become a direct report shall be in compliance with all of the following requirements. Failure to comply with the requirements of this subdivision shall result in the denial of the application to become a direct report.

- (c)
- (1) The district has submitted the applicable resolutions by the district’s governing board and the county governing authority required under Section 27703, and there has been no change to the correctness of each of the declarations therein.
 - (2) The district has demonstrated the ability to successfully transmit the following files to the system:
 - (A) An encrypted sample file formatted according to the F496 file format specifications incorporated by reference pursuant to Section 27000.
 - (B) An encrypted file containing member information related to accounts receivable to identify that a member is set up with automatic deduction to purchase service time through the employer.
 - (C) An encrypted file containing physical address details associated with the member.
 - (3) If the district was previously terminated as a direct report, more than five fiscal years have elapsed since the effective date of the termination.
 - (4) In the 36 months preceding its application to become a direct report, the district had an audit conducted by the system that demonstrated full compliance with reporting the following consistent with the Teachers’ Retirement Law:
 - (A) Mandatory membership.
 - (B) One-time or limited-term payments reported to the Defined Benefit Supplement Program.
 - (C) Outgrowth activities as creditable service.
 - (D) Information regarding the compensation to be paid to employees, including, but not limited to, employment contracts, written agreements, salary schedules, and board minutes.
 - (5) A review conducted by the system demonstrates sustained compliance with all of the following over the 12-month period preceding the district’s application:
 - (A) Responding to the system’s requests for adjustments within 60 days.
 - (B) Providing acceptable annotations to employer-approved edits in the F496 file format electronically in an encrypted format provided by the system.
 - (C) Reporting full-time minimum standards consistent with a written agreement with an exclusive representative.
 - (D) Providing the system with information regarding the compensation to be paid to employees within 30 days of a request by the system.
- (d) The board may deny an application to become a direct report if it finds any of the following:
- (1) The district has any outstanding or unresolved audit findings from the system at any point during the application process.
 - (2) There are any accounts receivable 30 or more days past due to the system attributable to the district at any point during the application process.

- (3) If the district was previously rejected by the system from entry as a direct report due to an audit or review finding under these regulations, and the rejection occurred within the previous five fiscal years.
- (e) The board may, at its discretion, defer consideration of an application until a future fiscal year.

Note: Authority cited: Sections 22207, 22213, 23004 and 22305, Education Code. Reference: Section 22458 and 23004, Education Code.

§ 27703. Documentation required with application to become a direct report.

- (a) An applicant to become a direct report shall submit the following documentation with the following content:
- (1) If contributions required to be paid by a member are picked up for the sole purpose of deferring taxes as authorized by Section 414(h)(2) of the Internal Revenue Code of 1986 (26 U.S.C.A Sec 414(h)(2)) and Section 17501 of the Revenue and Taxation Code, a resolution adopted by the district’s governing board certifying its intent to pick up member contributions in compliance with those provisions and the Teachers’ Retirement Law.
- (2) A resolution adopted by the district’s governing board resolving to become a direct report to the system and certifying each of the following.
- (A) “[District] hereby elects to become a direct report to the California State Teachers’ Retirement System, effective on July 1, [effective year].”
- (B) “[District] has a payroll system independent of the county.”
- (C) The district is fiscally accountable, fiscally independent, or both, as demonstrated by including the relevant statements from either of the following subdivisions:
- (i) For a school district: “[District] is [fiscally accountable as defined in Section 42647/ fiscally independent as defined in Section 42650/ both fiscally accountable and fiscally independent as defined in Sections 42647 and 42650] of the Education Code.”
- (ii) For a community college district: “[District] is [fiscally accountable as defined in Section 85266/ fiscally independent as defined in Section 85266.5/ both fiscally accountable and fiscally independent as defined in Sections 85266 and 85266.5] of the Education Code.”
- (D) “[District] has the ability to be in full compliance with the F496 File Specifications.”
- (E) “[District] is responsible for submitting contribution data and remitting contributions in accordance with the Teachers’ Retirement Law.”
- (F) “[District] is responsible for submitting contribution data and remitting contributions for all adjustments to contributions that relate to service performed prior to the effective date of the direct reporting relationship as requested by the system or as identified by the district.”

- (G) “[District] is responsible for payment of any penalty assessments for contributions and data submitted as a direct report on or after the effective date of the direct reporting relationship.”
 - (H) “[District] is responsible for submitting all contribution data and remitting all contributions on and after the effective date of becoming a direct report.”
 - (I) “For the last five fiscal years, [District] has been issued an unqualified opinion on its annual financial audit pursuant to Section 41020 or 84040 of the Education Code.”
 - (J) The district has maintained a status of acceptable standing with the most current accrediting body by affirming the relevant statement from either of the following subdivisions:
 - (i) For a school district: “[District] has not been on probationary accreditation status nor had its accreditation status withheld by the most current accreditation body sanctioned by the California Department of Education in the last five fiscal years.”
 - (ii) For a community college district: “[District] has not been ordered to show cause or been subject to the equivalent strictest sanctions applied from the most current accreditation body sanctioned by the Board of Governors of the California Community Colleges in the last five fiscal years.”
 - (K) “[District] shall notify the system within three business days if its payroll operations are no longer independent of the county or if its fiscally accountable status or fiscal independence is revoked. If any of these occur, the district shall cease submitting contribution data and remitting contributions to the system directly and shall resume submitting contribution data and remitting contributions through [County] effective on the date following revocation.”
 - (L) The relevant statement from either of the following subdivisions:
 - (i) For a school district: “[District] shall notify the system within three business days if it is placed on one-year probationary accreditation status or has its accreditation status withheld or an equivalent status by the accrediting body.”
 - (ii) For a community college district, “[District] shall notify the system within three business days if it is ordered to show cause or is placed on an equivalent status or sanction by the accrediting body.”
 - (M) “If [district] is terminated as a direct report, [County] shall be responsible for submitting or remitting any missed reports, adjustments, contributions, penalties, and interest associated with the time period that the district was a direct report.”
 - (N) “[District] may terminate the direct reporting relationship only when the system, the district, and [County] have agreed to the employer terminating the relationship.”
- (3) A resolution adopted by the county governing authority authorizing the district to become a direct report to the system and certifying each of the following:
- (A) “On [date district’s governing board approved resolution], [District] elected to become a direct report to the system effective on July 1, [effective year].”

- (B) “[District] meets the eligibility requirements of the system, as specified on a resolution adopted by the district’s governing board to become a direct report pursuant to paragraph (2) or subdivision (a) of Section 27703 of the California Code of Regulations.”
- (C) “[County] is not responsible for submitting contribution data and remitting contributions, including adjustments to contribution data and contributions made prior to the effective date of [District] becoming a direct report.”
- (D) “[County] is not responsible for any penalty or interest assessments for contributions and data submitted by [District] as a direct report on or after the effective date of becoming a direct report for the duration of the direct reporting relationship.”
- (E) “[County] shall notify the system within three business days of revocation should the district’s fiscally accountable status or fiscal independence be revoked, and shall resume submitting contribution data and remittance on behalf of the district on the revocation effective date.”
- (F) “If [District] is terminated as a direct report, [County] is responsible for submitting and remitting any and all reports, adjustments, contributions, penalties and interest to the system.”

Note: Authority cited: Sections 22207, 22213, 23004 and 22305, Education Code. Reference: Section 23004, Education Code.

§ 27704. Termination of direct reporting relationship.

- (a) The system may initiate termination of a direct reporting relationship at any time if any of the criteria or requirements for approval or responsibilities as a direct report are not met.
- (b) The system may terminate the direct reporting relationship if the district does not respond through compliance to an audit finding by the system by the due date specified on the audit determination letter, or through appeal within 90 days.
- (c) The district may voluntarily terminate the direct reporting relationship only when the system, the district’s governing body, and the county governing authority have mutually agreed to terminate the relationship, documented by a resolution specifying the effective date of the termination and approved by the district governing body, the county governing authority, and the Chief Executive Officer of the system or his or her designee. The resolution shall certify each of the following:
 - (1) “WHEREAS, [District] desires to terminate the relationship as a direct report that reports Defined Benefit contribution data and remits contributions directly to CalSTRS; and”
 - (2) “WHEREAS, the system Chief Executive Officer or his or her designee authorizes the District to terminate the relationship to report directly to the system; and”
 - (3) “WHEREAS, [County] does hereby affirm that [County] is responsible for submitting and remitting any and all reports, adjustments, contributions, penalties and interest beginning on the effective date of the termination and covering all time periods, including the period that [District] was a direct report to the system.”

- (4) “THEREFORE, BE IT RESOLVED that the California State Teachers’ Retirement System and [County] authorize [District] to discontinue as a direct report to the system.”

Note: Authority cited: Sections 22207, 22213, 23004 and 22305, Education Code. Reference: Section 23004, Education Code.

§ 27705. Review of termination of direct reporting relationship.

- (a) A district may request a review, in writing, the decision by the system to terminate the direct reporting relationship, within 30 days of receipt of a relationship termination letter, to the Chief Executive Officer of the system, or his or her designee. The resulting decision after such a review shall be final.

Note: Authority cited: Sections 22207, 22213, 23004 and 22305, Education Code. Reference: Section 23004, Education Code.