

SACRAMENTO CITY UNIFIED SCHOOL DISTRICT SELECTION OF A RETIREMENT INCENTIVE PROGRAM

Issue

Did the Sacramento City Unified School District (SCUSD) Board of Education and administrative staff exercise appropriate oversight and review in the selection of a retirement incentive program at the conclusion of the 2003-2004 school year? What options were evaluated? What process did SCUSD use to determine the effectiveness of the selected plan? Did the promised savings materialize?

Reason for the Investigation

Capitol Weekly Corporation publishes monthly local newspapers distributed in Sacramento neighborhoods. An article in the June 2005 issue raised concerns about SCUSD and the adoption of the Public Agency Retirement System (PARS) retirement incentive program.

Method of Investigation

The Grand Jury interviewed the following individuals:

- SCUSD Superintendent
- SCUSD Chief Financial Officer (CFO) 2003-2004, retired
- SCUSD Chief Business Officer (CBO)
- SCUSD Associate Superintendent, Human Resource Services
- Associate Vice President, School Services of California, Inc.
- SCUSD Board of Education President
- SCUSD Board of Education President at the time of the tentative adoption of PARS (April 2004)

The Grand Jury reviewed the following documents:

- June 2005 Capitol Weekly publication
- Keenan and Associates January 21, 2004 Fiscal Cost Analysis proposal
- California Association of School Business Officials Journal, January/February 2004, "*Evaluating Retirement Incentives*"
- Agendas and minutes of SCUSD Board of Education meetings for 2004
- Back-up agenda documents for March 8, April 1, and June 3, 2004 Board of Education meetings
- PARS proposal dated March 11, 2004
- PARS analysis supporting March 11, 2004 proposal
- PARS enrollment documents

- Audio tape of the June 3, 2004 SCUSD Board of Education meeting
- June 25, 2004 memo to the Superintendent and the Board of Education from the CFO
- PARS analysis supporting June 25, 2004 summary report
- 2004-2005 SCUSD budget, actuals and revisions
- Vilfer and Associates November 2, 2004 investigation report on San Juan Unified School District and PARS
- Two memoranda from Lozano Smith Law Firm regarding PARS
- Letters dated November 3, 2005 and December 23, 2005 from SCUSD Superintendent to the Grand Jury, with supporting material
- 2004 PARS retirees list prepared by SCUSD Human Resources Department, January 2006
- Documents requested from the Chief Budget Officer, February 2006

Background and Facts

SCUSD faced a budget deficit of approximately \$26 million for the 2004-2005 school year. In October 2003, a district-wide budget committee of approximately 40 members began meeting on a regular basis to consider budget recommendations. Their report was presented to the Board of Education by the Chief Financial Officer at the March 8, 2004 special board meeting. One cost reduction option was a recommendation to investigate possible savings through early retirement incentive programs, targeted at \$2 million.

What is a retirement incentive program? The basic premise is to target near-retirement age employees at the top of the salary schedule, entice them to retire with a monetary incentive, and either not replace them, or replace them with employees at the bottom of the salary schedule. During the investigation, it was learned that an early retirement incentive should not be offered too frequently, as employees anticipate it and do not retire at predictable rates. SCUSD looked into the possibility of offering an early retirement incentive program with the following goals in mind:

- Achieve budget savings
- Reduce staffing and reorganize central office departments
- Reduce the number of potential employee layoffs
- Minimal classroom impact

The CFO began looking into retirement incentive program options before the March 8, 2004 presentation. The CFO represented to the Grand Jury that Keenan & Associates was asked to provide an analysis of the California State Teachers' Retirement System (CalSTRS) early retirement incentive program. Keenan's January 21, 2004 Fiscal Cost Analysis, a document in excess of 100 pages, outlines the Keenan Supplemental Employee Retirement Plan, CalSTRS AB 1207 2 + 2 plan, and AB 1207 2-year golden handshake plan. Assembly Bill 1207 (AB 1207) permits CalSTRS members to receive an additional two years of service credit, under certain conditions, for the "golden handshake" option. It also creates an early retirement incentive of two additional years of service credit and two years of age, "2 + 2", if certain conditions are met.

In January 2004, the Superintendent asked the CFO to look at Phase II Systems PARS, a vendor offering retirement incentive plans since 1983, with participation of over 260 public agencies. The initial PARS proposal was dated March 11, 2004.

The Grand Jury could not find any evidence that the board considered other options, such as obtaining similar savings through a combination of retirements and resignations through natural attrition, layoffs, and non-replacement of staff, or even creation of its own plan. For example, previously, the district offered a one-time \$10,000 retirement incentive. SCUSD was experiencing declining enrollment, especially at the elementary level, so non-replacement of teachers was anticipated.

What process did the district utilize to evaluate these options: STRS, Keenan, PARS, non-replacement combined with natural attrition, layoffs, or developing its own plan? The Grand Jury requested any written analysis available to the public, employee groups and the Board of Education; nothing was provided. The superintendent's November 3, 2005 letter states, "Staff put careful thought and effort into selecting the PARS program." District staff informed the Grand Jury that information was orally presented and discussion often took place in closed sessions with the Board of Education because of collective bargaining issues. The district did not provide any materials from closed session discussions.

PARS is the Selected Vendor

By March 19, 2004, letters to the Sacramento City Teacher's Association (SCTA) and United Professional Educators (UPE) indicated that the district was interested in offering a retirement incentive plan through PARS. Discussions over a mutually agreeable plan were needed quickly; eligible employees needed to be informed.

The PARS proposal was presented for the first time in public at the April 1, 2004 Board of Education regular meeting. The agenda item began at 10:05 p.m. and concluded at 10:25 p.m. The CFO explained that participation in PARS would be contingent upon meeting the minimum number of retirees and reasonable impact on the educational and operational objectives of the district. The Vice President of Consulting for Phase II Systems, administrator of PARS, provided a Power Point presentation for the board that included background information on the company and an overview of how the plan would work. This presentation did not include assumptions imbedded in the analysis by Phase II Systems, including the fact that the projected savings were predicated on the assumption that 20% of the teachers projected to elect early retirement would not be replaced. The minutes state that board discussion followed; however, no audio or video tapes were available for the meeting. The agenda item was moved from conference to action, and the vote was 5-1 in favor of preliminary participation in PARS.

In general, the plan provides employees with a lifetime annual benefit equal to 7% of final pay. For example, a teacher who earned \$64,094 per year would receive \$4,486.58 per year (\$373.88 per month), plus normal retirement pay from STRS. PARS estimated that, with 229 employees participating, \$2.6 million net in first year savings would be realized. Over a five year period, PARS projected approximately \$6.7 million would be saved.

Ironically, at the same April 1, 2004 board meeting, an earlier agenda item was a resolution to terminate the operating agreement between SCUSD and the California Administrative Services Authority (CASA). CASA is a joint powers agreement that established an alternative retirement program for a select group of employees. Participation was purported to be cost neutral to SCUSD, but in fact became a liability to the district. The 2003-2004 Grand Jury report (www.sacgrandjury.org) includes a lengthy investigation which concluded SCUSD was negligent in the establishment and oversight of CASA. The district's failures in the CASA retirement program were widely reported in the media. It would have been expected that the district be especially careful in analyzing PARS.

Evaluating PARS

The PARS proposal relied on data supplied by the district, which included current employee census data, salary information, estimated retirements and district benefit costs. PARS proposed savings based on several assumptions, including savings from non-replacement of positions. Due to declining enrollment, some positions would not be replaced in the 2004-05 school year; these were already factored into the proposed budget compiled by the district. If PARS and the district both include the same non-replacement numbers, it would result in double counting of projected savings.

The Superintendent asked the CFO to contact School Services of California to review the PARS proposal. SCUSD has an agreement with School Services for consulting on financial issues. The district and School Services differ in how they characterize the extent of the review requested. The School Services representative spent approximately 1 ½ hours at the district, with several follow-up phone calls. He spotted the double counting of non-replacement positions. School Services was familiar with this issue because San Juan Unified School District (SJUSD) was also exploring the PARS program and School Services had done an analysis for them. No written record or report was requested or provided for SCUSD from this review by School Services of California.

The estimated savings projected by PARS varied widely at each meeting and in each memo. At the June 3, 2004 Board of Education meeting, the board unanimously authorized participation in PARS. The back-up information packet provided prior to the meeting for this agenda item reads, "PARS estimates that approximately \$1.37 million in first year savings will be realized if projected retirements are realized: 210 certificated; 18 certificated administrators, and 1 classified manager. The exact number of retirees interested in the PARS program will be available by the time of the board meeting and actual savings calculations will be presented." At the meeting, the PARS representative reported the final number of participants was 244; projected first year savings was increased to approximately \$2.1 million; the five year cumulative total savings was projected at \$2.78 million. No explanation was given for the substantial change in the savings projections. The actual number of retirees went from 229 to 244 and the first year savings from \$1.37 million to \$2.1 million; the five year savings from \$6.7 million to \$2.78 million. Each person interviewed was asked how this happened; no one could explain the variation. The Grand Jury was told that even a savings as low as \$1.37 million was acceptable. An audio tape of this meeting was reviewed. One board member started to question the difference in the savings figures, and was asked to hold the question to the subsequent

agenda item, which included the presentation by the PARS representative. PARS stated the \$2.1 million figure was the savings for the actual retirees, and no further questions were asked by board members.

Other concerns about the PARS proposal:

- PARS used a 7% benefit payout whereas the January, 2004 Keenan proposal used 5%. There is no analysis showing that the district was obligated to offer 7%. All PARS documents provided to the Grand Jury were consistent with the 7% benefit payout figure. The PARS commission was 5.5% of the total cost. PARS had an incentive to offer a higher benefit for the higher fees. The district could not provide any more information about the benefit level, except to say it was part of the negotiations with staff, and the PARS program was a complete package.
- There was no minimum number of years served in the SCUSD required to qualify for this lifetime benefit. Four management employees retired with this benefit after being with the district only 2-4 years.
- The CFO, Legal Counsel, Director of Employee Relations, and Executive Director of SCTA, presumably key managers sponsoring or reviewing early retirement incentive programs, all retired under the PARS plan.

The district provided only one memo concerning projected savings, a one page June 25, 2004 memo from the CFO to the Board of Education and the superintendent stating that the calculation of savings from PARS would be \$2.6 million, factoring in longevity pay for more senior employees that were not included in the earlier calculations. Supporting this memo was the last PARS analysis given to the Grand Jury, also dated June 25, 2004. The PARS analysis used to estimate the cost impact of retirements had two sets of calculations for each of three groups of employees. The first set estimated costs if the program were adopted. The second set estimated costs if the program were not adopted. These were then compared to arrive at the benefit or cost of the program. The assumptions for these analyses were generally the same, except imbedded deep in the comparisons was the premise that 14 more positions would be eliminated if the program were adopted. The final savings, despite the earlier correction for double counting, returned to the original \$2.6 million figure. What savings are related to the 14 positions? Were these differences in assumptions ever brought to the attention of the superintendent or the board?

PARS and the San Juan Unified School District

At the same time SCUSD was considering adopting PARS, SJUSD adopted participation in PARS. SJUSD faced huge budget deficits, declining enrollment, and a desire to avoid lay-offs. The issue of double counting was identified by School Services of California while doing a review requested by SJUSD. As issues were raised about participation in PARS, SJUSD conducted an internal fact finding investigation. They subsequently hired an outside independent investigator, Vilfer and Associates, to determine the facts involved in participating in the PARS program. The report dated November 2, 2004 is available on-line at www.sanjuan.edu/news/documents/vilfer-pars-report-11-2004.

Although SCUSD could not have been aware of the SJUSD investigation results at the time they were looking into PARS, some of the issues SCUSD faced were somewhat similar. Vilfer findings for SJUSD include:

- There was great confusion among SJUSD employees and board members involved in assessing PARS.
- PARS continued to represent savings in spite of knowing savings from non-replacement had been included in SJUSD budget cuts.
- The use of PARS cost the district significantly more than taking the same action without PARS.
- PARS represented that a 7% benefit level was common, while the investigation determined that lower percentages are more common.

Anticipated PARS Savings

Did PARS deliver for SCUSD? The question was asked of every person interviewed for this report. The superintendent's November 3, 2005 letter to the Grand Jury states, "We believe the PARS program is working appropriately." A similar comment was included in the superintendent's December 23, 2005 letter to the Grand Jury.

It appears, however, that no one could know the answer to this question, since no financial analysis had been done. It was generally assumed by the staff that the program worked because the 2004-05 operating results were within budget. Finally, after repeated inquiries, the district staff in February, 2006, responded with a one page document, "PARS Summary for 2004-2005", showing savings of approximately \$2 million, instead of the projected \$2.6 million. If this lower savings figure were correct, then does that mean years 2-5 in the projections by PARS are also too low? No analysis was provided.

The district, in the first year, paid \$3,771,102 to PARS to accomplish this net savings, and will pay \$18,855,510 over five years. Included in the \$18,855,510 cost to the district is the Phase II Systems/PARS total commission of \$1,037,000 from this contract.

The following chart represents a re-cap of the data outlined in this report:

MOVING TARGET OF PROJECTED SAVINGS (in millions)

<u>Date</u>	<u>Source</u>	<u>First year</u>	<u>Cumulative Five years</u>
April 1, 2004	Board minutes	\$2.6	\$6.7
June 3, 2004	Board agenda back-up	\$1.37	not stated
June 3, 2004	Board minutes & audio tape	\$2.1	\$2.78
June 25, 2004	Staff memo	\$2.6	\$4.02
February 14, 2006	CBO response to Grand Jury	\$2.01	not calculated

Findings and Recommendations

Finding 1. No written comparative analysis of retirement incentive options was prepared for the public, staff or the Board of Education.

Recommendation 1. On matters of significant cost, detailed analyses should be in writing, rather than oral summaries.

Finding 2. Staff could not provide the Grand Jury with documentation that the Board of Education received clearly understandable written information outlining the assumptions underlying the PARS proposal.

Recommendation 2. Written key assumptions underlying major decisions should be presented to the Board of Education.

Finding 3. Too much reliance for financial analysis was placed on the representations of the vendor (PARS). There was no independent financial review of the PARS assumptions or numbers before or after the program was selected.

Recommendation 3. A detailed process should be adopted for independent financial review by appropriate district personnel, or outside consultants, prior to action on matters of significant expense. Matters of this magnitude should be the work product of a multi-discipline team. Matters brought by outside interests who have a significant financial interest require independent evaluation.

Finding 4. No analysis was done by the district to determine the effectiveness of the program in relation to the stated goal of saving \$2.6 million in the first year.

Recommendation 4. Standards need to be developed by the district for a timely evaluation of the financial impact of major expenditures. PARS savings need to be identified for years 2-5.

Finding 5. District staff and the Board of Education did not take adequate steps to ensure confidence in the process used in adopting the PARS program. In light of the failure of CASA for SCUSD, the district should have been especially careful in entering into another retirement related program.

Recommendation 5. District staff and the Board of Education need to put policies and procedures in place to ensure accountability when using public monies. The district needs to be more open in its business transactions.

Finding 6. Board of Education meetings are currently video taped, but the tapes are only retained by the Sacramento Public Library for 60 days.

Recommendation 6. SCUSD should retain video tapes for three years or longer.

Response Requirements

Penal Code sections 933 and 933.05 require that specific responses to both the finding and recommendations contained in this report be submitted to the Presiding Judge of the Sacramento Superior Court by October 1, 2006 from:

- **Superintendent, Sacramento City Unified School District**
- **Board of Education, Sacramento City Unified School District**