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## **ATTENTION SPECIAL DISTRICTS! YOU TOO COULD FACE PENSION PLAN PROBLEMS**

### **Other Special Districts Could Learn From Pleasant Hill Recreation & Park District's Experience**

#### **SUMMARY**

In 2004, the Pleasant Hill Recreation & Park District learned that \$283,000 of part-time employee pension funds had disappeared. The discovery was made during an audit following the plan manager's death in 2004. A lawsuit against the plan manager's estate filed by the Pleasant Hill district and eight other similar districts across the state resulted in the recovery of only \$40,100 of funds contributed by the Pleasant Hill employees and district. The district has elected to not reimburse employees for the loss of pension funds contributed by the district.

The fact that the financial malfeasance was not detected before 2004 highlights the inadequacy of the periodic and cursory status reports provided by the plan manager to the district's board of directors and general manager. It also points to the minimal oversight the board of directors provided, and continues to provide, when it comes to the management of the district's pension fund.

In the wake of the problems with the defunct pension fund, the district's board of directors authorized its general manager to enter into an agreement with a new pension fund manager, and associated bank trustee. Both firms are indisputably larger, far more experienced, stable, and professional. However, the district's board of directors does not appear to have learned the key lesson from **the earlier fiasco**. The board still appears to be taking a largely hands-off approach when it comes to the district's pension fund. The board continues to delegate virtually all oversight responsibility to the district's general manager.

While the chances of a reoccurrence of the earlier problems appear to have been reduced, the board should take a much more proactive role regarding the management of its employees' pension funds.

The complete report is available through the Contra Costa County Grand Jury web site: [www.cc-courts.org/grandjury](http://www.cc-courts.org/grandjury).

# CONTRA COSTA COUNTY GRAND JURY REPORT 0803

## ATTENTION SPECIAL DISTRICTS! YOU TOO COULD FACE PENSION PLAN PROBLEMS

### Other Special Districts Could Learn From Pleasant Hill Recreation & Park District's Experience

One or more Grand Jurors recused themselves due to a possible conflict of interest and did not participate in the preparation or approval of this report.

**TO: Board of Directors, Pleasant Hill Recreation & Park District**

#### **BACKGROUND**

The Pleasant Hill Recreation & Park District (District) has annual revenues of approximately \$5.6 million, approximately half from property taxes on District residences and businesses. The District generates the balance through the provision of services such as sports activities, facility rentals, weddings, dances, and other functions. The District has 27 full-time and numerous part-time employees.

During the period 1992-2004, the District, and 10 other similar districts across the state, contracted with a retired insurance executive to manage pension funds for the district's part-time employees. The death of the plan manager in 2004 triggered an audit of the California Recreation District Employee Benefit Plan (Plan) he managed. The audit revealed that some \$700,000, including approximately \$283,000 of the Pleasant Hill District's pension funds, was missing.

As a result of the audit, Pleasant Hill and eight other districts filed a lawsuit against the deceased plan manager's estate seeking recovery of the missing funds. The lawsuit resulted in a combined settlement for the plaintiffs of approximately \$100,000. The Pleasant Hill Recreation & Park District's share of the settlement was approximately \$40,100. The District deposited the settlement funds into a separate bank account. However, because of the threat of ongoing litigation, the District has had difficulty finding an agent willing to manage the account. None of the money has been dispersed to eligible employees.

For the eight years in question, the District's Board of Directors relied on periodic and cursory updates from the Plan administrator. The updates covered the Plan's general status, but provided no detailed or audited information on the Plan's financial status or investment performance.

In October 2006, the Board authorized the District's general manager to enter into an agreement with Public Agencies Retirement Services (PARS) to act as the new administrator for the District's pension plan. The Board also authorized its general manager to enter into an associated agreement with Union Bank to act as the new pension plan's trustee.

## **FINDINGS**

1. The Pleasant Hill Recreation & Park District (District) was created by the voters in the District in 1951 pursuant to California Public Resources Code section 5780 et seq. The District covers approximately nine square miles, has approximately 22,000 voters, and provides parks, recreation facilities, open space, and recreation programs for District residents.
2. A five-member Board of Directors (Board) governs the District. The Board is made up of five District citizens directly elected by District voters.
3. The District's 2007-2008 budget includes approximately \$5.6 million in revenues, of which approximately \$2.4 million is from property taxes on District residences and businesses. The District generates the balance through the provision of services such as sports activities, facility rentals, weddings, dances, and other functions.
4. The District has 27 full-time employees, and also hires numerous part-time employees. The subject of this report affects approximately 1,400 former and current part-time employees.
5. The District has well-kept parks and extensive recreation programs.

### **A. The Former District Pension Plan**

6. Until 2004, the District, together with 10 similar districts across the state, invested funds in a pension plan on behalf of its part-time employees through the California Recreation District Employee Benefit Plan (Plan). An individual, who died in 2004, administered the Plan.
7. The Plan was a 401(a) FICA alternative plan, in lieu of Social Security.
8. The District's elected Board provided minimal oversight of the Plan, its manager, funds, and investments.
9. An audit performed in 2004, after the death of the Plan administrator, found that approximately \$700,000 was missing. Of that amount, this District's share of the loss was approximately \$283,000. After legal proceedings began against the administrator's estate, a settlement was negotiated in which this District received approximately \$40,100.

10. When concerns arose, the District withheld approximately \$17,000 from contributions it would have otherwise been required to deposit under the terms of the Plan. This sum, plus the \$40,100 received by the District as part of the settlement resulting from the suit brought against the Plan administrator's estate, has been deposited in the Local Agency Investment Fund (LAIF). The LAIF is an investment alternative available to local governments and special districts through the California State Treasurer.
11. The District has adopted a method to disburse the \$57,100 held in the LAIF to eligible employees. The District was awaiting cooperation from other affected districts, but has voted to proceed even if the other districts do not.
12. Following the death of the Plan administrator, legal proceedings revealed that he was neither bonded, nor covered by a type of insurance upon which the District could make a claim.
13. Not including the above-referenced settlement amount, approximately \$155,000, plus interest, remaining in the former Plan belongs to the District. This District has attempted, without success, to get the other districts to cooperate in an apportioned disbursement of the Plan's funds.
14. The District has not secured the services of an agent to manage and distribute the funds remaining in the former Plan. Since some of the retired employees have reached the IRS mandatory withdrawal age of 70½, the absence of an agent to handle legally required distributions exposes eligible retirees to potential IRS scrutiny.
15. The District has not replaced the money its employees lost due to the actions of the District's Plan administrator. The District intends to replace only the money that was contributed by employees through their payroll deductions. The District does not intend to replace the money the District contributed to the Plan.
16. The District's failure to replace the missing funds for its employees may result in tax problems for employees as they reach retirement age. Since the IRS has no knowledge of the missing funds, it may calculate mandatory minimum withdrawal amounts based on the total amount reported by the District for each employee. The District is aware of this potential. Some affected employees already have reached retirement age.
17. The failure of the District to replace missing funds for its employees may result in tax and /or legal implications to the District. The Plan was made available to part-time employees in lieu of Social Security. As with Social Security, the District has Plan funding obligations with which it has not complied.

## **B. The New Plan**

18. On September 7, 2006, the District Board unanimously authorized the District manager to sign documents for the District that appointed Public Agency Retirement Services (PARS) as the 457(a) FICA (Social Security) Alternative Retirement Plan's Trust Administrator.
19. On October 2, 2006 the District's General Manager signed an Agreement for retirement fund services with Phase II Systems, a California corporation, which does business as PARS.
20. PARS is not licensed to provide advice on tax, accounting, legal, investment or actuarial issues.
21. At PARS' suggestion, the District's General Manager signed a contract with Union Bank by which the bank will act as the trustee of the pension funds for the District's part-time employees.
22. The Union Bank contract does not include effective limits on fees that may be incurred by the bank and charged to the District.
23. The Union Bank contract permits the bank to make potentially risky investments, such as investing on margin (depositing only a small percentage of the funds actually at risk), and investing in its own **paper (investing in the bank itself)**. Current District practices preclude that from happening.
24. The Union Bank contract permits oversight by the District, including investment options. The District Board has not done so.

## **CONCLUSIONS**

1. The District's Board and its General Manager provided inadequate oversight of the former pension Plan, especially with regard to securing regular audits, and detailed financial status and performance reports from the Plan administrator.
2. The District's Board took, and continues to take, too much of a hands-off approach to the oversight of both the former and current District's pension plans.
3. Despite the losses incurred as a result of inadequate oversight, the Board still does not recognize the propriety of regularly and closely monitoring Plan financial status and investment performance, as well as establishing and monitoring pension Plan policies.
4. The District's Board has authorized the General Manager to enter into a trust agreement with Union Bank that could disadvantage the District. Thus far, this has not occurred, but the District must carefully monitor investment selections.

5. The District's Board does not appear to have seriously considered the obligation it has to reimburse the affected employees for the District's pension contributions that were lost as a result of the former Plan administrator's malfeasance.

## **RECOMMENDATIONS**

The 2007-2008 Contra Costa County Grand Jury recommends that the Pleasant Hill Recreation & Park District Board of Directors:

1. Require the Plan administrator (PARS) to provide the District with quarterly, detailed financial and investment performance reports.
2. Within three months of this report, appoint a qualified employee to oversee the District's part-time employee pension Plan.
3. Within three months of this report, adopt a Board policy to provide fiduciary oversight of the District's part-time employee pension Plan, not less than quarterly, to monitor Plan performance, establish and review investment guidelines, and monitor pension Plan policies.
4. Within three months of this report, engage the services of a qualified agent to manage the funds in the former Plan, including the transfer of funds to qualified employees.
5. Within three months of this report, publish and implement a strategy to fully reimburse the part-time employees for the funds (employee and District contributions) lost due to the former Plan manager's malfeasance.
6. Continue to closely review proposed investment selections to ensure that pension funds are not invested in potentially risky instruments such as margin accounts or commercial paper issued by the trustee bank.

## **REQUIRED RESPONSES**

### **Findings:**

Pleasant Hill Park and Recreation District: 1-24

### **Recommendations:**

Pleasant Hill Park and Recreation District: 1-5