

Integrity & Accountability: Exploring Special Districts' Governance

The Summary Report from the Interim Hearing

Monday, November 24, 2003
Auditorium, Orangevale Recreation & Park District
6826 Hazel Avenue, Orangevale

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INTEGRITY & ACCOUNTABILITY

On Monday afternoon, November 24, 2003, the Senate Local Government Committee held an interim hearing in Orangevale to explore special districts' governance. Testimony and comments came from local and state officials, special districts' representatives, and area residents. The hearing began at 12:40 p.m. and continued until 3:35 p.m. About 200 people attended the Committee's hearing, held in the Orangevale Recreation and Park District's auditorium.

Four legislators attended the Committee's hearing:

- Senator Tom Torlakson, Committee Chair
- Senator Michael J. Machado, Committee member
- Senator Deborah Ortiz, 6th Senate District
- Senator Nell Soto, Committee member

This summary report contains the Committee's staff explanation of what happened at the hearing [see the *white* pages], reprints the background policy paper [see the *blue* pages], and reproduces the witnesses' written materials [see the *yellow* pages].

STAFF FINDINGS

Any attempt to distill three hours of presentations, questions, and discussions into a few findings must necessarily gloss over important details and subtle nuances. But after carefully considering the witnesses' statements and reviewing their written materials, the Committee's staff believes that there was general --- although not universal --- support among legislators and the speakers for statutory reforms on:

- *Ethical behavior*, including:
 - Regular ethics training for special districts' board members and managers.
 - Whistleblower protection for staff who discover and report problems.
- *Directors' compensation*, including:
 - Limiting stipends to public meetings (allowing others with conditions).
 - Tighter procedures for increasing stipends.
 - Better record-keeping and reporting for directors' expenses.
 - Legislative review of directors' benefits.

- Auditing procedures, including:
 - Compliance audits, testing conformity with districts' policies.
 - Meetings between auditors and districts' governing boards.
 - Prompt remedial action by governing boards to audit exceptions.
 - Periodic changes in auditors (although they differed on specifics).
 - Quality control sampling of districts' audits, similar to school districts.

THE WITNESSES

Twenty-two people talked to the legislators at the Committee's hearing. Half of the witnesses provided the materials that appear in the *yellow* pages.

Peter Detwiler, Committee Consultant
Senate Local Government Committee

Donald E. Bunn, Former Member
Sacramento County Grand Jury

Hon. Steven L. Eggert, Board President*
Sacramento Suburban Water District

David Aranda, President*
Special District Leadership Foundation

Hon. William Miller, President*
California Special Districts Association

Hon. Bette Boatman, President*
Association of California Water Agencies

Bob Reeb, Legislative Advocate
Association of California Water Agencies

Mike Dillon, Executive Director*
California Association of Sanitation Agencies

Jeff Dubchansky, Administrators Representative to the Board*
California Association of Recreation and Park Districts

William C. Hazeleur, President*
Mosquito and Vector Control Association of California

Dewey L. Ausmus, Executive Director*
California Association of Public Cemeteries

Walter Barnes, Chief Deputy State Controller
State Controller's Office

Steven M. Gevercer, Deputy Attorney General
Attorney General's Office

Phil Jelicich, Deputy State Auditor*
Bureau of State Audits

Nancy Lyons, Deputy Executive Director*
Little Hoover Commission

Hon. Ron Wootton, Board Member*
California Association of LAFCOs

John Boyd
Sacramento resident

LeRoy Munsch, Former Director
Fulton-El Camino Recreation and Park District

Wayne Lowery, General Manager
El Dorado Hills Community Services District

Phil Johnson
Sacramento resident

Roy Imai, Board President
Fulton-El Camino Recreation and Park District

Sanford Kozlen, Director
Carmichael Water District

[* = Written material appears in the *yellow* pages.]

INTRODUCTORY REMARKS

As the Committee's Chair, **Senator Torlakson** began by explaining that Senator Ortiz had requested the hearing after problems surfaced with the Sacramento Suburban Water District. He explained that the Committee's policy interests were broader than just one district. Legislators want to learn how to prevent future problems and they want to strengthen special districts' integrity and accountability. Senator Torlakson emphasized that integrity and accountability are the bases for democratic government. The people must trust their leaders.

Senator Ortiz told the audience that she authored Senate Bill 456 to address some of the abuses that took place at the Sacramento Suburban Water District. She noted that "we were able to learn of these abuses through a series of *Sacramento Bee* news reports." Senator Ortiz explained that she delayed action on her bill so that she and her colleagues could address special districts' reforms more broadly. Senator Ortiz noted that at her request the State Controller was conducting an in-depth study of five special districts around the state so that legislators could get a better idea on how to reform the districts' accounting practices and financial reporting. She lauded those in the audience for coming out to talk about "reforms that can lead to greater accountability." Senator Ortiz commended the Sacramento Suburban Water District "for the policies they have implemented in the past year to prevent future abuses."

In his briefing to the legislators, Committee Consultant **Peter Detwiler** declared that special districts are the least understood but most numerous form of local government. The districts find themselves caught between two major themes in California political history: the Progressive movement which values expert knowledge and community leadership and the Populist impulse which advocates home rule and local control. Detwiler sketched the contents of the background policy paper, noting that 2/3 of the 3,300 special districts are independent districts with their own directly-elected boards of directors or governing boards that are appointed for fixed terms.

In the 25 years since Proposition 13, the overall number of special districts has declined. The number of dependent districts has increased but the number of independent districts has actually gone down. Detwiler reminded the legislators that Local Agency Formation Commissions (LAFCOs) are the Legislature's watchdogs over the formation, consolidation, and dissolution of special districts. He then directed the legislators' attention to the questions raised in the background policy paper, suggesting that they might ask witnesses to speak on these topics.

WHEN THINGS GO WRONG

The hearing's first witness was **Donald Bunn**, a former member of the Sacramento County Grand Jury that investigated eight water districts including the Sacramento Suburban Water District. Bunn described the Grand Jury's inquiry and reporting practices. He referred legislators to the Grand Jury's annual reports for specific details. Bunn also complimented the *Sacramento Bee* which "did an excellent job" in publicizing the water districts' practices. There were "numerous cases" where the Grand Jury thought that District officials had abused their per diem payments, Bunn said, noting that first class air travel costs were "not substantiated."

Steve Eggert is the current President of the Board of Directors of the Sacramento Suburban Water District that resulted from combining the former Arcade Water District and the former Northridge Water District in February 2002. As complaints unfolded that summer, the Board became concerned with past management practices and travel payments. In December 2002, the Board limited the directors' compensation and called for an independent audit. The results were "more troubling than we expected," he said.

Eggert described the additional steps his Board has taken, including the adoption of an ethics policy. Eggert presented the Committee with a 3½-inch thick binder of District documents and statements. He served up eight specific recommendations for statutory change:

- Require directors to report their compensation and travel expenses at regular board meetings, in writing.
- Specifically define a compensable "meeting" and require reporting of meeting compensation at regular board meetings.
- Limit compensation increases to one year, eliminating automatic increases.
- Regarding annual audits:
 - Require that only a district board can hire external auditors.
 - Require auditors to test expenses at a higher level than regular testing for financial statements.
 - Encourage boards to ask auditors to conduct compliance reviews for contractual obligations or a district's policies.
 - Require auditors to provide a written management letter to the board.
 - Require the rotation of audit partners every five years, following the federal Sarbanes-Oxley Act.
- Ban rules that prohibit reporting of wrongdoing by district staff to anyone but the district's management.

- Limit travel expenses to just those “reasonable and necessary” by amending Water Code §30507.
- Consider ethics training for district directors.
- Investigate the usefulness of LAFCOs’ municipal service reviews for consolidating districts, and adjust the legislation as needed.

SPECIAL DISTRICTS’ RESPONSES

While most of the presentations from special districts’ groups were descriptive, some offered recommendations for statutory changes. Before they began speaking, Senator Torlakson said that he understood that the public is often confused about where to lodge their complaints. He suggested the creation of an “800” number so that callers could have their questions routed to the proper oversight agency.

David Aranda is the President of the Special District Leadership Foundation (SDLF), a nonprofit corporation created in 1999 by a coalition of groups to recognize special districts’ professional managers. The SDLF also recognizes the efforts of district board members who educate themselves about their governance responsibilities. Aranda reported that 17 people have earned his group’s designation of “SDA” or Special District Administrator. Further, 33 people were in the first class of graduates from the Special District Governance Academy. He told the legislators that special districts don’t condone bad practices.

Bill Miller is the President of the California Special Districts Association (CSDA) that represents about 700 of the 2,300 independent special districts. Miller noted that districts have responded to both criticism and opportunities. District representatives now sit on about half of the LAFCOs. Responding to the Little Hoover Commission’s May 2000 report that criticized the districts’ handling of the budget reserves, CSDA wrote and issued its own *Special District Reserve Guidelines*.

Bette Boatman is the President of the Association of California Water Agencies (ACWA), representing 450 local public water agencies that deliver about 90% of California’s water service. Boatman told the legislators that she was “shocked and absolutely outraged” by the violations of public trust because water districts usually do an “excellent job overall” in delivering water to their customers. ACWA responded to recent criticism by appointing a task force to prepare guidelines for district management. Responding to the reforms suggested by the background paper, she agreed that districts’ audits should review whether expense

payments conform to written policies. But, Boatman cautioned, legislators need to remember that special districts are diverse and so “one size does not fit all” when drafting reforms. Further, legislators may wish to extend these reforms to cities and counties “since no local agency is immune to the potential for wrongdoing.”

The California Association of Sanitation Agencies’ 110 members provide about 80% of the sewer services, according to Executive Director **Mike Dillon**. When CASA’s leadership read the newspaper accounts of abuses, “we tried to jump on it right away” to keep the public’s confidence in local governments. Dillon reported that CASA President John Coleman has offered up five recommendations regarding accounting controls, expenses, open procedures, avoiding conflicts of interest, and ethics training.

Speaking as a representative of the California Association of Recreation and Park Districts, **Jeff Dubchansky** told the legislators that measuring special districts’ services is easy but it is harder to watch agencies’ internal operations. The Legislature contributed to open government in 2001 by revising the state laws that govern the recreation and park districts. The “vast majority” of these districts use competitive bidding to pick their auditors for three-year contracts. Districts ask their auditors to present their findings at public board meetings. The new GASB 34 requirements will improve public agencies’ annual reports but they also raise the audits’ costs. In closing, Dubchansky noted that his Association has supported the work of the Special District Leadership Foundation since its inception.

Bill Hazeleur is the President of the Mosquito and Vector Control Association of California, representing 53 mosquito and vector control districts. Hazeleur pledged his Association’s cooperation to improve special districts’ accountability. The Legislature’s 2002 revisions to the state laws that govern mosquito abatement districts spelled out the districts’ leadership roles, set a standard of ethical behavior, precluded trustees’ stipends and salaries, limited expense payments, and conformed the districts’ to the standard accounting and annual reporting requirements.

The 253 public cemetery districts provide essential services, “often in small communities where private cemeteries cannot operate profitably,” explained **Dewey Ausmus**, Executive Director of the California Association of Public Cemeteries. In 2003, the Legislature revised the state laws that govern the cemetery districts, including the authorization for district trustees and employees to attend training sessions. Along with the California Special Districts Association, the cemeteries’ group offers educational and training programs to district officials.

Ausmus told the legislators that his Association would support legislation requiring governing boards to take ethics training, providing protection to whistleblowers, requiring meetings with auditors, and requiring prompt remedial action on major audit violations.

MONITORING AND OVERSIGHT

Six speakers talked with the legislators about the ways in which they monitor and oversee special districts. Because state law gives the districts substantial political independence, state officials do not control these local governments. Special districts are ultimately accountable to the voters who elect their governing boards.

Senator Ortiz noted that the Sacramento County District Attorney and the Internal Revenue Service declined invitations to speak at the Committee's hearing because of their pending enforcement actions.

Walter Barnes, Chief Deputy State Controller, explained that all local governments --- including special districts --- annually report their financial transactions to the Controller's Office. The Controller's Office compiles and publishes these annual reports which are available both in print and on-line. Relying on its existing statutory authority, the Controller's Office is currently performing an audit of the Sacramento Suburban Water District and expects to release its findings in December. Similar audits of other local agencies have led the Controller's Office to five conclusions:

- Board members may not understand their duties and the consequences.
- Districts may not have adopted protocols and standards.
- Abuses occur in relatively small portions of districts' budgets.
- Problems appear in the general expenses and administration categories.
- Independent auditors may be "lax."

Barnes told the legislators that independent audits "can be a very good deterrent" to the misuse of public money, as borne out by the State Controller's experience in reviewing school districts' audits.

Steve Gevercer, Deputy Attorney General, described the Attorney General's civil and criminal enforcement powers but noted that "the Attorney General's Office is not the front line" for criminal enforcement. Local district attorneys respond to most of the complaints about criminal activities. Nevertheless, state laws clearly prohibit bad behavior. Government Code §8314 bans the diversion of state funds

for personal use. State and local officials who misuse public funds face four-year prison terms under Penal Code §424. The strict liability standard in Government Code §1090 prohibits public officials from being financially interested in their agencies' contracts, and Government Code §1097 disqualifies violators from holding office.

The Little Hoover Commission's May 2000 report on special districts came in the wake of "bad behavior," according to Deputy Executive Director **Nancy Lyons**. She told the legislators that Local Agency Formation Commissions (LAFCOs) could play an effective role in monitoring districts' behavior if they had the "right resources." Although voters select their special districts' governing boards, the electoral process is "not nearly as rigorous" as other local governments' processes.

The Little Hoover Commission's report also reviewed special districts' budget reserves and determined that "reserves need to be clearly explained to ratepayers." Legislators should "rethink" why some enterprise districts receive property tax revenues. The Commission's "central conclusion," Lyons said, was the "need for more transparency," a message which needs to be "repeated and reported." She explained that because audits are costly, "oversight of locals by locals is best."

Deputy State Auditor **Phil Jelcich** told the Senators that the Bureau of State Audits will respond next spring to Assembly Member Cohen's request to audit a sample of independent water districts. Because the Bureau is just starting that project, Jelcich said that there was "not much to offer." He agreed, however, that there is a need to develop an audit guide for special districts that would be similar to the guide for school districts.

Representing the California Association of Local Agency Formation Commissions (CALAFCO), **Ron Wootton** declared that LAFCOs lack the resources they need to carry out their oversight duties. While acknowledging that the commissions are the Legislature's watchdogs, he conceded that "we can only bark a lot."

PUBLIC COMMENTS

Six area residents accepted the Committee Chair's invitation to advise the legislators on special districts' governance topics.

John Boyd criticized water districts because "most of them are self-perpetuating." He recommended consolidating Sacramento County's smaller water districts into a

single water agency because it is “stupid to be electing people on water boards.” A single, centralized water agency with professional staff would be an improvement. A former board member of the Fulton-El Camino Recreation and Park District, **Leroy Munsch** explained that “there are some competent people on those boards.” Munsch specifically complimented the three board members of the Sacramento Suburban Water District who pushed for remedial reforms. He acknowledged that it is hard for residents to follow the districts’ agendas and often it is hard to understand the implications of those decisions. Munsch said legislators should be wary of bills to shorten the time for districts to retain their records. He recommended that state law require districts to retain financial records for five years.

Wayne Lowery, the General Manager of the El Dorado Community Services District, admonished legislators to be careful when adopting reforms because of the many conflicting statutes that govern special districts. Lowery said he “cringed” when earlier speakers suggested that county boards of supervisors should be the fiscal overseers of special districts but that he “cringed even more” when someone mentioned the State Controller’s Office. “Keep it as local as possible,” Lowery recommended, suggesting that legislators might select the county auditor-controller as the fiscal overseer.

A ratepayer from the Sacramento Suburban Water District, **Phil Johnson** supported Leroy Munsch’s comments. Under its new leadership the Sacramento Suburban Water District is a “template” for a district that is doing well. Johnson asked legislators to consider extending the statute of limitations for prosecuting past violations of ethics laws. He also recommended legislation that would require districts to adopt policies for reimbursing expenses, develop guidance for district directors, and protect district employees from retaliation.

Roy Imai chairs the Fulton-El Camino Recreation and Park District’s Board of Directors. Because his district is a customer of the Sacramento Suburban Water District, they are interested in good management. Imai said that special districts are “doing their best they can with limited budgets” and asked legislators not to lump all of the districts together when only a few have problems.

Sanford Kozlen was a board member of the Carmichael Recreation and Park District and currently serves as a member of the Carmichael Water District’s Board of Directors. While the impetus for the hearing is good, Kozlen said that more needs to be done. His district eliminated benefits for board members eight years ago and it reports directors’ stipends on “1099” forms instead of using “W-2”

forms. It would be an “erroneous item,” Kozlen said, to limit stipends just to publicly noticed meetings because there are other legitimate reasons to compensate board members for service. The Carmichael Water District publishes its payments to board members and uses a per diem control system. He said that these reforms should be placed in statute where they will apply to all local governments, not just special districts. Communities get great service for small stipends, Kozlen contended, and “we don’t want to discourage service.”

CONCLUDING COMMENTS

In closing the hearing, Senator Torlakson noted that there may be more than 10,000 Californians who serve on special districts’ boards of directors and that the “vast majority are conscientious.” He added, “we thank you for your service.”

Senator Ortiz noted that “solutions are yet to be developed” and then offered an extended list of possible statutory reforms that she plans on exploring. She intends to work on the four main topics of ethics, compensation, auditing, and directors’ benefits.