



*California State Teachers'
Retirement System
Audit Services
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Sacramento, California 95851
(916) 229-3945
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May 3, 2007

Board of Trustees
Mount San Jacinto Community College District
1499 North State Street
San Jacinto, California 92583

**RE: Final Audit Report of the Mount San Jacinto Community College District
Project No. S-05 047**

Dear Members of the Board of Trustees:

We have completed our audit of earnings and other information reported by the Mount San Jacinto Community College District (MSJCCD or District) to CalSTRS relative to the administration of the Teachers' Retirement Fund, as provided in Education Code (EC) Section 22000 et seq. Our audit, authorized by EC Section 22206, was performed in accordance with the International Standards for the Professional Practice of Internal Auditing published by the Institute of Internal Auditors.

We interviewed staff and reviewed personnel, payroll and other pertinent documents. Our conclusions are that the MSJCCD:

1. Incorrectly reported a member's reimbursement allowance.
2. Did not report a member's post-retirement earnings.


Please refer to the attached Confidential Appendix for the member's name and the exact corrections required. To maintain the confidentiality of member's account information in accordance with Education Code Section 22306, the appendix is confidential and must be restricted to those involved in making the needed adjustments.

The revised draft report, dated December 19, 2006 was sent for review and comment to MSJCCD. The District's response and the evaluation of that response by CalSTRS are included in this report.

If the District disagrees with the enclosed findings and corrective actions required, it may submit an appeal through the administrative hearing process. The District must make this request within 30 days after the date of this letter to Ms Kathleen A. Andleman, General Counsel – MS# 03, CalSTRS, and P.O. Box 15275, Sacramento, CA 95851-0275. **However, the District must make the required adjustments within the legal time frames stated at the end of the Findings.**

This report is intended for the use of the Mount San Jacinto Community College District and Riverside County Office of Education and CalSTRS. The restriction is not intended to limit the distribution of this report, which after submission to the Teachers' Retirement Board is a matter of public record, except for the Confidential Appendix.

Sincerely,



KAREN S. SCOTT *FOR KAREN SCOTT*
Director, Audit Services

cc: Mount San Jacinto Community College District:
Dr. Jon Tyler, Interim Superintendent
Becky Elam, Vice President, Business Services

Riverside County Office of Education:
Dr. David Long, County Superintendent of Schools
Carolyn Nielsen, Manager, District Administrative Fiscal Services – Payroll

CalSTRS:

Peggy Plett, DCEO, Benefits and Services
Ed Derman, DCEO, Plan Design and Communication
Kathleen A. Andleman, General Counsel
Peter Haley, Director, Member Account Services
Gail Chun-Deduonni, Director, Service Retirement
Suzanne De Fonte, Director, Disability and Survivor Benefits
Cynthia J. Steiger, Director, Customer Services
Gary Estrada, Assistant Director, Services and Support
Steve Fangundes, Assistant Director, Accounting
Ricardo Pardell, Assistant Director, Service Retirement
Sharon Whittington, Program Manager, Employer Services
Sandy Jimenez, Field Services Manager, Plan Design and Communication
Tom Barrett, CalSTRS Ombudsman
Hulen, McMinn, Audit Supervisor, School District Audits

Mount San Jacinto Community College District
1499 North State Street
San Jacinto, California 92583
School District No. 33-033

Detailed Audit Findings and Adjustments Needed
Project No. S05-047

Period Audited: July 1, 2000 to June 30, 2005 – Review of Active Members
July 1, 2000 to June 30, 2005 – Review of Retired Members
July 1, 2005 to April 30, 2006 – Review of Post-Retirement Earnings

Field Work: April 17 – 21, 2006

DETAILED AUDIT FINDINGS

**Finding -1- Mount San Jacinto Community College District Incorrectly
Reported A Member's Reimbursement Allowance**

Mount San Jacinto Community College District (MSJCCD or College) made several errors in reporting the Superintendent's contracted reimbursement allowance in the period July 1, 2001 through July 31, 2005. The member retired August 1, 2005. The College:

1. Did not calculate the proper gross amount to ensure the Superintendent received the contracted net reimbursement allowance. The total understatement was \$12,495.
2. Inappropriately reported the allowance as pay for service but no additional service was performed.
3. Did not report the monthly allowance on a timely basis.
4. Did not always report the earnings in the correct school year.

Finding Discussion – Point 1:

The Superintendent's employment contract stated in part that he "shall receive a net \$500 per month non-receipted reimbursement allowance." Non-receipted allowances are creditable compensation. College staff explained that the net \$500 was the amount he would receive after payroll taxes and CalSTRS member contributions were deducted. The contract language required staff to "gross up the net" to arrive at the actual non-receipted expense allowance to be paid and reported.

However, staff did not gross up the net correctly. Staff treated the annual 12-month net total of \$6,000 as if it were the member's only earnings. This led them to apply federal and state tax deduction rates of about 15 and 4 percent. However, given the Superintendent's total annual earnings, the tax rates should have been at least 25 and 9.3 percent according to federal and state tax rate schedules. The tax rate errors caused the Medicare and CalSTRS deductions to be understated.

These calculation errors caused the true net received to be about 71 percent of the contracted amount.

Teachers' Retirement Law Retirements – Point 2:

Education Code § 22119.2(a) states in part, ““Creditable compensation” means 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. Creditable compensation shall include:

- (2) 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.”

Finding – Discussion – Point 2:

The College inappropriately reported the reimbursement allowance as pay for extra service for the period July 2002 through July 2005 using Assignment Code 58 (part-time member in community college) and Contribution Code 1 (normal member contributions). The allowance was to cover a sundry of unspecified expenses incurred in the performance of his duties. The payments were not for additional service, but simply extra pay for service already performed.

Teachers' Retirement Law Retirement - Point 3 & 4:

Education Code § 23002 states in part, “Member and employer contributions required by this part and Section 44987 are due in the office of the system five working days immediately following the period covered by the monthly report upon which the compensation earned during the period is being reported and from and upon which the contributions are due.”

Education Code § 23005 states “Monthly reports are due in the office of the system 30 calendar days immediately following the month in which the compensation being reported under this part was earned, and are delinquent 15 calendar days immediately thereafter.”

Finding - Discussion – Point 3 & 4:

The College reported the allowance on a six month or annual basis rather than the contracted monthly basis. By reporting the payments on a six month or annual basis rather than the contracted monthly basis, the payment of the required employer and member contributions to CalSTRS was delayed, which, in turn, prevented CalSTRS from investing the contributions to adequately fund the future retirement.

The College reported only one of the two six month payments for the 2003-04 school year but three six-month payments for the 2004-05 school year. To ensure proper annual credit of contributions and interest, payments must be reported for the period earned regardless of when paid.

Finding – Effect:

These errors resulted in a \$451.73 monthly understatement of the retired member’s Defined Benefit (DB) modified retirement allowance. The errors also resulted in a \$3,296.37 overstatement of the member’s Defined Benefit Supplement (DBS) retirement benefit.

Finding - Corrective Action Required:

MSJCCD should confirm the federal and state marginal income tax rates for the years 2001 through 2005 with the retired member. The College should use those rates (presumed to be 25% and 9.3%) and recalculate the gross non-receipted reimbursement allowance so that the net allowance after taxes, Medicare, and CalSTRS contributions is \$500 each month (net \$6,000 each year). Please see the Confidential Appendix for more detail.

The College must delete the reported allowances reported as pay for service back to July 2002. MSJCCD must report the corrected gross allowances to the Riverside County Office of Education with Member Code 1 (member), Assignment Code 57 (full-time) and Contribution Code 6 (special compensation).

In accordance with Education Code § 23008(a), the corrections must be reported within 60 days of the date of the final audit report.

Finding -2- Mount San Jacinto Community College District Did Not Report A Member’s Post-Retirement Earnings

The College did not report to CalSTRS at least \$106,250 in post-retirement creditable compensation earned by its former superintendent and paid to a third party in the 2005-06 school year. With an earnings limitation of \$27,940, the excess earnings were at least \$78,310. Under Education Code § 24214 and 22119.5(b), the retired superintendent could and did perform post-retirement creditable service as an employee of a third party. Under Education Code § 22461, the College had a duty to report his post-retirement earnings as an employee of a third party.

Teachers’ Retirement Law Requirement:

Education Code Section 22119.5(b) states: “ ‘Creditable service’ also means the work of superintendents of California public schools.”

Education Code § 24214(a) states in part, “A member retired for service under this part may perform the activities identified in paragraphs (1) to (9), inclusive, of subdivision (a), or subdivision (b), of Section 22119.5 as an employee of an employer, as an employee of a third party, or as an independent contractor within the California public school system,...

(d) A member retired for service under this part may earn compensation for performing activities...in any one school year up to the limitation specified in subdivision (f) as an employee of an employer, as an employee of a third party, or an independent contractor, within the California public school system, without a reduction in his or her retirement allowance.

(f) The limitation that shall apply to the compensation for performance of the activities...by a member retired for service under this part either as an employee of an employer, an employee of a third party, or as an independent contractor, shall, in any one school year, be an amount calculated by the board each July 1...

(g) If a member retired for service under this part earns compensation for performing activities identified in paragraphs (1) to (9), inclusive, of subdivision (a), or subdivision (b), of Section 22119.5 in excess of the limitation specified in subdivision (f), as an employee of an employer, as an employee of a third party, or as an independent contractor, within the California public school system, and if that compensation is not exempt from that limitation under subdivision (e) or any other provisions of law, the member's retirement allowance shall be reduced by the amount of the excess compensation..."

Education Code § 22461(a) states in part, "Upon retaining the services of a retired member...the school district, community college district, county superintendent of schools, California State University, or other employing agency shall do both of the following regardless of whether the retired member performs the services as an employee of the employer, an employee of a third party, or an independent contractor:

- (1) Advise the retired member of the earnings limitation set forth in Sections 24116...24215.
- (2) Maintain accurate records of the retired member's earnings and report those earnings monthly to the system and the retired member regardless of the method of payment or the fund from which the payments were made."

Additional Guidance:

CalSTRS Employer Directive 2005-01 states in part:

The purposes of this employer directive are as follows:

- 3) To inform employers of the new earnings limitation for the 2005/2006 school/fiscal year.
- 4) To remind employers to report post-retirement earnings.
- 5) To provide Education Code section references pertaining to post-retirement employment that is usually subject to the earnings limitation,

The earnings limitation effective July 1, 2005 for the 2005-2006 school/fiscal year will be \$27,940.

All post-retirement earnings will be reported with member code 2 and assignment code 61, as shown on the attached matrix.

Activities considered to be creditable service and, therefore, subject to the earnings limitation are listed in Section 22119.5. If a member retired for service earns compensation in excess of the limitation as an employee of an employer, an employee of a third party, or as an independent contractor, the member's retirement allowance shall be reduced by the amount of the excess compensation.

ACTION

The employer is required to maintain accurate records of the retired members' earnings and to report those earnings monthly to CalSTRS and to the retired members regardless of the method of payment or the fund from which the payments were made.

The employer is required by Section 22461 to inform CalSTRS retired members who perform creditable service about the annual earnings limitation.

Finding 2 – Discussion:

- On May 12, 2005, the College entered into a contract with a third party to obtain the Superintendent's services as the interim Superintendent when he retired.
- In June 2005, the attorney for the College Board of Trustees provided a copy of CalSTRS Employer Directive (ED) 2005-01 to the attorney for a Board member in response to her objection to the contract.¹ A stated purpose of CalSTRS ED 2005-01 was to remind the College that all post-retirement earnings are to be reported to CalSTRS. That ED made specific reference to Education Code Section 22461. This Code Section is located in Chapter 10, Employer Duties, of the Teachers' Retirement Law. It states that community college districts have certain specific duties regarding post-retirement employment regardless if the retired member performs the services as an employee, or as an employee of a third party, or as an independent contractor. These duties include:
 - Advise the retired member of the earnings limitation.
 - Maintain accurate records of the retired member's earnings.
 - Report those earnings to CalSTRS on a monthly basis regardless of the method of payment.

1. The Board member's objection was based on several points. The other objections were dealt with by other oversight agencies. This audit report deals only with the non-reporting of post-retirement earnings that affect CalSTRS.

In addition to possessing CalSTRS ED 2005-01 and having responsibility for knowing and complying with Education Code Sections 22461 and 24214, the College and retired Superintendent received additional guidance from CalSTRS in August 2005:

- On August 5, 2005, in response to an inquiry from MSJCCD, the CalSTRS Service Retirement Division informed the College Human Resources Office by e-mail that management had reviewed the scenario. That e-mail stated that the retired superintendent may work as a third party consultant but he will be subject to the earnings limitation which is \$27,940.
- On August 22, 2005, the Superintendent's personal attorney asked CalSTRS Legal Division whether their "client as an employee of the independent company who is acting/serving as the interim President/Superintendent of the College will be limited in the amount he can earn" by CalSTRS? On August 31, 2005, a CalSTRS attorney informed the attorney that the retired superintendent is subject to the limitation found in Section 24214. She further stated that, with the salary being paid to him, he would reach that limitation rapidly.
- The College maintained that the retired superintendent's earnings as an employee of the third party were private and confidential between them and not the College. The May 12, 2005 contract with the third party called for an all inclusive fee of \$17,300 per month. This amount agreed to an April 28, 2005 letter from the third party to the College Board President which stated that the third party's cost of the retired superintendent as an employee consisted of:

Base Salary:	\$12,500 (monthly)
Employment Benefits including his IRA:	\$ 4,000 (monthly)
Administrative Charge	<u>\$ 800 (monthly)</u>
Total:	\$17,300 per month.

In that April 28, 2005 letter to the College Board President, the third party stated that he:

- Spent a significant amount of time making sure the compensation was reasonable.
- Considered the current superintendent cost obtained from the College.
- Calculated a cost that was the actual cost of the superintendent's contract with the third party.
- Developed the proposal of an all inclusive cost of \$17,300 per month for the position.
- Provided a copy of the April 28, 2005 letter to the superintendent.

Thus, this audit concludes that the College knew the retired superintendent's pay was at least \$12,500 a month. It could be significantly more had the College determined what part of the \$4,000 monthly Employment Benefits were payable in cash to the retired superintendent.

This audit also concludes that the superintendent knew his compensation in cash was at least \$12,500 per month and that, as Superintendent, he did not ensure that MJSCCD complied with Section 22461.

- The post-retirement service contract stated that the retired superintendent would be the Chief Executive Officer and perform the day-to day duties of the District Superintendent/President. However, the College could not provide a record of the day-to day service actually performed.

Finding – Effect:

Because the Superintendent did not ensure that the College kept accurate records and did not report his post-retirement earnings of \$106,250 to CalSTRS, more if an unknown amount of employment benefits is determined to be creditable compensation, CalSTRS:

- could not monitor the \$27,940 earnings limit for 2005-06,
- could not advise the retired superintendent that he would and did exceed the post-retirement earnings limit, and
- could not collect the excess of \$78,310, or more, from the retired member as required by Education Code Section 24214(g).

Additionally, the College contracted to pay for day-to-day duties, but did not keep accurate records. Thus, it may have received half-time service for full-time pay which may be contrary to the California State Constitution prohibition of gift of public funds.

Finding - Corrective Action Required:

MJSCCD must report all post-retirement earnings for the member identified in the above finding to CalSTRS. The earnings to be reported include the monthly base salary of \$12,500 plus any additional amount payable in cash to the retired member, through the third party, for his employment benefits.

The monthly post-retirement earnings are to be reported within 60 days of the date of the final audit report. CalSTRS will then take action in accordance with Education Code Section 24214(g).

MJSCCD must fully comply with Education Code § 22461 for any CalSTRS retired member who performs creditable service in the future.

When a retired member exceeds the post-retirement earnings limitation, Education Code § 24214(g) requires CalSTRS reduce the member's retirement benefit by the excess earnings amount. The amount of the reduction may be less than or equal to the gross monthly benefit payable, depending on the amount of the excess compensation earned. The member's benefit will be reduced dollar-for-dollar until the amount withheld equals the excess earnings amount up to the amount of the member's annual benefit.

DISTRICT'S

RESPONSE



Mt. San Jacinto Community College District

Mark J. Zacovic, Ph.D.
Superintendent/President

San Jacinto Campus
1499 N. State Street, San Jacinto, California 92583-2399

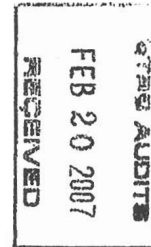
(951) 487-MSJC (6752)

February 14, 2007

Board of Trustees

Eugene V. Kadow
Dorothy J. McGargill
Ann Motte
Gwen Schlange
Joan F. Sparkman

California State Teachers'
Retirement System, Audit Services
Attn: Fred Snyder
7667 Folsom Boulevard, MS #37
Sacramento, CA 95851



RE: Response to letter dated December 19, 2006

Dear Mr. Snyder:

Audit Finding #1

Mt. San Jacinto Community College District Incorrectly Reported a Member's Reimbursement Allowance.

Mt. San Jacinto Community College District (MSJCCD) agrees with the following findings:

1. MSJCCD did not calculate the proper gross amount to ensure the Superintendent, Dr. Richard J. Giese, received the contracted net reimbursement allowance for the period July 1, 2001 through June 30, 2005. The District "grossed up" the monthly net \$500 in non-receipted allowances paid to Dr. Giese by erroneously treating the annual net total of \$6,000 as though the \$6,000 were his only earnings. The error resulted in reduced federal and state income tax deductions of 15% and 4% instead of the approximate rates of 25% and 9.3% respectively. The error also understated the deductions reported to CalSTRS by \$12,494.84 and Dr. Giese's Defined Benefit (DB) modified retirement allowance by \$451.73 monthly, and overstated his Defined Benefit Supplement (DBS) by \$3,296.37.
2. MSJCCD inappropriately reported the non-receipted allowance as "pay for service" instead of "extra pay for service already performed." The error generated additional service credit for Dr. Giese.
3. MSJCCD did not report the monthly allowance on a timely basis; the allowance was paid semi-annually and reported to CalSTRS either semi-annually or annually. The system of reporting did not follow Education Code Sections 23002 and 23005.
4. As a result of the delayed reporting in item 3, MSJCCD did not always report the earnings in the correct school year, that is, for the period earned as mandated.

In view of the above findings, MSJCCD will follow the recommended corrective actions within the timeline that is mandated by Education Code Section 23008(a), that is, to report the corrections within 60 days of the date of the final report. The corrective actions are as follows:

5. We will confirm the correct federal and state marginal income tax rates for the years 2001 through 2005 with Dr. Giese. We note that absent this confirmation, your office will accept the approximate rates of 25% and 9.3% for federal and state income taxes.
6. We accept the recalculation of Dr. Giese's non-receipted reimbursement allowance as shown in your report's Confidential Appendix.
7. We will delete the reported allowances reported as pay for service back to July 2001. We will report the corrected gross allowances through the Riverside County Office of Education with Member Code 1 (member), Assignment Code 57 (full-time) and Contribution Code 6 (special compensation).

Audit Finding #2

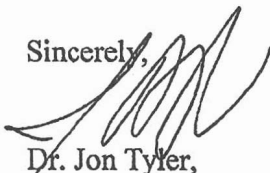
Mt. San Jacinto College Did Not Report A Member's Post Retirement Earnings.

Mt. San Jacinto College did not report to CalSTRS at least \$106,250 in post-retirement creditable compensation earned by its former superintendent and paid to a third party in the 2005-06 school year. With an earnings limitation of \$27,940, the excess earnings were at least \$78,310. Under Education Code Sections 24214 and 22119.5 (b) the retired superintendent could and did performed post-retirement creditable service as an employee of a third party. Under Education Code Section 22461, the College had a duty to report his post-retirement earnings as an employee of a third party.

District's Response

Mt. San Jacinto Community College District agrees with the finding with this concern. Our efforts to report the income was impacted by conflicting legal arguments and the absence of a reporting mechanism or method through the Riverside County Office of Education (RCOE). The District, RCOE and the responsible unit at CalSTRS, is currently addressing this challenge to the reporting process. We await further direction on this item.

Sincerely,



Dr. Jon Tyler,
Vice President of Human Resources

Mount San Jacinto Community College District
Final Audit Report
May 3, 2007

**EVALUATION
OF
DISTRICT'S RESPONSE**

Mount San Jacinto Community College District agreed with both findings in the draft Audit Report.

Finding 1: The College's action plan to address Finding 1 is acceptable and must be implemented not later than the June 2007 monthly report to CalSTRS.

Finding 2: The College asserts that there is an "absence of a reporting mechanism or method through the Riverside County Office of Education (RCOE)" that is preventing the District from reporting the \$106,250.00 in post-retirement earnings for the member involved in Finding 2. Because it may take an indefinite period of time to establish an on-going mechanism to report post-retirement earnings when paid through a third party, the College:

- a. Must send an official letter signed by the (interim) superintendent, not later than June 30, 2007, stating the monthly post-retirement earnings that would have been reported for this member since August 1, 2005. The letter affirming the monthly post-retirement earnings should be addressed to:

Carolyn Nielsen, Manager
District Administrative Fiscal Services – Payroll
Riverside County Office of Education
3939 Thirteenth Street
Riverside, CA 92501

Please send a copy of that letter to:

Peter Haley, Director
Member Account Services
CalSTRS
7667 Folsom Blvd.
Sacramento, CA 95826

Karen Scott, Director
Audit Services
CalSTRS
7667 Folsom Blvd.
Sacramento, Ca 95826

- b. Should avoid using contracts with third parties for post-retirement services by CalSTRS retired members until such time there is a mechanism to routinely report those earnings through the normal monthly reporting through RCOE.
- c. Must report post-retirement earnings for any and all CalSTRS retired members, regardless of the employment structure, to CalSTRS in accordance with Education Code Section 22461.