

SACRAMENTO LOCAL AGENCY FORMATION COMMISSION
1112 I Street, Suite #100
Sacramento, California 95814
(916) 874-6458

September 1, 2010

TO: Sacramento Local Agency Formation Commission
FROM: Peter Brundage, Executive Officer
RE: Response to Grand Jury Survey of Independent Special Districts

RECOMMENDATION

Approve the attached letter to the Sacramento Grand Jury

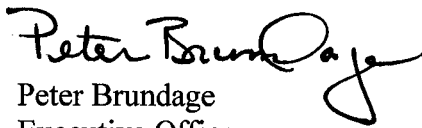
DISCUSSION

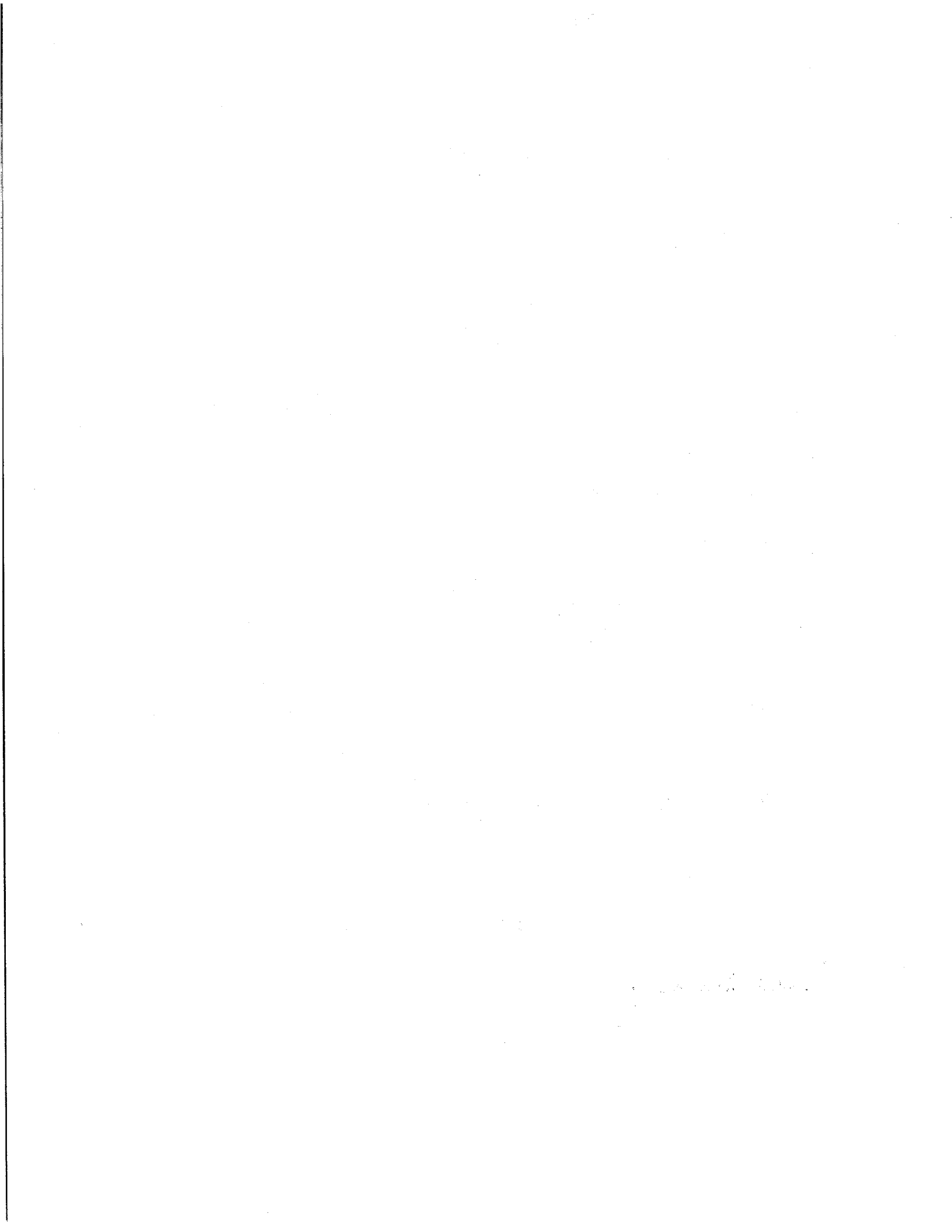
The Sacramento Grand Jury conducted a survey of 31 Independent Special Districts in Sacramento County. A copy the Grand Jury Report and Findings is attached. The Sacramento Grand Jury also made the Findings and Recommendations related to Sacramento LAFCo as set forth in the attached letter. This response is due by October 1, 2010.

In addition, staff has developed a status report and work plan related to Municipal Service Reviews. This plan incorporates the collaboration of independent special districts to incorporate their responses to the MSR questionnaire in Word format and provide supporting backup material and information. Carmichael Water District has recently completed their questionnaire and it appears that this may be a cost effective and efficient way to prepare the remaining MSR's. Regular progress reports will be provided to the Commission.

Respectfully Submitted

SACRAMENTO LOCAL AGENCY FORMATION COMMISSION


Peter Brundage
Executive Officer





SACRAMENTO LOCAL AGENCY FORMATION COMMISSION

1112 I Street, Suite 100 • Sacramento, CA 95814 • (916) 874-6458 • Fax (916) 874-2939

www.saclafco.org

DATE: September 1, 2010

TO: Honorable Steve White
Presiding Judge of the Sacramento Superior Court
720 9th Street, Department 47
Sacramento, CA 95814

FROM: Peter Brundage, Executive Officer
Sacramento Local Agency Formation Commission

RE: **Sacramento Local Agency Formation Commission Response to the Grand Jury Report related to Survey of Independent**

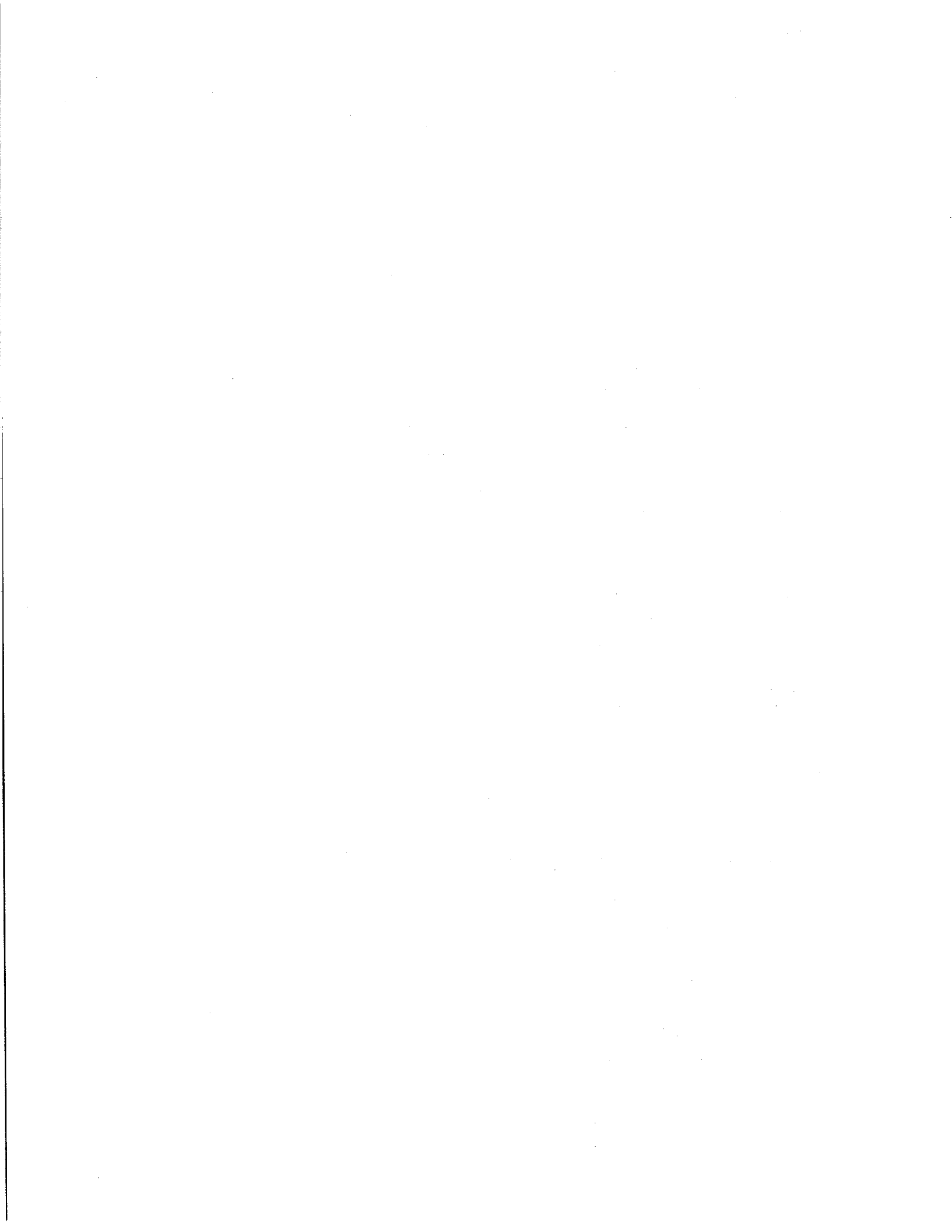
Pursuant to Penal Code Sections 933 and 933.05, the Sacramento Local Agency Formation Commission (Commission) submits the following comments and responses to the 2009-2010 Sacramento Grand Jury report on the Survey of Independent Special Districts.

Grand Jury Finding 6.0: Sacramento LAFCo is responsible for oversight of government agency functions and performance, and for all changes of agency boundaries and functions. Sac LAFCo has not completed the state mandated Municipal Service Reviews for the majority of Independent Special Districts in Sacramento County. If special district malperformance is identified, Sac LAFCo is often the last best hope for corrective action when Independent Special Districts fail to perform.

Response: Sacramento LAFCO agrees with the finding and is aware of its statutory obligations, but believes additional information is necessary for an effective discussion. Currently, prior to any public hearings for annexations, reorganizations, district formations, consolidations, and spheres of influence amendments the Sacramento Local Agency Formation Commission conducts Municipal Service Reviews (MSRs). MSRs are conducted on all project applications.

In Sacramento County most Independent Special Districts' (ISD) Sphere of Influence boundaries are coterminous with their District boundaries which abut another District's boundaries. There are relatively few unserved areas in Sacramento County resulting in few opportunities to meaningfully update ISD Spheres of Influence. The Commission agrees that notwithstanding a related proposal to revise or amend a Sphere of Influence, valuable information may be gleaned through the MSR process regarding the functions and performance of an ISD.





Grand Jury Recommendation 6.1: Sac LAFCo must conduct, and review as necessary, the state mandated Municipal Service Reviews for every Independent Special District.

Response: Sacramento LAFCo has implemented this recommendation as it has an approved plan to conduct a number of MSRs in any given year and it remains committed to meeting all of its statutory obligations. Very limited staff and fiscal resources limit the number of MSRs that are prepared in any given year. Additionally, because the Commission is tasked with limiting its costs and the contributions from local agencies, and because the Commission has received an unusually large amount of proposals over the last approximately 10 years, including four separate municipal incorporation proposals, the Commission is only able to prepare a finite number of MSRs. Despite these limitations the Commission has already completed 19 MSRs and an additional 15 MSRs are in the process of being completed. The Commission is also scheduled to complete another 10 MSRs in FY 2010-11, with the remaining MSRs scheduled for FY 2011-12. Finally, besides continuing to conduct MSRs of ISDs, the Commission will also endeavor to see that the ISDs meet their own statutory obligations, such as the Independent Financial Audit Report, by communicating the necessity of these actions to the ISDs.

Grand Jury Recommendation 6.2: Sac LAFCo must evaluate, and forthrightly judge, the performance of every Independent Special District. When needed, it should initiate reorganization (consolidation, dissolution, or annexation) proceedings to assure protection of public health, safety, and welfare.

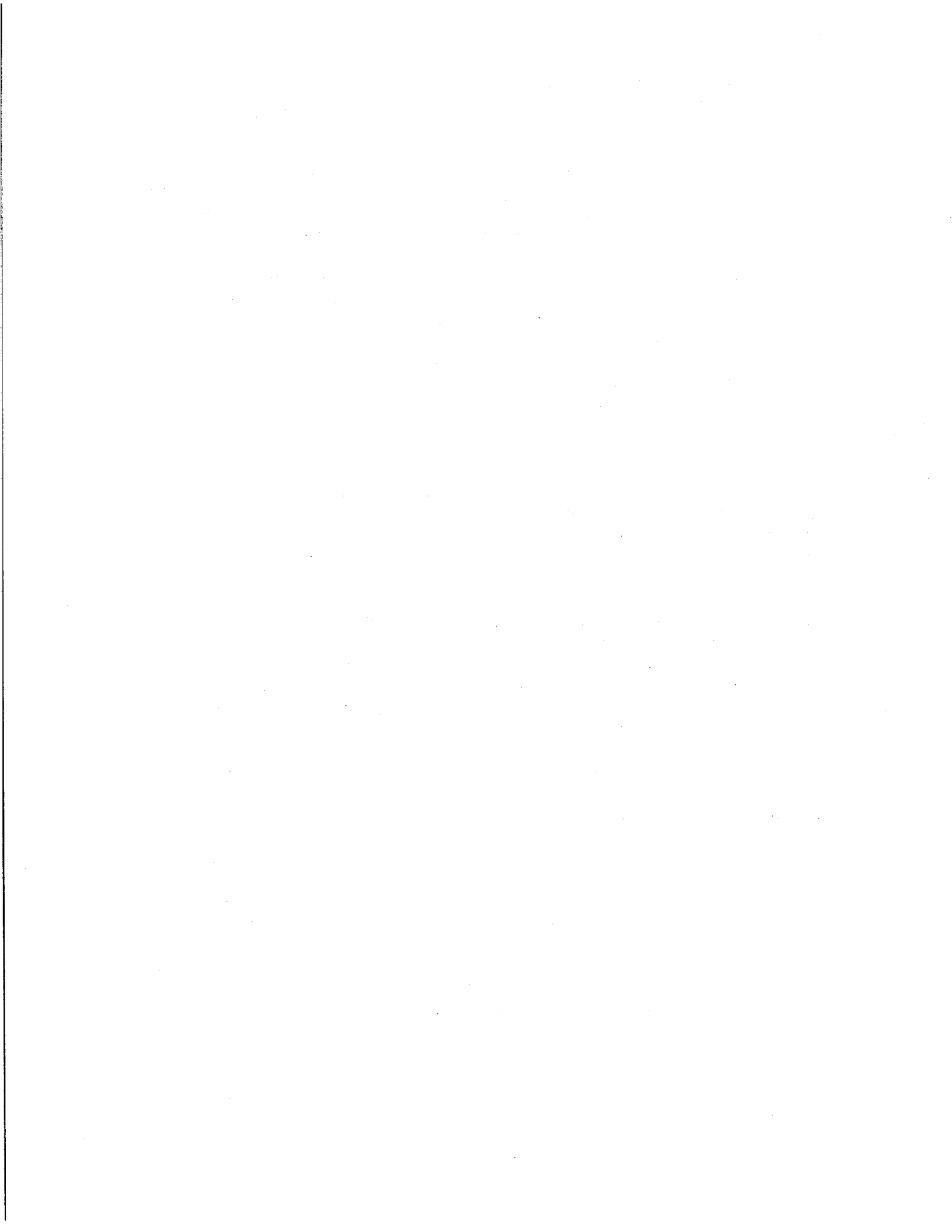
Response: Sacramento LAFCo has implemented this regulation and evaluates and forthrightly judges any ISDs when conducting a Municipal Service Review. In the past the Commission has taken necessary actions including reorganizing ISDs, such as fire protection districts, into more appropriate organizations. The Commission has used its discretion in the past to initiate consolidations, dissolutions, and/or annexations based on the results of an MSR and subject to the relevant protest provisions set forth in Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000.

If, in evaluating and forthrightly judging the performance of ISD through an MSR, the Commission determines reorganization is needed, the Commission will conduct any reorganization in accordance with the Cortese-Knox-Hertzberg Reorganization Act of 2000.

While the Commission has the authority to initiate Reorganization Studies and proposals and approve the potential reorganization of an ISD, current State Law provides that a Commission-initiated reorganization proposal is subject to the following protest provisions:

- a. At least 10 percent of the number of landowners within the affected territory who own at least 10 percent of the assessed value of land within the territory; or





- b. At least 10 percent of the voters entitled to vote as a result of residing within, or owning land within, any affected district within the affected territory.

(Gov. Code, § 57113.) Thus, if 10 percent of voters or landowners submit a protest petition an election is triggered. If a majority does not approve the reorganization, the reorganization is terminated.

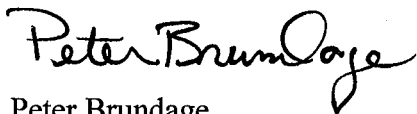
Grand Jury Recommendation 6.3: Local agency information on Sac LAFCo web site should be improved by including documents or links on Independent Special District budgets, required financial reports and audits, utility rate schedules, current regulatory citations and compliance orders, enabling laws and director rosters.

Response: Sacramento LAFCo links to all ISDs that maintain web sites (www.saclafco.org). Sacramento LAFCo will notify and encourage all ISDs to maintain and update their web sites to provide the information set forth in Recommendation No. 3.

The Commission submits the foregoing responses to constructively and effectively respond to the findings and recommendations of the Grand Jury. If the Grand Jury has any additional questions or concerns, the Commission will assist the Grand Jury in any way that it can.

Respectfully Submitted,

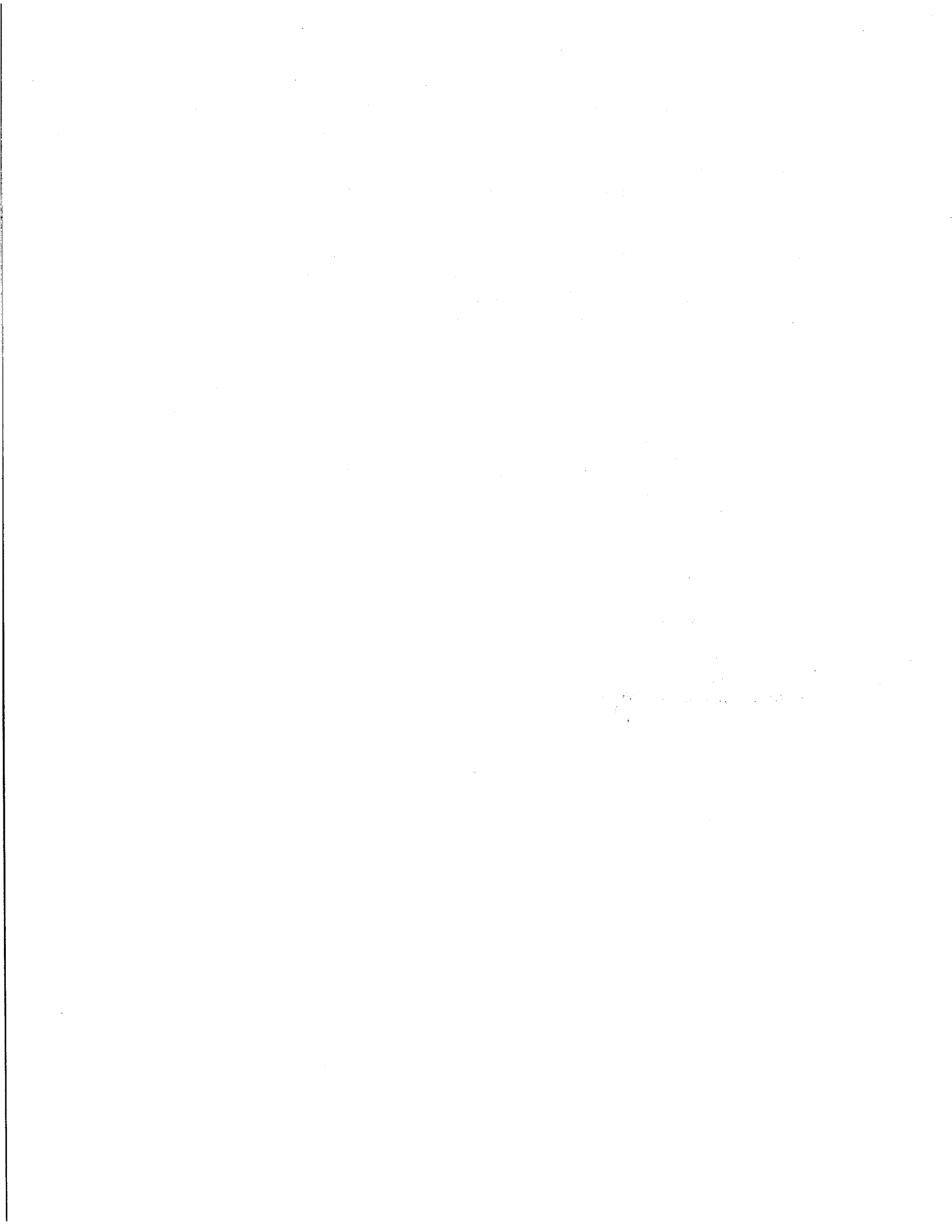
SACRAMENTO LOCAL AGENCY FORMATION COMMISSION



Peter Brundage,
Executive Officer

cc: LAFCo Commissioners





Survey of Independent Special Districts

By The Sacramento County Grand Jury

1. Summary

California's special districts are service-providing government agencies formed under state law. There are about 3,400 special districts in California, with about 100 in Sacramento County. They provide most of the local public services in this county. They fight fires, repair levees, provide water and maintain parks. They range in size from the River Delta Fire District with an annual budget of \$250,000 to the Sacramento Municipal Utility District with 2,100 employees and an annual budget of \$1.3 billion. While the names of these districts are probably known to most residents, their structures and governance are not well understood.

Some special districts are governed and managed by larger agencies, mainly cities and counties, or combinations of these in joint ventures. Other districts have their own elected boards of directors and operate autonomously. These are called independent special districts (ISDs) and are the focus of this grand jury's study. Thirty-one ISDs in Sacramento County were selected for inquiry and were sent a mailed questionnaire. These 31 ISDs serve the urbanized portions of Sacramento County. All of them responded and cooperated with this grand jury project.

The governance and operations of ISDs are nearly invisible to many citizens. They operate with little financial oversight or public scrutiny. That is because they are mostly smaller, single purpose organizations which do their important but routine jobs effectively without fanfare. Their functions and their elections do not evoke much media attention unless their services are interrupted, their rates increase, or an extraordinary problem arises.

The low visibility of most ISDs can be a source of problems and suspicions about the districts and their management. The grand jury's concern about some ISD management and governance practices arose from citizens' complaints, previous grand jury reports, state level studies of ISDs and numerous media reports. The issues addressed in this report relate to four areas of governance and management.

- District boards of directors' practices and policies
- District employees' pay and pensions
- District financial reporting and purchasing

- District oversight by the Sacramento Local Agency Formation Commission (SacLAFCo)

The grand jury used the information submitted by the selected 31 ISDs, where it was adequate and definitive, to assess these practices. Obviously, there are many differences among the studied ISDs regarding their terminologies, formats, and policies. There are no “cookie-cutter” model approaches to most district practices. However, each district hires and pays employees, purchases products and services, sets rates, and keeps accounts and records. There are also basic legal and regulatory requirements, ethical and business standards, and plain good-sense practices which apply to all ISDs. The grand jury calls attention to these benchmarks and good practices and departures from them.

Answers provided by ISDs to the grand jury questionnaire revealed the following:

- One-third of all ISD directors are initially appointed rather than elected
- Two-thirds of the districts are not conducting management audits
- Changes in ISD pension formulas in the last ten years have significantly increased pension awards
- Millions of dollars are being spent by the districts in uncompetitive purchasing
- SacLAFCo has completed only a few of the required Municipal Service Reviews
- Only 58% of the ISDs reported filing the required financial audits

Most of the findings and recommendations call for ISDs to review and improve their management and governance practices. One of the practices which needs improvement is the method of awarding pension benefits. The surveys reveal wide differences in pension awards with serious instances of compensation spiking and pension boosting. ISDs must work to ensure that employee benefits are responsible, fair and sustainable.

The final section of this report defines the oversight powers and role of SacLAFCo. SacLAFCo is the only “regulatory” agency with the power to approve special district functions, boundaries, and spheres of influence (extended areas of probable future service). SacLAFCo also has the power to assess whether each agency is efficiently and satisfactorily providing the public services for which it is responsible. In cases of district dysfunction, SacLAFCo has the power and responsibility to initiate corrective changes. It has not done so. SacLAFCo needs to strengthen its role and fulfill its responsibilities.

2. Foreword

California special districts are service-providing government agencies formed under, and enabled by state laws. There are numerous California enabling laws under which more than 3,400 special districts have been formed. Special districts are most commonly formed to provide essential and desirable public services in areas where such services are not provided by counties or municipalities. In fact, the majority of all public services in California and in Sacramento County are provided by special districts.

Special districts have, for a century, been vital components of Sacramento County's urban development. Outside the City of Sacramento, the county's urbanization occurred in dozens of communities and places deemed too small to incorporate as cities. As these unincorporated communities grew, their service needs were most often met by the formation of special districts charged with providing their service areas with a specific service, or combination of services. In recent decades several new cities have been formed in Sacramento County and the number of special districts in the county has plateaued, now being about 100. The new Sacramento County cities have each assumed operating responsibility for certain public services. But many enterprise services (i.e., revenue producing functions) have remained with Sacramento County (e.g., wastewater disposal), or with existing independent special districts. Examples of the latter situation are Citrus Heights Water District serving in the City of Citrus Heights, Sacramento Metropolitan Fire District serving most of the newly formed cities' residents, and Cordova Recreation and Parks District serving the City of Rancho Cordova.

There are many kinds of special districts, conveniently divided by type of service rendered, and type of political organization. Independent Special Districts (ISDs) are those that were formed (under state law) independent of any other political entity, and have a governing board whose members are elected by the voters residing within the ISD. Directors serve for a prescribed term, usually four years. There are some variations, but this common definition of Independent Special District is used herein. There are about 2,300 ISDs in California, including 63 in Sacramento County. These ISDs do a remarkably good job of providing essential services. One reason they do so is that their efforts and energies are sharply focused on the specific service(s) they are chartered to provide.

Most citizens know relatively little about the special districts which serve them and many take their services for granted. Not surprisingly, this relative "invisibility" can sometimes obscure district performance or political behavior that does not meet formal requirements or public expectations.

3. Reasons for This Survey

The Sacramento County Grand Jury became concerned about some management and governance practices of some of the county's ISDs. Concerns about potential inadequate or

inequitable practices have arisen from complaints to this grand jury, past grand jury investigations, and from news media reports. This project focused on ISDs because they often do not have the established resources and oversight mechanisms that dependent special districts have. The dependent special districts generally operate as subsidiary arms of counties or municipalities and their governing boards are, by law, drawn from, or appointed by, the boards of their "parent" agencies.

It was decided to include in this study a survey of all ISDs serving urbanized portions of Sacramento County. Thirty-one ISDs meet this criterion (Table 1). Excluded from this list were small reclamation districts, mainly rural, whose sole or main function is protection of agricultural lands from flood damage, school districts and joint powers authorities.

Table 1
Sacramento County
Independent Special Districts
Surveyed by the 2009-10 Sacramento County Grand Jury

1. American River Flood Control District
2. Arcade Creek Recreation and Park District
3. Arden Manor Recreation and Park District
4. Arden Park Recreation and Park District
5. Carmichael Water District
6. Citrus Heights Water District
7. Cordova Recreation and Park District
8. Cosumnes Community Services District
9. Del Paso Manor Water District
10. Delta Fire Protection District
11. Fair Oaks Recreation and Park District
12. Fair Oaks Water District
13. Florin County Water District
14. Fulton-El Camino Recreation and Park District
15. Herald Fire District
16. North Highlands Recreation and Park District
17. Omochumne-Hartnell Water District
18. Orangevale Recreation and Park District
19. Pacific Fruitridge Fire District
20. Rancho Murieta Community Services District
21. Reclamation District 1000
22. Rio Linda/Elverta Community Water District
23. Rio Linda-Elverta Recreation and Park District
24. River Delta Fire District
25. Sacramento Metropolitan Fire District
26. Sacramento Municipal Utility District
27. Sacramento Suburban Water District
28. San Juan Water District
29. Sloughhouse Resource Conservation District
30. Southgate Recreation and Park District
31. Wilton Fire Protection District

This survey is not comprehensive; it focuses on selected issues. Concerns about management and governance fall into several categories. In question form, they include the following:

District Boards of Directors

- Do ISDs have adequate by-laws or rules of procedure to govern the conduct of district business and meetings of the boards of directors?
- Are appointments to director positions used to avoid open elections?
- Is there enough turn-over of ISD directors to ensure vigor, innovation, independent judgment, and fresh ideas? Should there be some form of term limits?
- Are ISD directors' pay and benefits equitable and transparent? Do directors enjoy any district-paid health or retirement benefits?
- Are ISD boards obscuring important but sensitive matters by approving them on consent calendars? Are executive pay decisions made by consent calendar?

District Employee Pay and Pension Practices

- Are pay or rank increases granted for superficial diplomas, degrees, or certificates?
- Are pension increases granted for short-term or unusual (non-universal) increases of final compensation ("compensation spiking" and "pension boosting")?
- What are recent actual pension awards compared to a "baseline" pension award based on actual base salary and a common pension formula?
- What trends in pension awards are evident and need further scrutiny?

Financial Reporting and Purchasing

- Has the district filed each year, complete and timely, the state-required Financial Transaction Report?
- Has the district filed each year, complete and timely, the state-required annual Independent Financial Audit?
- Have regular and substantive management audits or reviews been completed by an independent professional auditor?
- What percent of the total cost of purchased goods and services were purchased without competitive bids or from other than the lowest bidder?

- Do district employees or directors accept any goods, meals, services, travel, or entertainment from vendors or providers (past, present or prospective)? Are there appropriate rules governing gratuities?

ISD Oversight by Sacramento Local Agency Formation Commission (SacLAFCo)

- Have SacLAFCo Municipal Service Reviews (MSRs) been completed for each district?
- Has SacLAFCo taken appropriate initiative to correct ISD inadequacies, and eliminate unneeded non-operating ISDs?
- Can SacLAFCo improve public information and public understanding of information about special districts?

4. Survey Method

The 31 selected ISDs (Table 1) were surveyed with a questionnaire mailed to each of the districts' chief executive officer. While it was recognized that a common questionnaire cannot address all the many differences among the surveyed districts, it was useful to:

- Obtain a broader, more balanced knowledge of where problems may be occurring.
- Note differences from norms which might warrant more attention.

To their credit, all of the surveyed ISD executive officers responded to the grand jury survey. Thirty-one questionnaires were sent; 31 replies were received. There were differences in completeness of the replies, but all replies represented the districts' major efforts to be responsive. The questionnaire replies were reviewed, then data were written on forms from which spreadsheet inputs were made. Most of the results and findings presented below used this data bank.

Disclaimer: In this report, the numbers of ISDs, directors or retirees are not always the same in all the figures shown. They vary because of incomplete data provided by the ISDs. Some ISDs provided answers to all the questions; some did not or provided obviously incorrect data. The decision was made to use only data that appeared to be correct. In some cases, the numbers were different because the comparison only included a given subset of the total (e.g. public safety retirees or miscellaneous retirees).

5. Background and Facts

Information obtained from the survey of Sacramento County ISDs and other sources was used to prepare this section. It is presented in generally the same order as the issues outlined

above. For each issue the background and focus of this report are explained, and the facts and findings of the project are presented.

5.1 District Boards of Directors

Governing boards of elected directors are critical to the effective functioning of ISDs. In general, these directors are residents of the districts and are elected by the voters in the district for specified terms (usually four years) as set forth in the ISD enabling law. The size of the ISD boards varies; most commonly there are five directors. Several models of director representation are used by ISDs. Most commonly they are either (1) all directors elected at-large to serve either at-large or to represent delineated zones of the ISD (usually termed districts or wards), or (2) elected by voters in wards to serve those wards. The latter model is usually preferred by local ethnic or interest groups as it maximizes their chance to be better represented. In the past few years some at-large elections have been successfully challenged for violating the California Voting Rights Act of 2001. More challenges are pending. When a board seat becomes vacant, an ISD board has the option of leaving the seat vacant, if a general election is scheduled within a few months time, or appointing a new director, or doing nothing (e.g., a political impasse), in which case an appointment can be made by the county board of supervisors.

Every ISD is required by law to have a formally adopted set of by-laws or rules of procedure to establish its responsibilities and procedures and govern its conduct and governance process. All of the ISDs surveyed for this project have adopted by-laws or rules of procedure, but some are outdated and some inadequate. Good practice would dictate that every ISD should have by-laws drafted with the help of an attorney experienced in public agency law, and should periodically review and update their by-laws.

Accusations of unconstructive behavior or dereliction of duty by directors are common. This grand jury received complaints regarding such behavior at ISDs. District directors must comply with the California Ralph M. Brown Act²⁹ (open meeting law) and basic rules of diligence and behavior, and provide penalties or impeachment for violation of these rules. District counsels and general managers can be helpful in identifying potential violations of the by-laws.

Other grand jury studies have shown a surprisingly high percentage of appointed versus elected directors in some ISDs. Understandably, this raises the questions of whether director appointments are being used to avoid open and fair elections, and whether incumbents are strategically resigning their seats before elections to aid the selection of their cronies, who

²⁹ http://www.ag.ca.gov/publications/2003_Intro_BrownAct.pdf

thereby gain incumbency and usually safe tenure. In this survey, the percentages of all 209 directors, sitting on ISD boards in the last decade, who were originally appointed, are:

All surveyed ISDs.....33 % appointed

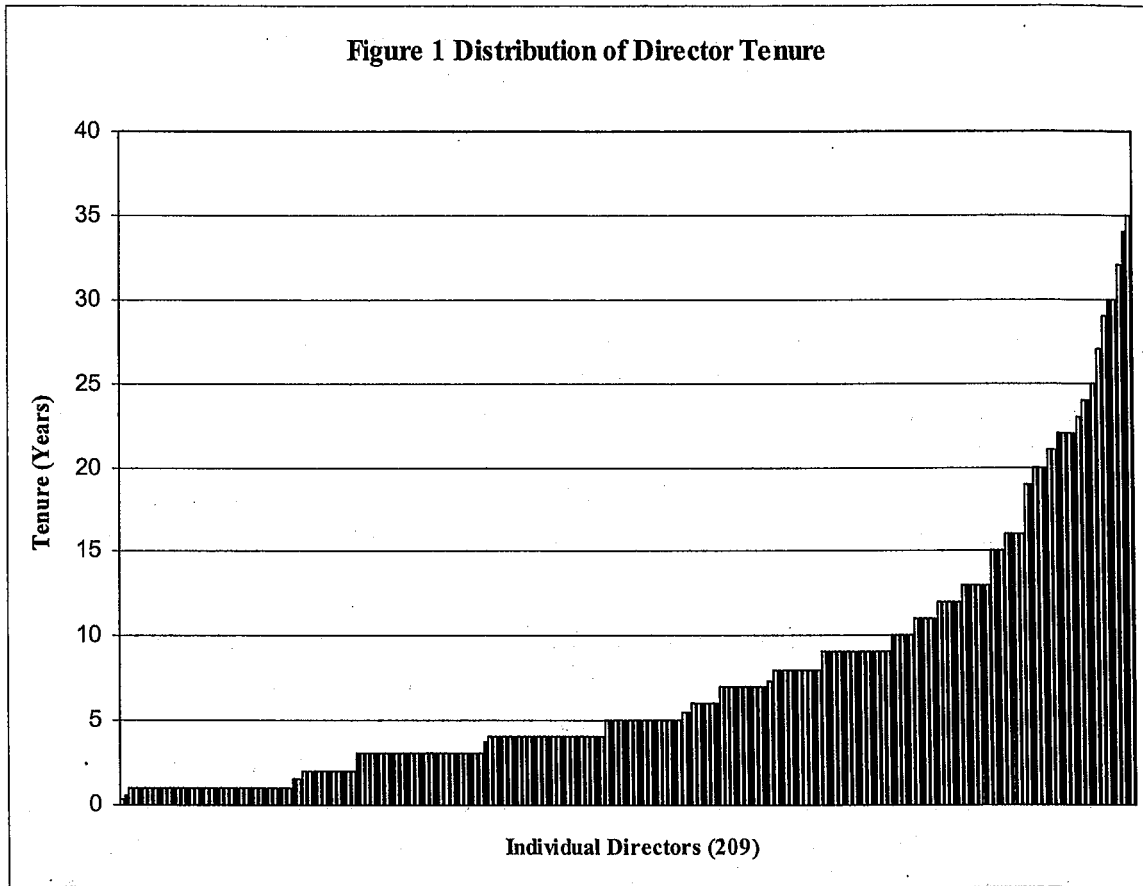
Water districts..... 28 % appointed

Fire districts..... 39 % appointed

Corresponding director appointment data for Sacramento County were reported in 2000 by the state Little Hoover Commission.³⁰ Water district director appointments have improved (28%, down from 43% in 2000), but fire district appointments have gone up (39% from 36% in 2000). The appointment percentages could be further reduced, and the competition for open director seats (both elected and appointed) increased through enhanced public information efforts. Only half of all Sacramento County ISD director seats were filled by contested elections.

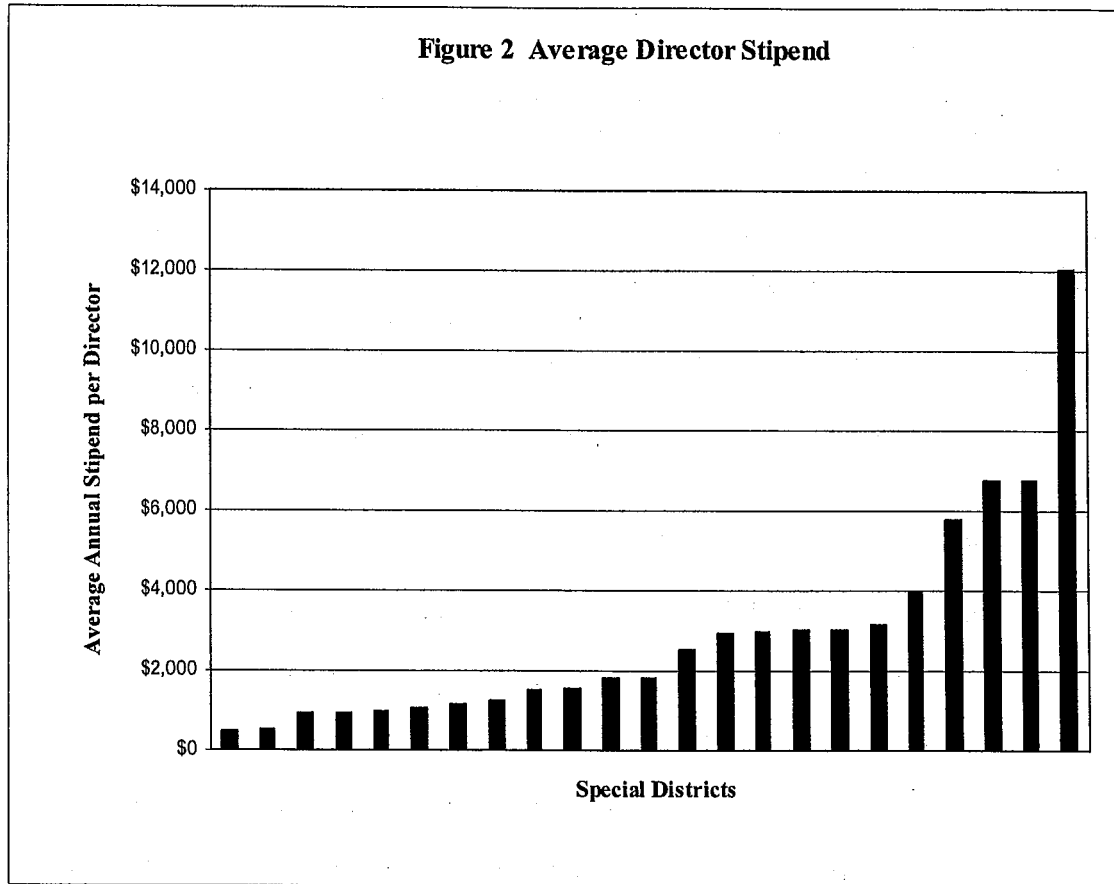
A parallel concern about ISD directors is whether there is enough director turnover to ensure vigor, innovation, and fair representative governance. Figure 1 shows the distribution of tenure among all surveyed ISD directors who occupied seats in the last decade for whom adequate information was available. Median tenure was 5 years, and the maximum 35 years. Ten percent of this group of directors has served at least 20 years, and most of them are still serving. As with any term limits debate, there are pros and cons for limiting ISD director tenure. The objective here is to stimulate discussion of whether communities would be better served by limiting ISD director tenure.

³⁰ "Special Districts: Relics of the Past or Resources for the Future?" May 2000, California Little Hoover Commission.



ISD directors' compensation and benefits vary considerably. As mentioned earlier, no employee-like benefits (e.g., pensions or health insurance) are known to be granted to current directors. The most common directors' compensation, which is the largest directorial cost for most ISDs, is directors' meeting stipends. Among the surveyed ISDs such stipends vary from zero to \$12,056 annually and most pay stipends for only one meeting per day. The median annual directors' stipend is \$1,839. Figure 2 shows the distribution of average annual directors' stipends. Each bar in the figure represents one ISD. Most boards set their own stipends, usually with an eye on the practices of similar districts. In the survey the reported average annual cost (including stipends and expenses) per director was \$3,803, and the median cost was \$1,976. Most ISD directors are undercompensated for the effort and value they contribute.

Most complaints about ISD director costs in recent years have been aimed at travel and entertainment expenses. It is clear that some ISDs (e.g., some larger districts and some water districts) became complacent about entertainment and other unnecessary board expenses.



The principles of propriety and proper cost control are simple. They are:

1. All directors' expenses and reimbursements should be budgeted and individually approved by the full board.
2. Expenses should be incurred only by board members (not guests), and should be limited to documented necessary expenses of reasonable participation in scheduled, approved professional activities.

3. If meals, entertainment, or other services are accepted from other persons or entities, they should be limited, transparent, and consistent with state law and written policies of the board.

The California Political Reform Act (Government Code Sec. 81000), which created the state Fair Political Practices Commission (FPPC), imposes strict limits on gift acceptance and reporting by public officials. Gifts over \$50 (per source, cumulatively) per half-year are reportable on FPPC Form 700, and gifts are prohibited from exceeding \$420 per calendar year (in 2010). There are numerous other restrictions in the FPPC "fine print." Form 700 is filed twice per year by each official. FPPC penalties and exposure for improper filing are severe, and have effectively limited improper political gift giving.

Consent items are included on the board meeting agendas of almost all the surveyed ISDs. Consent items usually encompass a few or several sub-items which all get approved with one vote when the consent item is adopted. The consent item procedure is an efficient way for a board to act on items of business which are small in impact and, generally, have been vetted by a board committee or workshop before the formal board meeting. Good practice, which is followed by most but not all ISDs, puts these limitations on the use of board agenda consent items:

1. The consent item process and limitations are specified in the ISD by-laws.
2. Consent items and sub-items are documented in the agenda packet.
3. Any director can unilaterally remove any consent item or sub-item.
4. Consent items should be limited in dollar value.
5. No executive or director compensation decisions should be made by consent item.

In this survey not all ISDs comply with these practices. Management and legal counsel can help review and revise policies regarding use of consent calendars.

5.2 Financial Reporting and Purchasing

Independent special districts, as the adjective "independent" implies, are highly autonomous entities which operate with little financial oversight or scrutiny. ISDs are required by California law to submit two financial reports each year to the California State Controller. These two reports are the Financial Transaction Report and the Independent Financial Audit report. Other matters discussed in this section are management audits and no-bid purchasing.

5.2.1 Financial Transaction Report

Filing the Financial Transaction Report is required by California Government Code Section 12463. This is a highly formatted report, with the format provided by the state controller.

The reporting special district simply fills in the blanks. This allows all districts to present their information in a uniform, consistent manner and reduces the controller's workload. The controller is able to spot anomalies quickly and easily by comparing current reports with past reports and by comparing current reports between like districts.

There are two forms of this Financial Transactions Report, one for enterprise districts (financed by user fees) and another for non-enterprise districts. They differ in detail, but each demonstrates whether or not the district is solvent. Enterprise districts report operating and non-operating revenues, operating and non-operating expenses, and profit or loss. Non-enterprise districts report revenues, expenditures, financing sources, and whether or not the combination of revenues plus financing sources exceeds expenditures.

A district which fails to file a timely report can be punished, per California Government Code Section 53895. Failure to file a timely report results in a fine of up to \$5,000, and the case can be referred to the California Attorney General for action. If a district files an erroneous report, the controller may commission an audit of the report and the district will be responsible for the cost of the audit, per Government Code Section 12464.

Financial Transaction Reports for each special district are available on the California State Controller's web site³¹ back to Fiscal Year 1995-96. Each of the districts in this survey has filed timely reports, according to the web site.

5.2.2 Independent Financial Audit Report

Filing this report is required by California Government Code Section 26909, and must be submitted within twelve months of the close of each special district's fiscal year. This report must be prepared by a Certified Public Accountant (CPA), an accredited accounting firm, or a county auditor. The report goes into much greater detail than the Financial Transaction Report, reporting on more than profit and loss. It assesses a district's overall financial health and its likelihood to stay in business, and makes recommendations for improving its financial governance. It notes trends and other factors beyond the district's control which may affect its financial future. By its nature, this report is not conducive to being completed by filling in the blanks.

Thirteen of the thirty-one surveyed districts indicated they had not filed this report, or did not respond to the question. Although filing the report is a requirement, there is no penalty for failure to do so, and there is no penalty for failure to file a timely report. This report is not included on the California State Controller's web site.

5.2.3 Management Audits

Performance of periodic management audits is important to the health of any organization, whether it is a small business, large corporation or a government entity such as a special

³¹ http://www.sco.ca.gov/ard_locarep_districts.html

district. It is troubling that twenty-five of the 31 districts surveyed have not had a management audit during the past five years or did not respond to the question. Management audits are normally performed by a multi-disciplinary team and are often headed by a management consultant. These audits, when done properly, are comprehensive and thorough examinations of a district's management and governance, and answer such questions as:

Do the district's management and employees understand the district's mission?
Are the employees adequately trained?

Are employees fairly compensated with wages and benefits?

Are taxpayers' funds spent wisely?

For enterprise districts, are customers getting their money's worth?

Are there better, more efficient ways of providing service?

5.2.4 No-bid Purchasing

Sixteen of the 31 districts surveyed in this study did not respond to the questions about no-bid purchasing. Five districts reported 25% or less of their purchase amounts were made without competitive bidding. The remaining ten districts reported more than 25% of their purchases were made without competitive bidding. For the five-year period of this survey, these ten districts spent more than \$200,000,000 without competitive bidding, an average of more than \$40,000,000 per year of taxpayer or utility customer funds. A significant portion of these amounts may have been spent for utility services, emergency construction and other items where no-bid purchasing was appropriate.

5.3 District Employee Pay and Pension Practices

It is a universal truth that, to provide high quality services over the long term, ISDs must attract and retain high quality employees and must compensate them fairly. In our society, fair compensation of public service employees includes good health care insurance and attractive pensions. Until recent years, some ISDs warped the definition of employee benefits to include district directors. Most people now believe that it is poor public policy to pay employment benefit rewards to directors or other citizen politicians.

5.3.1 Rewards for Training and Education

The 2008-2009 Sacramento County Grand Jury investigated payment of monetary rewards to county special district employees for obtaining educational degrees and certificates. At least half of the ISDs surveyed in this study currently have some form of economic incentives for learning achievements. Most of these programs are valuable, rational, and moderate, but, up to 2009, some gave monetary awards for superficial degrees. These commonly called "diploma mill" degrees are issued without rigorous

training by private for-profit institutions, often with the terms “university”, “college”, or “institute” in their names. Private postsecondary training is a huge business in our country and proportionately larger in California. It is growing rapidly because of the surge of computer-based remote teaching (“distance learning”), and the ease of obtaining superficial degrees. The high pressure recruiting practices of some for-profit educational organizations are well documented. This report is concerned with their academic value.

It is important that each public agency evaluate employees’ certificates before they are accepted as prerequisites for hiring, compensation or job promotions. Cost reimbursement (or direct sponsorship) of the cost of bona fide education is commendable and constructive. Educational prerequisites for job and salary advancements are effective and well established. However, direct economic rewards (such as bonuses or one-time cash payments) are of questionable value and can lead to diploma mill abuses.

Broadly stated, there are three ways that legitimate degrees and certificates can be recognized by agencies for hiring and advancements:

1. Accredited postsecondary degrees: Accreditation of degree issuing institutions is done by national accrediting agencies or commissions. Acceptable accrediting agencies are recognized by the U.S. Department of Education, Office of Postsecondary Education (OPE). There are “accrediting” organizations that are not recognized by OPE. Good management policy dictates that degrees/certificates be recognized only if granted by a higher education institution accredited by an OPE recognized accrediting agency.
2. State approval of private postsecondary institutions: After years of substandard private postsecondary regulation in California, AB 48 was signed by the governor in October 2009, creating the California Bureau for Private Postsecondary Education (BPPE). The new BPPE approval process now provides oversight and conditions for acceptance of degrees and certificates from non-accredited educational organizations.
3. Professional and trade certificates that are mandated, regulated or recognized by state law: There are many forms of such requirements. They vary from professional practice licenses (e.g., health practitioners, engineers, etc.) to certificates required for protection of public health and safety (e.g., water system operators). There are dozens of such required certifications. All are regulated by the State of California, and all carry reasonable assurance of their appropriateness and adequacy.

Good practices require that each ISD periodically review its education-based requirements for conformance with the above principles. If in doubt, the agency can obtain the expertise of a postsecondary education consultant to maximize value and avoid abuse.

5.3.2 Pension Awards

Public agency pensions and other retirement benefits are a large and growing burden on public resources. There is much current discussion and debate about the magnitude and management of these benefits. Recently, several efforts have been made to change benefits policies. This report focuses on only a few aspects of the entire pension/benefits dilemma.

Most Sacramento County ISDs are member agencies of the California Public Employee Retirement System (CalPERS). Accordingly, some 95% of the ISD employees addressed in this study are employee members of CalPERS. CalPERS' main functions are to operate the world's largest fixed-benefit state employee pension program, and to manage a complementary health care insurance program to which Sacramento County ISDs can subscribe. Health care is the largest component of retirees' non-pension benefits which, collectively, are usually termed "other post-employment benefits" (OPEB). This report does not focus on the CalPERS health care program or its funding, though clearly it is of great importance and great public policy concern because of rapidly rising health care costs and retiree longevity. CalPERS applies similar management, actuarial, and funding principles to its OPEB and its pension programs. However, such protections are not universal among public OPEB plans.

A fixed pension benefit is one which is determined by an agreed formula applied to all like members of a group or pool at the time of each employee's retirement. The CalPERS pension pools are financed by a fixed contribution by each member employee (generally 7% of miscellaneous compensation; sometimes paid by the employer on behalf of the employee), and a variable contribution by the employer agency. The employer contribution is varied according to a CalPERS "smoothing formula" which is designed to maintain a stable long-term balance in the pension funds and avoid risky levels of unfunded liability. Each employer contribution is evaluated annually, and revised as needed.

Unfunded liability of a benefit fund is a valuable indicator of the long-term fiscal health of a benefit program. This parameter is formally termed the "unfunded actuarial accrued liability" (UAAL). Unfunded liability is a useful indicator only if the concept is precisely defined and carefully used. For this study, unfunded liability of the pension pools is defined as:

The present value of an actuarially anticipated long term series of contractually obligated benefit payouts minus the present value of fund assets and an anticipated series of contributions and earnings.

Present values of future pension fund earnings and obligations are calculated using assumed earning and discount rates (usually the same rate for both). The annual rates currently used by CalPERS are 7.75%. Some economists point out that calculated unfunded liability is very sensitive to this assumption, and that using a more current, more conservative discount rate could raise CalPERS unfunded liability several-fold.

The “funded ratio” of a benefit fund is the ratio of these two defined series; i.e., the percentage of anticipated fund obligations that is covered by anticipated assets and income. In recent years CalPERS’ overall unfunded liability has ranged from about \$20 billion to a current amount of about \$40 billion. Its funded ratio has varied in recent years from a high of 118% to a current low of about 87%. The funded ratio is an important measure of benefit fund health. It is not as volatile as the unfunded liability. Most benefit fund professionals believe that a funded ratio below about 80% is reason for concern. CalPERS has always exceeded this criterion.

There are many assumptions that go into these complex funding calculations. The resulting unfunded liability (expressed as dollars or funded ratio) can vary markedly with these assumptions. All actuarial and economic assumptions are evaluated by CalPERS at intervals not exceeding three years. Large variations of CalPERS unfunded liability also occur because of investment market conditions, number of public employees, and benefit enhancements. Recent unfavorable changes in all these variables have led to the doubling of CalPERS’ unfunded liability, and to major increases of required employer contributions. More increases of both are expected. This phenomenon has been termed by California’s governor as a “freight train” and “the single biggest threat” to California’s future, and by the CalPERS chief actuary as “unsustainable.”

This report looks only at the CalPERS pension programs to which most ISDs subscribe. Although many citizens and many public policy pundits believe that public employee pensions are too generous and are unsustainable, the grand jury makes no judgment on these basic questions but looked closely at pension award trends and fairness, especially pension “spiking” and “boosting”. These terms are vernacular for pension increases granted for short-term or unusual (non-standard) increases of employee final compensation upon which a lifetime benefit is computed. This report uses similar terms in very specific ways:

“Compensation spike” is the CalPERS’ reported final pensionable compensation divided by the retirees’ next to last year basic salary.

“Pension Boost” is CalPERS’ unadjusted initial pension award over a calculated baseline pension amount.

CalPERS, and other public employee pension plans, recognize the unfairness and seriousness of compensation spiking and are trying to control it. CalPERS disallows the inclusion of overtime pay in pensionable compensation, and it has a compensation auditing program whose function is to catch retiree compensation violations or errors by ISDs and other member agencies. CalPERS recognizes that its rules and its auditing program need improvement and is trying to make improvements. Many of the details of pension formulas

and spiking rules are prescribed by state law and are beyond CalPERS' direct control or influence. As California's benefits funding crises loom larger, more agencies and interest groups, including the ISDs, will demand reform.

There are many ways that a retiree's final pensionable compensation and pension can be spiked. Some of these are plain cheating, but more are legal although they may represent poor public policy. Each CalPERS member agency selects the desired pension formula from a list of options. In the last decade, there has been a trend toward selecting higher pension formulas (higher percent per year payouts) and calculating pensions on the retirees highest 12 months of compensation rather than 36 months. In the last decade, the surveyed ISDs that base final compensation on 12 months increased from 33% to 67%. This change not only invariably increases the pensionable compensation but also makes it more likely that compensation gimmicks can be used to spike pensionable compensation. In 2006, in an effort to call attention to the pension boosting issue, the Sacramento County based watchdog organization Peoples Advocate published a booklet "30 Ways To Spike Your Pension". This booklet and other similar testimony was scoffed at, but not refuted, in testimony at a May 2007 hearing of the California Governor's Public Employees Post-Employment Benefits Commission (the Parsky Commission). The commission's December 2007 final report, Funding Pensions & Retiree Health Care for Public Employees, made 34 specific recommendations addressing every aspect of retiree benefits funding. Most of these recommendations await implementation.

Sacramento County ISDs that are members of CalPERS pension plans have elected a variety of pension formulas for their employees. Their current pension formulas are listed in Table 2, and their distribution is shown on Figures 3 and 4. ISDs that have both public safety employees (e.g., fire fighters, police, and some others) and miscellaneous employees (all other employees) have both pension formulas listed. The listing format is 2.0%@55 (36 mos.). This means the retiree is entitled to a basic (unadjusted) pension of 2.0% of highest three years pensionable compensation per year of service time if he/she retires at age 55. Retirement at a different age results in an up or down adjustment.

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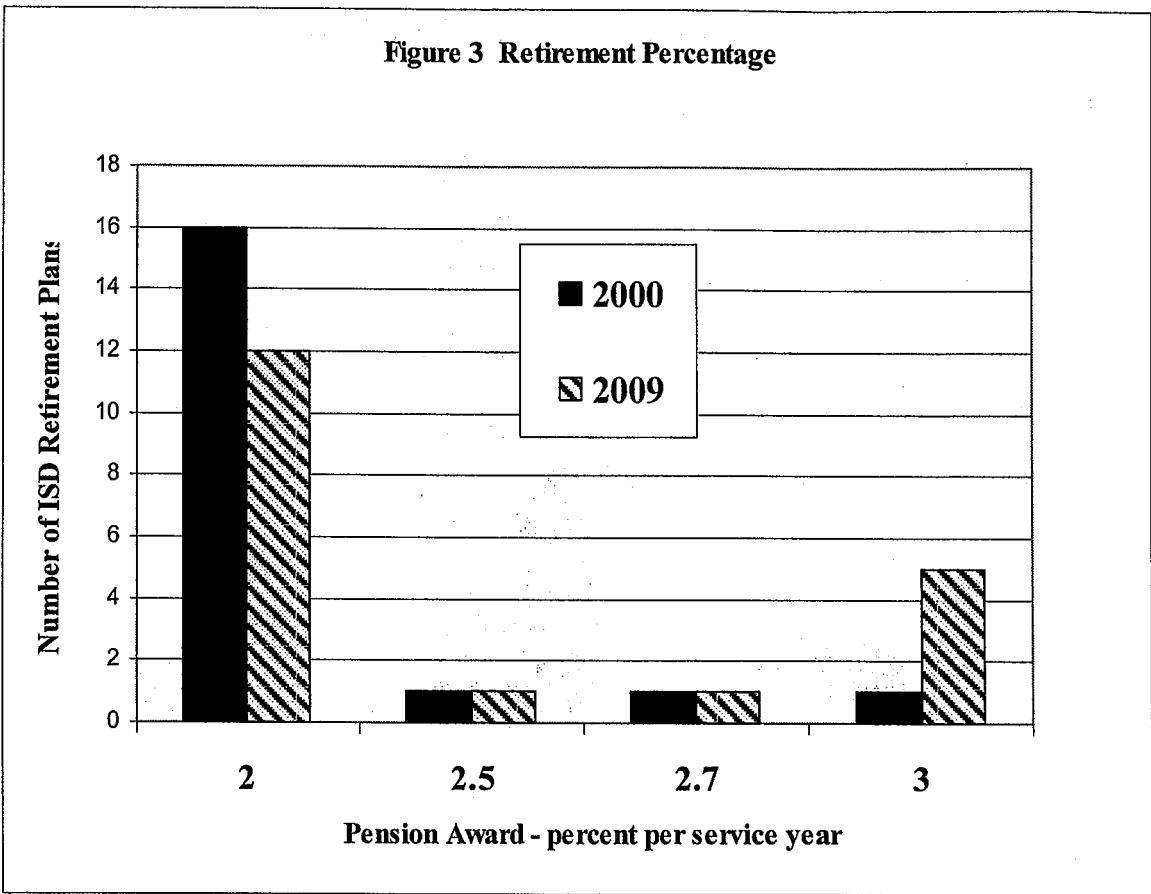
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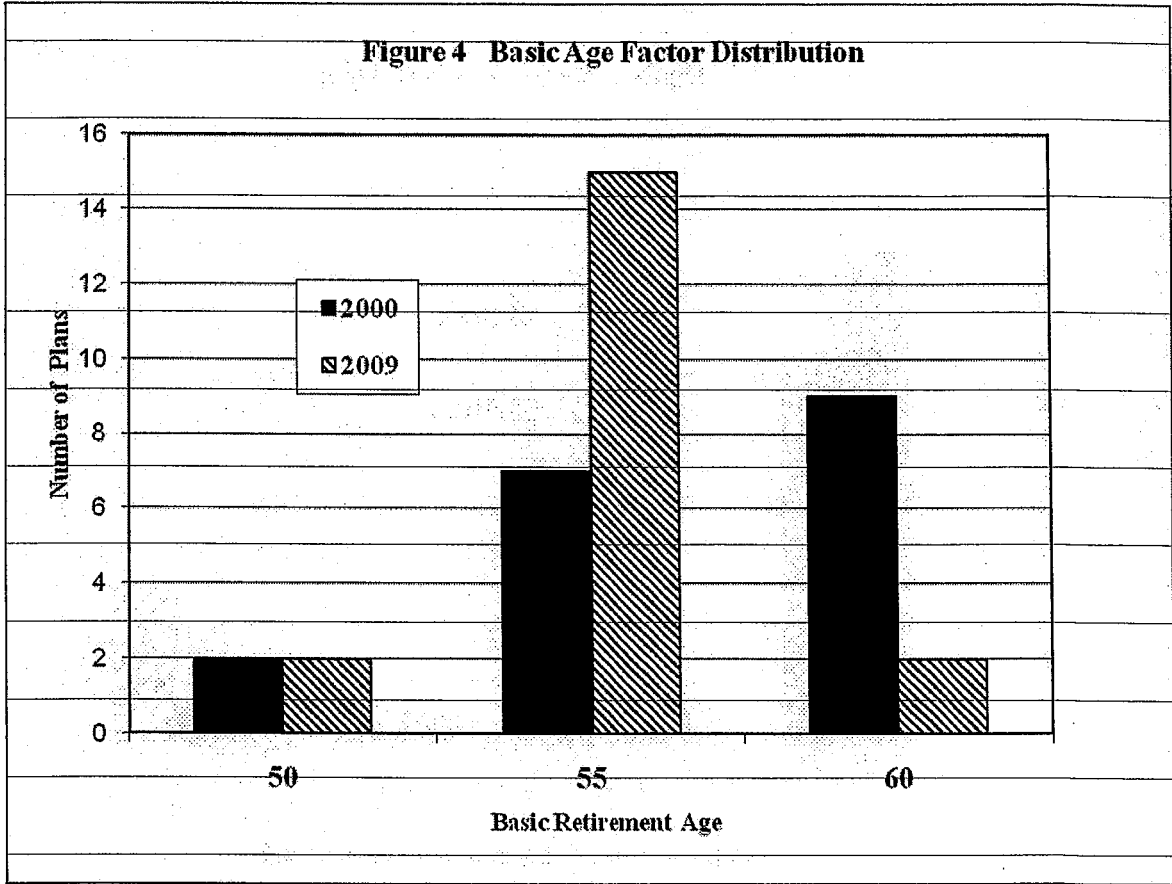
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Table 2 CalPERS Retirement Formulas

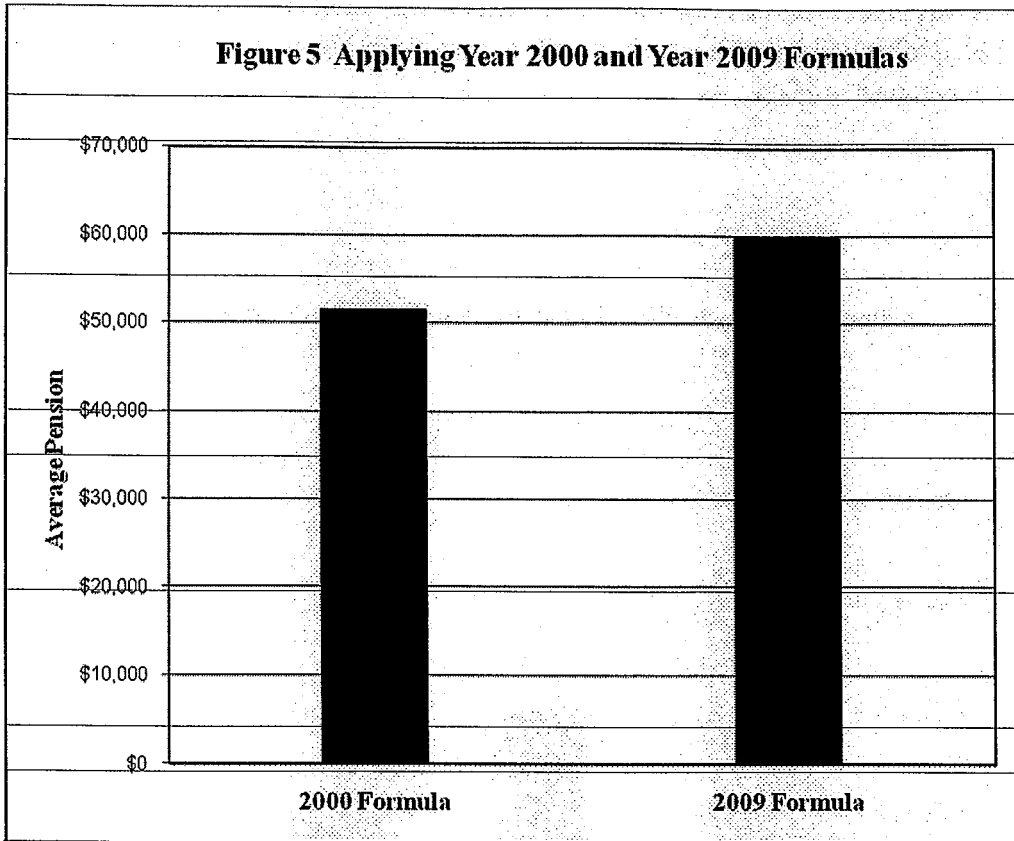
Special District Name	Miscellaneous Employees	Public Safety Employees
American River Flood Control District	2.0% @ 55 (12 months)	
Citrus Heights Water District	2.0% @ 55 (12 months)	
Cordova Recreation and Park District	2.0% @ 55 (12 months)	
Cosumnes Community Services District	2.5% @ 55 (12 months)	3.0% @ 50 (12 months)
Del Paso Manor Water District	2.0% @ 55 (12 months)	
Fair Oaks Recreation and Park District	2.0% @ 55 (12 months)	
Fair Oaks Water District	2.0% @ 55 (36 months)	
Fulton-El Camino Recreation and Park District	2.0% @ 55 (12 months)	
Herald Fire District	2.7% @ 55 (36 months)	3.0% @ 55 (36 months)
Rancho Murieta Community Services District	2.0% @ 55 (12 months)	
Reclamation District 1000	2.0% @ 55 (12 months)	
Rio Linda/Elverta Community Water District	2.0% @ 55 (36 months)	
Sacramento Metropolitan Fire District	3.0% @ 60 (12 months)	3.0% @ 50 (12 months)
Sacramento Municipal Utility District	2.0% @ 55 (36 months)	
Sacramento Suburban Water District	2.0% @ 55 (36 months)	
San Juan Water District	3.0% @ 60 (12 months)	

Figure 3 Retirement Percentage





The pension formula changes in the past decade have significantly increased pension awards. Figure 5 shows the overall average awards calculated with the actual 2000 and 2009 pension formulas for each ISD. Actual salary data and all other parameters for each retiree were unchanged. As a result of this trend, average initial pension awards for the ISD survey group rose from \$52,000 to \$60,000 annually, an increase of 15%.

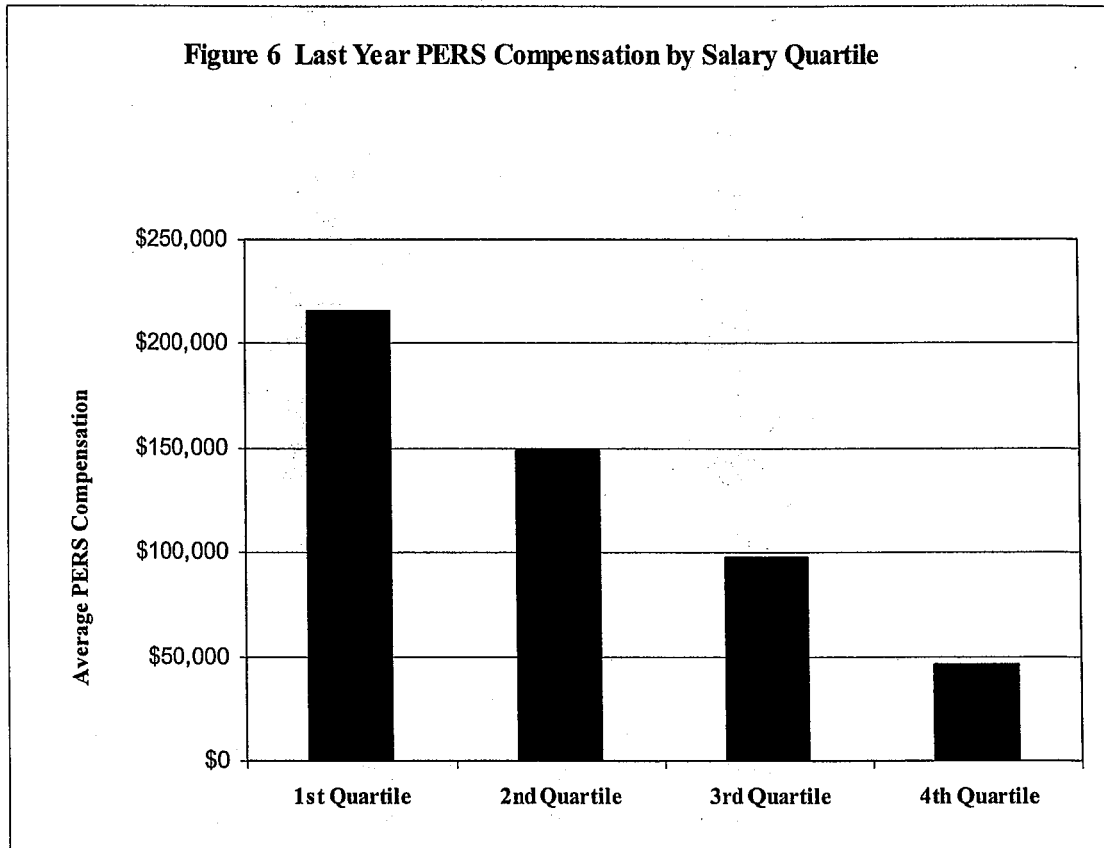


Public safety retirement pension formulas are, on average, significantly higher than other public pension formulas. Public safety employees also retire at younger ages, a traditional consequence of their hazardous and strenuous jobs. Most public safety employees' pensionable compensation amounts include more than basic salary due to more liberal provisions in their negotiated contracts. These differences lead, on average, to larger spikes in public safety employees' pensionable compensation.

In this limited study, pension data for about 100 retirees from Sacramento County ISDs for the past decade were reviewed. Data for 58 retirees from 17 ISDs were used for the calculations made in this study. Data for a maximum of 10 retirees from each of 29 CalPERS member ISDs were requested. Some of these ISDs had no retirees; some had more than 10. Obviously there are big differences in salaries and the retirement circumstances and awards among these retirees. Salary distribution (by quartiles of the total retiree group) for this group is shown on Figure 6. This report does not provide retirement data for individual retirees or ISDs; such information is confidential.

Salary quartiles are determined as follows: All retirees were ranked in order of salary. The retiree with the highest salary made \$388,000 and the lowest made \$27,000. The top 25% of

the retirees was defined as the 1st quartile, the next 25% was defined as the 2nd quartile, and so on. The salary distributions within each quartile are shown in Figure 9 and the average salary per quartile is shown in Figure 6.

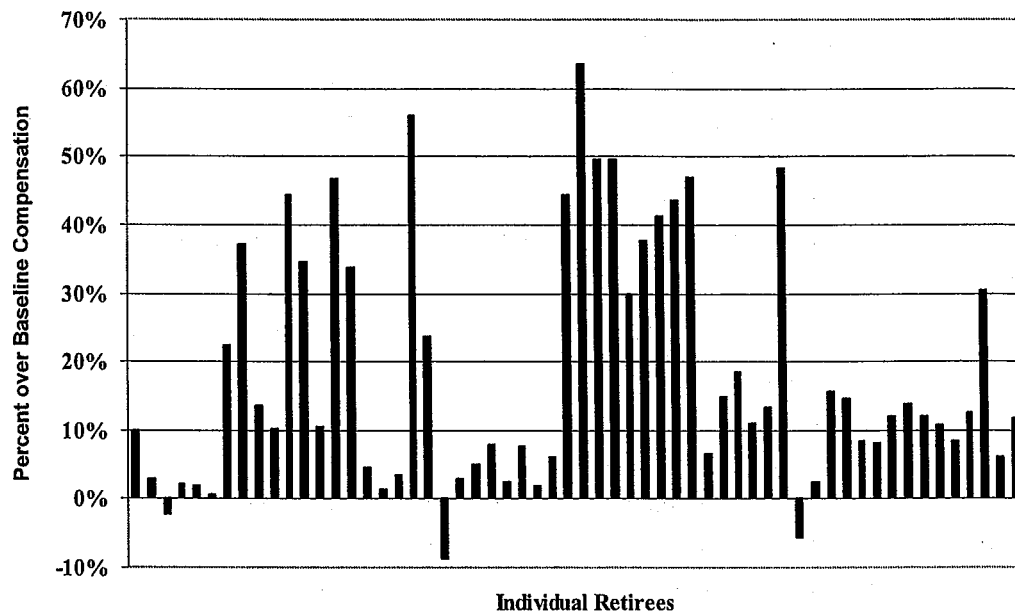


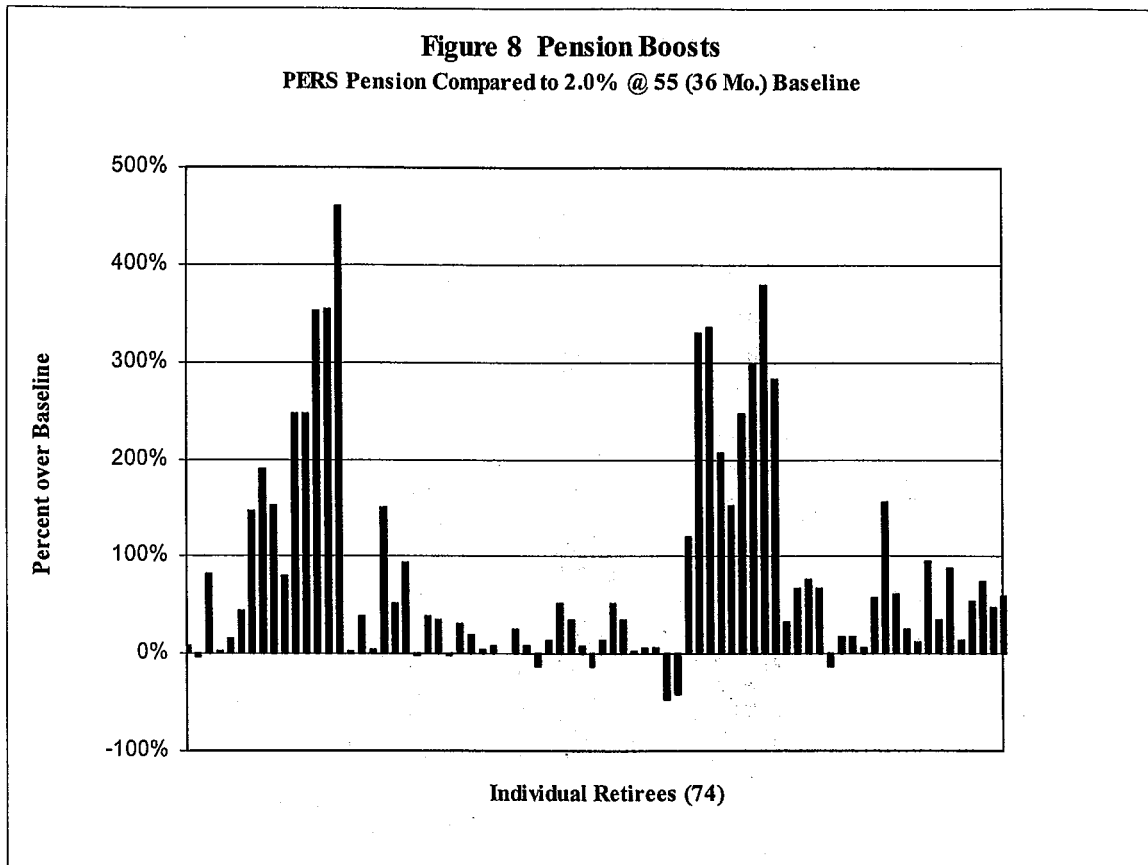
In an effort to show the magnitude of public pension differences in the sample, the study compared actual unadjusted pension awards by CalPERS to a calculated baseline pension amount. The baseline pension formula used in this study is 2.0%@55 (36 mo.) with applicable retirement age adjustments. A pension award percentage of 2.0% is used because that is the most common miscellaneous pension basis, covering 83% of the ISDs (it was 75% a decade ago). (See Figure 3) A basic age factor of 55 years old is used as the baseline for this analysis because it is the age factor used by 92% of the miscellaneous ISDs and is now the “norm”. (See Figure 4) A decade ago half of the ISDs used a basic age factor of 60 years. Obviously, lowering the retirement age factor has a major impact on retirement costs. If

employees retire at the same age as a decade ago, their average pension is increased by as much as one-third. Or, if they retire earlier as permitted by the lowering of the age factor, they will receive pension payments longer. In any event, the strong trend toward lowered age factors in CalPERS pensions, while employees are living longer and healthier, is a major reason for rising pension obligations at this time of diminishing public resources. A baseline highest compensation period of 36 months is used even though the majority of the ISDs now use 12 months. It is well known that a shorter final compensation period leads to more pension boosting, and several legislative attempts have been made to mandate a 36-month basis. It is prudent to use the multi-year compensation period and this report shows its impact on pension awards. The selected baseline pension formula is simply a rational basis of comparison.

Using the defined pension baseline, the compensation spike and the pension boost (as defined above) was calculated for each retiree in the database. The individual results are shown on Figures 7 and 8. A small number of spikes and boosts are negative because the baseline formula is more favorable than the actual pension formula. Compensation spikes vary up to 63% and the median spike is about 12%. This amount of spike mainly reflects last-year increases in pensionable compensation compared to a 3-year level, and is not surprising. Higher spikes indicate that unfair or unethical advantage is being taken of the retirement system. Compensation spiking is the main component of pension boosts (Figure 8). Pension boosts in this sample go as high as 460%. Boosts that exceed the spikes, mainly result from more favorable pension formulas that have been selected to favor either public safety employees, or, in some cases, all employees.

Figure 7 Compensation Spikes
PERS Final Compensation Compared to Baseline Compensation





Most actual CalPERS unadjusted pension awards are greater than this study's baseline pension amounts. The percentage by which the actual pension award exceeds the baseline calculated award reflects pension increases that result from the ISD selection of a more generous pension formula, plus the impact of compensation spiking (increases in pensionable compensation in the final full year of employment). Both of these factors are important; they are not separated here. The percentage increase in actual over baseline pension is the pension boost, as defined earlier. Average percent compensation spike and pension boost for retirees at different salary levels (by salary quartiles) are shown in Figure 9. Average percent compensation spike and pension boost for public safety and for miscellaneous retirees are contrasted in Figure 10. The resulting pension amounts are shown on Figure 11. The huge impact of more liberal public safety pensions is obvious. Average public safety pensions were more than twice as much as average miscellaneous employee pensions. Whether this difference and its impact on public agency finances are appropriate is an ongoing policy debate.

Figure 9 Pension Boost and Compensation Spike By Salary Quartile

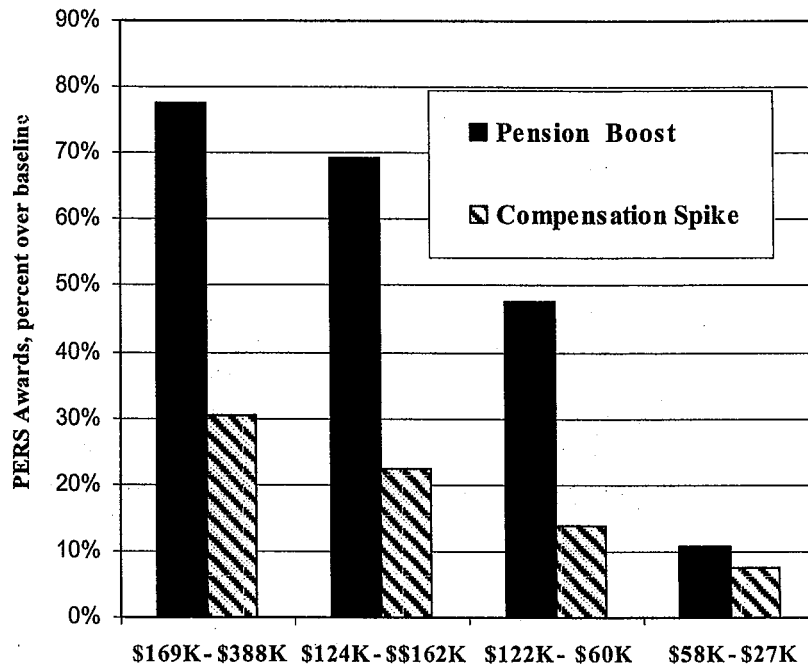


Figure 10 Average Pension Boost and Compensation Spike
Public Safety Retirees vs Miscellaneous Retirees

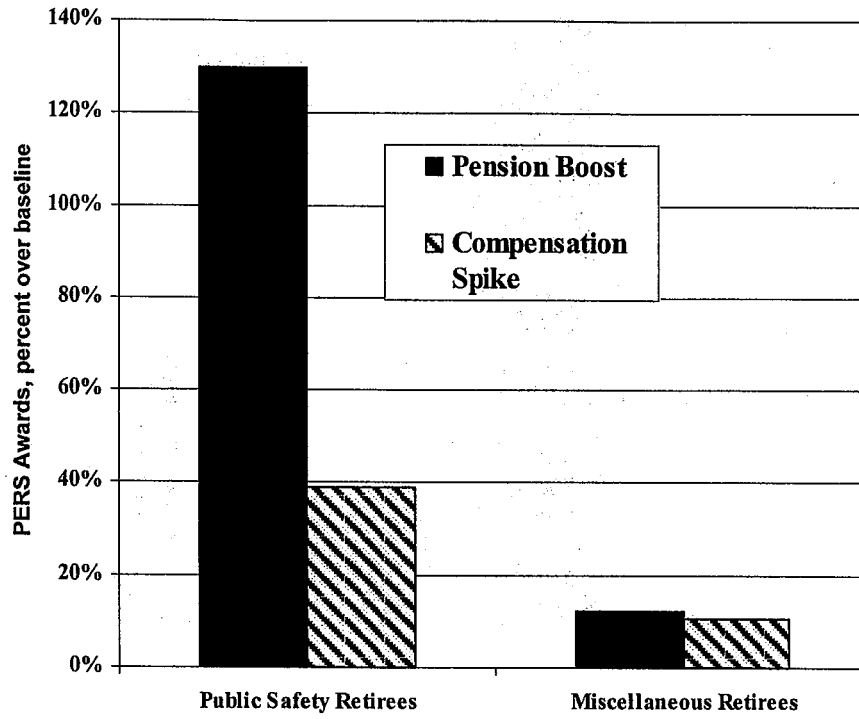
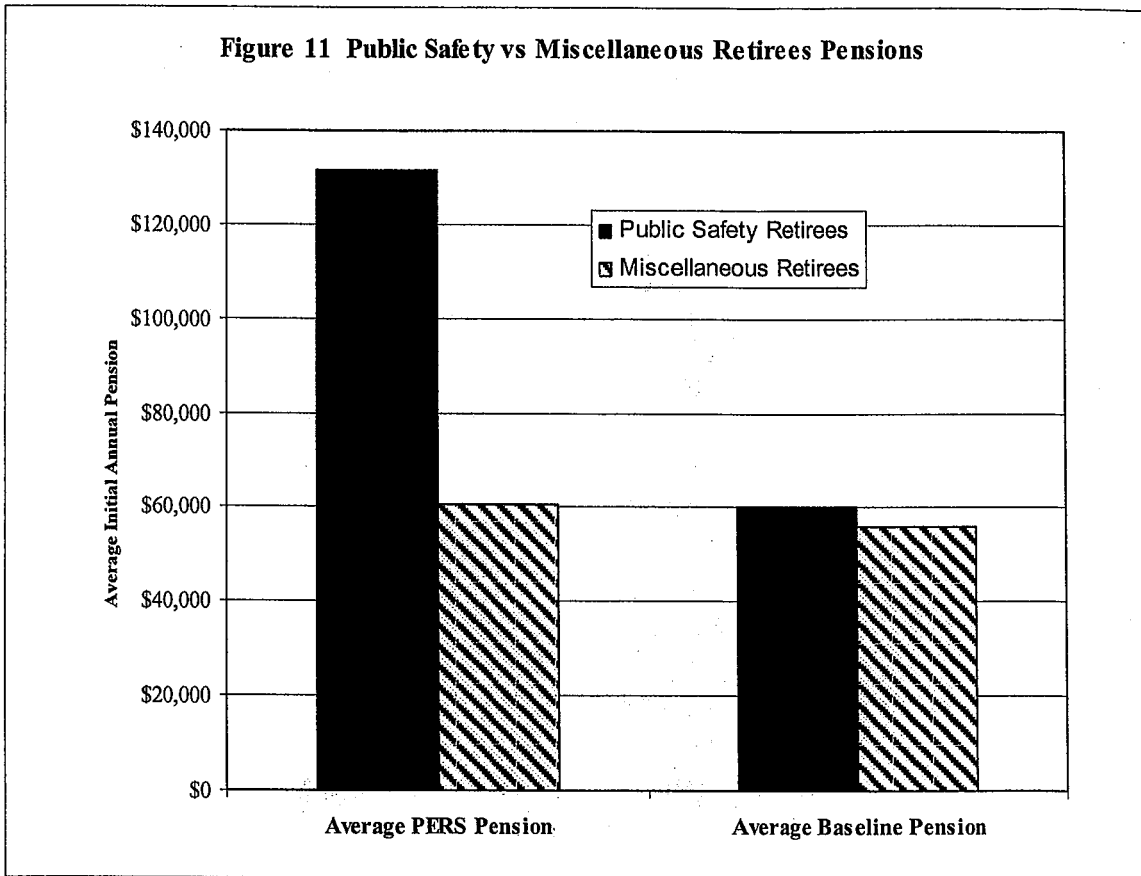


Figure 11 Public Safety vs Miscellaneous Retirees Pensions



Taking a strong role in the implementations of tough but fair changes in retiree benefits formulas and rules is the duty of CalPERS and its member agencies. Their expertise is needed to keep these funds healthy and to ward off unsound mandates from the state legislature.

5.4 Oversight by Sacramento Local Agency Formation Commission (SacLAFCo)

SacLAFCo is the Local Agency Formation Commission for Sacramento County and is a state-required countywide commission.³² LAFCo's mandates are to ensure the orderly formation of local governmental agencies, preserve agricultural and open space lands, and discourage sprawl. They govern boundary changes (annexations) of cities and special districts, formation or incorporation of new agencies, incorporate new cities and districts, consolidation or reorganization of special districts, and updating spheres of influence (logical future service areas). SacLAFCo is responsible for coordinating logical and timely changes in local governmental boundaries and conducting special studies that review ways to reorganize,

³² Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, as amended

simplify, and streamline governmental structure. SacLAFCo can initiate reorganization of an agency or district. State legislation gives them this authority. However, any contested reorganization requires approval of the electorate.

Municipal Service Reviews (MSR) is a LAFCo mandated report which must be completed for each district every five years as needed to support LAFCo actions. These reviews capture and analyze information about the governance structures and efficiencies of service providers, thereby assisting in the coordination and cooperation among providers. In the MSR Guidelines Final Draft (October 3, 2002)³³, a staff summary to the SacLAFCo, the executive director states, "I think that the MSR process will be multi-dimensional, and should be flexible, with different tiers and/or phases. I suggest that the MSR process begin by reviewing each service provider separately, with a progression towards an overall system review of similar municipal services (parks, water, fire, etc.)."

This investigation found that most LAFCos in the larger counties in California have completed nearly all their MSRs, while SacLAFCo has only completed about 16 out of the more than 80 MSRs required. The SacLAFCo staff acknowledges they are way behind and have no current plan or budget to catch up.

There is also the issue of inactive districts. These districts are either inactive or they contract with other agencies/districts for their services. In Sacramento County, the non-operating contracting districts are: 1) Pacific Fruitridge Fire Protection District (contracts with City of Sacramento Fire Department); 2) Natomas Fire Protection District (contracts with City of Sacramento); and 3) Granite Resource Conservation District (Inactive). It appears that consolidation or dissolution of these districts would better serve the county. SacLAFCo has the ability to encourage such reorganizations.

³³ <http://www.saclafco.org>

6. Findings and Recommendations

Finding 1.0 ISD directors perform valuable service at minimal cost. However, this survey reveals inconsistent behaviors regarding compliance with sound management practices.

Recommendation 1.1 Directors should review their by-laws every four years to assure compliance with applicable laws, ethical practices, and appropriate behavior.

Recommendation 1.2 Directors should limit compensation to reasonable meeting stipends and necessary costs of professional activities. All ISD boards should ensure that their compensation practices conform to the principles in Section 5.1 of this report.

Recommendation 1.3 Directors should limit the use of consent calendars according to the principles in section 5.1 of this report.

Finding 2.0 Some ISDs grant monetary awards for education and training; many have inadequate evaluation of employees' degrees and certificates.

Recommendation 2.1 All ISDs should encourage education and training, but should not make direct monetary (cash) awards for educational achievement.

Recommendation 2.2 All ISDs should recognize educational degrees and certificates only if they meet the criteria listed in Section 5.3.1.

Finding 3.0 ISD pension awards and Other Post Employment Benefits (OPEB) have increased markedly in the last decade. Some of these awards are unfair and unsustainable.

Recommendation 3.1 All ISDs should adopt pension and OPEB plans that are fair, affordable and sustainable.

Recommendation 3.2 To minimize unfair pension boosting, all ISDs should ensure that calculations of employees' base pension awards are on actual base salary earnings over their highest 36 months of earnings and urge CalPERS to promote this standard.

Recommendation 3.3 All ISD pension/OPEB changes should be made only after analysis and full disclosure to all parties of the fiscal ramifications.

Recommendation 3.4 All ISD pension/OPEB benefits should have an employee contribution component.

Finding 4.0 The majority of the ISDs surveyed in this study are neglecting their fiduciary responsibility to taxpayers and ratepayers by excessive use of no-bid purchasing.

Recommendation 4.1 Every ISD in Sacramento County should establish and adhere to a goal of minimizing no-bid purchasing. Essentially all purchases except utilities and emergency construction should be by contracts awarded to the lowest responsive responsible bidders.

Finding 5.0 ISDs have not consistently conducted and reported required Independent Financial Audit Reports and management audits.

Recommendation 5.1 All ISDs must complete and file the required annual Independent Financial Audit.

Recommendation 5.2 All ISDs should commission a thorough periodic management audit. These audits should be completed by a multi-disciplinary team qualified to examine a district's management practices. This audit should be done in fiscal year 2011, and every four years thereafter.

Finding 6.0 Sacramento County Local Agency Formation Commission (SacLAFCo) is responsible for oversight of government agency functions and performance, and for all changes of agency boundaries and functions. SacLAFCo has not completed the state mandated Municipal Service Reviews for the majority of ISDs in Sacramento County. If special district malperformance is identified, SacLAFCo is often the last best hope for corrective action when ISDs fail to perform.

Recommendation 6.1 SacLAFCo must conduct, and review as necessary, the state mandated Municipal Service Reviews for every ISD.

Recommendation 6.2 SacLAFCo must evaluate, and forthrightly judge, the performance of every ISD. When needed, it should initiate reorganization (consolidation, dissolution, or annexation) proceedings to assure protection of public health, safety and welfare.

Recommendation 6.3 Local agency information on SacLAFCo's web site should be improved by including documents or links on ISD budgets, required financial reports and audits, utility rate schedules, current regulatory citations and compliance orders, enabling laws, and director rosters.

7.0 Response Requirements

Penal Code sections 933 and 933.05 require that specific responses to indicated findings and recommendations contained in this report be submitted to the Presiding Judge of the Sacramento County Superior Court by October 1, 2010, from:

- All 31 independent special districts listed in Table 1 herein, response to Findings 1 through 5, and their associated Recommendations.
- Sacramento Local Agency Formation Commission, response to Finding 6 and its associated Recommendations.

A response is requested from:

- The California Public Employees Retirement System to Finding 3.0 and its associated Recommendations.

Mail or hand-deliver a hard copy of the response to:

Hon. Steve White, Presiding Judge
Sacramento County Superior Court
720 9th Street, Dept. 47
Sacramento, CA 95814

In addition, e-mail the response to Becky Castaneda, Grand Jury Coordinator, at castanb@saccourt.com