



# El Toro Water District

*"A District of Distinction"*

Serving the Public - Respecting the Environment

July 20, 2012

Orange County Superior Court  
700 Civic Center Drive West  
Santa Ana, CA 92701

Attention: Thomas J. Borris, Presiding Judge of the OC Superior Court

Subject: El Toro Water District Response to the "Let there be Light" Report Findings and Recommendations

Dear Honorable Judge Thomas J. Borris:

The El Toro Water District respects the good work of grand juries throughout the State and does not take issue with there being a review of a special district or a segment of special districts. We acknowledge and appreciate the public's interest in local government efficiency, transparency and welcome objective thorough reviews of same. However, we do have some concerns with this particular report.

Specifically, we believe the "Let There Be Light" Report (Report) lacks objectivity from the beginning, as indicated in the title, and throughout. Moreover, we feel it is overly broad and relies upon opinions in place of sound analysis. Deficient of any significant new investigation or thorough evaluation, the report depends predominantly upon previous reports from other entities-some of which are decades old.

Another concern with this grand jury investigation is related to its lack of significant engagement with the special districts subject to its sweeping findings and recommendations. In the future we look forward to working with grand juries to further education about special districts. A collaborative exchange of information could provide a better understanding of the true policy and operational environment within the districts as well as clarify data on how districts have achieved significant efficiencies by working together with other agencies to deliver core local services in Orange County.

Please find attached the district's response to applicable findings and recommendations contained in the Report. If you should have any questions or require further information do not hesitate to contact me at (949) 837-7050, Ext. 219 or by email at [bhill@etwd.com](mailto:bhill@etwd.com).

Respectfully Submitted,

EL TORO WATER DISTRICT

Robert R. Hill, General Manager

Cc: Grand Jury File

## **FINDINGS:**

*F1. Most Orange county special districts, with or without the assistance of the Local Agency Formation Commission (LAFCO), have been incapable or unwilling to consolidate, absorb, or eliminate these outmoded and/or redundant agencies. LAFCO typically addresses larger issues such as merging of cities and elimination of "islands" within the county. The special districts themselves have not worked seriously toward their consolidation or demise. In this regard, the enterprise special districts and the non-enterprise special districts require independent evaluation and handling.*

**Response:** El Toro Water District (ETWD) disagrees. ETWD is aware of, at a minimum, 9 voluntary OC Special District consolidations, dissolutions, mergers and/or acquisitions that were the direct result of collaborative studies conducted by Special Districts and LAFCO. Further, Special Districts and LAFCO have conducted numerous additional studies that concluded certain proposed reorganizations were not deemed appropriate or prudent to pursue.

Since 2000 ETWD has been directly involved with multiple independent South County Merger/Dissolution Studies where OC LAFCO reviewed, considered, received and filed same. The most recent Study, which took place in 2002, concluded that the high level of service satisfaction by the customers of the respective districts, existing competitive cost of providing services, the dissimilarities in the rate structures (primarily influenced by variations in collected non-rate revenue and Capital Funding Sources), governance structures, employee retirement plans, the significant upfront reorganization investment and speculative benefit did not justify the cost and disruption of current service provision.

On the other hand, the Study concluded that existing and planned supply and system joint ventures and shared services arrangements between districts are cost-beneficial and savings are not speculative. Further, continued cooperative contractual joint ventures by districts while remaining independent, will over time and in a logical orderly manner, accomplish economies and reliabilities one might expect to achieve through a larger formal reorganization.

Today, ETWD proactively participates in and supports the legislatively mandated Municipal Service Review and Sphere of Influence Assessments conducted by the OC LAFCO every five years. The Assessment and any justifiable reorganizations take into consideration specific determinations related to growth and population projections, location and characteristics of any disadvantaged communities, present and planned capacity of facilities and services, financial ability of the agencies to provide services, accountability for community service needs including governmental structure and operational efficiencies, and any other matter related to effective or efficient service

delivery. The assessment is deliberative, objective and without preconceived notions regarding the continued viability of a particular agency. Further, the assessment relies on significant stakeholder engagement and factually based data.

*F2. Special districts have made very little progress in complying with the recommendations made by various governmental agencies. To ensure recommendations are followed, more coordination and cooperation is needed from the city and county agencies.*

**Response:** ETWD cannot comment to what extent or how Special Districts in general have or have not responded to specific recommendations that have come from “unknown” governmental agencies.

*F5. The sixteen enterprise districts typically started as local agricultural irrigation providers and sanitation providers for local communities. These special districts have transitioned into providers of potable water and sewerage disposal for the cities that blossomed around them after 1950. These districts grew until their boundaries met a neighboring special district that was also growing. Some of these local smaller providers have already been absorbed by larger districts under one management.*

**Response:** ETWD agrees.

*F6. The sixteen enterprise special districts of Orange County founded between 1919 and 1964 have grown with the urbanization of the county. Thirteen of these special districts rely upon taxes collected by the county while three rely on fees and other sources for their revenue. This suggests that all of these enterprise special districts could wean themselves from tax subsidies and rely on fees for their revenue. Severance from the tax subsidies would enable financial transparency and let the customers see the true cost of the services provided.*

**Response:** ETWD disagrees.

Ad-Valorem tax revenue is but one source of non-rate revenue collected by some agencies. Other sources of non-rate revenue includes but is not limited to interest income on investments, collection on installment notes, collections by the County on the tax rolls to fund Special District voter approved General Obligation Bonds. As the Grand Jury Report points out, the sources of non-rate revenue collected and the purpose for which they are collected varies widely between districts.

A shift of Ad-Valorem tax revenue which, is dedicated by special districts to fund core services, would not in of itself provide the rate payer with a true cost-of-service. It would however equate to an increase to the customer’s monthly water bill and without an increase, a reduction in core services. Further, it is unclear if the Ad-Valorem tax

revenue taken from Special Districts could be committed for the use of the rate payers to offset cost increases.

For clarification, ETWD "rate" revenue currently accounts for 87% of the District's independently established cost-of-service. Of the remaining 13%, Ad-Valorem tax revenue accounts for 4%.

*F7. The unrestricted reserves of the special districts are available to the governing boards to spend as they please. Local citizens are not openly informed of this wealth when agencies ask for fee increases, special assessments, or bond measures. Most of the special districts do not appear to have specific criteria for amassing these reserves nor do they have published long-range plans for their constructive use.*

**Response:** ETWD disagrees with the Grand Jury's general statement that "The unrestricted reserves of Special Districts are available to the governing boards to spend as they please". State Water Code and relative State Legislation dictate that governing boards limit expenditures and revenue collection to that which is necessary to fulfill the chartered purpose for which they exist. In the case of ETWD and its neighboring agencies that definitive purpose is efficient and reliable provision of water, sewer and recycled water service to the rate payers served.

Under Proposition 218 Special District's considering increases to rates and charges must prepare a Cost-of-Service study that clearly provides a nexus between revenues and expenditures taking into consideration available reserves and future reserve requirements. Further, Proposition 218 prescribes specific rate payer transparency as it relates to formal customer notification and protest procedures.

The ETWD Board of Directors first established and adopted a comprehensive Cash Reserve Policy (Policy) in 1994. An element of the Policy is a strict requirement that the Policy be reviewed annually by the Board during a regularly scheduled Public Meeting. The Policy establishes a minimum reserve level and categorizes reserves as those that are restricted contractually and/or legally and board mandated that are deemed necessary and specifically limited to Rate Stabilization, Operations, Capital Construction and Working Capital.

*F8. The twenty-seven special districts in Orange County have amassed unrestricted reserves of over \$866,000,000. That is enough money to fund all of these special districts for more than a year without taxes, fees, interest, or other sources of revenue. The boards of directors have the sole discretion to spend these unrestricted reserves.*

**Response:** ETWD cannot comment on and/or confirm the validity of the Grand Jury's above referenced conclusions.

**F10.** *The enterprise special districts could save millions of dollars in administration costs by consolidation into regional special districts. Five or six such enterprise special districts within Orange County could save at least \$500,000 per year for each special district absorbed.*

**Response:** It is unclear what criteria, if any, the Grand Jury utilized in choosing “five or six” enterprise districts or in arriving at the figure of \$500,000. As such, ETWD will not speculate as to its validity and/or to its practicality.

**F14.** *The true cost of water and sanitary sewers in the enterprise special districts is hidden when both taxes and fees fund these districts. Only when the monthly service bills to the customers include all the costs for these services without the tax subsidy will the public understand the true cost of these services and achieve financial transparency.*

**Response:** Please refer to the response to F6.

**F15.** *Only one of the special districts, the South Coast Water District, has had recent performance audits. The lack of performance audits for the remaining special districts leaves the potential for inefficiencies, poor practices, outmoded operations, etc. hidden from the governing boards and the communities they serve. The lack of published performance audits has contributed to the public’s ignorance of these districts.*

**Response:** ETWD cannot validate the Grand Jury’s reference to only “one of the Special Districts” completed a performance audit.

ETWD concurs that internal and/or independent performance audits should be performed routinely and as circumstances dictate. ETWD believes that multiple audits based upon specific industry disciplines can be beneficial and provide a focus on a particular discipline’s Best Practices. ETWD utilizes independent resources to audit financial and internal control practices. ETWD recently completed an independent evaluation of its Information Technology Systems which included recommendations where appropriate to incorporate Best Practices. ETWD utilizes independent resources to assess efficiency and reliability characteristics of system wide water, sewer and recycled water infrastructure and operations today and into the future. ETWD participates actively in the LAFCO MSR process and incorporates LAFCO findings and recommendations into near and long term strategic planning.

### **RECOMMENDATIONS:**

**R1.** *All special districts (except the Vector Control District and the County Cemetery District) should be eliminated from the county tax rolls and should rely solely on fees or the services of surrounding governments. (See F2, F3, F4, F5, &F6.)*

**Response:** Please refer to the response to F6.

**R4.** *Water and sewer districts should be consolidated into no more than six regional districts. Consideration should be given to including the city water agencies in the consolidation. LAFCO should meet with the water and sewer districts before October 31, 2012 to develop plans and schedules for consolidation. (See F5, F6, & F9.)*

**Response:** Please refer to the response to F10.

**R5.** *Water and sewer districts should be removed from the tax rolls and operate solely on fees and other revenues for their services. Consideration should be given to forming non-profit agencies with ownership shared by the constituents. These districts should meet with county officials before October 31, 2012 to prepare plans and schedules to remove themselves from the county tax rolls. (See F2, F5, & F6.)*

**Response:** Please refer to the response to F6.

**R6.** *Special districts should adopt "board of director's practices" for all their reserves, restricted and unrestricted. All reserves should be classified in their 2013-14 budgets according to GASB Standard No. 54. LAFCO should work with the special districts to prepare standard criteria for accumulating reserves according to the new classifications by December 15, 2012. These standards should be used in preparing the 2013-14 budgets. (See F7 & F9.)*

**Response:** Please refer to the response to F7. ETWD's practice of incorporating and publishing its restricted and designated reserves will continue as part of its annual budgeting process.

Further, reserve guidelines have already been developed by CSDA for use by Special Districts. The guidelines identify both the essential elements (Best Practices) of a reserve policy and the issues to be discussed during policy development in order to assist districts in fulfilling their commitment to provide cost-effective and efficient public services for the communities they serve.

**R7.** *Excessive unrestricted reserves should be used to reduce existing debts. Future revenues should be reduced to avoid the accumulation of unallocated revenue that does not meet the adopted new standards. (See F7 & F8.)*

**Response:** Please refer to the response to F-6 & F7.

**R8.** *Each special district should have an independent performance audit at least every three years. The executive summary of the performance audit should be distributed to all the taxpayers of each special district. Each of the special districts that has not had a performance audit within the last five years should contract with an*

*independent outside consultant to conduct such an audit during 2012. These audits should be repeated at least every three years. (See F15.)*

**Response:** Please refer to the response to F15.

**R9.** *Each special district should contribute 1% of its unrestricted reserve fund to LAFCO to help finance preparing and directing the consolidation, absorption, or elimination, and the setting of standards for reserves for the special districts. These funds should be included in LAFCO's future programs and budgets until the consolidation, absorption or elimination of each special district is achieved. With these additional funds, LAFCO should begin meeting with each special district before the 2014 fiscal year is budgeted for consolidation, absorption and/or elimination of these districts. (See F1, F2, F3, F4, F5, & F6.)*

**Response:** The arbitrary nature of this recommendation of 1% is similar to the recommendation of six regional water agencies in Orange County. It is unclear as to what, if any, criteria were used in quantifying how much revenue needs, not to mention the implications of using this funding source.

As prescribed by law, ETWD provides LAFCO with its proportionate "Special District" LAFCO budget share based upon a definitive LAFCO budget which encompasses routine LAFCO staff and commission administrative activities and identified special efforts. The LAFCO budget is funded in equal parts by the Special Districts, by the Cities and by the County.

In practice, specific reorganization considerations/studies are typically funded by the agencies collaboratively seeking LAFCO involvement.