



SUNSET BEACH SANITARY DISTRICT

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July 13, 2012

The Honorable Thomas J. Borris,
Presiding Superior Court Judge
700 Civic Center Drive West
Santa Ana, CA 92701

Dear Judge Borris:

As required, Sunset Beach Sanitary District (SBSD) is responding to the April 2012 Grand Jury report on special districts, 'Let There Be Light – Dragging Special Districts from the Shadows'.

The introductory premise of the report, that special districts were generally formed before cities, is only one of several reasons special districts were formed. Another far more important reason was to have a public agency provide dedicated, specialized services at a low cost. This is why, in Orange County, many school districts (although not mentioned in the report) were formed: to provide educational services free from the distractions and funding problems associated with the day-to-day business of cities and counties. In recent years, fire and road authorities (similar to the few special districts studied in the report) have been also been formed for the same reason.

Special Districts generally have one thing in common: they do their job well. Their elected, local Boards of Directors are able to focus on the agency mission and demand performance. The recommendation in the report that the special districts studied should be re-grouped or dissolved and services transferred, seem to have been made without benefit of a comparison of costs and performance between special districts and general law agencies.

The report infers that special districts, such as SBSBD, should not accumulate financial reserves. This deserves special comment. SBSBD provides sewage collection, treatment and disposal, and municipal solid waste collection, recycling and disposal for portions of Huntington Beach and Seal Beach. It does this in a very cost effective manner, probably at the lowest total cost in Orange County. The district operates a system of sewage facilities built in 1936.

Over the past 14 years, these facilities have been modernized and rehabilitated and groundwater infiltration cut to such a degree that sewage flows have been reduced by 50%, saving a tremendous amount on treatment costs, and allowing the district to hold its low fee rates steady for the last six years.

This didn't happen by accident. The District's Board of Directors developed and followed a financial plan to raise funds to insert a water tight plastic liner in the old sewers, upgrade the old

pump stations (including installation of remote monitoring systems) and add new standby power generators.

All this was done by following a financial plan and without borrowing or paying interest. No funds have been spent on financial advisors or bond sales.

Maintaining this type of public works infrastructure and doing this type of rehabilitation requires long range fiscal planning including setting aside yearly reserves. Needs must be anticipated, a steady funding source planned, and the work done before disaster strikes. The Grand Jury report really missed its mark on this point.

SBSD currently has reserves of about \$1.5 million, earmarked for 2012-2013 sewer rehabilitation in Surfside Colony (\$125,000); abandonment of one pump station in 2013-2014 (\$500,000); and a siphon replacement in 2014-2015 (\$400,000). The District's financial plan also calls for a true emergency fund of at least \$1 million to help in a disaster, such as an earthquake. SBSB is still short funds for its goals, but with continued annual funding, the goals will be met. The District's expenditures are regulated under the California Health and Safety Code.

The district's past rehabilitation work has already saved its rate payers more sewage treatment charges than the original cost. It could not have been done in this cost effective manner without developing and following a financial plan that included yearly reserve funding for future, needed work. Reserves are not a bad thing.

Responses Required to Findings/Conclusions

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.

We disagree with the underlying assumption that special districts have outlived their usefulness. In the case of SBSB, it would be somewhat difficult for a city to take over since the district serves portions of two cities, and our cost of service is less than in either city.

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 city and county agencies.

We disagree. SBSB is in compliance with federal, state and regional requirements, and works well with the cities it serves.

F3 and F4. No response requested.

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 sewage 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.*

We disagree. SBSB has not grown since formation. There is no neighboring larger District or City that could provide a more quality and cost-efficient service by absorbing the SBSB.

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 customers see the true cost of services provided.*

We disagree. First of all for the SBSB, Table 2a incorrectly reports Actual Budgeted Tax Revenue of \$941,000. Budgeted property tax revenue reported to the County of Orange for the 2011-12 tax year was only \$491,200. Table 1a also incorrectly reports "Sewer Revenue" at \$430,000. Of the \$430,000, \$245,520 was collected to pay for twice-weekly municipal solid waste collection provided by a private firm, the remaining \$184,480 was sewer revenue. Again, both of these service fees appear to be the lowest cost in Orange County. The larger question is what better service would the public served receive from this money? Cities also receive a share of the basic levy and use it for similar services.

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.*

We disagree. SBSB does not spend its reserves 'as they please' and residents are openly informed. Reserves are accumulated yearly according to a financial plan to rehabilitate facilities built in 1936. Following this procedure has allowed SBSB to upgrade old facilities without 'fee increases, special assessments, or bond measures'. Nothing has been borrowed and no interest paid.

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.*

We disagree. In the text of this letter, we stated the uses SBSB has for reserves. SBSB does not accumulate reserves for day to day operations. Reserves are set aside for needed replacements and emergencies. This is the most cost effective manner to provide sewage services.

F9. No response requested.

F10. *The enterprise special districts could save millions of dollars 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.*

We disagree. SBSB does not border another district. We operate in an extremely efficient manner due to the limited services that we provide in accordance with State law and see no way to save our customers money by combining with a remote district. SBSB is a locally controlled agency where the directors are neighbors with the customers.

F11, F12 and F13. No response requested.

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 customer 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.*

We disagree. Proposed Fees are published annually in the local paper and detailed financial data is available to the public at all of our monthly meetings and website. Also, if utility bills were to replace the current method of billing then the consumer would be burdened with a much higher cost of bill collection.

F15. *Only one of the special districts, The South Coast Water District, has had recent performance audits. The lack of performance audits 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.*

We disagree. As part of the audit process, our independent auditors review our internal control structure and processes and have not recommended a performance audit which is a service recommended when deficiencies are noted in specific processes. Requiring a performance audit in addition to our financial statement audit would unnecessarily increase our administrative costs.

Responses Required to 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.*

The recommendation will not be implemented. We disagree. We know of no fair way this could be equitable.

R2 and R3. No response requested.

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 & F7)*

We disagree. Is the Grand Jury sure that getting bigger can save money? SBSB is already the lowest cost sewage and garbage collection agency in Orange County.

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)*

The recommendation will not be implemented. We disagree. This recommendation appears without any analysis or facts.

R6. *Special districts should adopt "board of director's practices" for all their reserves, restricted and unrestricted. All reserves should be classified in their 2013-2014 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 2013-2014 budgets. (See F7 & F9)*

The recommendation has already been implemented. SBSB has a policy in place for reserves and the audited financial statements starting with the fiscal year ended 06/30/11 classifies reserves in accordance with GASB Standard No. 54.

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)*

The recommendation will not be implemented since SBSB has reserves for projects and no debt.

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 every five years. (See F15).*

The recommendation will not be implemented unless our independent auditors recommend a performance audit. Currently, based on their reviews of our internal control structure and

processes, it would appear to be an unwarranted administrative expense. SBSB has an independent audit every two years and posts the audit on our website.

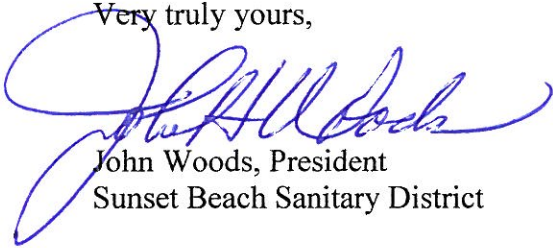
R9. *Each special district should contribute 1% of its unrestricted reserve fund to LAFCO to help finance preparing and directing the consolidation, absorption, or elimination, and the setting of standards for reserves for the special districts. These funds should be included in LAFCO's future programs 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)*

The recommendation will not be implemented. We disagree.

R10. No response requested.

This report might have been better if the Grand Jury had discussed it with the agencies it is written about. As it stands, it shows a lack of understanding about funding and maintaining public infrastructure and the important role of good budgeting and local control.

Very truly yours,



John Woods, President
Sunset Beach Sanitary District