

Up a Creek without a Financial Paddle The Lompico County Water District

Summary

The Santa Cruz County Grand Jury strongly recommends that the Lompico County Water District (LCWD) and the San Lorenzo Valley Water District continue to evaluate a merger of the two districts post haste. LCWD is teetering on the edge of total collapse. Between the time the Grand Jury began looking into the Lompico water district in July 2009 and finished its formal investigation in mid-May 2010, an experienced member of the board of directors has resigned; the district secretary has been fired and arrested on felony charges of embezzlement; the general manager has been fired; and the District Attorney's Office has opened an investigation of the water district's finances.

Thirty years ago, LCWD was considered by some to be among the best water districts in Santa Cruz County, proudly represented by its new, state-of-the-art redwood water tanks. Today, its infrastructure is falling apart. Up to 60 percent of the lateral pipes that feed the residences need to be replaced. Water tanks are leaking so seriously that pumps from the four district wells are being overworked to keep up with the loss of water. One of the two largest leaking tanks needs a foundation and two other tanks need to be replaced or rebuilt. The cost of replacing the dilapidated tanks and the faulty pipes is estimated to be one to two million dollars. The water district runs the risk of system failure if these pieces of the infrastructure are not replaced immediately.

The financial health of LCWD is in worse shape than its infrastructure. Although its water rates are the highest of any public water district in the county, it has been operating at a deficit for the past five years and is unable to cover district employee costs, day-to-day operations, and infrastructure needs. Through years of ineffective actions and neglect by its boards of directors and management staff, LCWD is on the verge of bankruptcy. By the end of 2009, employee costs had escalated to consume 75 percent of the district revenue. Employee overtime has contributed significantly to these escalating personnel costs. That several boards of directors permitted this situation to exist is inexcusable. Without strong and inquisitive boards, district management has had too much control, which has led to questionable hiring practices and accounting of district funds.

A healthy water district would pull money from its capital improvement fund or its reserve fund to address these financial challenges, but LCWD has no money in either fund, nor does it have the realistic capability of attracting new sources of funding, such as bonds or loans.

Since July 1, 2009, Santa Cruz County has taken over check writing for LCWD and has been providing "dry period financing" to the district to help it meet its monthly obligations when cash has not been adequate to cover expenses. However, this financing will not be available beyond April 2010. LCWD remains in serious debt to creditors, including fines owed the State of

California and bills owed creditors like PG & E, which has threatened to shut off the district's electrical power.

The financial shortfall of the water district has far-reaching ramifications beyond the obvious operational needs. With public knowledge of LCWD problems, there is the associated problem of possible loss of private property values. Mortgage lenders potentially will be reluctant to extend loans on residential properties that do not have guaranteed access to potable water and adequate water supply for fire protection.

The LCWD general manager has been in charge of day-to-day system operations and maintenance and also has been the chief administrative employee overseeing the business office functions including finances, record-keeping, and planning for the district. In a well-functioning water district, the general manager would keep the board of directors fully apprised of the water quality, the condition of the infrastructure, the financial health of the organization, new employees, and customer concerns. The general manager would present annual and ongoing budgets, capital improvement and equipment replacement plans, and strategies for making other improvements to the board for its approval. Board members rely on management to provide them the specifics in all these areas, as it is their responsibility to oversee all aspects of the district operations and respond in a timely way to keep everything running smoothly. In the Lompico Water District, management was reported to have given inaccurate and incomplete information to the board members, causing them to believe all was well when, in fact, the water district was falling apart. For its part, the board did not effectively make use of the systematic processes in place to assure that all its oversight responsibilities were being accomplished. Ultimately, it is the LCWD board of directors that has principal responsibility for all decisions affecting the operation of the water district. **However, it is the Lompico water district residents themselves who have the most to lose if potable water cannot be delivered to them – and at a reasonable cost.**

The body of this Grand Jury report provides details of the problems in the LCWD. Some of the problems identified can be attributed, at least in part, to the demands placed on a district the small size of LCWD. However, even small districts must perform in a manner consistent with the needs of the people for safe and reliable public service. After the Background and Scope, the report is divided into three major sections: Finances, Governance, and Management. Each section includes an Overview, Findings, and Conclusions. The detailed Recommendations of the Grand Jury cover all three major sections.

Definitions

Accrual or accrued liability: An expense that is recorded when it is incurred rather than when it is paid. For example, vacation and overtime pay are expenses recorded but not paid until some future date, at the current rate of pay.

Agenda: A list of meeting activities and topics in the order in which they are to be addressed during the public meetings. The Lompico district manager is responsible for preparing the LCWD agendas.

At-will: An “at-will” employee is someone an employer can terminate at-will for any reason or for no reason at all. An employer cannot fire employees in any way that constitutes discrimination, a violation of state public policy, or that contradicts any actual or implied promise regarding the criteria or procedures for employee termination. That still leaves wide latitude to fire employees for economic or performance reasons, for violating the law or internal company policies, or even for no reason at all, in some cases.

Audit: Review of an organization’s finances. Audits are performed to ascertain the validity and reliability of information. The goal is to express an opinion that the financial statements are accurate and complete and free from material error.

Blog: Also known as a web log. It is a type of web site with commentary from one or more individuals.

Board of Directors’ Policy Manual: Document used to govern the actions of the board of directors of the Lompico County Water District, adopted May 19, 2009.

Brown Act: Enacted in 1953, this law guarantees the public’s right to attend and participate in meetings of local legislative bodies. The Act promotes the transparency of government by requiring that the people’s business be conducted in public. It applies to the governing boards of all local governments in California.

Budget: A list of all estimated and planned revenues and expenses, including a strategy for the coming financial period. A prudent budget would include income, expenditures, cash flow, infrastructure maintenance, a capital improvement plan, and reserves for economic uncertainty. Typically a budget is created on an annual basis and reviewed frequently to ascertain the viability of the financial operations.

California Water Code: Laws governing water usage in the state of California. Special water districts such as the LCWD are subject to Water Code section 30000 *et seq.*

Capital Improvement Plan: A capital improvement plan or CIP is a plan, usually extending four to six years, which identifies capital projects and equipment purchases, provides a schedule, and identifies options for financing the plan.

Dry Period Financing: Financing an overdrawn account for a specified period of time. In county government, it typically is used to pay expenses until tax revenues are received from the State, at which time the amount borrowed is reimbursed to the County with interest.

FEMA: The Federal Emergency Management Agency is the federal agency within the Department of Homeland Security that is tasked with responding to, aiding in the recovery from, and mitigating against man-made and natural disasters. Entities that experience disasters can be reimbursed by FEMA for expenses related to a local emergency, but only for that purpose.

Forensic Audit: An examination of an organization's financial affairs resulting in a report designed especially for use in a court of law; it focuses on the application of accounting methods for the investigation and prosecution of criminal acts such as embezzlement or fraud.

Lateral Pipe: Pipe that connects the water main to the residential water meters.

Local Agency Formation Commission (LAFCO): Local government agency authorized by state law to regulate governmental boundary changes to cities and districts for the purpose of managing urban sprawl and efficiently providing governmental services such as recreation, water delivery, or fire protection.

Lompico Board of Directors: Five citizens residing within the geographical boundaries of the LCWD elected by the community to govern the water district.

Lompico County Water District (LCWD): A special district in Santa Cruz county designed to provide potable water to approximately 1,500 residents in the Lompico Canyon of the San Lorenzo Valley.

Lompico Personnel Manual: Document containing the policies governing the water district's employees. Original adoption date unknown. Revised Manual adopted January 12, 2010.

Meeting Minutes: The official written record of discussions and decisions of a board or committee. Minutes are used to acknowledge correspondence received and record old and new business. Minutes document official actions taken by the district's board of directors.

MEMCOR® XP Filters: A self-contained membrane filtration system that uses advanced, industry-proven membrane technology. MEMCOR® XP is ideally suited for small communities and industrial applications where suspended solids removal is critical. Its straightforward and compact design maximizes the efficiency and reliability in producing the quality and quantity of water needed, at any time. It is also ideal for remote systems, schools, developments and disaster relief applications.

Proposition 218: "The Right to Vote on Taxes Initiative." An amendment to the California Constitution (November 5, 1996 ballot) requiring local government to obtain the vote of taxpayers for any proposed new or increased tax or the approval of affected property owners for any proposed new or increased assessment.

Ready to Serve (RTS): Basic service charge that every customer pays before receiving water.

Special District: An agency established under California state law for the performance of a local government function (fire, water, roads, etc.) within specific boundaries in order to serve a common community interest.

Sturgis' Rules of Order: Parliamentary rules of order by which LCWD board meetings are to be conducted.

Turbidity: A measure of the degree to which water loses its transparency due to the presence of suspended or colloidal particles; it commonly is used as an indicator of the quality of drinking water. The more total solids in the water, the murkier it seems and the higher the turbidity.

Background

Lompico County Water District (LCWD) is an independent special district serving 500 residential hookups and supplying the water to about 100 fire hydrants in the isolated mountain valley community of Lompico. The LCWD was founded in 1963, is governed by five directors elected by the voters residing in the water district, and operates pursuant to the California Water Code 30000 *et seq.* Lompico is located north of Felton at the southeastern tip of Loch Lomond Reservoir. In the 1920's the Lompico Canyon area was divided into lots which by the early 1950's had developed into a summer retreat of small cottages. Now the area is a year-round community of permanent homes.

In 1979 the district built a new state-of-the-art water facility, financed with funds from grants and bond sales, to upgrade and integrate the water system. Now, thirty years later, major parts of this system are failing. Two 100,000 and one 60,000 gallon redwood water storage tanks are leaking. Laterals from the water mains to each residence are breaking at a rapid rate from the inferior plastic pipe installed in 1979 and now require emergency replacement.

The costs to replace and upgrade these basic elements of the system have created an alarmingly large financial burden. In addition, the district's boards of directors and management historically have ignored long term planning for capital improvements and have not analyzed employee costs or day-to-day expenses for their impact on the total district budget.

The 2009-2010 Grand Jury decided to investigate LCWD after reviewing information from the latest Local Agency Formation Commission's (LAFCO) state-mandated five-year review, statements made on the public record at recent LAFCO meetings, and articles and blogs published in *The Press-Banner* newspaper in late summer of 2009. The 2005 LAFCO five-year report observed that residents of LCWD had the highest public water rates in the county; that is still true today. These sources mention a variety of critical issues facing the LCWD including payroll shortages, the poor state of the infrastructure, and the possibility of bankruptcy. Concerns about the ability of the elected LCWD officials and management to govern and operate the water district effectively also were communicated to the Grand Jury. In response to this information and these concerns, the Grand Jury initiated an investigation.

Scope

The Grand Jury investigation of LCWD focused on three areas: (1) fiscal solvency, (2) infrastructure needs, and (3) governance by the board of directors and management. Multiple interviews were conducted with the board members, employees, and residents living within the LCWD. The Grand Jury attended board and committee meetings and also requested documents relevant to the fiscal and operational management of the district. The investigation was conducted to evaluate the status of the finances and infrastructure of the district, what factors contributed to the current condition of LCWD, and what solutions could be suggested to continue to provide quality

water service to the Lompico residents within the constraints of the budget. Topics investigated included:

- the financial status of LCWD
- the infrastructure of the water district
- the policies and practices used by the board of directors and management concerning governance of the district
- long-term plans for capital improvement projects and deferred maintenance
- water rates and service to the community
- employee costs and hiring practices
- potential strategies for financial recovery

Financial Overview

The LCWD financial structure is in worse shape than its water system. Five years of negatively certified budgets put LCWD on the verge of bankruptcy. The water district's present financial situation is worsened by an ever-increasing need to repair and replace worn out equipment and facilities.

A financially well-functioning water district, in addition to covering its regular operational costs, should have a fully-funded capital improvement plan and an adequate reserve fund. In contrast, LCWD is struggling to pay regular operating costs and has no capital improvement plan or reserve fund. Therefore, money is not available to accommodate the systematic replacement of old equipment or to handle emergencies.

Financial Findings

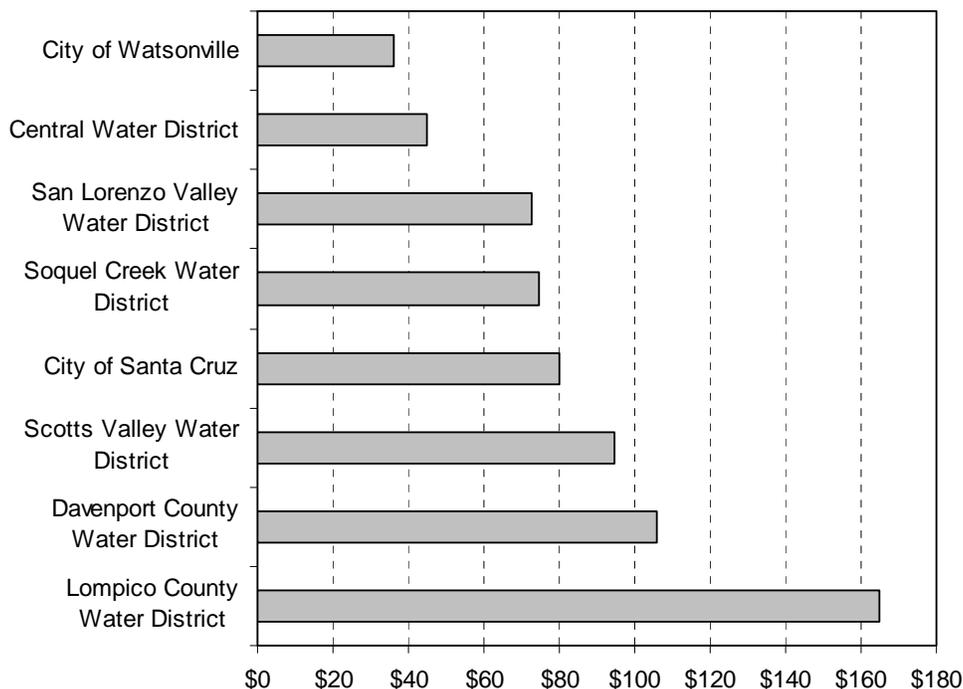
F1. Upon reviewing annual audits, the Grand Jury determined that LCWD has been operating at a deficit for at least the past five years. LCWD budgets are incomplete, inaccurate, and do not provide for economic uncertainties or a capital improvement plan.

- Revenue to the district comes from customer water bill payments and a percentage of property taxes refunded to the water district from the State. In two recent years, a portion of the tax money was not released to the district on schedule because of the State's budget crises. Although that money now has been released, the water district finances remain in a deficit status.
- The approximate revenue to LCWD is \$400,000 annually. The Grand Jury was unsuccessful in its efforts to obtain an accurate copy of the district's budget, including up-to-date revenue and expenditure figures. The budgets received were incomplete, were missing information, and did not include a capital improvement plan or a reserve account.
- Three redwood water storage tanks have serious leaks and need to be replaced. Moreover, the system of old lateral pipes going to residences needs to be replaced due to manufacturer defects in the pipes originally purchased by the district.

Approximately 40 percent of the plastic lateral pipes have been replaced with copper. Much of the replacement work was done on an emergency overtime basis, costing the district additional money.

- The ready-to-serve (RTS) rate, which must be paid by every customer before any charge for actual water usage, is \$82.64 every two months; this includes the most recent rate hike of \$15 per billing period. The actual water usage portion of the bill is based on a tier system calculated on the amount of water used in the current billing cycle.

Bi-Monthly Residential Charge for Average Santa Cruz County Customer
(5/9 x 3/4" meter and 20 CCF usage)



Source: Santa Cruz LAFCO: Countywide Service Review - June 2005

Until very recently, customers' water bills were not itemized to show the amount in each category on an individual's water bill. LCWD has the highest water rates of any public district in the county. This was true in 2005, as revealed in the chart below, and it is still true today.

- The board of directors was dependent upon staff for all financial and budgetary information. Board members indicated that their financial oversight of the water district budget was hampered by their lack of direct access to information maintained on the district's computer.
- An independent audit in 2008 recommended that LCWD hire a qualified bookkeeper. This recommendation was not implemented.

- After the secretary and the district manager were fired in early 2010, the board of directors became aware that the district's financial information was disorganized, incomplete, inaccurate, or missing altogether. Additionally, the board found many overdue bills in the office.
- The Santa Cruz County Auditor-Controller's office performed an *Independent Accountant's Report on Applying Agreed-Upon Procedures* at the request of the LCWD board of directors and presented the report on December 3, 2009. The audit examined payroll procedures for the three-year period of June 30, 2005, through June 30, 2008. That report, now part of public record, indicated the following:
 - Pay rates for this three-year period were provided for the secretary but not the district manager.
 - At the time of the LCWD 2008 official audit by an outside auditor, the accrued compensation for district employees for unpaid vacation and overtime since 1999 had grown to \$140,000.
 - Numerous errors abound in timekeeping and payroll processing, including inaccuracies in tracking forms, inaccurate reporting for the California Public Employees Retirement System (CalPERS), and intermittent omission of state and/or federal tax withholdings.
 - LCWD did not provide any evidence of payroll-related policies for this report, which includes executive leave accrual guidelines, board-approved minutes authorizing various cost of living adjustments (COLA), and other payroll details.
 - During the period analyzed, there were numerous examples of apparent misreporting of on-call pay, overtime pay, executive pay, and vacation time, including lack of reporting state and federal taxes and correct hours for CalPERS, ultimately resulting in loss of district funds.
- Since July 1, 2009, at the request of the LCWD board of directors, the County Auditor-Controller's office has taken over the function of paying the bills and payroll. They also have been extending "dry period financing" to cover payroll and bills when there have not been adequate district funds on hand to cover these expenses. The County covered two pay periods in February 2010 due to lack of revenue in LCWD. Once the tax revenues are distributed to the water district in April 2010, the Auditor-Controller's office, by statute, will no longer be able to extend financing to LCWD.
- Due to the District Attorney's arrest of the district secretary for embezzlement, the most recent independent auditor stated that a detailed forensic audit is required, which could push this year's accounting costs to approximately \$20,000.

- PG & E has threatened to cut off power to LCWD for failing to pay bills in a timely manner and for ignoring two negotiated payment plan agreements. As of March 2010, LCWD had an outstanding bill of \$2,700 with PG & E.
- LCWD currently is on a cash-on-delivery basis with suppliers. In March 2010, the district could not pay for the chemicals needed for the filtration system and had to appeal to the County of Santa Cruz to cover the bill.

Response: Lompico County Water District Board of Directors – AGREE, with the exception of current budget.

As of July 1, 2009 the budget is filed with the County and included with each monthly board agenda packet showing all income and expenditures. The budget for 2009-2010 allowed for \$23,000 excess revenue over appropriations, which was designated to reserves.

F2. Employee costs including compensation and accrued benefits have escalated in recent years, placing a significant strain on the district's limited resources.

- With a budget of approximately \$400,000 in revenue, LCWD spends about \$300,000 annually on personnel costs for three employees. The remainder of the budget, approximately \$100,000, is left to run the district, to make repairs, buy replacements, and maintain water quality. This amount has proven insufficient to meet the district's needs.
- During the five-year period 2001-2006, approximately 55 percent of the district budget went for employee expenses. By 2007-2009, these expenses increased to approximately 75 percent of the budget due to increased salaries and benefits. At the same time, revenue remained flat due to reduced tax revenues and reduced income from customers because of drought-condition water conservation.
- In 1999, Resolution 99-679 was approved by the board placing a two-year limit on compensation and benefit accruals. However, the Grand Jury found no evidence that the board adhered to this resolution thus creating a substantial unfunded liability to LCWD.
- Records indicate that day laborers' wages were paid out of petty cash funds and were not part of budget planning and development.

Response: Lompico County Water District Board of Directors – AGREE

F3. LCWD does not have the funds to conduct the preparatory work required to apply for grants or loans. The generally weak national and local economy severely hampers LCWD's ability to qualify for additional working capital. Most large projects require studies and pre-engineering costs which the district cannot afford. Furthermore, grant money generally is restricted to innovative projects and cannot be used to replace leaky tanks or to subsidize operational costs.

Response: Lompico County Water District Board of Directors – AGREE

Financial Conclusions

- C1. Neither the board of directors nor management fulfilled their fiscal responsibilities to create and maintain a budget to meet the financial and infrastructural needs of the water district.
- C2. LCWD has not created an adequate rate structure to sustain the operation of the water district, and so the revenues are insufficient to cover the district expenses or the present and future facility needs and obligations.
- C3. While elsewhere salaries have remained flat and some City and County employees have been furloughed due to the State financial crises, LCWDs salaries and benefits have increased in the past few years, further contributing to the deteriorating financial conditions of the district.
- C4. The handling of the district’s financial resources by the boards of directors and management staff has left LCWD on the verge of bankruptcy.

Governance

The LCWD is governed by a board of five directors and managed by a single general or district manager. Registered voters in the Lompico water district elect the five members of the board. Candidates do not need to meet any qualifications, other than being a qualified voter in the water district, or hold any special credentials, and frequently they do not have any relevant experience to hold this office. Once elected, they receive limited training to prepare them for the considerable challenge of governing a district that supplies water to 500 homes. Since the early 1960’s, the board has suffered financial and infrastructure demands that have led to turmoil and dissension, resulting in frequent resignations by board members. The resulting vacancies were filled by board appointments on some occasions and by uncontested or hotly contested elections on other occasions.

In the 1970’s the board of directors planned an ambitious \$2 million modernization and upgrade of the water distribution system. It successfully financed the project with bonds and grants and completed the work in 1979. Just six years later, however, several directors were recalled as the result of an outstanding bill for \$138,000 for a mandated San Lorenzo Valley septic system study; the septic system was not built and the debt eventually was forgiven.

In April 1987, the *Scotts Valley Banner* published an article titled “Down the Drain” describing the directors’ dissension and indecision in collecting bills, a situation that cost LCWD thousands of dollars. In May 1987, the *Santa Cruz Sentinel* reported that two directors resigned. In the fall of that year, the Santa Cruz County Grand Jury began an investigation of the LCWD. Its report, *Lompico Water District*, was published in June 1988 and described the lack of governance and oversight and the poor accounting that resulted in the LCWD’s failure to collect thousands of dollars owed by customers. The report revealed that the board of directors tried to manage the water district itself for several years after the departure of the district manager. The Grand Jury

recommended “a public dialogue concerning some combination or coordination of operations with the neighboring San Lorenzo Valley Water District.”

During the 1990’s, despite frequent turnovers in board membership, numerous resolutions were passed only to be later ignored by subsequent boards. As an example, in 1999 a two-year limit on vacation and overtime accruals was approved, but successive boards appear to have ignored or were not made aware of the limit. Furthermore, while water rates were raised occasionally, there was never enough revenue to create a healthy reserve fund for replacing equipment.

From 2006 to 2008, district residents were divided on what role LCWD should play in replacing a section of Lake Boulevard’s main water line loop that failed in a landslide. The issue was prominently featured in the November 2008 election, with eight candidates competing for three of the five board seats. Two new directors were elected and an incumbent was re-elected. Months of difficult discussions followed, and on November 23, 2009, the board voted 2-2 with one abstention on whether to apply for an extension on a request for FEMA funds to reconnect the water line. Three years after the event, the board could not agree on how to fix the problem.

Governance Findings

- F4.** Through a review of district records and interviews with past and present directors, the Grand Jury determined that the boards of directors have failed to adequately perform some of the basic duties of a governing board.
- LCWD directors indicated that they had little or no training to be board members. In addition they have not taken sufficient advantage of opportunities to educate themselves, nor have they created a training manual or handbook to appropriately educate successive boards.
 - The LCWD board has not created rules or guidelines for its proceedings, such as district bylaws, as required by the California Water Code section 30530.
 - The Board Policy Manual created in 2009 was duplicated from San Lorenzo Valley Water District.
 - Interviews and documentation reveal that the LCWD consistently failed to hold regular board and committee meetings.
 - LCWD board members stated that the agenda for meetings did not reflect items board members requested to be placed on the agenda.
 - The Grand Jury observed that some LCWD board members were not familiar with using Sturgis’ Rules of Order and that they sometimes failed to treat each other and members of the public with civility when conducting their meetings.
 - The Grand Jury’s review of meeting minutes from 2006 to the present revealed that the LCWD board did not monitor minutes for completeness or accuracy.

- Letters from the District Attorney's office in 2008 and 2009 indicated that citizens filed complaints about alleged violations of the Brown Act. The District Attorney did not find sufficient grounds to warrant criminal charges.

Response: Lompico County Water District Board of Directors – AGREE, with updates.

In 1964, the Board of directors of Lompico County Water District adopted Ordinance 2, which defined when and where the board would meet to conduct meetings, the order of the agenda, and that the board of directors shall use Robert's Rules of order. The Board of directors reviewed Ordinance 2 at a special meeting on June 8, 2010.

The board of directors has been improving its compliance with Robert's Rules of order in conducting meeting. Within 72 hours of the regular board meetings, the District Secretary writes up the minutes from the meeting, and emails the minutes to each director for review. The corrections, if any are transmitted back to the District Secretary for update.

The Board conducted a special meeting on June 8, 2010 to review Ordinance 3 Rules and Regulations of Water Service and enhance their understanding of those rules and regulations. The original Ordinance 3 was passed in 1964. In the 45 1/2 years since, Ordinance 3 has undergone numerous additions and changes. While these changes have been available in the district's files, it was difficult to know all the rules, as they were found in more than 40 different ordinances. The board has produced a single document containing all of Ordinance 3, complete with additions and changes from the last 45 1/2 years. The board members are in the process of providing needed updates for consideration by the board. The resulting ordinance will contain updates needed due to a reorganization of the staff positions and duties, reorganization of the ordinance to improve its readability, as well as clarifications, and other changes needed to reflect county policies. The board will be reviewing and consider for adoption the resulting codified version. The result will be one document that defines the rules and regulations of water service.

The board recently adopted a budget for fiscal 2010 - 2011 with revenue excess of \$32,675. This includes one time large expenses for forensic audits. These numbers are based on reasonable forecasts of income.

The board has scheduled a workshop on planning and rate setting with a professional in small water districts from the California Rural Water Association.

The board and District Secretary have aggressively pursued collection of delinquent water charges and the board is in pursuit of placing delinquent water charges on the tax rolls to recover long delinquent accounts receivable. The delinquent water charges have not been included in the income forecasting. The pursuit of delinquent water charges has brought \$13,524.00 in funds to the district. The 5 day disconnect notices for remaining delinquent charges for water services have been sent, and the district expects additional collection of delinquent charges for water service as a result. By the end of the billing cycle for May-June 2010, any remaining accounts that are delinquent will be either making payments under an agreed to payment plan, or will be locked off for non-payment.

The board has educated themselves on the billing and collection procedures described in the Rules and Regulations of Water Service, and has brought action to bring enforcement of collection of delinquent water charges through disconnection of water service. The board's enforcement of the disconnection process is now current. Per Ordinance 3, Rules and Regulations of Water Service, Accounts that are delinquent will be disconnected within 60 days from billing of charges not paid (if not under payment arrangements).

Response: Santa Cruz County LAFCO Directors – AGREE to the extent that LAFCO does not have any information that contradicts the findings.

In its role as a boundary regulatory agency, LAFCO gathers information for its periodic preparation of service reviews and agency spheres of influence. When a boundary change application is filed, LAFCO prepares a detailed staff report that analyses the proposed boundary change. LAFCO has not received a boundary change application concerning the Lompico County Water District in many years. Therefore, LAFCO does not have first-hand information concerning any of the subsections of Finding F4. LAFCO does maintain a file of district bylaws that special districts in Santa Cruz County voluntarily submit, and any public agency is welcome to use these samples when drafting a set of bylaws.

- F5.** The board of directors failed to adequately oversee the financial activities of the water district and to verify that operations were conducted according to good business practices, and they made questionable business decisions.
- LCWD board did not set rates and charges at a level sufficient to provide for repairs and depreciation of works owned or operated by the district as required by California Water Code section 31007.
 - LCWD directors did not set rates and charges sufficient to cover the operational expenses of the water district, in part because they lacked the background or knowledge of bookkeeping and budgeting procedures in general, and they did not demand the information specific to the district that would allow them to set rates reasonably. In interviews, board members stated they were reluctant to impose higher rates on their friends and neighbors.
 - In 1998, the LCWD board made a voluntary \$100,000 CalPERS retirement payment on behalf of the district manager for ten years he had worked for the district prior to the adoption of the retirement program.
 - LCWD boards ignored or did not know about a 1999 resolution to cap the accrual of vacation and overtime pay to two years. The Grand Jury was unable to find any official action to rescind the limits. However, the board did re-impose the limits in 2009.

Response: Lompico County Water District Board of Directors – AGREE

Response: Santa Cruz County LAFCO Directors – AGREE to the extent that LAFCO does not have any information that contradicts the findings.

As a boundary regulatory agency, LAFCO does not gather detailed information such as retirement system payments or employee vacation accrual rules. LAFCO does not have information that verifies or counters the Grand Jury's findings.

F6. The past and present board of directors failed to provide adequate oversight of the personnel and personnel functions and activities of the district.

- The original Personnel Manual was rewritten and approved in early 2010. The approved manual is still incomplete because there are no job descriptions.
- The LCWD board did not conduct adequate due diligence to confirm the qualifications of new hires, specifically the district secretary.
- The LCWD board did not systematically conduct in-depth performance evaluations for the district manager.
- The LCWD board did not hold the site management adequately accountable for day-to-day activities, long-term planning, and financial tasks.

Response: Lompico County Water District Board of Directors – PARTIALLY AGREE

The current board, when made aware of the Personnel Manual, took steps to enforce and update these policies. The board met with extreme resistance from the manager and secretary on day-to-day activities, long-term planning and financial tasks.

Governance Conclusions

- C6.** The boards of directors consistently demonstrated a lack of knowledge and oversight of all aspects of the district's operations: governance, finances, management and facilities.
- C7.** The directors often appeared to disregard the California Water Code, the Director's Guide for Setting a Budget, the Lompico Water District Manual, the Board Policy Manual, and resolutions passed by preceding boards.
- C8.** Members of the board of directors appear to lack the financial knowledge necessary to develop and oversee a balanced budget and consequently may not be adequately prepared to guide the district in a financially sustainable direction.
- C9.** Because agendas are poorly developed and meeting minutes are incomplete and inaccurate, there is a lack of reliable records to allow consistent governance of the district's business.
- C10.** Board policies pertaining to personnel matters have at times not been followed.

C11. The board of directors did not hold the site management and staff sufficiently accountable from day-to-day activities to long-term planning.

Management

The LCWD district manager is an at-will employee reporting to the board, and management duties are outlined in the Personnel Manual and referenced in the Board Policy Manual. The district manager is responsible for the business activities and the day-to-day operations of the district. The other employees (two at the time of this investigation: the district secretary and the operations technician) report to the manager, who also serves as the safety officer for the district. While there have been many members of the board of directors through the years, there has been only one district manager over the past 20 years.

Management Findings

F7. The board of directors depends on the LCWD staff for accurate information delivered in a timely manner.

- The LCWD board did not receive timely and accurate board meeting agendas. Furthermore, protocol and board requests regarding the preparation of the agendas were at times disregarded or altered.
- For the last five years, management did not provide complete and realistic budgets for review and approval by the board.
- The urgency of infrastructure repairs was evident upon inspection of the physical plant. However, board members stated that management did not stress the importance of the need for immediate repairs.

Response: Lompico County Water District Board of Directors – AGREE

F8. The business and personnel activities of the district were not always conducted in a professional and appropriate manner.

- The district's independent auditor recommended hiring a bookkeeper in 2008; however, the district did not hire one, citing the lack of funds.
- In 2009, a district secretary was hired who had no bookkeeping experience, which was a specific qualification for that position. Selection protocol established by the board, such as posting the position in the newspaper, was not followed.
- Performance reviews for the secretary and the operations technician were not performed annually as specified in the Personnel Manual.
- Daily work logs sometimes were not completed and were not given to the board even when requested.

- The office file of customer work was not updated on a daily basis.
- Creditors' bills were not always paid in a timely fashion. Board members revealed that checks were written and then stored in the district office safe until adequate revenues arrived to cover the checks. Consequently, in July 2009 the board of directors asked the Santa Cruz County Auditor-Controller's office to take over payroll and other accounts payable functions.
- LCWD received a letter dated February 1, 2010, from the State Controller's Office Division of Accounting, informing it that the Annual Report of Financial Transactions had not been filed for the fiscal year ending June 30, 2009. The State imposed a \$5,000 penalty for non-filing.
- The Santa Cruz County Auditor-Controller's office performed an *Independent Accountant's Report on Applying Agreed-Upon Procedures* at the request of the LCWD board of directors and presented the report on December 3, 2009. The report revealed that sufficient and accurate data on payroll procedures was not provided to the County despite multiple requests.
- Communications and unresolved complaints from customers sometimes were not recorded in the minutes or addressed, nor were they always reported to the board.
- The main and satellite offices, and the records and files associated with the district's business, were not maintained in an organized, orderly fashion.

Response: Lompico County Water District Board of Directors – AGREE

The current board is addressing all items.

F9. The infrastructure was not maintained in good and working order.

- The California State Public Health Department (CSPH) shut down the LCWD water treatment plant from May 6, 2010 to May 14, 2010 because the water treatment filters (Memcor filters) in the plant were no longer viable. The filters dated from 1996 and the effective life span of the filters, according to their manufacturer, was seven years. New Memcor filters were installed on May 12, 2010.
- The monthly reports to the CSPH documenting the turbidity of the drinking water in LCWD were not accurate. The chart wheels that record daily turbidity provide the information that is transferred to the report form that is submitted to the CSPH. The information on the chart wheels should be exactly the same as information on the reports. Grand Jury members compared the two and noted that they did not match.
- A written capital improvement plan (CIP) was not found.

- There was no immediate systematic replacement plan for the faulty lateral pipes; consequently, failing pipes needed emergency repair, causing customers inconvenience and resulting in additional expense in overtime pay.
- Facility maintenance was not done on a routine basis; for example, the fire hydrants had not been flushed annually nor had the gate shut-off valves been checked regularly.
- There was no plan for the repair or replacement of the three finished water storage tanks that have severe leaks. Water tanks are leaking so seriously that pumps from the four district wells are being overworked to keep up with the loss of water. In addition, there is extra expense for the chemicals and power to treat additional water.

Response: Lompico County Water District Board of Directors – AGREE

F10. The safety of LCWD staff and the Lompico community was put at risk.

- Frequently just one employee responded alone to night emergencies, regardless of the weather.
- Employees failed to shore up the sides of the trench and walls of a deep excavation pit.
- The fire hydrants had not been flushed for several years, although they should be flushed annually.
- Zayante Fire District was not always notified of low water conditions that were a consequence of the tank leaks.
- Zayante Fire District was not always notified when LCWD was doing repairs or maintenance on the tanks and there was low water pressure or no water at all.

Response: Lompico County Water District Board of Directors – AGREE

Management Conclusions

- C12.** There often was poor communication between the board of directors and district management, and the board consistently lacked the accurate and complete information necessary to help it govern the district competently.
- C13.** The condition of the district's finances is so poor that the district is near collapse. Additionally, the infrastructure has deteriorated almost to the point of failure, and the board of directors was not properly apprised of the true condition of either the finances or the facilities.
- C14.** The lack of water or water pressure puts the residents of the community at risk of serious fire damage, particularly when the Zayante Fire District is not informed of conditions.

Recommendations

R1. The Santa Cruz County Grand Jury recommends that the board of directors of LCWD should continue to evaluate and, if appropriate, pursue a merger with the San Lorenzo Valley Water District (SLVWD) using one of the three options listed below. Although many residents of Lompico are passionate about their independent water district, the Grand Jury finds the ongoing crises facing this water district too overwhelming for it to handle by itself. Three merger options are listed in order of increasing complexity and time:

- (1) A working alliance with SLVWD using a Joint Powers Agreement (JPA) which is established by the two water district boards of directors. This type of agreement is very flexible. For instance, it could be used for management of the districts only, and can be revised as necessary. A JPA could go into effect immediately and could in time lead to LAFCO reorganization of the district.
- (2) A consolidation of LCWD and SLVWD through LAFCO. If the boards of each district file with LAFCO for consolidation, it would happen automatically. This process generally takes about six months.
- (3) Reorganization through application to LAFCO. Any party can file directly to LAFCO, for example, a group of property owners, registered voters, or a board of directors. Whoever applies pays the filing fee. This process usually takes at least a year and a half.

Response: Lompico County Water District Board of Directors – REQUIRES FURTHER ANALYSIS

The board is currently exploring the possibility closest to item (2), which would require dissolution of Lompico Water District; San Lorenzo Valley Water District would then request a Sphere of Influence amendment for the annexation of the territory of Lompico. The board has held a series of public meetings for education and community input. This action will require further negotiations of indeterminate time, and is also subject to the timeframe held by the LAFCo review process.

Response: Santa Cruz County LAFCO Directors – THIS RECOMMENDATION SHOULD BE IMPLEMENTED AS QUICKLY AS POSSIBLE.

This section has not been implemented yet because the Lompico and San Lorenzo Water Districts are studying their options, and no application has yet been filed with LAFCO. After receiving a consolidation or reorganization application, LAFCO will prepare a comprehensive report and conduct a public hearing on the application. LAFCO expects its review process and public hearing to take between three and six months. LAFCO staff has already provided information to Board Members of the Lompico County Water District and the San Lorenzo Valley Water District to explain the LAFCO processes. LAFCO staff attended a public forum at the Zayante Fire Station on July 8, 2010 at which the Lompico community discussed their options.

LAFCO acknowledges the 2009-2010 Grand Jury's thorough investigation of the Lompico County Water District, which emphasizes the problems facing the Lompico water system.

LAFCO notes the Grand Jury's recommendation, under Recommendation R2 on page 162, that the Lompico County Water District evaluate an immediate merger with the San Lorenzo Valley Water District. In the last ten years, LAFCO has reviewed two applications to "merge" water systems into the San Lorenzo Valley Water District--the Mañana Woods Mutual Water Company and the Felton Service Area of the California-American Water Company. Both mergers were complicated. In both cases, the San Lorenzo Valley Water District presented a professional service plan, LAFCO authorized the mergers, the affected communities found the costs to be reasonable. The San Lorenzo Valley Water District is now operating both of the merged systems in a manner consistent with the service plans that accompanied the original applications to LAFCO.

- R2.** The Santa Cruz County Grand Jury recognizes the possibility that LCWD might want to reorganize and recast itself as a viable water district. The difficulty of the challenges involved should not be minimized. Continuing the status quo would almost certainly lead to financial collapse and possible bankruptcy. If the board of directors of LCWD chooses this option, to remain an independent, unassociated water district, the following actions would be critical in the restructuring:
- (1) Adopt a clear and thorough set of bylaws as a binding ordinance.
 - (2) Establish a clear and binding personnel hiring and management system, and follow bylaws and the guidelines in the Personnel Manual when hiring staff.
 - (3) Separate business operations/administration from maintenance operations to allow the manager to run the district in a financially prudent manner without the potential conflict of interest that exists when serving two roles.
 - (4) Hire a permanent, qualified bookkeeper.
 - (5) Develop a training program for the directors to educate them in the business operations of a water utility, including: budgets and finance, parliamentary procedures, water utility functions.
 - (6) Create a reliable system to provide the board of directors full access to all of the district's business.
 - (7) Generate and implement a new financial business plan that includes:
 - a fee structure that guarantees that all operational expenses can be met,
 - an immediate assessment on all property owners to fund a capital improvement fund and a reserve fund,
 - a long range plan to increase revenues incrementally to continue to build the capital improvement and reserve funds, and

- the implementation of all recommendations made by the County Auditor-Controller’s office in the recent public report of December 2009 titled *County of Santa Cruz Report on Agreed-Upon Procedures of the Lompico County Water District For the Period June 30, 2005 through June 30, 2008*.

Addressing all the recommendations in (R2) would be daunting. It is unclear whether the current or future boards of directors will have the ability, knowledge, and strength-of-purpose to accomplish these tasks in a time frame that will prevent LCWD from financial or infrastructure collapse. **The Grand Jury highly recommends that LCWD evaluate an immediate merger with SLVWD (R1). Doing so will not necessarily be less expensive than the changes suggested in R2 but could prevent the failure of the water system.**

Response: Lompico County Water District Board of Directors – REQUIRES FURTHER ANALYSIS, PROBABLY NOT POSSIBLE

Perhaps if the board five years ago had been made aware of the district’s situation, they could have made the corrections necessary to survive.

The current board is working to resolve financial, management and structural problems. R2 would be a daunting task and possibly not financially sustainable by the community.

Commendation

The Grand Jury commends the actions taken in 2010 by the Lompico Water Board. This board has begun to recognize and understand the challenging issues facing the District and has taken difficult but necessary first steps to address them.

Responses Required

<i>Respondent</i>	<i>Findings</i>	<i>Recommendations</i>	<i>Respond Within/ Respond By</i>
Lompico County Water District Board of Directors	F1-F10 All parts, all findings	R1, R2	60 Days August 1, 2010
Santa Cruz County LAFCO Directors	F4, F5 All parts, both findings	R1	90 Days September 1, 2010

Sources

Emails

Member of County Counsel's Office
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Interviews

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Santa Cruz County Assessor's Office
Santa Cruz County Auditor-Controller's Office
Santa Cruz County LAFCO
Zayante Fire District
LCWD:
Administration and Staff
Board Members, past and present
California Environmental Consulting
Independent Auditor
Members of the County Board of Supervisors

Letters and Bills to/from LCWD

From California Department of Public Health, 2/8/2010
From California State Controller, 11/23/2009, 2/1/2010
From PG&E, 2/2/10.
From Department of the Treasury, Internal Revenue Service, 10/5/2009, 12/28/2009, 3/15/10
From Board of Directors LCWD to Local Government Reporting Manager, California State Controller's Office, 3/17/10

Meetings and Visits

LAFCO monthly meetings, August and September, 2009
LCWD Board of Directors and committee meetings:
August, September, October, November, 2009
LCWD facilities site visits: November 12, 2009, and May 14, 2010

Minutes

LCWD Board of Directors meetings, January 2006 to August 2009
Santa Cruz County LAFCO, 8/05/2009, page 19
Santa Cruz County LAFCO, 9/02/2009, page 9

Newspaper Articles

The Press Banner:

"Lompico Water Considers Rate Hike," Peter Burke, 5/07/2009
"Water Board Says Increase Necessary to Avoid Bankruptcy," Peter Burke, 5/21/2009
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"LCWD Under Investigation By Grand Jury," Peter Burke, 10/06/2009
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"Lompico Water Board Speaks Out," LCWD Board of Directors, 3/26/2010

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Photos

100,000 Gallon Tank, Lewis #I, 5/14/2010, courtesy of R. Perez

Publications/Documents

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California Water Code section 30520-31007

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A Director's Guide for Setting the Budget

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