

**Cajon Valley Union School District  
Teachers' Retirement Law Compliance Review  
Membership and Compensation Reporting  
Final Audit Report  
January 9, 2013**

**CALSTRS**

**HOW WILL YOU SPEND YOUR FUTURE?**

***Securing the Financial Future and Sustaining the Trust of  
California's Educators***

**Audit Services:**

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# CALSTRS

HOW WILL YOU SPEND YOUR FUTURE?

## Cajon Valley Union School District Final Audit Report

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**Cajon Valley Union School District**  
750 E. Main Street  
El Cajon, California 92020  
School No. 37006  
Project No. SEA10-51

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## ***BACKGROUND***

The Cajon Valley Union School District (District) encompasses the greater part of the City of El Cajon with approximately 8,800 kindergarten through eighth grade students living within the City. The District covers an area of 66.3 square miles and is made up of 19 elementary and six middle schools.<sup>1</sup> The District employs approximately 900 CalSTRS members.

The District uses the San Diego County Office of Education (SDCOE) payroll system. The SDCOE collects members' and associated contribution data from the District, formats payroll information with applicable assignment codes, pay codes, and member codes, and submits the monthly contributions report (F496) to CalSTRS.

## ***AUDIT OBJECTIVES AND SCOPE***

To protect the integrity of the State Teachers' Retirement System Defined Benefit Plan's fund, CalSTRS Audit Services, under the Teachers' Retirement Board (TRB) delegated authority, conducted a review of the District's membership and compensation reporting procedures. The objective of this review was to determine District compliance with the Teachers' Retirement Law (Education Code § 22000 et seq.) regarding eligible membership and creditable compensation reported to CalSTRS. Specifically, our objectives were to determine whether the District:

- Submitted accurate monthly reports and the required contribution amounts to CalSTRS.
- Accurately reported and remitted contribution for all qualified employees as CalSTRS members and offered right of election to non-members.
- Reported monthly reports and contribution data based on eligible members' creditable services and creditable compensations.

The audit period was July 1, 2007, through June 30, 2010. However, we expanded the scope of our audit to include July 1, 2004, through June 30, 2012, for Finding 1.

The audit was performed in accordance with the *International Standards for Professional Practice of Internal Auditing* (Standards) promulgated by the Institute of Internal Auditors.

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<sup>1</sup> <http://www.cajonvalley.net>; May 29, 2012

## ***METHODOLOGY***

To achieve the objectives, we performed the following tasks:

- ✓ Worked with CalSTRS Member Account Services and Accounting staff to identify any outstanding issues regarding the District's contribution reports and/or remittance advice submissions.
- ✓ Utilizing CalSTRS corporate database, extracted and analyzed the reported members, non-members, earnings, compensations, and contribution data for the audit period. Identified potential risks in the areas of non-members, late reports, special compensations, and unusual increases in final compensation, etc.
- ✓ Selected sample individuals and pay periods based on the above risk assessment results.
- ✓ Interviewed appropriate District management and staff members to obtain an understanding of the District's personnel and payroll reporting processes as they relate to CalSTRS operations.
- ✓ Reviewed certificated employee bargaining agreements, employment contracts, salary and wage schedules, personnel files, and payroll records.
- ✓ Reviewed non-CalSTRS members reported to CalSTRS and determined the eligibility of these employees for CalSTRS membership.
- ✓ Reconciled District reported pay rates and compensations for sampled active and retired members with the District's payroll registers, salary/wage schedules, employee contracts, and other relevant personnel files.
- ✓ Determined the validity of the District's supporting documentations of the final compensation, basic sick leave days, base days, and other pertinent retirement data for the sampled retired members.

## ***SUMMARY RESULTS***

The audit disclosed the District did not comply with the Teachers' Retirement Law regarding creditable compensation reported to CalSTRS. Specifically, we noted the District:

1. Incorrectly reported (coded) retirement incentive payments to the CalSTRS Defined Benefit (DB) Program for 78 retired members.

Refer to the attached finding for details, including the District's response.

We have not expressed an opinion related to the internal controls over the District's accounting and administrative operations.

***REPORT OF AUDIT FINDING:***

**Finding 1 – Cajon Valley Union School District Incorrectly Reported (Coded) Retirement Incentive Payments to the CalSTRS Defined Benefit (DB) Program for 78 Retired Members.**

**Finding 1 – Discussion:**

Cajon Valley Union School District (District) incorrectly reported (coded) retirement incentive payments as creditable compensation to the CalSTRS Defined Benefit (DB) Program for 78 retired administrators and teachers during the 2004-05 through 2011-12 school years. The District included the retirement incentive payments with these members' salary and incorrectly reported all earnings using Assignment Code 57 (full-time) and Contribution Code 1 (normal). The District paid the retirement incentives during the final school year of these members' service (employment) ending in their retirements. The District should have reported the retirement incentive payments separately using Assignment Code 71 (special compensation to the Defined Benefit Supplement Program) and Contribution Code 6 (special compensation).

The District offered and approved the retirement incentive program for certificated teachers and administrators during the 2004-05 school year and continued these retirement incentives through the 2011-12 school year.

The District authorized and approved the retirement incentive program in the certificated teachers bargaining agreement. The Collective Bargaining Agreement between the District and the Cajon Valley Education Association dated June 16, 2003, Article XX: Retirement Incentive Programs states in part:

“... Commencing with the 2004-2005 school year, unit members who have completed 30 years of service with the District shall be eligible to receive a 30-year longevity increment ... if they execute, on or before September 1, a resignation/retirement letter effective June 30 of the school year in which they receive the longevity increment ....”

For example, the specific retirement/resignation letters signed/submitted by retired members [Retirement Option Application] state in part:

“... I am submitting this signed form as my letter of resignation for retirement and hereby select the following retirement incentive option offered by the Cajon Valley Union School District. According to the labor contract agreement, I understand that my choice will be irrevocable ....”

“... OPTION 1: ARTICLE XX: RETIREMENT INCENTIVE PROGRAM

“Unit members who have completed at least 30 years of service with the District shall be eligible to receive a 30-year longevity increment (i.e., 10% of Range 1, Step 1) if they execute, on or before September 1, a resignation/retirement letter effective June 30 of the school year in which they receive the longevity increment ....”

The District also authorized and approved a retirement incentive program to the District administrative employees. The Memorandum of Understand between the District and the Administrative/Confidential Employees executed in November 2003 states in part:

“...4. Effective July 1, 2004, Administrative and Confidential employees may receive a 25-year longevity increment of 4.4% of their last year of employment provided they have attained 54 years of age at the time of application and have completed 24 years of service with the District, of which the last four years have been consecutive. To receive the 25-year longevity, qualifying employees must submit an application/resignation to the Director of Personnel 12 months prior to their retirement date.”

For example, the specific retirement/resignation letters signed/submitted by retired members [Retirement Option Application] state in part:

“... Commencing with the 2004/05 fiscal year, unit member are eligible to receive a 25-year longevity increment of ... if at least 54 years of age at the time of application and have completed 24 years of service with the District ... Qualifying employees ... must submit an application/resignation to the Director of Personnel twelve (12) months prior to retirement date.

“I, [member name], Social Security Number [member social security number], am submitting my letter of resignation for retirement and hereby select the following retirement incentive option offered by the Cajon Valley Union School District. I understand that my choice will be irrevocable ...”

Based on our analysis, these retirement incentive payments are not creditable to the DB Program for the following reasons:

1. The compensation was not consistent over the members' careers; thus, reporting it to the DB Program violates Education Code § 22119.2(f).
2. The compensation was not payable to all persons within the same class of employees; thus, reporting it to the DB Program violates Education Code § 22119(c)(1).
3. The compensation was a one-time payment; thus, reporting it to the DB Program violates Education Code § 22905(b)(3).

(Note: CalSTRS is not questioning the amount paid to District employees. CalSTRS has a fiduciary responsibility to ensure compensation reported to the DB program complies with the Teachers' Retirement Law.)

**Finding 1 - Teacher's Retirement Law Requirements:**

Education Code § 22112.5 (a) states, "Class of employees" means a number of employees considered as a group because they are employed to perform similar duties, are employed in the same type of program, or share other similarities related to the nature of the work being performed."

Education Code § 22119(c)(1) states, "Creditable compensation" does not mean and shall not include remuneration that is not payable in cash or is not payable to all persons who are in the same class of employees.

Education Code § 22119.2(f) states in part, "This definition of 'creditable compensation' reflects sound principals that support the integrity of the retirement fund. Those principles include, but are not limited to, consistent treatment of compensation throughout a member's career, and consistent treatment of compensation among an entire class of employees, preventing adverse selection, and excluding form compensation earnable remuneration that is paid for the principal purpose of enhancing a member's benefit under the pan. The board [CalSTRS] shall determine the appropriate crediting of contributions between the Defined Benefit Program and the Defined Benefit Supplement Program according to these principles..."

Education Code § 22905(b)(3) states, "Member and employer contributions on a member's compensation under the following circumstances shall be credited to the member's Defined Supplement account: ... Compensation that is payable for a specified number of times as limited by law, a collective bargaining agreement, or an employment contract."

**Finding 1 - Effect:**

The incorrect reporting of the retirement incentive pay to the DB Program caused 77 of the 78 retired members' final compensation to be overstated. As a result, their retirement allowances are overstated by an approximate range of \$26 to \$566 per month. The accumulated benefit overpayments to these members totaled approximately \$1,071,664 from the date of their retirement through October 2012. Future benefit overpayments could total approximately \$2,415,720 by extrapolating these monthly benefit overpayments over the next ten years. The overpaid benefits totaling approximately \$20,131 per month for the 77 retired members will continue to grow until the corrections to these members' accounts are made. Contributions of approximately \$48,889 will be transferred from these members' DB accounts to these members DBS accounts. Please see the Confidential Appendix for detailed information.

**Finding 1 – Corrective Action Needed:**

- The District must submit corrections to CalSTRS to reverse out the 78 retired members' reported retirement incentive payments for the 2004-05 through 2011-12 school years and correctly report these earnings (transactions) using Assignment Code 71, Contribution Code 6.
- The District must work with the SDCOE to make the corrections on the CalSTRS Form F496, "Report of Retirement Contributions." Please refer to the Confidential Appendix for specific adjustments needed. The District must make these corrections within 60 days of the final audit report date.

Education Code § 23008(a) states in part, "If more or less than the required contributions ... are paid to the system based on any payment of creditable compensation to a member, proper adjustments shall be made on a monthly report ... district superintendent ... who submitted the report, within 60 days after discovery or notification by the system and any refund shall be made to the member within the same time period by the employing agency."

- If the District fails to make the required corrections within 60 days, CalSTRS will adjust the affected member accounts.
- Once the adjustments to creditable compensation are correctly reported, CalSTRS will recalculate these members' retirement allowances using the correct final compensation and notify the retired members of the adjustments made to their benefits. Overpayment of retirement benefits totaling \$1,071,664 as of October 2012 related to incorrectly reporting retirement incentive payment will continue to increase until properly reported/adjusted by the District, as instructed in this audit.
- CalSTRS will establish a receivable and collect overpayments from the members, former members, or beneficiaries pursuant to Education Code § 24616 and 24617.

Education Code § 24616 states in part, "Any overpayment made to or on behalf of any member, former member, or beneficiary, [...] shall be deducted from any subsequent benefit that may be payable [...], except as provided in Section 24616.5."

Education Code § 24617, subdivision (a) states in part, "To recover an amount overpaid, the corrected monthly allowance payable [...] may be reduced by no more than [five] 5 percent if the overpayment was due to error by the [...] school district."

- The District will pay to CalSTRS the difference between the overpayment and the actuarial present value of payments expected to be paid by the members, former members, or beneficiaries.

Education Code § 24616.5 states, "If an employer reports erroneous information, the system shall calculate the actuarial present value of the expected payments from the member, the former member, or beneficiary pursuant to Sections 22008 and 24617. The employer shall pay

the difference between the total amount of the overpayment and the calculation of the actuarial present value of expected payments.”

- The District must report retirement incentive payments from FY 2011-12 forward using Assignment Code 71, Contribution Code 6.

# Cajon Valley Union School District

## APPENDIX INDEX

### Appendices

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#### Appendix A

- District's Response Dated August 29, 2012 [Excluding 98 pages of additional documentation]
- CalSTRS Audit Services Evaluation of District's Response

#### Confidential Appendix B

- Finding 1 – Cajon Valley Union School District Incorrectly Reported (Coded) Retirement Incentive Payments to the CalSTRS Defined Benefit (DB) Program for 78 Retired Members.

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**Appendix A**

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August 29, 2012

**VIA OVERNIGHT COURIER AND E-MAIL.**  
**MCAMPBELL-SMITH@CALSTRS.COM**

Maryann Campbell-Smith, Chief Auditor  
Audit Services  
California State Teachers' Retirement System  
P.O. Box 15275, MS #37  
Sacramento, California 95851

Re: *Response by Cajon Valley Union School District to May 29, 2012 Draft Audit Report*

Dear Ms. Campbell-Smith:

We submit the following on behalf of our client, Cajon Valley Union School District ("District"). We are in receipt of the Audit Service's May 29, 2012 draft audit report ("Draft Report") related to the District's contract with the California State Teachers' Retirement System ("CalSTRS"). We appreciate your department's efforts in conducting its compliance review, and in particular Ms. Highsmith's efforts and level of professionalism. We also appreciate the opportunity to comment on the Draft Report.

As will be explained in greater detail in this response, we respectfully disagree with the proposed finding in the Draft Report with respect to the longevity payment provided to certain retiring employees that had reached a substantial number of years of service with the District. The Draft Report concludes that the foregoing longevity incentive was a retirement incentive that was incorrectly reported as creditable compensation to the CalSTRS defined benefit program rather than the CalSTRS defined benefit supplement program ("Finding"). It is our hope that this response will lead CalSTRS to change the Finding to conclude that the retirement longevity payment was properly reported as creditable compensation.

Although the District's written response was initially due June 29, 2012, the District was graciously given an extension until August 31, 2012 to provide this response. We thank you for granting us this additional time to prepare our response.

In order to facilitate your review of the District's position with respect to the Finding, we will discuss the basis of our disagreement in three separate sections each addressing a separate ground upon which we strongly believe that CalSTRS' proposed finding is not only incorrect but also inequitable. First, although offered in connection with the retirement of a certificated



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teacher or an administrative employee, the longevity payment which is the subject to the Draft Report was properly reported as creditable compensation. Second, both the District and the affected individuals detrimentally relied upon the advice of multiple CalSTRS staff members that the longevity incentive was properly included as creditable compensation. They also detrimentally relied on CalSTRS' failure to notify both the District and retiring employees that a fully transparent payment was, according to CalSTRS, incorrectly included as creditable compensation. Due to CalSTRS' implied approval by its inaction, it was reasonable to conclude that the payment was permissibly reported as creditable compensation. Third, and only as an alternative argument, there are multiple grounds upon which the proposed corrective action can be mitigated such that it lessens the detrimental impact upon the 77 retired District employees ("Subject Retirees") that the Draft Report suggests received retirement allowances that were overstated.

**A. The longevity payment made available to the Subject Retirees upon their retirement ("Retirement Longevity Payment") from the District was properly reported by the District as creditable compensation.**

The Finding is based on certain provisions of the Teachers' Retirement Law (the "Law"). Thus, it is prudent that we review the provisions that are relevant to said conclusion before we discuss the District's position.

1. LEGAL FRAMEWORK

Under Education Code section 24202.5, subdivision (a)(1),<sup>1</sup> a member is entitled to retirement benefits based on the "percentage of the final compensation" of the member. That percentage is determined by the member's age at retirement, as set forth in subdivision (a)(1) of section 24202.5. Section 22134 defines "final compensation" as "the highest average annual compensation earnable by a member during any period of three consecutive school years while an active member." However, the final compensation period is reduced to 12 months for those employees with 25 or more years of creditable service.<sup>2</sup> Section 22115 defines "compensation earnable" as "the creditable compensation a person could earn in a school year for creditable service performed on a full-time basis, excluding service for which contributions are credited by the system to the Defined Benefit Supplement Program."

Section 22119.2, subdivision (a), defines "creditable compensation" as "remuneration that is payable in cash by an employer to all persons in the same class of employees and is paid to an employee for performing creditable service." Subdivision (b) of section 22119.2 provides:

<sup>1</sup> All further statutory references are to the Education Code unless otherwise specified.

<sup>2</sup> Education Code §22134.5.



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"Any salary or other remuneration determined by the board to have been paid for the principal purpose of enhancing a member's benefits under the plan shall not be credited under the Defined Benefit Program. Contributions on that compensation shall be credited to the Defined Benefit Supplement Program. A presumption by the board that salary or other remuneration was paid for the principal purpose of enhancing the member's benefits under the plan may be rebutted by the member or by the employer on behalf of the member. Upon receipt of sufficient evidence to the contrary, a presumption by the board that salary or other remuneration was paid for the principal purpose of enhancing the member's benefits under the plan may be reversed."

Subdivision (f) of section 22119.2 sets forth the policy underlying subsection (b). It provides:

"This definition of 'creditable compensation' reflects sound principles that support the integrity of the retirement fund. Those principles include, but are not limited to, consistent treatment of compensation throughout a member's career, consistent treatment of compensation among an entire class of employees, preventing adverse selection, and excluding from compensation earnable remuneration that is paid for the principal purpose of enhancing a member's benefits under the plan. The board shall determine the appropriate crediting of contributions between the Defined Benefit Program and the Defined Benefit Supplement Program according to these principles, to the extent not otherwise specified pursuant to this part."

2. CALSTRS' POSITION

Pursuant to the Draft Report, the Retirement Longevity Payment may not be credited to the Defined Benefit Program for the following three reasons:

- (i) The compensation was not consistent over the members' careers; thus, reporting it to the Defined Benefit Program violates Education Code § 22119.2(f).
- (ii) The compensation was not paid to all persons within the same class of employees; thus, reporting it to the Defined Benefit Program violates Education Code §22119.2(f).



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- (iii) The compensation was a one-time payment for the purpose of retiring; thus, reporting it to the Defined Benefit Program violates Education Code § 22905(b)(3).

3. DISTRICT'S RESPONSE

a. The Retirement Longevity Payments were consistent over the Subject Retirees' careers.

Contrary to the conclusion stated in the Draft Report, the Retirement Longevity Payments were consistent over the Subject Retirees' careers. The Retirement Longevity Payments were a form of longevity payment, incentives that have been paid to District employees in recognition of their service to the District since at least the 1977/1978 school year, that were distinct from the traditional longevity payments only in that they were paid in the final year before the Subject Retirees' retirement.

As part of this discussion, it is necessary that we address the use of the term "retirement incentive payment" as used in the Draft Report, the retirement option application for administrative/confidential employees and certificated employees, and the memoranda of understanding for the foregoing employees. While the use of the term in various District documents might suggest that the Retirement Longevity Payment was a one-time payment designed to enhance final compensation, the fact is that the payment was part of a pattern of payments designed to reward District employees for their service with the District. These payments were consistently paid to District employees over the course of their careers upon their attainment of a certain number of years of service and once earned, these payment were incorporated into the receiving employees' compensation. The Retirement Longevity Payment was added as a new tier in the longevity payments beginning in the 2004/2005 school year in direct response to the steep decline in student enrollment beginning in the 2003/2004 and enduring through the 2005/2006 school years only to continue in significant, but decreased, levels through the most recently concluded school year. At the height of this decline, the District lost 583 students in 2003/2004, 718 students in 2004/2005 and 786 students in 2005/2006. An enrollment report is enclosed at Tab 1 for your reference. In addition, the Retirement Longevity Payment was added in response to the fiscal constraints that the District faced as a result of decreased enrollment and budget cuts.

Thus, the use of the term "retirement incentive" was a misnomer perpetuated only as a result of an ill-advised negotiating tactic designed to reassure bargaining group members that the elimination of a former retirement incentive was not a complete elimination of the District's retirement incentive program by retaining the title despite the difference in the benefits. The fact of the matter is that while the former incentive was truly a retirement incentive in that it encouraged retirement age employees to retire in exchange for a generous payment despite a relatively short tenure with the District, a minimum of 10 years, the



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Retirement Longevity Payment was the complete opposite. That is, it was designed specifically to reward significant service with the District and, unlike the former retirement incentive, the Retirement Longevity Payment was not available to all retiring employees (though all employees could earn the payment had they met the service requirements). Rather, it was only available to those employees who met the requisite years of service. Thus, the Retirement Longevity Payment was more like the longevity payments properly reported as creditable compensation – designed to reward service – rather than retirement incentives – designed to encourage all retirement aged employees to retire. In that way, the Retirement Longevity Payment was merely an additional step in the tiered longevity payments that had been provided consistently throughout the Subject Retirees' career.

The foregoing is confirmed by reviewing the District's salary schedules for administrative/confidential employees and certificated employees. For administrative/confidential employees, longevity payments were in place since at least the 1977/1978 school year. The longevity payment was a 4% increase in the daily rate (i.e., responsibility factor) upon the completion of 15, 20 and 25 years of service. In 1984/1985, longevity payments were revised to honor service at 12, 16 and 20 years. In 1986/1987, an additional increment rewarding 8 years of service was added. Effective with the 2001/2002 school year, the longevity payment was modified so that it provided a 2% increase at 4 years, a 2.4% increase at 8 years and a 4% increase for 12, 16 and 20 years. Then, beginning with the 2004/2005 school year, the District added a sixth longevity tier to reward employees who had dedicated 24 years of service to the District. This longevity payment was equal to 4.4% of salary, consistent with the pattern to provide an increasing payment with increased service, but was available only to those employees opting to retiree and providing notification of such retirement to the District one year in advance. The value of the sixth longevity tier varied from year to year increasing to 6.4% in the 2005/2006 school year and decreasing to 3% through the 2011/2012 school year. In fact, the longevity payment that had been paid as a Retirement Longevity Payment beginning in the 2004/2005 school year, became a continuing employee longevity payment effective with the 2007/2008 school year when a seventh tier longevity payment equal to 6.4%, made available to retiring employees with at least 30 years of service, was implemented that year. The foregoing demonstrates that the longevity payment, whether offered in connection with an impending retirement, as was the case with the Retirement Longevity Payment, or offered to a continuing employee, was designed to serve the same purpose to the District – the reward of longevity – thus the conversion of the 2004/2005 Retirement Longevity Payment into a continuing employee longevity payment. A complete set of the referenced salary schedules is enclosed at Tab 2.

A similar pattern is evident upon a review of the Educators' Salary Schedule. That is, since at least the 1968/1969 school year, the District extended a longevity incentive to teachers upon the completion of 15, 20 and 25 years of service. In 1986/1987, a fourth longevity increment was added resulting in longevity payments at 15, 19, 23 and 27 years of service. Beginning with the 2004/2005 school year, the District added a fifth tier longevity



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payment payable upon the completion of 30 years of service with the District except an eligible employee had to elect to retire. Upon a timely election to retire, the longevity payment, like all other longevity payments, was incorporated into the electing teacher's annual compensation. This was no different than a teacher electing to retire one year after receiving the longevity incentive after 27 years of employment. Further evidence that this Retirement Longevity Payment was just another step in the longevity payments provided consistently throughout a teacher's career is the fact that effective with the 2005/2006 school year, the District added an additional tier for teachers completing 35 years of service with the District. That is, teachers not electing to take the 30 year longevity incentive received a 35 year incentive. The foregoing similarly demonstrates that the longevity payment, whether offered in connection with an impending retirement, as was the case with the Retirement Longevity Payment, or offered to a continuing employee, was designed to reward longevity. A complete set of the referenced salary schedules is enclosed at Tab 3.

Again, a similar pattern of longevity payments was provided to preschool teachers upon the completion of 8, 12, 16, 20, 24 and 28 years of service, with the introduction during the 2004/2005 school year of a seventh tier longevity payment offered to preschool teachers with at least 30 years of service and who elected to retire. This Retirement Longevity Payment was, therefore, consistent with past incentive payments that were provided to these employees upon their attainment of a certain number of years of service with the District. A complete set of the preschool teachers salary schedules is enclosed at Tab 4.

Thus, the District had historically increased base salary of the Subject Retirees by a longevity incentive to recognize experience and loyalty. These payments were available to all members of the referenced employee groups so long as they satisfied the terms of the payment. The Retirement Longevity Payment was simply a merger of this principle and the District's fiscal constraints brought on by decreased enrollment and budget cuts.

On the basis of the foregoing, it is our position that the Retirement Longevity Payments were consistent over the Subject Retirees' careers and, thus, reporting them to the Defined Benefit Program was permissible under section 22119.2(f).

**b. The Retirement Longevity Payments need not be actually paid to all persons within the same class of employees but they must be made available to all persons within the same class of employees.**

We respectfully disagree with the conclusion in the Draft Report that the Retirement Longevity Payment had to be "paid to all persons within the same class of employees." In fact, the Draft Report incorrectly identifies the standard established in Section 22119.2(f) as requiring that a payment be "paid to all persons" within the same class of employees. Rather, section 22119.2(a) provides the following with respect to class of employees: "[c]reditable compensation refers to amounts "payable in cash by an employer to all



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persons in the same class of employees.” (Emphasis added). With respect to amounts reportable as creditable compensation, section 22119.2(a)(2) states that it includes “remuneration that is paid in addition to salary, providing it is *payable* to all persons who are in the same class of employees in the same dollar amount, the same percentage of salary, or the same percentage of the amount being distributed.” (Emphasis added). Finally, section 22119.2(f) provides that among the principles to be taken into consideration by CalSTRS in determining creditable compensation is the “consistent treatment of compensation among an entire class of employees.” Thus, at no point does the statute require that a payment actually be paid to all members of a class of employees in order for it to be creditable compensation. Rather, the proper interpretation is that the amount of compensation must be available for all members of a class of employees such that each has the right to earn the payment if they meet the requirements.

Interpreting the term “payable” to require that a payment actually be paid to all members of a class of employees would be inconsistent with past CalSTRS practice. If such an interpretation were correct, then it would mean that a CalSTRS employer would be unable to provide longevity payments since, by definition, only those employees attaining the desired years of service would receive the payment. This clearly is not intended by the Law. Similarly, while the Retirement Longevity Payment was not paid to all persons within the same class of employees, all such persons were eligible to earn the Retirement Longevity Payment if they attained the desired years of service. This is consistent with section 22119.2(f). In fact, the exact language used in section 22119(f) as it relates to class of employees is that a key principle, of creditable compensation, is “consistent treatment of compensation among an entire class of employees.” Though the Draft Report suggests that the foregoing requires that compensation actually be paid to all persons within the same class in order for it to be creditable compensation, nothing in section 22119.2(f) could be interpreted so narrowly. Rather, as argued in this Section b, the requirement that compensation be “consistent among an entire class of employees” merely means that the same conditions and requirements apply equally to all members of the class of employees. That was the case with the Retirement Longevity Payment. Thus, reporting the Retirement Longevity Payment to the Defined Benefit Program was consistent with Section 22119.2(f).

**c. The Retirement Longevity Payment was not paid for the principal purpose of enhancing the Subject Retirees’ retirement allowance. Thus the payment was properly reported to the Defined Benefit Program.**

The Draft Report concludes that the Retirement Longevity Payment was not creditable compensation because “the compensation was a one-time payment for the purpose of retiring; thus, reporting it to the Defined Benefit Program violates Education Code § 22905(b)(3).” Thus, it appears that it is CalSTRS’ position that the Retirement Longevity Payment was provided for the purpose of enhancing the retirement allowance of the Subject Retirees.



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The foregoing principle is codified in section 22119.2(b) which in its entirety provides the following:

“Any salary or other remuneration determined by the board to have been paid for the principal purpose of enhancing a member’s benefits under the plan shall not be credited under the Defined Benefit Program. Contributions on that compensation shall be credited to the Defined Benefit Supplement Program. A presumption by the board that salary or other remuneration was paid for the principal purpose of enhancing the member’s benefits under the plan may be rebutted by the member or by the employer on behalf of the member. Upon receipt of sufficient evidence to the contrary, a presumption by the board that salary or other remuneration was paid for the principal purpose of enhancing the member’s benefits under the plan may be reversed.”

There are a number of significant points to draw away from the preceding. First, the principle outlined in section 22119.2(b) is further detailed in section 22905(b)(3) which provides, in relevant part, that “compensation that is payable for a specified number of times as limited by law, a collective bargaining agreement, or an employment agreement” . . . “shall be credited to the member’s Defined Benefit Supplemental account.” Thus, taking the conclusion stated in the Draft Report and reviewing it in light of sections 22119.2(b) and 22905(b)(3), very clearly reveals that CalSTRS is concerned that the Retirement Longevity Payment was paid for the purpose of enhancing the Subject Retirees’ retirement allowance. Second, Section 22119.2(b) only excludes from the Defined Benefit Program compensation is paid for the principal purpose of enhancing a member’s benefits. Thus, by implication, if the Retirement Longevity Payment was not paid for the principal purpose of enhancing a member’s benefits, then it was not in violation of sections 22119.2(b) or 22905(b)(3) to report it to the Defined Benefit Program. Third, and most significantly, section 22119.2(b) provides that the presumption that a payment is paid for the principal purpose of enhancing a member’s benefits can be rebutted by the member or the employer.

The Retirement Longevity Payment was not paid by the District to the Subject Retirees for the principal purpose of enhancing their retirement allowance. Rather, as has been discussed in this Section A, the Retirement Longevity Payment was merely an extension of the longevity payment that was paid to employees upon the attainment of a certain number of years of service with the District. The principal purpose of the Retirement Longevity Payment was to reward District employees for their years of service.

On the basis of the foregoing, we respectfully request that CalSTRS revise its Draft Report to conclude that like the longevity payments, the Retirement Longevity Payment was properly reported by the District as creditable compensation.



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**B. The Subject Retirees and District have detrimentally relied on representations made by various CalSTRS benefit counselors and, thus, imposing the proposed corrective action would be inequitable.**

While we dispute CalSTRS' position that the Retirement Longevity Payment is not creditable compensation, there is an alternative basis upon which to grant relief to the Subject Retirees and District. That is, the Subject Retirees and the District relied to their detriment upon advice given by CalSTRS. Therefore, it would be inequitable to impose the proposed corrective action upon the Subject Retirees and the District. Thus, we respectfully submit that the District should not be required to make any correction to the reported earnings of the Subject Retirees as increased by the Retirement Longevity Payment for periods prior to the District's receipt of the Draft Report, that neither the Subject Retirees or the District should be asked to repay amounts deemed to have been overpaid and that the retirement allowances of Subject Retirees should not be adjusted as suggested in the Draft Report.

Imposing the proposed corrective action on the District and the Subject Retirees would be inequitable in light of the representations by CalSTRS benefit counselors that the Retirement Longevity Payment was properly reported as creditable compensation and CalSTRS' implied consent that the Retirement Longevity Payment was properly reported as creditable compensation when it failed to raise any concerns after more than 7 years of fully transparent reporting by the District. During this time, CalSTRS was aware of the District's treatment of the Retirement Longevity Payment as creditable compensation. Further, the Subject Retirees relied on CalSTRS benefit counselors' review of compensation and benefits, including full acknowledgement of the Retirement Longevity Payment in benefit worksheets, in making their retirement decisions.

It cannot be emphasized enough that at no point did the District or the Subject Retirees' intend to artificially inflate the Subject Retirees' payrate for the purpose of increasing their retirement allowance. Rather, the increase in compensation was arrived at by the Board after consideration of the enormous value that long service yields to the District and its students. Further, at all times, the increase in the Subject Retirees' payrate due to the Retirement Longevity Payment was transparent to CalSTRS and at no time, until receipt of this Draft Report, was the increase brought into question.

The foregoing considerations coupled with the amount of time that has expired since the Subject Retirees have retired, some as early as July 1, 2005, and the time that the Draft Audit was issued on May 29, 2012, i.e., almost 7 years since the earlier retirements, suggest that the proposed adjustment to the retirement allowance currently paid to Subject Retirees and the obligation to repay amounts that have been deemed to have been overpaid would be inequitable. At no time after the Subject Retirees submitted their retirement applications but before their retirement allowance commenced, when CalSTRS benefit counselors evaluate a retiree's compensation to determine whether all elements thereof are reportable under the Law, did any



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CalSTRS benefit counselor call the Retirement Longevity Payment into question. Rather, the Subject Retirees' final compensation, which included the Retirement Longevity Payment, was approved by CalSTRS benefit counselors. Thus, it would seem patently unfair to penalize the Subject Retirees' for an oversight of CalSTRS particularly when the increased compensation had been in effect as early as July 1, 2004 for some Subject Retirees and contributions on the Retirement Longevity Payment were paid throughout the last year of employment by both the District and Subject Retirees. This is no different than a District certificated employee receiving a longevity incentive after 23 years of employment with the District and then opting to retire one year after receiving the longevity payment. Thus, it is important to recognize that the purpose of the Retirement Longevity Payment was to reward long-serving employees for their dedication to the District and its students, rather than to enhance their retirement allowance.

On the basis of the foregoing, we respectfully request that CalSTRS revise its Draft Report to provide that no adjustment to the retirement allowance of the Subject Retirees or repayment amounts that CalSTRS suggests were overpaid is appropriate in light of the foregoing.

**C. In the alternative, but in no way conceding the positions advanced in Sections A and B, there are several grounds upon which an adjustment to the proposed corrective action is warranted.**

While it is our position that the Retirement Longevity Payments were properly reported by the District as creditable compensation, and that even if CalSTRS disagrees with the District's position, it would be inequitable to impose the proposed corrective action as both the Subject Retirees and District have detrimentally relied on representations made by CalSTRS benefit counselors, we offer the following as an alternative argument for your consideration. However, we do not intend for the following to be a concession of the District's position that the Retirement Longevity Payments were properly reported by the District as creditable compensation, or that the Subject Retirees and District have detrimentally relied on CalSTRS representations.

1. DELAY IN ISSUING THE DRAFT REPORT

District staff received notification of the CalSTRS audit on April 25, 2011. The initial review of District records was carried out promptly by Ms. Highsmith from May 2-6, 2011. Upon the completion of this review it was the District's understanding that no concerns had been identified. In fact, Ms. Highsmith specifically mentioned to a District employee that she understood why the District was offering the Retirement Longevity Payment and reporting it as creditable compensation thus implying that it was properly included in compensation.

It was not until December 12, 2012, more than 7 months after the initial review, that Ms. Highsmith contacted the District to advise the District that there might be an issue with the manner in which the Retirement Longevity Payment was reported to CalSTRS. It



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was at this time as well that the District was asked to provide substantial information and documents. Not only was this delay both unreasonable and unexplainable considering that Ms. Highsmith was given access to and did in fact review relevant documents in May, but the request was poorly timed as the District was operating with limited staff due to winter vacation and a District closure from December 23, 2011 to January 2, 2012.

Thus, we believe that the more than 7 month delay which contributed to the delivery of the Draft Report more than a year after the initial review was conducted, was unreasonable and unnecessary. As a result, we believe that it is not only appropriate but fair, that if CalSTRS does not agree with the arguments set forth in Sections A and B above, that this delay should be the basis for CalSTRS foregoing the recovery of deemed overpayments made over the delay.

2. ALTERNATIVE HIGHEST FINAL COMPENSATION

In calculating the "audited" final compensation for purposes of calculating the retirement allowance of the Subject Retirees, CalSTRS simply deducted the amount of the Retirement Longevity Payment from the "reported" final compensation. However, District staff reviewed the annual compensation of all Subject Retirees and discovered that 16 Subject Retirees had a prior year that was higher than the "audited" final compensation calculated by CalSTRS. Thus, if CalSTRS does not agree with the arguments set forth in Sections A and B above, we request that CalSTRS permit such retirees to designate an alternative year for purposes of determining final compensation. A list of these retirees and their highest compensation is enclosed at Tab 5.

3. VERIFICATION OF OVERPAYMENT CALCULATIONS

We have reviewed the proposed overpayments calculated by CalSTRS. However, we are unable to confirm the accuracy of the calculations as it appears that we are missing key variables including the total years of service for each Subject Retiree and the retirement factor applied to each Subject Retiree. This information is necessary, in the event that CalSTRS does not agree with the arguments set forth in Sections A and B above, so that the District can confirm that the overpayments have been properly calculated. Since the District may be responsible for a portion of the deemed overpayments pursuant to section 24616.5, it is appropriate for the District to confirm said overpayments. Therefore, to properly assess whether CalSTRS calculated the correct overpayment, the District requests that CalSTRS provide the District with all the variables used to calculate the overpayments.



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In closing and on the basis of the preceding, we respectfully request that CalSTRS reconsider its Finding and the related recommendations and find, instead, that the Retirement Longevity Payment was properly reported as creditable compensation for periods before the Draft Report was issued. We thank you for the opportunity to submit this written response and we look forward to working with CalSTRS to ensure that the final recommendations and the implementation of said recommendations are not only appropriate but equitable.

Respectfully submitted,

A handwritten signature in black ink that reads "Joseph R. Sanchez".

Joseph R. Sanchez  
of BEST BEST & KRIEGER LLP

and

A handwritten signature in black ink that reads "Isabel C. Saffie".

Isabel C. Saffie  
for BEST BEST & KRIEGER LLP

cc: Sharon Highsmith, CalSTRS auditor  
Janice Cook, Ed.D., Superintendent

## **CalSTRS Audit Services Evaluation of the District's Response dated August 29, 2012**

### **Finding 1 – The District Incorrectly Reported (Coded) Retirement Incentive Payments to the CalSTRS Defined Benefit (DB) Program for 78 Retired Members.**

#### *The District's Response:*

The District disagreed with the finding for the following reasons:

- A.1. The retirement longevity payments were a form of longevity payment, part of a pattern of payments designed to reward District employees for their service with the District since at least the 1977/78 school year. The retirement longevity payment was merely an additional step in the tiered longevity payments that had been provided consistently throughout the Subject Retirees' career.

#### *CalSTRS Evaluation:*

- A.1. Contrary to the District's other longevity programs, the District's retirement longevity program (Retirement Incentive Program) required employees to submit a letter of resignation/retirement in order to receive payment. Thus, the Retirement Incentive Program does not comply with Education Code 22119.2(f).

#### *The District's Response:*

- A.2. The retirement longevity payments need not be actually paid to all persons within the same class of employees but they must be made available to all persons within the same class of employees.

#### *CalSTRS Evaluation:*

- A.2. The District's retirement longevity payment was not available to educators and administrators who met the service year requirements but continued to work for the District. (e.g. only educators and administrators who submit a letter of resignation/retirement received the retirement longevity payment.) Thus, the District's Retirement Incentive Program was not made available to all persons within the same class of employees.

#### *The District's Response:*

- A.3. The retirement longevity payment was not paid for the principal purpose of enhancing the Subject Retirees' retirement allowance. The retirement longevity payment was merely an extension of the longevity payment that was paid to employees upon the attainment of a certain number of years of services with the District.

CalSTRS Evaluation:

- A.3. The District's Retirement Incentive Program required employees to submit a letter of resignation in order to receive the one-time payment. In accordance with Education Code 22905(b)(3), the reporting of the one-time payment should be to the Defined Benefit Supplement Program and not the Defined Benefit Program.

The District's Response:

- B. The Subject Retirees and District have detrimentally relied on representations made by various CalSTRS benefit counselors and, thus, imposing the proposed corrective action would be inequitable.

CalSTRS Evaluation of the District's Responses:

- B. CalSTRS counselors provide retirement estimates to members based upon data reported by member employers. If a conflict arises between information provided by a CalSTRS counselor and the law, the law takes precedence.

In addition, the United States Supreme Court has refused to uphold an estoppel claim brought by a benefit claimant against the Government based upon incorrect pension advice by an employee. (*Office of PERS Mgmt v. Richmond* (1990) 496 U.S. 414, 422.) The *Richmond* case presented the question of whether erroneous oral and written advice given by a government employee to a benefit claimant may give rise to estoppel against the government and so entitle the claimant to a monetary payment not otherwise permitted by law. The Supreme Court held that a plaintiff who was misinformed about his qualification to collect disability benefits could not estop the government from collecting overpayments caused by the erroneous advice of a government employee. (*Id.* At 434.) No court has expressly invoked principles of estoppel to contravene directly any statutory or constitutional limitations. *Medina v. Board of Retirement* (2003) 112 Cal. App. 4th 864,869.

The District's Response:

- C.1. Delay in issuing the Draft Report – “Thus, we believe that the more than 7 month delay which contributed to the delivery of the Draft Report more than a year after the initial review was conducted, was unreasonable and unnecessary. As a result, we believe that it is not only appropriate but fair, that if CalSTRS does not agree with the arguments set forth in Sections A and B above, that this delay should be the basis for CalSTRS foregoing the recovery of deemed overpayments made over the delay.”

CalSTRS Evaluation of the District's Response:

- C.1. The District was notified on May 6, 2011, the Retirement Incentive Program was a potential issue. The audit scope was expanded to identify and review the entire population of retirees. CalSTRS continued communication with the District's Controller and/or Payroll Manager on

the status of the audit on the following dates, September 22, 2011; December 12, 2011; February 6, 2012; March 19, 2012; April 18, 2012; April 30 – May 11, 2012; May 29, 2012; ending with an exit conference on June 6, 2012.

*The District's Response:*

- C. 2. Alternative Highest Final Compensation – “District staff reviewed the annual compensation of all Subject Retirees and discovered that 16 Subject Retirees had a prior year that was higher than the “audited” final compensation calculated by CalSTRS.

*CalSTRS Evaluation of the District's Response:*

- C.2. CalSTRS reviewed 98 pages of additional documentation provided by the District and agreed to adjust the 16 identified retirees benefit allowances to reflect their highest compensation year. Additionally, CalSTRS reviewed all retirees to ensure their highest final compensation was reflected in their adjusted benefit calculation. The final report, Confidential Appendix, has been updated to reflect these adjustments.

*The District's Response:*

- C.3. Verification of Overpayment Calculations – The District requests that CalSTRS provide the District with all the variables used to calculate the overpayments.

*CalSTRS Evaluation of the District's Response:*

- C.3. CalSTRS will work with the District and San Diego County Office of Education to ensure the accuracy of all corrections.