

# POST AUDIT DIVISION

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MAY 20, 2018  
LEGISLATIVE LETTER REPORT

## TAXABLE FRINGE BENEFIT RETIREMENT CONTRIBUTIONS

### LEGISLATIVE AUDITOR'S STAFF CONTRIBUTORS

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## GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS STATEMENT

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (**GAGAS**). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



**WEST VIRGINIA LEGISLATURE**  
*Joint Committee on Government and Finance*

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**Aaron Allred**  
**Legislative Manager**

May 22, 2018

The Honorable Mitch Carmichael, President  
West Virginia State Senate  
Post Audits Subcommittee, Co-Chair  
Room 229 M, Building 1  
State Capitol Complex  
Charleston, WV 25305

The Honorable Timothy Armstead, Speaker  
West Virginia House of Delegates  
Post Audits Subcommittee, Co-Chair  
Room 228 M, Building 1  
State Capitol Complex  
Charleston, WV 25305

Dear Mr. President and Mr. Speaker:

During the course of the work performed for the statewide commuting evaluation, the Legislative Auditor discovered an issue that may have an impact on the financial position of the Public Employees Retirement System (PERS). The Legislative Auditor has reason to believe that many payroll officers are not including the value of taxable fringe benefits, such as those associated with the use of state-owned vehicles for commuting, in calculating retirement contributions for members of PERS. As a result, there is a shortfall of payments into the system that funds future pension benefits of the PERS members.

From a brief, initial review, it appears that this situation arises from lack of awareness of the requirements of state law and from ambiguities in the law itself.

According to the West Virginia Public Employee Retirement Act, located in W. Va. Code §5-10-2(8), "compensation" is defined to mean:

*. . . the remuneration paid a member by a participating public employer for personal services rendered by the member to the participating employer. **In the event a member's remuneration is***

*not all paid in money, his or her participating public employer shall fix the value of the portion of the remuneration which is not paid in money: Provided, That members hired in a position for the first time on or after July 1, 2014, who receive nonmonetary remuneration shall not have nonmonetary remuneration included in compensation for retirement purposes. [Emphasis added].*

There are three crucial points to be drawn from this definition:

1. “Compensation” includes some benefits that are not paid as salary;
2. The employer has a duty to assign a monetary value for those benefits that are not paid in money; but
3. For a certain class of employee/members, the “nonmonetary remunerations” are not considered compensation.

Proper calculation of any individual employee’s compensation is necessary both to determine what must be paid into the system to keep it solvent and what must be paid out to fulfill the employee member’s statutory pension benefit.

The responsibility for making the proper calculation falls upon the public employer’s payroll staff. West Virginia Code §5-10-29 requires the “officer or officers responsible for making up the payrolls for payroll units” of participating public employers to make pension deductions from every member employee’s compensation every payroll period. **The Legislative Auditor has learned that many payroll clerks are not including fringe benefits in the employee compensation category for purposes of determining the proper amount to be deducted for the employee.**

When employee compensation is not properly calculated for all employee members, this leads to subsequent deficits when calculating the employer’s contribution into PERS. Because the employer contribution is calculated as a percentage of the “members’ total annual compensation,” W. Va. Code §5-10-31, errors in individual payroll calculations accumulate within the calculation of the employer’s contribution into the system.

## **Many PERS Members are Legally Entitled to Pension Payments Based Upon the Value of Their Fringe Benefits.**

Employees hired prior to July 1, 2014 are entitled under the law to receive the benefit of including the value of a taxable fringe benefit in the calculation of their final average salary. **Yet, this legally enforceable benefit is accruing without the required contributions to the system to support the proper pension payouts.** In effect, this has resulted in an unintentional, unfunded liability to the State. The Legislative Auditor does not know the full scale of this problem, but there is reason to believe it affects multiple agencies and employees.

This is not to say, however, that the issue exists for all public employers. \* The Consolidated Public Retirement Board has indicated that some payroll officers have been accounting for nonmonetary fringe benefits for several years. For instance, the Division of Natural Resources includes the monetary value of residences provided to park superintendents in their withholding and employer contribution calculations.

However, the Legislative Auditor is unable to quantify the exact number of employees affected or the total amount of contributions that should have been deposited into the PERS system.

### **The wvOASIS System is Currently Configured in a Manner That Will Allow These Deductions to be Automatically Withheld.**

Until the implementation of the wvOASIS system, there was no way to break down employee and employer contributions to determine what portion was derived from nonmonetary fringe benefits. The wvOASIS system has the capability of making appropriate calculations for employee withholding and employer contributions. In fact, the system is including the value of these taxable fringe benefits with employee wages for purposes of income tax and FICA withholdings. The same amount could be used to calculate appropriate PERS contributions.

Currently this depends on a payroll clerk's determination of whether each individual employee falls within the class of PERS members for whom the fringe benefits count as compensation. The compensation definition excludes "members hired in a position for the first time on or after July 1, 2014" for purposes of the fringe benefit calculations. This means that a payroll clerk must make an assessment based upon the employee's position and then code the employee's compensation accordingly. As stated by the head of wvOASIS:

*HRM/Advantage payroll system can handle the pensionable wage distinctions/issues . . . We just need to know definitively the answer and can work with anyone to set [it] up.*

*. . . these type of issues came to our attention in February of this year . . . The Auditor's office Central Payroll group got into it and found some exceptions that we have been working with CPRB to fix. . . Getting definitive guidance has been a challenge on what fits into which bucket so we could make sure the programming was correct and assist the Agencies and CPRB on the correct way to handle.*

In other words, wvOASIS system is programmed to do the math, but the technical staff cannot program it to make what they understand is a subjective determination: whether the employer was "hired in a position" with nonmonetary compensation prior to July 1, 2014.

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\* Also, the issue only affects members of the PERS system. Nonmonetary fringe benefits are not included as compensation for purposes of the state's other public employee retirement systems.

## **Ambiguities in the West Virginia Public Employee Retirement Act Have Resulted in the Value of Nonmonetary Fringe Benefits Being Excluded in pension calculations.**

It appears that the omission of the dollar value of fringe benefits is due to a lack of awareness of the requirements of the Public Employee Retirement Act. Simply put, many employers do not appear to know that nonmonetary fringe benefits should be considered as part of PERS calculations. The Legislative Auditor acknowledges that, until beginning the commuting study, he had never considered including the value of vehicle use by employees of the Joint Committee on Government and Finance.

At this point, the Legislative Auditor requested legal counsel to review the applicable law and provide guidance as to the legal issues involved. The following points have been prepared in the light of that analysis and guidance.

One reason for the lack of awareness among payroll staffs may be due to a basic inconsistency in the language of the Retirement Act. Though all of the Act's requirements are based on "compensation," the Act refers to "final average salary" for benefit calculations. Salary and compensation are not necessarily equivalent terms.

There is another ambiguity, though, which has prevented the complete automation of the payroll and employer contribution calculations. This is the language that was added in 2014:

*"Provided, That members hired in a position for the first time on or after July 1, 2014, who receive nonmonetary remuneration shall not have nonmonetary remuneration included in compensation for retirement purposes."*

As interpreted by the CPRB, this language excludes nonmonetary fringe benefits from pensionable compensation for an employee that, on or after July 1, 2014, enters a position that provides nonmonetary fringe benefits. The CPRB does not read this to mean the "first-hire" date for the employee, but rather, when the employee is placed in a given position. As a result, payroll clerks for public employers must attempt to determine both the nature of the employee's position and the date at which the employer entered that position, a similar position, or the same position within another administrative unit. The complexities of this determination, including interpretation of the terms "hired" and "position" are likely to cause many incorrect determinations.

The 2014 amendment is sufficiently ambiguous that the CPRB interpretation of the phrase "hired in a position" may not be supported if challenged. The CPRB is entitled to some deference in its interpretation of statutes relating to its functions, but if public employers are reading the statute to refer to the employee's first-hire date, that may be an equally valid reading. It is important to note that the Retirement Act must be "liberally construed" to provide for a "system for the employees of the state," W. Va. Code §5-10-3a. Thus, where there is ambiguity, courts are required to give weight to an interpretation that benefits the employees over any other equally valid interpretation.

As a final point, the application of the CPRB's interpretation may conflict with contract principles articulated by the West Virginia Supreme Court of Appeals for public employees. Most notably, the Court addressed the effects on employees when pension plan terms are altered after an employee has been working for a number of years in the case of *Booth v. Sims* (193 W. Va. 323, 341, 456 S.E.2d 167, 185, 1994 W. Va. LEXIS 291 (1994):

*“Should the legislature seek to reduce certain advantages of a pension plan, it must offer other equal benefits in their place as just compensation. \* \* \* the legislature cannot reduce a participating employee's pension property rights once it establishes the system unless the employee acquiesces in the changes to the pension plan or unless the employee has so few years in the system that he or she has not detrimentally relied on promised pension benefits.”*

Although the 2014 amendment to the definition of compensation appears to have been written to avoid this very problem, it only works if a court agrees that a change in an employee's position effectively results in a new contract between the state and the employee, under new contract terms. Staff counsel believes that, based upon prior decisions of the Supreme Court, it is doubtful that our Court would agree with this position.

If the Legislature were to amend the compensation definition to exclude the value of fringe benefits for employees first hired on or after July 1, 2014, this would remove the contract benefit issue, create a clear threshold for payroll staff to understand, and create a programmable condition that could automatically calculate the pensionable compensation amount based upon the employee hire date.

## **Recommendations**

1. The Legislative Auditor recommends that state employer payroll clerks participate in a mandatory training program to explain the current legal requirements for including nonmonetary fringe benefits in pension calculations.
2. The Legislative Auditor recommends that the Legislature amend the definition of “compensation” in West Virginia Code §5-10-2 to exclude the value of fringe benefits for employees *first hired* on or after July 1, 2014.

Sincerely,

  
Aaron Allred