



Ross Valley Sanitary District

The Board and Management Have Only Recently
Begun to Address Significant Weaknesses in the
District's Financial and Administrative Functions

Report 2014-122

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April 16, 2015

2014-122

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor (state auditor) presents this audit report concerning the Ross Valley Sanitary District (district). This report concludes that the board of directors (board) and management have failed to properly oversee the district's financial and administrative functions until recently. Specifically, reviews by an external auditor in October 2013 and October 2014 identified several weak or missing internal controls and in April 2014 human resources consultants identified ineffective or nonexistent administrative systems and processes. We also reviewed the district's controls over significant financial and administrative functions, including the controls implemented in response to the findings of the district's external auditor, and found that new policies strengthen these controls but weaknesses still exist. As the governing body of the district, the board needs to ensure that management further develops existing controls and implements additional controls over key financial and administrative functions to ensure prudent management of the district and to protect against the potential for fraud, waste, abuse, and conflicts of interest. Potential causes of the board's failure to adequately oversee the district are that board members receive inadequate training and their responsibilities are not adequately documented to ensure that board members, particularly those that are newly elected, fully understand their fiduciary responsibilities.

The board's oversight over employee compensation has been lax and resulted in high salaries for district employees relative to what employees in similar positions receive at comparable sanitation agencies. District practices of increasing salary ranges without adequate justification, paying excessive cost-of-living adjustments, and offering longevity pay without justifying the need for it have led to these high salaries. Further, the district does not ensure that it receives the best value for its ratepayers when contracting for professional services because it does not always use a competitive process or justify using sole-source contracts. Finally, the district has not properly managed its human resources functions. For example, the district did not comply with state law by ensuring that its supervisory employees attend sexual harassment prevention training every two years, nor did it always complete annual performance evaluations of its employees as required by its policies. In addition, the district did not ensure that all required employees filed documentation to identify potential conflicts of interest.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The Ross Valley Sanitary District (district) has only recently taken steps to correct weaknesses in its financial and administrative policies and practices. Located in Marin County, the district provides wastewater collection services to residents and businesses in the communities of Fairfax, Greenbrae, Kentfield, Larkspur, Kent Woodlands, Ross, San Anselmo, and Sleepy Hollow. The district's revenue comes in large part from wastewater collection fees and property taxes. A five-member board of directors (board) governs the district, and a general manager oversees the district's day-to-day activities. The district's former general manager resigned in July 2012 and has since been arrested on charges of misappropriation of public funds, embezzlement, and money laundering related to a \$350,000 down payment assistance loan the district provided him as part of his employment contract.

Reviews of the district by an external auditor in October 2013 and October 2014 found that the district had weak or missing internal controls. For example, the auditor found that one employee was responsible for entering invoices into the accounting system, preparing checks to pay those invoices, and reconciling bank statements to the district's records. Such an arrangement could allow the employee to create and conceal fraudulent financial transactions. In addition, in April 2014 a team of human resources consultants found that the district had ineffective or nonexistent organizational administrative systems and processes. The human resources consultants created a work plan that calls for the district to revise and in some cases develop administrative and human resources policies and performance measurement metrics, among other tasks.

The district is in the process of implementing the external auditor's outstanding recommendations and the elements of the human resources consultants' work plan. We also reviewed the district's controls over significant financial and administrative functions, including the controls implemented in response to the findings of the district's external auditor, and found that new policies strengthen these controls but that weaknesses still exist.

As the governing body of the district, the board needs to ensure that management further develops existing controls and implements additional controls over key financial and administrative functions to ensure prudent management of the district and to protect against the potential for fraud, waste, abuse, and conflicts of interest. One potential cause of the board's failure to adequately oversee the district is that board members receive inadequate training. Board

Audit Highlights . . .

Our review of the Ross Valley Sanitary District's (district) policies and practices over its financial and administrative operations highlighted the following:

- » *The district's management and board of directors (board) had failed to implement important controls over the district's financial and administrative practices until recently.*
- » *Weaknesses still exist in the district's financial and administrative controls that could potentially allow fraud, waste, and abuse of public funds to go undetected.*
- » *The board has failed to provide adequate oversight of the district's activities.*
 - *Board members lack an understanding of their role in ensuring the prudent management of the district and lack adequate training.*
 - *Compensation for district employees is high relative to salaries at comparable sanitation agencies.*
 - *The board did not appropriately review two of the district's most costly emergencies to determine if it should continue the work without seeking competitive bids.*
- » *The district does not always use a competitive process for procuring professional services and thus cannot ensure that it receives the best value for its ratepayers.*
- » *The district adhered to state law when awarding contracts for capital improvement projects.*
- » *The district has not properly managed its human resources functions.*

members have demonstrated a lack of understanding of their roles in certain key district processes, including establishing appropriate compensation levels, reviewing and approving declarations for emergency procurements, and contracting for professional services. Further, the board's responsibilities are not adequately documented to ensure that board members, particularly those that are newly elected, fully understand their fiduciary responsibilities. For example, the district has not documented in its policies the board's responsibilities for establishing appropriate salary structures or reviewing district finances. In addition, the district's management failed to begin implementing key controls over the district's financial and administrative functions until fiscal year 2013–14.

The board's oversight over employee compensation has been lax and resulted in high salaries for district employees, relative to what employees in similar positions receive at comparable sanitation agencies. For example, the top salary ranges of some of the district's key management positions are 12 percent to 18 percent higher than those for similar positions at larger sanitation agencies. Furthermore, the district has paid its employees excessive annual cost-of-living adjustments (COLAs) of between 3 percent and 5 percent that are not tied to changes in an actual cost-of-living index. For example, even though the consumer price index increased by only 0.7 percent in 2009, the district paid its employees a 5 percent COLA that same year. In addition, the district provides its employees longevity pay without justifying the need for this extra pay to retain or attract qualified employees. We do not believe that the district's practice of offering excessive compensation to its employees is an appropriate use of revenue generated from fees and taxes paid by its ratepayers.

In contrast, the salary for the district's new general manager is in line with comparable agencies, ranking 11th out of the 13 sanitation agencies and comparison groups we reviewed. Furthermore, the district's employment contract with its current general manager does not include the same excessive provisions found in the former general manager's contract, such as a \$350,000 down payment assistance loan, a one-time \$9,850 bonus, and student debt relief. However, the board still has not established in policy its approach for periodically evaluating the general manager's performance and for determining any merit-based compensation increases.

Additionally, the board did not appropriately review two of the district's most costly emergencies to determine if it should continue the work without seeking competitive bids. In an emergency—a sudden, unexpected occurrence that poses a clear and imminent danger, requiring immediate action to prevent or mitigate the loss or impairment of life, health, property, or essential public services—state law allows the board to vote to avoid competitively bidding the

work necessary to resolve the emergency. However, state law also requires the board to reassess and vote whether the situation is still an emergency at every subsequent monthly board meeting. The board did not follow this requirement at meetings during which the two emergencies were ongoing and thus may have unnecessarily allowed the district to continue to avoid competitive bidding.

Although the district adhered to state law when awarding capital and construction-related contracts, it does not ensure that it receives the best value for its ratepayers when contracting for professional services, because it does not always use a competitive process or justify using sole-source contracts. For example, the district awarded a sole-source contract not to exceed \$84,000 for one year of marketing-related services that the board approved without questioning why district staff did not solicit additional proposals. In addition, after the contract term expired, the district continued to pay for the marketing services for several months without having a written contract in place, until the district renewed the contract. Ultimately, the district terminated this contract as part of its efforts to reduce expenses. However, by that point the district had paid this contractor more than \$175,000.

Finally, the district has not properly managed its human resources functions. For most of the period from fiscal years 2009–10 through 2013–14, the district did not have staff with expertise in human resources management to whom district employees could turn for guidance in handling human resources issues. Also, the district did not have established processes for some essential human resources functions and/or did not ensure that those functions were performed. For example, the district did not comply with state law by ensuring that its supervisory employees attend sexual harassment prevention training every two years, nor did it always complete annual performance evaluations of its employees as required by its policies. In addition, the district did not ensure that all required employees filed documentation to identify potential conflicts of interest.

Recommendations

The board should ensure that management continues to develop and strengthen its controls over the district's financial and administrative functions. For example, district management should fully implement all of the external auditor's remaining recommendations by June 30, 2015. Management should also ensure that staff follow these policies and should create and implement a plan for monitoring its system of controls.

The district should implement all of the remaining recommendations contained in its human resources consultants' work plan.

To clarify the roles and responsibilities of board members, the district should create a more comprehensive board member manual that describes all of the board's roles and fiduciary responsibilities. The district should also provide for additional training for board members in the following areas over which they exercise important responsibilities: financial management, contracting, emergency procurement, and human resources.

The board should reduce the salary ranges for all positions in the district's salary schedules to better align with comparable positions at comparable sanitation agencies. While we are not suggesting that the board cut the current salaries of its employees, it is imperative that the board reduce the salary ranges in its salary schedules before more employees reach the top step of their respective salary ranges. The board should also ensure that COLAs are tied to an appropriate cost-of-living index and that any merit raises are based on satisfactory performance that is documented in an appraisal. Further, the board should either justify its need for longevity pay to attract and retain qualified employees or discontinue its practice of offering longevity pay to those employees who are not already receiving this extra pay. The board should make these changes for unrepresented employees immediately and should seek to make these changes for represented employees by negotiating with the American Federation of State, County, and Municipal Employees Local 2167 when the current memorandum of understanding expires in July 2015.

To ensure that compensation for the general manager remains reasonable, and to prevent the excesses that existed in the former general manager's contract, the district should develop a policy that establishes the criteria to be used when periodically evaluating the general manager's performance and determining any merit-based compensation increases.

To ensure that it follows state law and its policies for emergency procurement, the board should review and reapprove all emergencies at each board meeting subsequent to the initial emergency declaration and should terminate emergency declarations as soon as possible to ensure that it competitively bids any work that is no longer an emergency.

The district should ensure that it hires qualified vendors at a reasonable price by using a competitive process when contracting for professional services. When this is not possible

or appropriate given the nature of the services, the district should adequately justify its use of a noncompetitive process (sole-source procurement).

The district should ensure that it has access to qualified human resources professionals, whether contracted or in-house, to assist staff when handling human resources issues.

Agency Comments

The board unanimously agrees with all of our recommendations and will make their implementation a top priority.

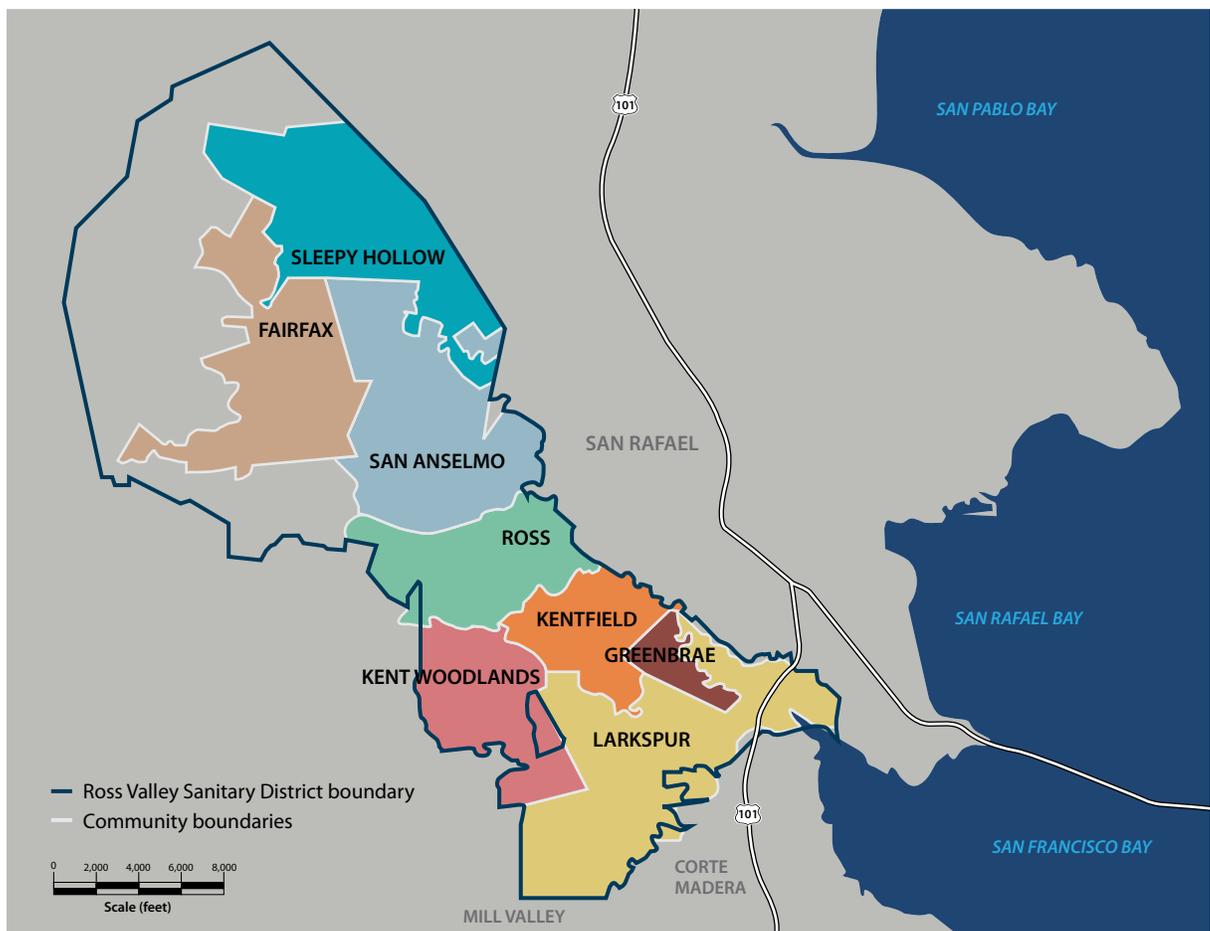
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Introduction

Background

Sanitary District No. 1 of Marin County, also known as the Ross Valley Sanitary District (district), is a special district located in Marin County and was established in 1899 under the Sanitary District Act of 1891. The district provides wastewater collection services for residents and businesses in the communities of Fairfax, Greenbrae, Kentfield, Larkspur, Kent Woodlands, Ross, San Anselmo, and Sleepy Hollow, as shown in Figure 1. The district serves a population of approximately 55,000.

Figure 1
Ross Valley Sanitary District Map



Source: Ross Valley Sanitary District's fiscal year 2013–14 comprehensive annual financial report.

The district maintains approximately 200 miles of sewer pipelines. Residents and businesses connect to the district's sewer system through privately owned sewer lines. The district has an agreement with the Central Marin Sanitation Agency for the treatment of wastewater, and it operates 19 lift and pump stations that collect, pump, and transport wastewater to the Central Marin Sanitation Agency treatment plant. During dry weather, the district collects approximately 5 million gallons of wastewater per day; during wet weather, this number can increase to more than 50 million gallons per day. In order to operate, the district must adhere to regulations set by the State Water Resources Control Board.

The district is funded primarily by wastewater collection fees from ratepayers and property taxes. It receives a historically proportionate share of the property tax revenue collected in the area it serves. The district also has the authority to issue bonds. As Table 1 shows, in fiscal year 2013–14, the district had total revenues of approximately \$21.3 million. These revenues consisted mainly of about \$14.9 million from wastewater collection fees and \$5.8 million from property taxes. In the same fiscal year, the district's expenses totaled approximately \$18.3 million, including more than \$6 million for operating and maintenance expenses; approximately \$4 million for wastewater treatment charges; \$2.7 million for administrative expenses; and \$5.6 million for depreciation, debt service, and other expenses. At the end of fiscal year 2011–12, the district had significantly depleted its unrestricted balance, which includes funds used for general operating purposes and money not tied to any particular use, because it previously spent money on budgeted and unexpected sewer system repairs. In August 2013 the district issued \$17.8 million in revenue bonds that it used to refinance existing debt and finance improvements to its wastewater system, such as pipe and equipment replacements and repairs, and to rebuild its cash balance. More recently, in November 2014, the district issued another \$30.2 million in revenue bonds to finance additional improvements to its wastewater system. State law requires the district to file financial reports annually with the California State Controller's Office. In addition, state law requires the county auditor to ensure that the district obtains regular financial audits of its accounts, prepared by either the county auditor or an independent public accounting firm.

A five-member board of directors (board) governs the district. Voters in the district elect the board at large, with two or three members elected in alternating, even-numbered years. Board members are elected to serve four-year terms with no term limits, and the current members come from a variety of different backgrounds, including nursing, consulting, and law. The board meets at least once a month and holds special meetings as necessary. Typical duties of a board, such as the

district board, include approving the annual budget, approving contracts, evaluating the performance of the general manager of the district, establishing job descriptions and salary ranges for all district positions, and reviewing district finances. As of April 2015 board members earn \$299 per day of service and can be paid for a maximum of six days each month, or roughly \$1,800. According to state law, a day of service can consist of attending monthly board meetings or attending conferences, among other things. Board members do not receive pension benefits or any other benefits (such as health or dental insurance) for their service to the district.

Table 1
Condensed Statements of Net Position and Revenues, Expenses, and Changes in Net Position
Fiscal Years 2009–10 Through 2013–14
(In Thousands)

Condensed Statement of Net Position					
FISCAL YEAR ENDING					
	JUNE 30, 2010	JUNE 30, 2011	JUNE 30, 2012	JUNE 30, 2013	JUNE 30, 2014
Total assets	\$67,984	\$70,522	\$73,944	72,913	\$85,566
Total liabilities	(16,521)	(15,705)	(15,259)	(10,721)	(20,362)
Net investment in capital assets	38,920	49,341	57,483	56,485	54,552
Restricted	0	0	42	42	42
Unrestricted	12,543	5,476	1,160	5,665	10,610
Total net position	\$51,463	\$54,817	\$58,685	\$62,192	\$65,204

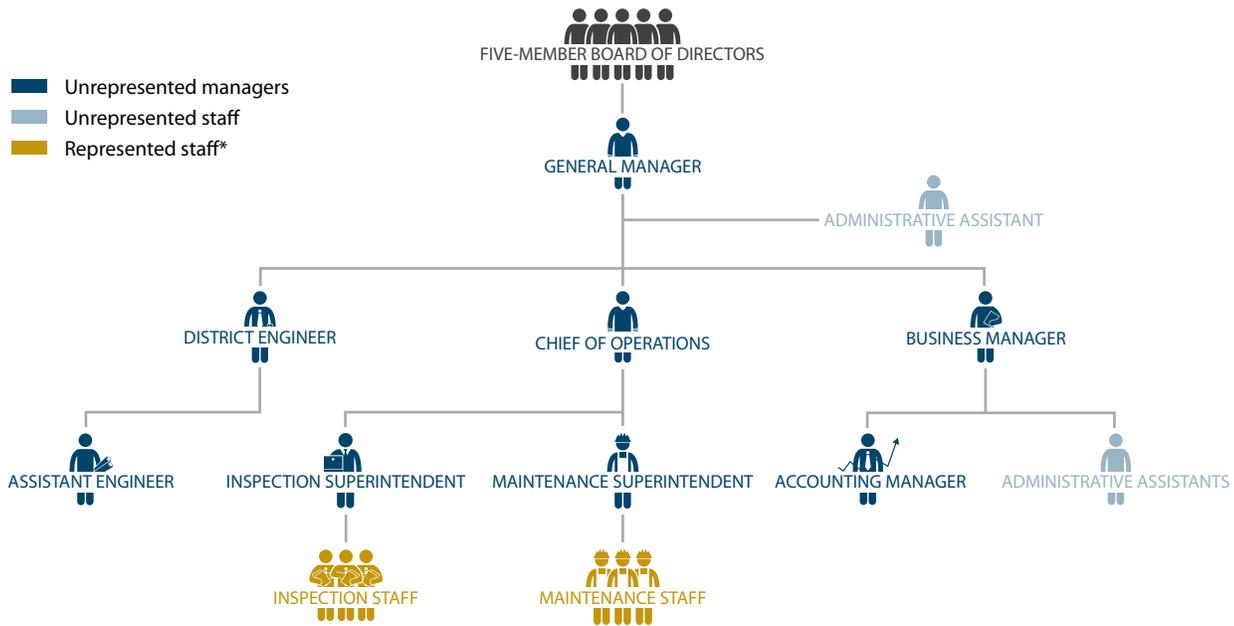
Condensed Statement of Revenues, Expenses, and Changes in Net Position					
FISCAL YEAR ENDING					
	JUNE 30, 2010	JUNE 30, 2011	JUNE 30, 2012	JUNE 30, 2013	JUNE 30, 2014
Total revenues	\$20,584	\$20,749	22,097	20,338	\$21,322
Total expenses	(17,246)	(17,395)	(18,229)	(16,832)	(18,310)
Changes in net position	3,338	3,354	3,868	3,506	3,012
Beginning net position	48,125	51,463	54,817	58,686	62,192
Ending net position	\$51,463	\$54,817	\$58,685	\$62,192	\$65,204

Source: Ross Valley Sanitary District's June 30, 2014, audited comprehensive annual financial report.

As shown in Figure 2 on the following page, the general manager, under the direction and supervision of the board, oversees the district's activities. The general manager is responsible for directing and supervising the district's managers, including the district engineer, chief of operations, and business manager. The district engineer supervises all of the district's engineering activities, including overseeing the bidding process for capital construction contracts and construction-related contracts for engineering, design, and construction management services. The chief of

operations directs all operations and maintenance and repairs of district facilities. The business manager’s responsibilities include financial planning, developing internal controls, and preparing the district’s annual budget. The assistant engineer, inspection and maintenance superintendents, and accounting manager are also management staff. The assistant engineer performs design work; administers contracts; conducts studies regarding capital projects; and provides engineering, planning, and technical support to the district engineer. The inspection superintendent is responsible for training, scheduling, and leading the inspection crew. The maintenance superintendent plans, directs, and evaluates the activities of the maintenance department. The accounting manager coordinates and performs the district’s accounting under the direction and supervision of the business manager.

Figure 2
Ross Valley Sanitary District Organizational Chart



Source: Ross Valley Sanitary District fiscal year 2013–14 comprehensive annual financial report.

* District staff are represented by the American Federation of State, County, and Municipal Employees Local 2167.

The district has 38 authorized positions for fiscal year 2014–15. Employees at the district fall into three categories: unrepresented management employees, unrepresented administrative employees, and represented employees. The district has negotiated a memorandum of understanding (MOU) for its 25 represented positions that establishes their benefits and cost-of-living adjustments and has an MOU with similar terms with its

13 unrepresented management and administrative positions. The American Federation of State, County, and Municipal Employees Local 2167 negotiates labor issues for the district's represented employees. The current MOUs are in effect from June 2009 to June 2015. The district has created job descriptions for all its positions. The board has established pay ranges for all district positions except the general manager, whose salary is established in an employment contract.

In July 2012 the district's former general manager—who had been in the position since November 2008—voluntarily resigned. The district attorney of the County of Marin (district attorney) has since filed a criminal complaint accusing the former general manager of misappropriation of public funds, embezzlement, and money laundering. Specifically, the district had previously provided \$350,000 to the former general manager as part of his employment contract to use as a down payment assistance loan so that he could purchase housing in the Bay Area; however, he allegedly did not use the money for that purpose. The district attorney conducted an investigation, and a trial is scheduled to begin in August 2015. The district also filed a civil lawsuit to recover the \$350,000 loan, which has been stayed until the criminal trial is decided. After the former general manager resigned, the district's business manager served as interim general manager for roughly seven months until February 2013 when the district hired its current general manager from outside the district.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor to evaluate the district's policies and practices over its financial and administrative operations. Table 2 beginning on the following page lists the audit committee's objectives and the methods we used to address them.

Table 2
Audit Objectives and Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	<ul style="list-style-type: none"> • Reviewed relevant laws and other background materials related to the Ross Valley Sanitary District (district). • Reviewed relevant district policies and procedures.
2 Determine what steps the district has taken to identify weaknesses in its financial, operational, and administrative policies and practices that were in place from 2009 through 2013, and determine the status of the district's corrective actions resulting from its own reviews or from recommendations in past audits and reviews.	<ul style="list-style-type: none"> • Reviewed the audits of the district's financial statements conducted by external auditors for fiscal years 2009–10 through 2013–14. • Reviewed internal control reports provided by the district's external auditor for fiscal years 2012–13 and 2013–14. • Reviewed the needs assessment and work plan developed by the district's human resources management consultants. • Interviewed key district staff and members of the board of directors (board) about their efforts to implement corrective actions identified in the reports previously mentioned.
3 Determine whether the district's current governance structure promotes sound operational and financial practices, and identify the extent to which the board and senior management exercise oversight of the district's financial and administrative operations.	<ul style="list-style-type: none"> • Reviewed the district's governance structure, including board member responsibilities described in relevant policies and procedures and the district's orientation manual for new board members. • Compared board oversight of key district functions with best practices included in the California Special Districts Association's <i>Special District Board Member/Trustee Handbook</i>. • Reviewed board meeting minutes and interviewed board members to identify board responsibilities and practices that the district has not formally documented. • Reviewed the training that board members receive.
4 Examine the district's operational structure and assess its management controls and practices. Determine whether the controls over significant financial and administrative functions provide reasonable assurance that the practices are consistent with relevant laws, regulations, and accounting standards.	<p>Identified and evaluated controls over the district's key financial and administrative functions. Specifically, we determined whether the district's internal controls were adequate by assessing their design as documented in the district's policies and determining whether they were operating effectively by performing testing in these functional areas.</p>
5 Determine whether the district's financial practices safeguard assets and ensure proper accounting and reporting of revenues, expenditures, and capital asset values. <ol style="list-style-type: none"> a. Determine whether revenues and capital asset valuations are appropriate and properly recorded. b. Determine whether expenditures (including bond proceeds) are for allowable activities and properly recorded. 	<ul style="list-style-type: none"> • Reviewed the district's audited financial statements to ensure that the district received an unqualified opinion for each of the last five fiscal years and to verify that the district properly accounts for and reports revenues, expenditures, bonds, and capital asset values. • Interviewed district staff to obtain an understanding of the district's financial practices. • Reconciled district financial data to bank statements and to audited financial statements. Determined that the district's financial data were complete for the purposes of selecting transactions for review. • Judgmentally selected and reviewed 10 transactions from each of the five fiscal years from 2009–10 through 2013–14, including expenditures for capital projects, procurement of goods, professional and legal services, payroll, board compensation, and reimbursement for travel expenses to verify that the expenditures were allowable and made in the ratepayers' best interest. • Reviewed relevant documentation for revenue bonds the district issued in August 2013 and November 2014. In addition, we determined whether bond expenditures were for allowable activities by reviewing procurements for capital projects.

AUDIT OBJECTIVE	METHOD
<p>6 Determine whether the district's current compensation levels of pay and benefits for its workforce, including the general manager, are commensurate with the duties and responsibilities of comparable public wastewater agencies.</p>	<ul style="list-style-type: none"> • Reviewed the district's most current salary and wage information. • Compared the salary ranges of six key management positions and maintenance and inspection positions at the district with the salary ranges for equivalent positions at comparable wastewater agencies using the 2014 salary and benefits survey conducted by the California Association of Sanitation Agencies (sanitation association). • Reviewed the district's practices of offering cost-of-living adjustments, longevity pay, and merit salary increases. • Compared the benefits that the district offers its employees with the benefits that comparable agencies reported in the sanitation association's salary and benefits survey. • Reviewed changes the district made to salary ranges for key management positions in the last five fiscal years. • Compared employment contracts for the district's former and current general managers.
<p>7 Review a selection of the district's contracts for capital projects and determine whether it complied with laws, regulations, and best practices for awarding such contracts. Specifically, determine whether the district used a competitive bidding process where appropriate and obtained the best value for its contracted capital projects.</p>	<ul style="list-style-type: none"> • Reviewed relevant laws and policies and interviewed district staff to understand the processes for awarding capital construction contracts, construction-related professional services contracts, and general professional services contracts. • Reviewed district records of capital contracts for fiscal years 2009–10 through 2013–14 to determine the completeness of those records. Determined that the district records were complete for the purposes of selecting contracts for review. • Reviewed the following contracts that the district awarded between July 2009 and September 2014 and assessed compliance with laws, district policy, and best practices: <ul style="list-style-type: none"> – Six of the 22 capital construction contracts. – Three of the 16 construction-related professional services contracts. – Six general professional services contracts for legal, audit, human resources management, and public relations services. • Reviewed the district's seven emergency actions from fiscal year 2009–10 through 2013–14 to determine if its practices complied with relevant laws and district policies.
<p>8 Assess whether the district's financial and administrative policies, practices, and controls are adequate to prevent, identify, and address fraud, abuse, and conflicts of interest.</p>	<ul style="list-style-type: none"> • Reviewed the district's ethics training requirements, fraud reporting policy, and conflict-of-interest code. • Determined whether board members and other designated employees filed annual conflict of interest forms (Form 700) during 2009 through 2013. • Evaluated the effectiveness of the district's financial and administrative controls by testing the appropriateness of expenditures, compensation, and contracts as previously described.
<p>9 Review and assess any other issues that are significant to the operations and financial practices of the district.</p>	<p>We did not identify any other significant issues.</p>

Source: California State Auditor's analysis of Joint Legislative Audit Committee audit request 2014-122, and information and documentation identified in the table column titled *Method*.

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Audit Results

Until Recently, the Board of Directors and Management Had Failed to Implement Important Controls Over the Ross Valley Sanitary District's Financial and Administrative Functions

The Ross Valley Sanitary District (district) has only recently taken steps to correct weaknesses that its external auditors and human resources consultants identified in its financial and administrative policies and practices—beginning those efforts in fiscal year 2013–14. These weaknesses include significant deficiencies in the district's internal controls that could potentially allow fraud, waste, and abuse of public funds to go undetected. Further, an assessment of the district's human resources management systems found numerous problems, including ineffective communication channels and a lack of clear performance expectations. Although the district has implemented new policies that strengthen its internal controls and address some of these concerns, weaknesses still exist. In addition, the district's board of directors (board) has failed to provide adequate oversight of the district's activities. Board members lack an understanding of their role in ensuring the prudent management of the district, and receive inadequate training in how to fulfill their responsibilities.

External Auditors Identified Significant Concerns With the District's Internal Controls

In accordance with state law, the district hired an external auditor to conduct an annual audit of its financial statements for each of the last five fiscal years. As part of those audits, the external auditors determined that the district's revenues, expenditures, and capital asset values were presented fairly in the district's annual financial statements in accordance with applicable accounting principles.

For some of the fiscal years we reviewed, the external auditors also raised concerns regarding the district's internal controls. The auditors considered the district's internal controls over financial reporting as a basis for designing their auditing procedures for the purpose of expressing their opinions on the financial statements. The objectives of the district's internal controls are to provide management with reasonable assurance regarding the safeguarding of assets against loss from unauthorized acquisition, use, or disposition and to provide reliable financial records for maintaining accountability for assets and for preparing financial statements. For fiscal years 2009–10 through 2011–12, the external

An external auditor that was hired in May 2013 to audit the district's fiscal years 2012–13 and 2013–14 financial statements identified several significant deficiencies in the district's internal controls.

auditors that performed the audit during that time did not identify any deficiencies in internal controls that they considered material or significant.¹

However, the new external auditor that was hired in May 2013 to audit the district's fiscal years 2012–13 and 2013–14 financial statements identified several significant deficiencies in the district's internal controls. For example, the auditor found during its fiscal year 2012–13 audit that the accounting manager was responsible for entering invoices into the accounting system, preparing checks to pay those invoices, and reconciling bank statements to the district's records. Such an arrangement could allow an employee to issue a fraudulent check by altering accounting entries or preparing fictitious bank reconciliations. The external auditor appropriately concluded that this lack of segregation of duties could lead to errors or irregularities that might not be detected. During the fiscal year 2013–14 audit, the external auditor followed up on the status of the prior year's recommendations and identified additional concerns. For example, the external auditor found that the district still did not have formal written policies governing travel, credit card use, or purchasing activities. Later in this section, we discuss our review of the controls the district has implemented in response to the concerns raised by the external auditor. The Appendix describes the problems noted by the external auditor in more detail, including the effect of each problem and the status of each recommendation.

The external auditor engaged for the fiscal years 2012–13 and 2013–14 audits also tested the district's compliance with certain provisions of laws, regulations, contracts, and grant agreements—noncompliance with which could have a direct and material effect on the district's financial statements—and reported that these tests disclosed no instances of noncompliance that were required to be reported under government auditing standards.

Consultants Found Serious Problems With the District's Management of Human Resources

In August 2013 the district contracted with a separate entity to provide human resources management consultants to help the district assess and develop its human resources management systems. The consultants interviewed district managers and staff and reviewed the district's administrative policies, personnel policies, labor contracts, and payroll information. In addition, the

¹ A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

consultants provide weekly on-site human resources services to the district. In April 2014 the human resources consultants reported that the district had ineffective or nonexistent organizational communication channels, a lack of role clarity throughout the organization, and a lack of clear performance expectations and accountability at the individual level. Moreover, the consultants found that the members of the management team did not have technical expertise in human resources management and generally took a reactive rather than a proactive approach to human resources issues. The consultants also found that human resources data and pay and benefits data were not maintained in a system that allowed for easy access or analysis. Furthermore, the consultants reported that the district's personnel administration system was not well matched to current employment law, best practices, or the present needs of the organization.

The human resources consultants created a work plan to resolve these deficiencies that identified six major priorities that the consultants would work with the district to complete. These priorities are as follows:

- Develop and use a performance management system that includes performance measurement metrics that can be used to clearly identify performance problems and/or the need for training.
- Improve administrative policies to provide a clear set of workplace expectations and roles for managers and staff.
- Develop a long-range staffing plan and update job descriptions to align with current industry best practices.
- Create and implement training plans to train all employees in respectful and effective workplace communication and behavior.
- Develop a strategy for upcoming labor negotiations, and hire a professional labor negotiator to lead this complex process. Because district employees have enjoyed six years of salary growth under the current labor agreement, and because salaries and benefits represent a substantial portion of the district's budget, as part of developing this strategy the district should perform a comprehensive review of present and projected personnel costs and carefully weigh such costs against the value received and the district's overall financial condition.
- Implement certain ideas presented by staff in an initial strategic planning workshop, such as developing a succession plan and identifying employee recognition methods.

In April 2014 the human resources consultants reported that the members of the management team did not have technical expertise in human resources management and generally took a reactive rather than a proactive approach to human resources issues.

Table 3 summarizes the district's progress in implementing the six elements of the work plan.

Table 3
Progress Made and Target Completion Dates for the Elements of the Ross Valley Sanitary District's Human Resources Work Plan

ELEMENTS OF HUMAN RESOURCES WORK PLAN	EXAMPLES OF PROGRESS MADE	TARGET COMPLETION DATE
Develop and use a performance management system	<ol style="list-style-type: none"> 1. Completed draft of new performance management tool for supervisors to use when assessing employee performance. 2. Provided skills development coaching to supervisors and managers. 	September 1, 2015
Revise, update, or create administrative policies and systems	<ol style="list-style-type: none"> 1. Drafted policies on numerous topics, including mandated leave and employee training. 2. Improved district's hiring systems by implementing an online application process, developing a selection process, and providing additional training for supervisors overseeing new employees. 	June 30, 2016
Develop a long-range staffing plan	<ol style="list-style-type: none"> 1. Developed three-part exercise to assess future needs and plan for skills development. 2. Met with general manager to redefine focus of the planning process. 	September 1, 2015
Create and implement training plans	<ol style="list-style-type: none"> 1. Developed and delivered initial training on respectful and effective workplace communication and behavior. 2. Facilitated the development of job-based training plans. 	June 1, 2015
Prepare a strategy for 2015 labor negotiations	<ol style="list-style-type: none"> 1. Assisted in obtaining services of a professional labor negotiator for the district. 2. Reviewed language in memorandum of understanding for administrative and employment law issues. 	July 1, 2015
Implement strategic planning workshop ideas	<ol style="list-style-type: none"> 1. Facilitated management review of certain staffing and leadership needs, which resulted in clear staff assignments and workload parameters. 2. Facilitated the implementation of several official communication channels within the organization. 	July 1, 2015

Sources: November 2014 Human Resources work plan progress report and the Ross Valley Sanitary District's target completion dates.

Although the District Has Strengthened Its Controls and Policies, Weaknesses Still Exist

We reviewed the district's controls over significant financial and administrative functions, including controls it implemented in response to the findings of its external auditor. During our review, we evaluated the adequacy of 32 of the district's key controls over financial, procurement, payroll, and human resources functions for preventing, identifying, and addressing the potential for fraud, abuse, and conflicts of interest. The results were mixed. Although we found 17 of the district's key controls to be adequate, 15 were not.

The district has recently implemented many new policies that strengthen its controls over its financial and administrative functions, as shown in Table 4 beginning on page 20, but weaknesses still exist. For example, in February 2015 the district implemented a new policy that strengthens controls over travel and other expense reimbursements claimed by board members and employees. However, the new policy is inadequate because it does not provide sufficient limitations on lodging costs. As another example, the district strengthened its controls over its inventory

by conducting a physical count of its inventory at the end of fiscal year 2013–14 and by implementing an inventory and valuation policy in September 2014. However, the district still does not record inventory in its accounting system and does not track inventory that comes in or goes out. According to the district's business manager, the district is currently working on implementing an inventory tracking system. Moreover, as described in subsequent sections of this report, the district did not always follow the policies it had in place.

The failure of the district's management to establish adequate controls over the district's financial and administrative functions until recently may have been the result of poor leadership. As mentioned in the Introduction, the former general manager, who was hired in November 2008, resigned in July 2012 amid allegations of civil and criminal misconduct. Nevertheless, good management practices and the job descriptions for the district's management positions make it clear that management is responsible for developing and implementing these controls and ensuring that the district operates efficiently and effectively.

The Board Failed to Adequately Oversee the District, and Board Members Receive Little Training

The board is the governing body responsible for ensuring that the district fulfills its stated mission to deliver to its customers the highest-quality and most cost-effective wastewater collection system possible. However, the board has not adequately overseen the district's financial and administrative functions over the past five fiscal years. Although the district has begun to strengthen its policies and procedures, the board needs to ensure that management continues to strengthen the controls over its key financial and administrative functions to protect against the potential for fraud, waste, abuse, and conflicts of interest.

One potential cause for the board's failure to adequately oversee the district may be that board members receive insufficient training. State law requires board members to attend biannual ethics training and training on the Brown Act, which governs public local government meetings. In addition, in September 2014, the district provided new board member training that covered board member roles, the board governance process, and board communications, among other topics. We believe that these are important concepts for board members to understand, but they are not sufficient to guide board members in fulfilling all of their duties and responsibilities. As described in subsequent sections of this report, board members have demonstrated a lack of understanding of their role in certain key district processes, including establishing appropriate compensation levels, reviewing and approving declarations for emergency procurement, contracting for professional services, and ensuring that the district has established appropriate processes for essential human resources functions. We believe that the board should seek additional training in these areas.

We believe board members should seek additional training in establishing appropriate compensation levels, reviewing and approving declarations for emergency procurement, contracting for professional services, and ensuring appropriate processes for essential human resources functions are in place.

Further, the board's roles and responsibilities are not adequately documented. We would expect the district to have a comprehensive manual that includes policies describing the various oversight roles and responsibilities of the board in a manner that would allow board members, particularly those newly elected, to fully understand their fiduciary responsibilities. Instead, the district provides new board members an orientation manual that includes the district's mission statement and service area map, examples of district financial statements, budget information, copies of its memorandums of understanding (MOUs) with its employees, and various regulatory documents. This manual does not adequately describe the board's responsibility for ensuring that management has appropriate controls in place over important financial and administrative functions.

Key Board Responsibilities That the Ross Valley Sanitary District Has Not Documented in Its Board Policies and Procedures or Board Member Orientation Manual

- Support and assess the performance of the general manager.
- Approve personnel policies.
- Establish salary structure and benefits packages.
- Approve job descriptions and organizational structure.
- Ensure that sound fiscal policy exists, and that controls are in place.
- Approve the annual budget.
- Establish financial goals and review district finances.
- Develop capital improvement plans.
- Set rates and fees.

Source: Best practices from the California Special Districts Association's *Special District Board Member/Trustee Handbook*.

Very few board responsibilities, such as signing contracts and declaring emergencies when the sewer system fails, are established in state law. However, the California Special Districts Association identifies in its *Special District Board Member/Trustee Handbook* several board responsibilities over financial and administrative functions that could serve as best practices for the district. Although the board does some of these things in practice, the board orientation manual and the board policies and procedures do not describe the board responsibilities shown in the text box. It is important to document these responsibilities so that board members know all of the things they are required to do to adequately oversee the district.

Compensation for District Employees Is High Relative to Salaries at Comparable Sanitation Agencies

The board's oversight over employee compensation has been lax and has resulted in high salaries for district employees relative to what employees in similar positions receive at comparable sanitation agencies. We do not believe that the district's practice of offering excessive compensation to employees is an appropriate use of revenue generated from fees and taxes paid by its ratepayers. Personnel costs take up an increasing portion of the district's total expenses—rising from 20 percent in fiscal year 2009–10 to 28 percent in fiscal year 2013–14.

Using the 2014 salary and benefits survey that the California Association of Sanitation Agencies (sanitation association) conducted, we compared the salaries of the district's key management employees with salaries of a variety of local agencies that provide sanitation services in California. For the survey, participating agencies self-report salary information to the sanitation association via a standard form, which includes a list of standardized positions and a description of each; agencies select which positions most closely match their own based on the qualifications and responsibilities included in the descriptions. Several of the agencies we selected were similar to the district in number of employees, annual budget, complexity of operation, and population served. However, we also included agencies that are larger and more complex than the district (for example, agencies that also operate their own wastewater treatment facility). In addition, the sanitation association survey categorizes agencies with similar numbers of employees into different groups and calculates an average salary range for each position in each group. We included two of these groups in our comparison.

Except for the general manager, the top of the district's salary ranges for all of the positions we reviewed ranked fourth or higher among the agencies we compared. For example, Table 5 beginning on the following page shows that the salary range for the district's business manager is the highest of the comparable positions at all nine agencies and agency groups (including the district). In fact, the high end of the business manager's salary range is \$2,613 higher per month, or 18 percent greater, than that of a comparable position at the Dublin San Ramon Services District (Dublin), which reported serving a population nearly three times larger than the district's, having an annual operating and maintenance budget more than three times larger than the district's, and employing nearly three times as many people.

Similarly, at \$12,754 per month, the top of the district's assistant engineer salary range is the highest in our comparison of that position at 12 agencies and agency groups. It is 14 percent higher than the top monthly salaries of comparable positions at Dublin and Delta Diablo (Delta). Both Dublin and Delta serve populations that are significantly larger than the district and employ significantly more people.

The top of the district's accounting manager's salary range is also high, ranking second out of the 12 agencies and agency groups in our comparison. At \$12,754, it is nearly 12 percent higher than the top of the salary range for a similar position at Delta, which is a larger agency.

Except for the general manager, the top of the district's salary ranges for all of the positions we reviewed ranked fourth or higher among the comparable agencies.

Table 5
Monthly Salary Ranges for Key Management Employees at Comparable Sanitation Agencies

AGENCY INFORMATION									
AGENCY	ANNUAL OPERATIONS AND MAINTENANCE BUDGET	POPULATION SERVED	TOTAL EMPLOYEES	GENERAL MANAGER			ASSISTANT GENERAL MANAGER/CHIEF OF OPERATIONS		
				MINIMUM	MAXIMUM	RANK	MINIMUM	MAXIMUM	RANK
Ross Valley Sanitary District (district)*	\$14,760,770	55,000	38	\$14,978	\$14,978	11	\$11,610	\$15,928	4
Central Marin Sanitation Agency	10,080,000	105,000	41	17,322	17,322	5	NA	NA	
Daly City, City of†	15,920,121	105,000	66	12,860	15,631	10	NA	NA	
Delta Diablo	22,900,000	200,000	74	22,391	23,391	2	14,602	18,236	1
Dublin San Ramon Services District	53,094,704	157,000	106	23,433	23,433	1	15,088	17,109	2
Novato Sanitary District	9,300,000	52,550	22	15,832	15,832	9	11,477	13,950	6
South Tahoe Public Utility District	9,344,520	36,363	108	13,318	16,998	6	12,116	15,464	5
Tahoe-Truckee Sanitation Agency	12,483,310	60,000	48	14,902	14,902	12	11,532	13,377	7
Union Sanitary District	31,355,356	331,387	130	19,871	19,871	3	NA	NA	
West County Wastewater District	13,040,000	97,296	57	16,584	16,584	8	NA	NA	
West Valley Sanitation District*	26,200,000	109,000	29	16,958	16,958	7	NA	NA	
Group 3 (30 to 55 employees)‡	This information was not included in the survey		30–55	13,215	13,460	13	9,558	11,870	8
Group 4 (56 to 99 employees)‡			56–99	16,951	17,758	4	14,180	16,638	3

Sources: District operating and capital budget, fiscal year 2013–14; district employee salary chart, fiscal year 2014–15; and the California Association of Sanitation Agencies (sanitation association) 2014 salary and benefits survey.

Note: Position titles include the generic position used by the sanitation association followed by the district's comparable position.

NA = This agency did not report information for this position.

* These agencies do not operate their own wastewater treatment facility.

† The City of Daly City provides wastewater treatment services.

‡ The minimum and maximum salaries for these groups represents an average for agencies that participated in the sanitation association's salary and benefits survey whose number of employees falls within the specified range.

DIRECTOR OF FINANCE/ BUSINESS MANAGER			ACCOUNTING SUPERVISOR/ ACCOUNTING MANAGER			SENIOR ENGINEER/ DISTRICT ENGINEER			ASSOCIATE ENGINEER/ ASSISTANT ENGINEER		
MINIMUM	MAXIMUM	RANK	MINIMUM	MAXIMUM	RANK	MINIMUM	MAXIMUM	RANK	MINIMUM	MAXIMUM	RANK
\$12,502	\$17,153	1	\$9,296	\$12,754	2	\$10,518	\$14,430	4	\$9,296	\$12,754	1
NA	NA		7,193	8,743	9	11,160	13,565	5	7,977	9,696	8
12,990	15,790	3	7,640	9,287	7	NA	NA		7,369	8,957	9
NA	NA		9,128	11,400	3	12,965	16,192	1	8,932	11,155	2
14,540	14,540	4	10,499	12,761	1	13,061	15,088	2	8,050	11,147	3
7,046	8,564	9	NA	NA		8,564	10,410	11	6,547	7,957	11
10,245	13,076	6	7,347	9,377	6	10,237	13,065	7	7,712	9,843	5/6
NA	NA		7,094	8,233	12	10,538	12,225	9	6,818	7,917	12
13,061	17,143	2	6,820	8,951	8	NA	NA		7,944	10,427	4
NA	NA		7,954	9,802	5	11,817	14,560	3	7,989	9,843	5/6
10,589	12,457	7	8,528	10,033	4	11,157	13,126	6	NA	NA	
7,337	9,615	8	7,045	8,436	11	9,702	12,085	10	7,055	8,945	10
11,030	13,619	5	6,930	8,625	10	10,178	12,703	8	7,809	9,757	7

Finally, the top of the salary range for the district's chief of operations is high relative to comparable agencies, ranking fourth out of the eight agencies and agency groups we used for comparison. The top of the district's salary range for its chief of operations position is \$15,928 per month, which is 34 percent higher than the high end of the salary range for the category of agencies with 30 to 55 employees (Group 3).

Of the four key management staff just discussed, the chief of operations and the assistant engineer have advanced to the highest salary step; however, they have not yet qualified for longevity pay, which would put them at the top of their ranges. The business manager and accounting manager have not yet reached the top salary step, nor have they qualified for longevity pay. We discuss longevity pay in the next section.

In addition to the key management employees shown in Table 5, we compared the salary ranges of the district's maintenance workers, maintenance supervisors, and maintenance and inspection superintendents to the salary ranges of comparable positions at the same agencies shown in Table 5. We found that the salary ranges for each of these district positions were the highest among the comparable positions at all of the other agencies. For example, the top of the district's salary range for its maintenance workers was 27 percent higher than for comparable positions at Dublin, which had the next highest salary range.

Questionable Practices by the Board Led to High Employee Salaries

The high salaries for district employees appear to be the result of questionable district practices sanctioned by its board. One of these is the district's practice of paying excessive annual cost-of-living adjustments (COLAs). The district's MOU with represented employees and its MOU with management employees, which are in effect for the period July 1, 2009, to June 30, 2015, include annual COLAs of between 3 percent and 5 percent that are not tied to changes in an actual cost-of-living index. During the period of the MOUs, the consumer price index for the San Francisco Bay Area increased annually by between 0.7 percent and 2.8 percent, which is much lower than the range of COLAs that the district provided its employees. For example, in 2009 the consumer price index increased 0.7 percent, while the district paid its employees a 5 percent COLA that same year, as shown in Table 6.

In 2009 the consumer price index increased 0.7 percent, while the district paid its employees a 5 percent COLA that same year.

Table 6
Ross Valley Sanitary District Annual Cost-of-Living Adjustments Compared to Increases in the Consumer Price Index

YEAR	CHANGE IN CONSUMER PRICE INDEX	DISTRICT COST-OF-LIVING ADJUSTMENT
2009	0.7%	5%
2010	1.4	4
2011	2.6	3
2012	2.7	3
2013	2.2	3
2014	2.8	4

Sources: Ross Valley Sanitary District's memorandums of understanding with its employees, and the United States Department of Labor, Bureau of Labor Statistics, consumer price index for San Francisco, Oakland, and San José.

In addition to the annual COLAs, the board authorized a salary increase for the business manager position in September 2009. The low end of the salary range for that position increased by 56 percent, from \$6,459 monthly to \$10,074 (as shown in Table 5 beginning on page 24, this amount has since increased). A former board member who voted to approve the higher salary range stated that he supported the increase in order to make it equitable for the then-interim business manager to stay with the district. The former general manager provided the board with a comparison of the proposed salary with salaries at other agencies, five of which we included in our own comparison. Even though the top of the proposed salary range was higher than all but one of the agencies used in the comparison, including agencies that are larger and more complex than the district, such as Dublin and Delta, the board approved the increase. However, as we describe more fully later, the former business manager agreed to resign after not passing the probationary period in June 2010, approximately nine months after the board approved the new salary for the business manager position. The district then paid the former business manager a generous three-month severance package of \$37,000.

In January 2011 the board also authorized a 28 percent salary increase for the accounting manager position, which increased the low end of the salary range from \$6,390 monthly to \$8,180 monthly (as shown in Table 5 beginning on page 24, this amount has since increased). The former general manager informed the board that the district had attempted to fill this position twice at the lower salary level but could not find a suitable candidate. He also told the board that the proposed salary was competitive with the sanitation association's 2009 salary survey but did not offer any evidence to justify this claim; instead, he said he would bring the sanitation association's survey to the next board meeting. However, he never did so. Two board members

expressed reservations about approving this high salary without looking at comparisons and voted against it. However, the three remaining members of the board voted to approve the salary increase.

Furthermore, in April 2010, the board approved two new positions at the district: chief of operations and assistant engineer. In his proposal to the board for the two new positions, the former general manager provided no comparative information demonstrating that the proposed salary ranges were in line with those for positions with commensurate responsibilities at other comparable agencies. The board did not request any additional information about the proposed salaries and voted to approve the salary ranges for the two positions. Because the board did not receive or request any salary comparisons, it had no way to adequately determine whether the salary ranges for these positions were reasonable given the assigned duties. As we mentioned previously, and as illustrated in Table 5 beginning on page 24, the top salary ranges for both of these positions are high relative to comparable positions at other sanitation agencies.

Finally, the district's MOUs with its represented and management employees include longevity pay, which inflates the high end of its salary ranges. This serves to exacerbate the already high salary ranges for positions at the district compared with those at other agencies. Employees who have worked for the district for more than 10 years receive an additional 5 percent over their base salary, and employees who have worked for more than 15 years receive an additional 7.5 percent. However, the district was unable to provide us a rationale for offering this benefit; for example, the district could not provide evidence that it needed longevity pay to retain or attract qualified employees. It also could not explain how it determined the two percentages. Currently, only six of the district's employees—one management employee and five represented employees—are receiving longevity pay; none of its other employees have been with the district long enough to receive it. By eliminating the possibility of longevity pay for employees who are not already receiving it, the district could avoid annual future salary expenses that could reach \$99,000 per year if all management and other unrepresented employees were to receive it and an additional \$115,000 per year if all represented employees were to receive it.

Employees who have worked for the district for more than 10 years receive an additional 5 percent over their base salary, and employees who have worked for more than 15 years receive an additional 7.5 percent.

The Current General Manager's Salary and the Benefits the District Provides Its Employees Are Generally in Line With Those of Comparable Agencies

Unlike the salaries of other district managers, the current general manager's salary in fiscal year 2013–14 was in line with the salaries paid by comparable agencies, ranking 11th out of the 13 agencies

and comparison groups we reviewed. Also, as shown in Table 7, the current general manager’s contract does not include the same excessive provisions as those in the former general manager’s contract. For example, the contract includes the same retirement benefits as other district employees receive, severance pay of four months’ salary if he is terminated without cause, rather than 18 months’ salary, no housing loan or student debt relief, and no one-time bonus. The current general manager’s contract states that the board will annually evaluate his performance and may consider merit-based increases and market-based compensation adjustments.

Table 7
Comparison of Key Provisions in the Former and Current General Manager’s Employment Contract

KEY CONTRACT PROVISIONS	FORMER GENERAL MANAGER*	CURRENT GENERAL MANAGER
Annual salary	\$197,000	\$179,740 [†]
Deferred compensation contributions	District matches 457(b) deferred compensation contributions annually, not to exceed 50 percent of maximum allowable.	None
Monthly automobile allowance	\$500	\$400 [†]
Student loan repayment	Loan balance up to \$28,000	None
Housing loan	\$350,000	None
One-time bonus	\$9,850	None
Severance payment if terminated without cause	18 months’ salary	4 months’ salary
Additional termination protections	General manager shall not be terminated or asked to resign during the three years after the effective date of the contract or 90 days prior to any board election, 180 days after such an election, or 90 days following any change in board membership, except upon unanimous vote by the board.	None

Source: California State Auditor’s analysis of Ross Valley Sanitary District’s employment contracts with its former and current general managers.

* Based on contract provisions in effect when the former general manager resigned in July 2012.

[†] In January 2015 the board of directors increased the current general manager’s annual salary by 5 percent and increased his monthly automobile allowance by \$100.

In October 2014 the board performed an evaluation of the general manager and gave him a very positive overall rating for his efforts to improve the district. The board used a scoring sheet to rate his performance on several criteria, including his ability to assist the board with policy making, maintain proper external relationships, and administer the district internally, as well as his personal characteristics. Based on his performance, the board recently increased the general manager’s salary by 5 percent and increased his monthly automobile allowance by \$100. However, to protect against the excesses it allowed in the former general manager’s contract, the board needs to formalize in policy its approach for periodically evaluating the general manager’s performance and for determining any merit-based compensation increases.

Finally, 12 of the district's 38 authorized positions are not currently required to contribute anything to their pension; instead, the district is making the full contribution for employees hired before July 2010, as Table 8 shows. These employees were hired before July 2010, when the district finalized new MOUs with its employees. District employees hired after the MOUs were finalized but before January 1, 2013, are required to contribute 8 percent of their salaries to their pensions, which is in line with or even on the high end compared to other sanitation agencies. Effective January 1, 2013, the Public Employees' Pension Reform Act (act) established a new retirement formula of 2 percent at age 62 for all miscellaneous members new to the California Public Employees' Retirement System. Under the act, until June 30, 2015, the employee contribution rate is set at 6.25 percent for these members and will be subject to recalculation after that date. We believe the district should take necessary steps to begin requiring all of its employees to contribute an appropriate amount to their pensions. The district's retirement formula of 2.7 percent at age 55 (which applies to the vast majority of its employees), is generally comparable to the formulas the other sanitation agencies use, as shown in Table 8. Other benefits that the district provides, including medical, vision, and dental benefits, all seem to generally fall within the range of other sanitation agencies; however, we believe that the district's policy of reimbursing its represented employees up to \$300 a year for gym memberships is an inappropriate use of ratepayer funds.

Table 8
Retirement Benefits Among Comparable Sanitation Agencies

AGENCY	RETIREMENT FORMULA*	EMPLOYEE CONTRIBUTIONS AS A PERCENTAGE OF EMPLOYEE SALARIES
Ross Valley Sanitary District (district employees hired before July 1, 2010)	2.7% at 55	0%
District employees hired from July 1, 2010, to December 31, 2012		8
District employees hired after January 1, 2013, and classified as new members [†]	2% at 62	6.25
Central Marin Sanitation Agency	Tier 1 - 2.7% at 55	represented employees: 1 unrepresented employees: 0
Daly City, City of	not provided in survey	8
Delta Diablo	Tier 1 - 2.7% at 55 Tier 2 - 2% at 55 Tier 3 - 2% at 62	1 7 6.5
Dublin San Ramon Services District	Tier 1 - 2% at 62 Tier 2 - 2.7% at 55	6.25 10
Novato Sanitary District	Tier 1 - 2% at 55 Tier 2 - 2% at 62	3.5/7 6.25

AGENCY	RETIREMENT FORMULA*	EMPLOYEE CONTRIBUTIONS AS A PERCENTAGE OF EMPLOYEE SALARIES
South Tahoe Public Utility District	Tier 1 - 2.7% at 55 Tier 2 - 2% at 62	7%
Tahoe-Truckee Sanitation Agency	2.7% at 55	0
Union Sanitary District	Tier 1 - 2% at 62 Tier 2 - 2.5% at 55	5
West County Wastewater District	3% at 60	3-8
West Valley Sanitation District	2.5% at 55	5

Sources: 2014 California Association of Sanitation Agencies salary and benefits survey and the district's memorandums of understanding with its management and represented employees.

Note: As of January 1, 2013, the Public Employees' Pension Reform Act (act) established a new retirement formula of 2 percent at age 62 for all miscellaneous (non-safety) members new to the California Public Employees' Retirement System (CalPERS). Under the act, until June 30, 2015, the employee contribution rate is set at 6.25 percent for these members, and will be subject to recalculation by CalPERS after that date.

* The retirement formula is used to calculate an employee's retirement benefit by using the employee's years of service, age at retirement, and final monthly compensation. For example, a district employee with 20 years of service and final monthly compensation of \$10,000 who retires at age 55 would receive a monthly retirement benefit of \$5,400 ($20 \times 2.7\% = 0.54$; $0.54 \times \$10,000 = \$5,400$).

† A new hire who is brought into CalPERS membership for the first time on or after January 1, 2013, and who has no prior membership in any other California public retirement system, and who is not eligible for reciprocity with another California public retirement system, or a member who established CalPERS membership prior to January 1, 2013, and who is hired by a different CalPERS employer after January 1, 2013, after a break in service of greater than six months.

The Board Did Not Consistently Follow the District's Emergency Procurement Procedures and Thus Cannot Ensure That It Is Getting the Best Value

The board failed to consistently follow procurement procedures for emergencies and, as a result, cannot be sure it received the best value for emergency work that was performed. The district defines an emergency as a sudden, unexpected occurrence that poses a clear and imminent danger, requiring immediate action to prevent or mitigate the loss or impairment of life, health, property, or essential public services. In the event of an emergency, state law requires the board to make a finding based on substantial evidence set forth in the minutes of a meeting that the urgency of the situation does not permit the competitive solicitation of bids. The board must then pass a resolution by a four-fifths vote to take any action directly related to and immediately required by the emergency and may procure the necessary equipment, services, and supplies without undergoing a competitive process. The board's resolution may delegate the authority to spend district funds to the general manager. Procurement criteria for emergencies allows the district to engage a contractor without receiving a bid proposal or cost schedule—documents that, when part of a competitive bidding process, help the district determine whether the contractor's costs are reasonable. Once the district

For five of the seven emergency construction projects we tested, the district complied with the emergency procurement criteria.

begins emergency work, state law requires the board to review and reapprove the emergency with a four-fifths vote at every subsequent monthly board meeting until the district determines that the emergency has ended. Ending the declaration of an emergency in a timely manner allows the board to seek competitive bids for additional work and helps ensure that project costs are fair and reasonable.

The district identified seven emergency construction projects that occurred from fiscal years 2009–10 through 2013–14. The district complied with the emergency procurement criteria we tested for five of the seven emergency construction projects. However, the board did not appropriately review the two most costly of the district's emergency projects. These two projects were associated with the district's most expensive capital construction project—the Kentfield force main replacement project. The Kentfield force main replacement project began in 2010 and involved replacing a force main—a pressurized pipe—near the community of Kentfield. The district estimated it would cost \$9 million for the project's two segments: \$5 million for the first segment starting in fiscal year 2010–11 and \$4 million for the second segment starting in fiscal year 2011–12. In May 2010 the district awarded a \$4.1 million contract—almost \$1 million less than the estimated amount—for the first segment to a contractor through competitive bidding, as state law requires, and the contractor began the work of replacing the force main.

By not competitively bidding the second segment of the project or following required procurement procedures for emergencies, the district may have missed an opportunity to achieve lower costs similar to those it achieved by competitively bidding the first segment. In December 2010, the former general manager reported to the board that the new pipe sections that the contractor had installed in the first segment increased stress on the older sections that were to be replaced in the second segment of the project, increasing the risk of sewer overflows into a local waterway. For this reason the board declared an emergency, which allowed the district to avoid competitively bidding the work and instead amend the existing contract with the current contractor through a time-and-materials change order. The former general manager estimated that the emergency work would cost \$1.5 million of the original \$4 million estimate for the second segment. The emergency essentially led the district to begin work on portions of the second segment of the project earlier than planned and without competitive bidding. However, although the board followed protocol when declaring this emergency, it did not review and reapprove the emergency at subsequent board meetings from January 2011 through March 2011 to make certain there was a need to continue the action. Thus, the district continued to spend funds without

considering whether it could discontinue the emergency declaration and complete the project by using competitive bidding. The district approved the \$1.47 million total cost of this emergency work.

In a May 2011 board meeting, district staff recommended that the board declare a second emergency in the Kentfield force main replacement project because there was an immediate risk that the settling of the dirt adjacent to an older section of pipe included in the second segment of the project could damage the pipe and cause a sewer overflow. Staff believed that a potential sewer overflow due to a ruptured pipe during the rainy season constituted an immediate threat to public health and safety. The board agreed and unanimously voted to declare an emergency.

This second emergency declaration authorized the former general manager to complete the remaining portion of the second segment of the Kentfield force main replacement project by using a change order to the existing contract with the contractor instead of competitively bidding the project as originally planned. The board set a spending cap of \$2.5 million of the original \$4 million estimate to complete the second segment. Similar to the first emergency, the board did not review and reapprove this emergency at each subsequent board meeting as required by state law. The district never terminated the emergency and declared the project complete in June 2012, more than a year after declaring the second emergency.

The December 2010 and May 2011 Kentfield force main emergency declarations contributed to the district paying just under the \$4 million budgeted for the second segment without competitive bidding. Although the district originally estimated that the second segment would cost \$4 million, by not following required procurement procedures for emergencies or competitively bidding the project, the district may have missed an opportunity to pay less than the original estimate, similar to the lower costs it achieved by competitively bidding the first segment.

The board did not consistently fulfill its responsibility to review and reapprove emergencies because the board's legal counsel at the time did not ensure that the board followed the law. We reviewed minutes from each of the eight meetings in which the board should have reviewed and reapproved the two emergencies and found that, although present at all but the first meeting, the minutes do not reflect that the board's legal counsel ensured that the board followed the required procurement procedures for emergencies.

The board did not consistently fulfill its responsibility to review and reapprove emergencies because the board's legal counsel at the time did not ensure that the board followed the law.

When the district does not receive quotes or proposals from multiple bidders, it cannot compare the cost and quality of services and may not be able to determine whether a proposal from a single vendor is fair and reasonable.

The District Did Not Ensure That It Received the Best Value When Procuring Professional Services Because It Did Not Always Use a Competitive Process

The district did not always use a competitive process or justify using sole-source contracts and thus cannot ensure that it received the best value for its ratepayers when contracting for professional services. State law does not establish procedures for how the district must award contracts for certain types of professional services, including legal services, public relations services, and administrative services. Nevertheless, the district approved a procurement policy requiring competitive bidding for such services whenever reasonably feasible in September 2014. Issuing a request for proposals and soliciting proposals from prospective professional service providers is a good business practice because it allows the district to compare the cost and quality of services in the proposals it receives. When the district does not receive quotes or proposals from multiple bidders, it cannot make this comparison and may not be able to determine whether the costs in a proposal from a single vendor are fair and reasonable.

In August 2013 the district entered into a one-year agreement not to exceed \$100,000 with a separate entity for human resources management services using a sole-source contract. According to the general manager, he conducted phone interviews with two entities and checked their references. He stated that the entity the district ultimately hired was clearly the better fit for the district, as it had the capacity to provide weekly on-site presence because it had staff in the Marin area, and it had outstanding references from local agencies that had also dealt with significant unaddressed human resources issues. However, the district did not develop a request for proposals and advertise the contract opportunity to other qualified entities that may have wanted to submit a proposal. The services described in this contract—for example, assessing the district’s human resources needs, developing or updating policies and procedures, and providing training—do not appear to be so specialized or unique that they would be available from only one provider and would therefore justify a sole-source contract. Nevertheless, the board approved the contract unanimously.

Another example of the district not competitively bidding a professional services contract occurred in July 2010, when the district awarded a sole-source contract not to exceed \$84,000 for one year of marketing-related services. The services included publishing and distributing a quarterly newsletter, press releases, advertising, and community outreach materials. In the report district staff provided for the June 2010 board meeting regarding the one proposal, the former general manager justified using a sole-source contract because the district had already been

working with that contractor for a year and the contractor's work was effective. This is not sufficient justification for awarding a sole-source contract. However, the minutes from the July 2010 meeting show that the board approved this contract without questioning why district staff did not solicit additional proposals. Although the contractor's proposal included a breakdown of activities and the hourly rates the contractor planned to bill, the district had no other proposals against which to compare these activities and rates to determine if they were reasonable. After the contract term expired, the district continued to pay for the marketing services without having a written contract in place for another 10 months, until the district renewed the contract in May 2012. Ultimately the district terminated this contract in September 2012 as part of its efforts to reduce expenses. However, by that point the district had already paid this contractor more than \$175,000.

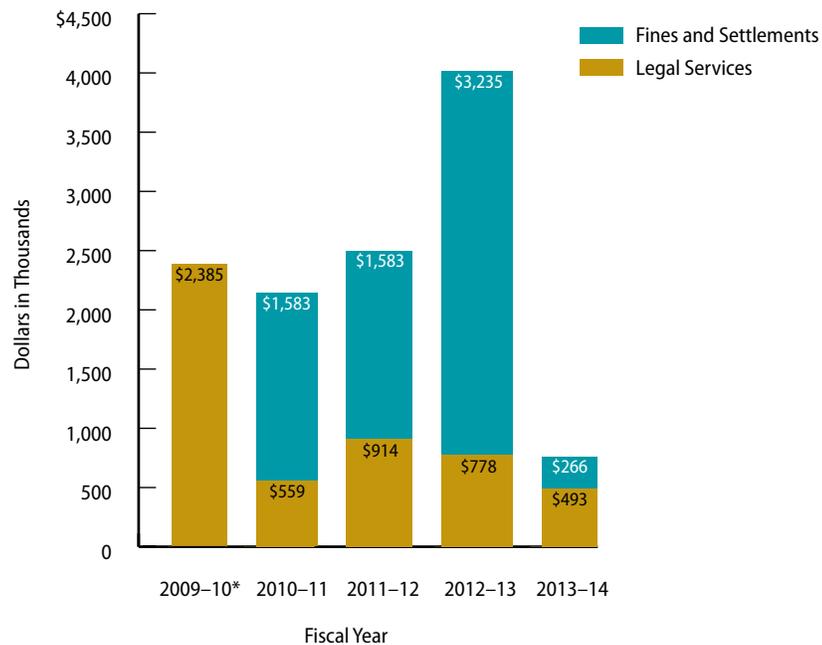
Additionally, on two occasions, the district did not receive a proposed engagement letter or cost estimate that could have allowed it to better ensure that it was getting a good value after it directed its former legal counsel to initiate litigation. According to the contract with the district's former legal counsel, the legal counsel was required to provide a proposed engagement letter describing the scope of the engagement and estimated cost when the district requested any litigation or special project services. However, after the district directed its legal counsel to initiate litigation for two lawsuits in March 2011 and May 2012, it did not ensure that it received engagement letters or cost estimates. On both occasions, meeting minutes show that the board discussed the litigation services with its former legal counsel in closed sessions. However, according to the district's business manager, the board never requested engagement letters. Because the district did not receive a written scope of services or cost estimate for the two lawsuits, it did not have enough information to determine whether this litigation would be cost-effective. In addition, although the district provided estimated total costs, it did not separately track its expenditures for these litigation services so it could accurately monitor the total costs. Consequently, according to its accounting manager the district could not accurately determine how much it spent on these services. The district's inability to accurately monitor and control litigation costs may have contributed to it spending more than \$5.1 million on legal services over the last five fiscal years, as Figure 3 on the following page shows.

In addition, Figure 3 shows that over the last five fiscal years the district has spent approximately \$6.7 million on fines and settlements related to legal matters. For example, in April 2011 the district agreed to pay more than \$4.7 million over a three-year period to settle a lawsuit resulting from the district allegedly failing

The district's inability to accurately monitor and control litigation costs may have contributed to it spending more than \$5.1 million on legal services over the last five fiscal years.

to remove hazardous materials from a property it had agreed to sell. Additionally, according to the district's external auditor, the district was required to pay a fine of more than \$800,000 after it experienced sewer overflows in December 2010 that resulted in a large volume of sewage being discharged into local waterways via storm drains. In fiscal year 2013–14, the district's data show that it spent significantly less on legal costs and fines and settlements. According to the general manager, the decrease is due, among other things, to resolving outstanding lawsuits and avoiding new litigation; implementing regular monitoring and cost controls for legal services, such as reporting monthly to the board on all legal activities; and improving operations and preventive maintenance, which has decreased the number and severity of sewer overflows.

Figure 3
Ross Valley Sanitary District's Expenditures for Legal Services, Fines, and Settlements
Fiscal Years 2009–10 Through 2013–14



Sources: Ross Valley Sanitary District's (district) unaudited financial data from fiscal years 2009–10 through 2013–14.

* The district's financial data for fiscal year 2009–10 did not identify separate amounts for fines and settlements.

The District Appropriately Awarded Contracts for Capital Improvement Projects and for Construction-Related Professional Services

We found that the district adhered to state law when awarding contracts for capital improvement projects. The district contracts with outside firms to perform important, often costly changes to the district's wastewater system. Specifically, we reviewed six of the 22 capital improvement contracts identified by the district as being awarded from fiscal year 2009–10 through September 2014, and found that it properly advertised the contract opportunities with the required information, evaluated proposals submitted by bidders, and awarded the contract to the lowest responsible bidder.

Capital improvement projects—the district's single largest expenditure category in its fiscal year 2013–14 budget—totaled approximately \$8.5 million, or 32 percent of total budgeted expenditures. State law requires the district to contract with the lowest responsible bidder for any project for the construction, reconstruction, alteration, enlargement, renewal, or replacement of sewer facilities when the cost exceeds \$15,000. The law establishes requirements related to when and how the district must advertise notices inviting bids for projects and mandates that each contractor must submit a bid form and professional qualifications to the district.

The district also adhered to state law when awarding contracts for construction-related professional services. The district can enter into contracts to obtain professional services such as construction management, design, architecture, and engineering services. As with contracts for capital improvement projects, the district must comply with state law when awarding construction-related contracts. Specifically, the district must select firms on the basis of demonstrated competence and professional qualifications for the services required. The district does this by preparing a request for proposals to which prospective firms respond with their bid proposals. Furthermore, the district documented these requirements in its procurement policy established in September 2014. We reviewed three of the 16 construction-related professional services contracts the district identified as being awarded during our audit period and found that the district followed the required procedures we tested in awarding those contracts.

We reviewed three of the 16 construction-related professional services contracts the district identified as being awarded during our audit period and found that the district followed the required procedures.

The District Has Poorly Managed Some of Its Human Resources Functions

Although it has recently made improvements, the district has not properly managed its human resources functions. For most of the period from fiscal years 2009–10 through 2013–14, the district

did not have staff with expertise in human resources management to whom district employees could turn for guidance in handling human resources issues. Also, the district did not have established processes for some essential human resources functions and/or did not ensure that those functions were performed. This lack of guidance and processes has resulted in costly mismanagement of some human resources issues. For example, the district had contracted with a staffing agency for a temporary business manager since December 2008 and decided to hire the individual in January 2010. However, in June 2010, the temporary business manager agreed to resign after the district determined that this individual had not successfully completed the probationary period and it paid a severance equal to three months' salary, totaling about \$37,000 less taxes and withholdings. The district had no discernible basis for paying this money, because not only did the employee fail to successfully complete the probationary period, but the district's MOU with its management staff does not require severance payments. Qualified human resources staff would likely have handled this situation more appropriately and would have known that the severance payment was not required. We do not believe that this severance payment was in the ratepayers' best interest.

Although the district has had a policy prohibiting harassment since 2001, it has not ensured that employees participate in harassment prevention training as required by state law.

Additionally, although it has had a policy prohibiting harassment since 2001, the district has not made sure employees participate in harassment prevention training as required. State law requires the district to provide sexual harassment prevention training to supervisory employees every two years. Although the district has provided annual harassment prevention training since 2012, it has not made attendance a formal requirement in policy. In fact, we found that the district's supervisory employees have not always attended the training. For example, three district supervisory employees did not attend the training in either 2012 or 2013. Without training and qualified human resources staff to assist employees who may experience harassment issues in the workplace, the district violates state law and risks mishandling these sensitive and potentially costly issues. The general manager stated that the district will work toward full compliance with state law regarding harassment prevention training.

Furthermore, the district did not always complete annual performance evaluations of its employees as required by district policy. We reviewed the district's performance evaluations for key management staff from fiscal years 2009–10 through 2013–14. During this period, the district did not complete eight annual evaluations for three different employees: the chief of operations, district engineer, and business manager. According to the general manager, the district had not developed or documented a process for monitoring performance evaluations to ensure that they are completed in a timely manner. The general manager further

stated that he is currently completing the evaluations for senior management staff, and he believed that the district did not complete several of the evaluations in the earlier years because the former general manager abruptly resigned, leaving the district without clear leadership. By not performing timely performance evaluations, the district does not provide its employees with important formal feedback to help them improve and develop professionally.

In addition, the district did not develop proper controls to reduce the risks that employees and board members would make decisions in matters for which they have a conflict of interest. As required by state law, the district's conflict-of-interest code identifies designated employees—positions that are involved in making or that participate in the making of decisions that may have a material effect on a financial interest. The district has identified its general manager, business manager, chief of operations, district engineer, maintenance superintendent, and inspection superintendent, as well as all board members and district counsel, as designated employees who must report their economic interests. State law requires these designated employees to annually file a Form 700—Statement of Economic Interests (Form 700). These individuals use this form to report for themselves and their spouses certain assets, sources of income, and loans in order to identify potential conflicts of interest. Because Form 700 is a public document, any interested person is able to review an official's Form 700 at any time. According to the district's business manager, who reviews the conflict-of-interest code along with the board and district counsel every two years, the district designated these employees to file because they have the ability to act autonomously in their positions and to make financial decisions.

However, the district does not have a documented process for annually reviewing the forms to ensure that they are completed or to identify any potential conflicts of interest, and it did not always ensure that all of its designated employees filed one. For example, the district did not have a Form 700 on file for its inspection superintendent for 2010 and 2011. According to the general manager, the district experienced discipline issues with its former inspection superintendent for more than a year, and another employee filled in for the position temporarily. During this time, the district did not prioritize having its inspection superintendent file a Form 700. In addition, the district did not have a Form 700 for its chief of operations for 2011. The general manager stated that it is likely that the employee did not file one in that year.

Although state law requires board members to complete ethics training biannually, the district has not adopted a policy with those requirements. However, the district provided records showing that all board members completed biannual ethics training in 2011

The district did not develop proper controls to reduce the risks that employees and board members would make decisions in matters for which they have a conflict of interest.

and 2013. In addition, state law allows the board to require certain district employees to attend biannual ethics training. However, the board does not require any of the district employees to attend these trainings. We believe that the board should require the employees designated under its conflict-of-interest code to participate in ethics training because they are involved in making or participate in the making of decisions that may have a material effect on a financial interest.

As discussed previously, the district recently contracted with a separate entity to provide human resources services, which may help resolve some of these concerns and decrease the likelihood that some of the problems previously mentioned, such as paying severance unnecessarily, will reoccur. Additionally, the consultants' work plan focuses on improving the performance management system, which would help ensure that the district completes performance evaluations and helps its employees develop professionally. Further, the work plan includes an element to improve the district's administrative policies and systems, which should include developing a documented process for annually reviewing and monitoring Form 700s that designated employees and board members file. Finally, training is one of the six priorities of the consultants' work plan, and the plan specifically calls for providing training in respectful workplace communication and behavior. We believe developing a policy for and monitoring ethics training for board members and designated employees should be included in the work plan training efforts as well.

Recommendations

The board should ensure that management continues to develop and strengthen its controls over the district's financial and administrative functions. For example, district management should fully implement all of the external auditor's remaining recommendations by June 30, 2015. Management should also ensure that its staff follow these policies and should create and implement a plan for monitoring its system of controls. The board should also consider periodically contracting with qualified professionals to conduct a review of the effectiveness of the district's system of internal controls.

The district should strengthen its financial and administrative policies to do the following:

- Make it clear that the activities of approving invoices, recording invoices, preparing checks, and reconciling bank statements to the district's records should be performed by separate individuals.

- Make it clear who is responsible for reviewing and approving monthly bank reconciliations.
- Limit California lodging costs to the rate set by the State for its employees, and limit any out-of-state lodging costs to rates set by the federal government for its employees. In addition, the district should remove from its travel policy the reimbursement for exercise equipment use.
- Require periodic reporting of financial information to the board.
- Require a periodic review to ensure that only appropriate personnel are included as authorized signers on financial accounts.
- Establish an appropriate system for tracking and valuing inventory.
- Require employees to obtain their supervisor's approval before working paid overtime.
- Require all employees, including managers, to complete timesheets to track time worked and any compensated time off.
- Develop and document a process for reviewing and monitoring designated employees' and board members' filing of Form 700.
- Develop and document a policy that requires board members and designated employees to attend ethics training biannually and a process for monitoring attendance.

To clarify the roles and responsibilities of board members, the district should create a more comprehensive board member manual that describes all of the board's roles and fiduciary responsibilities. This manual should address the best practices contained in the California Special Districts Association's *Special District Board Member/Trustee Handbook*. The district should also provide for additional training for board members in the following areas over which they exercise important responsibilities: financial management, contracting, emergency procurement, and human resources.

The board should reduce the salary ranges for all positions in the district's salary schedules to better align with comparable positions at comparable sanitation agencies. While we are not suggesting that the board cut the current salaries of its employees, it is imperative that the board reduce the salary ranges in its salary schedules before more employees reach the top step of their respective salary ranges. The board should also ensure that COLAs are tied to an appropriate cost-of-living index and that any merit raises are based on satisfactory performance that is documented in an appraisal. Further, the board should either justify its need for longevity pay

to attract and retain qualified employees or discontinue its practice of offering longevity pay to those employees who are not already receiving this extra pay. In addition, the district should revise its employee retirement contribution policy to require all employees to contribute an appropriate amount to their pensions and should discontinue its practice of reimbursing its represented employees up to \$300 annually for gym memberships. The board should make these changes for unrepresented employees immediately and should seek to make these changes for represented employees by negotiating with the American Federation of State, County, and Municipal Employees Local 2167 when the current MOU expires in July 2015.

To ensure that employee compensation remains appropriate after making the changes described in the previous recommendation, the board should develop robust policies that outline how it will establish future compensation for all district positions. This policy should require the district to conduct a salary survey of comparable sanitation agencies to determine what compensation levels are appropriate for the job duties of district positions and to present the results to the board.

To ensure that compensation for the general manager remains reasonable, and to prevent the excesses that existed in the former general manager's contract, the district should develop a policy that establishes the criteria to be used when periodically evaluating the general manager's performance and for determining any merit-based compensation increases.

To ensure that it follows state law and its policies for emergency procurement, the board should review and reapprove all emergencies at each board meeting subsequent to the initial emergency declaration and should terminate emergency declarations as soon as possible to ensure that it competitively bids any work that is no longer an emergency.

The district should ensure that it hires qualified vendors at a reasonable price by using a competitive process when contracting for professional services. When this is not possible or appropriate given the nature of the services, the district should adequately justify its use of a noncompetitive process (sole-source procurement). In addition, the district should obtain a written description of services to be provided (scope of services) and a cost estimate from legal counsel before engaging in litigation.

The district should ensure that it has access to qualified human resources professionals, whether contracted or in-house, to assist staff when handling human resources issues.

The district should implement the remaining recommendations contained in its human resources consultants' work plan by the targeted dates shown in Table 3 on page 18, including the following:

- Improve its performance management system to ensure that staff receive required annual performance evaluations.
- Develop and document a policy that requires board members and supervisors to attend harassment prevention training biannually and a process for monitoring their attendance.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: April 16, 2015

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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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Appendix

SIGNIFICANT INTERNAL CONTROL DEFICIENCIES AND OTHER MATTERS IDENTIFIED BY ROSS VALLEY SANITARY DISTRICT'S EXTERNAL AUDITOR

As explained in the Introduction, state law requires the county auditor to ensure that the Ross Valley Sanitary District (district) obtains regular financial audits of its accounts prepared by either the county auditor or an independent public accounting firm. Table A beginning on the following page summarizes, for fiscal years 2012–13 and 2013–14, the significant deficiencies and other matters identified by the district's external auditor as well as the current status of the fiscal year 2012–13 recommendations as determined by the external auditor and the current status of the fiscal year 2013–14 recommendations as determined by the California State Auditor.

Table A
Significant Internal Control Deficiencies and Other Matters Identified by Ross Valley Sanitary District's External Auditor
Fiscal Years 2012-13 and 2013-14

FISCAL YEAR 2012-13		FISCAL YEAR 2013-14		CURRENT STATUS AS DETERMINED BY THE CALIFORNIA STATE AUDITOR*	
FINDING	EFFECT	RECOMMENDATION	EFFECT	RECOMMENDATION	STATUS
Significant Deficiencies					
Internal control deficiencies	<p>(a) One employee is solely in charge of payroll and entering/changing employee wage rates.</p> <p>(b) One employee is responsible for preparing bank reconciliations and enters invoices and prepares checks.</p> <p>(c) Blank check stock is not safeguarded.</p> <p>(d) Bank reconciliations are not reviewed.</p>	A lack of segregation of duties can lead to errors or irregularities that arise in the normal course of an employee's duties that may not be detected.	To better segregate duties and safeguard assets, the Ross Valley Sanitary District (district) should have more than one employee perform each of the functions listed in a and b. In addition, blank check stock should be kept in a secured and locked location, with an employee who does not prepare checks keeping the key. Bank reconciliations should be reviewed and approved by an appropriate responsible official on a monthly basis.	Implemented.	
Cash receipt deficiencies	The cash box at the front is not locked, and deposits to the bank are made by an employee every two weeks, on average. There are also discrepancies between deposit slip dates and bank statement dates. In addition, there is no count or approval by a supervising employee before the cash is deposited, and there is no referencing on the permits issued regarding receipt of cash or check.	Deficiencies in the cash receipts process can expose the district to the possibility of loss or theft of cash or checks or a misappropriation of funds. It can also adversely affect the district's ability to properly track its revenue and ensure that all cash receipts are deposited.	The district should ensure that the cash box is locked and that deposits to the bank are made on a weekly basis. The district should also implement procedures to have a supervisor count and approve the cash before it is deposited, and to ensure that the deposit slip is filled out the same day the deposit is made, and implement a proper system for referencing permits issued to the receipt of cash or checks.	Implemented.	
Insufficient inventory controls	There is no annual inventory count, and inventory is not recorded in the accounting system. In addition, there is no formal tracking system to account for inventory received or disbursed.	Without proper safeguards, inventory may be misappropriated. A failure to record inventory in the accounting system could also lead to a misstatement of the financial statements.	The district should implement a policy for safeguarding inventory that includes maintaining records of all inventory and performing a physical count of inventory at the end of each fiscal year.	Partially implemented. See repeat finding for fiscal year 2013-14.	

CURRENT STATUS AS DETERMINED
BY THE CALIFORNIA STATE AUDITOR*

FISCAL YEAR 2012-13	FINDING	EFFECT	RECOMMENDATION	CURRENT STATUS AS DETERMINED BY THE CALIFORNIA STATE AUDITOR*
Other Matters	Lack of fraud reporting policy	Without a formal fraud reporting policy, employees are less likely to report suspected fraud.	The district should implement a policy for employees to report suspected fraud and post this policy and the related procedures in a place visible to all employees.	Implemented.
	Lack of written accounting policies	Without written accounting policies, accounting principles may not be applied uniformly by all employees for all financial transactions.	The district should establish written accounting policies in these areas.	Not implemented. See repeat finding for fiscal year 2013-14.
	Members of the board of directors (board) are not treated as employees	The district is not in compliance with federal Internal Revenue Service (IRS) guidelines.	The district should treat board members as employees for payroll purposes and issue wage and tax statements (W-2) at the end of the year.	Not implemented. See repeat finding for fiscal year 2013-14.
	Incorrect authorized signers on Local Agency Investment Fund (LAIF) account	The district is exposed to theft and unauthorized transactions.	The district should immediately remove signers that are no longer associated with the district.	Implemented.
	Deficiencies in employee reimbursements	Without proper documentation and approval of employee reimbursements, funds may be misappropriated and go undetected.	The district should ensure that all check request forms are signed by the employee, are properly reviewed and approved, and are retained for future verification.	Implemented.
	Lack of receipts for credit card purchases	Without proper supporting documentation for purchases, there is no way to ensure that purchases made were for district business.	The district should ensure that all supporting documentation is retained with the credit card statements.	Implemented.
	Payroll deficiencies	Missing or incomplete payroll documents could result in fines if the district is ever audited by a government agency. Also, auditors are unable to determine if the district is following board directions when employees are not being paid in accordance with the approved position schedule.	The district should update the position schedule to include the board-approved wage rate for temporary maintenance employees and adjust the schedule for the one employee whose wage rate is in between steps. All payroll documents should be reviewed for completeness at the time of preparation and be retained for future verification.	Implemented.

continued on next page...

CURRENT STATUS AS DETERMINED BY
THE CALIFORNIA STATE AUDITOR*

RECOMMENDATION

EFFECT

FINDING

FISCAL YEAR 2013-14

Significant Deficiency

<p>Insufficient inventory controls (repeat finding)</p>	<p>Inventory is not recorded in the accounting system, and there is no formal tracking system to account for inventory received or disbursed.</p>	<p>Without proper safeguards, inventory may be misappropriated. Lack of recording inventory in the accounting system could also lead to a misstatement of the financial statements.</p>	<p>The district should maintain records of all inventory received and placed into the field, and should record inventory amounts in the accounting system on a regular basis.</p>	<p>Partially implemented. An inventory management and valuation policy was approved by the board in September 2014. According to district management, inventory and supplies were organized and security measures were put in place to limit access to stored materials. A physical count of inventory items was completed at the end of fiscal year 2013-14. The inventory items were listed, but the costs for some items were not available. Implementation of a tracking system was delayed because the district's Computerized Maintenance Management System was not capable of performing this function. Management is continuing to work on an inventory tracking system and process, which may include the addition of an inventory module to the existing accounting software.</p>
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Other Matters

<p>Lack of written accounting policies (repeat finding)</p>	<p>There are no formal written policies for travel, credit card use, a disaster recovery plan, or a purchasing policy. In addition, the capital asset policy does not address the treatment of contributed capital items.</p>	<p>Without written accounting policies, accounting principles may not be applied uniformly by all employees for all financial transactions.</p>	<p>The district should establish written accounting policies in these areas.</p>	<p>Partially implemented. The board approved a procurement policy in September 2014. A new travel reimbursement policy was implemented in February 2015. According to district management, the additional policies are part of an ongoing effort to establish policies and procedures for the district.</p>
<p>Board members are not treated as employees (repeat finding)</p>	<p>District board members are not treated as employees for payroll purposes.</p>	<p>The district is not in compliance with IRS guidelines.</p>	<p>The district should treat board members as employees for payroll purposes and issue W-2s at the end of the year.</p>	<p>Implemented.</p>
<p>Journal entries lack approval signatures</p>	<p>Journal entries do not contain the reviewer's signature.</p>	<p>Auditors are unable to determine if journal entries were reviewed and approved if there is no approval signature.</p>	<p>The district should implement procedures to ensure that all journal entries are reviewed and approved, as evidenced by a signature, by a separate employee who did not prepare or input the journal entry.</p>	<p>Implemented.</p>
<p>Late fees and interest charges incurred</p>	<p>One credit card statement contained late fees and interest charges.</p>	<p>The district incurred unnecessary fees.</p>	<p>The district should implement procedures to ensure that all credit card statements are paid on time, to avoid late fees and interest charges.</p>	<p>Implemented.</p>
<p>Timesheets not required for all employees</p>	<p>Two management employees are not required to complete a timesheet; rather, they complete forms requesting time off when they take compensated leave.</p>	<p>When request for time off forms are the only document required to track compensated time taken, there is potential for employees to take time off without reporting it appropriately. Timesheets more accurately track when employees use compensated leave.</p>	<p>The district should implement procedures to require all employees to complete a timesheet to more appropriately track compensated leave balances.</p>	<p>Partially implemented. According to the district's business manager, the district has selected an electronic timesheet program and will be installing it in March 2015. The district plans to begin requiring all employees to submit electronic timesheets by April 2015.</p>

Sources: Management reports and auditor's communication letters prepared by the district's external auditor at the conclusion of the financial audits for fiscal years 2012-13 and 2013-14.

* During the fiscal year 2013-14 audit, the external auditor determined whether the district had adequately implemented the auditor's recommendations from the prior year.

April 2015



Ross Valley Sanitary District

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Audit Principal
California State Auditors Office
621 Capitol Mall, Suite 1200
Sacramento CA 95814

Dear Mr. Tilden,

The RVSD Board has received and reviewed the draft audit report titled "*Ross Valley Sanitary District: The Board and Management Have Only Recently Begun to Address Significant Weaknesses in the Districts Financial and Administrative Functions*". The RVSD Board unanimously concurs with all of the audit recommendations, and will make their implementation a top priority moving forward. Attachment A to this letter presents a summary of the audit recommendations, along with the implementation steps RVSD has in progress or pending.

The RVSD Board voluntarily sought this audit under the State Auditor's high risk local agency program, in coordination with Assemblyman Mark Levine, who sponsored the request before the Joint Legislative Audit Committee. The goal was to seek an independent and objective review of the District, identify actions to improve the leadership and management oversight of the District, and ensure necessary and appropriate changes are being made to address past problems.

The review period of the audit includes five fiscal years from 2009-10 through 2013-14. The first three years of the audit period reflect a number of significant problems at RVSD including management and Board shortcomings, excessive litigation and legal fees, regulatory enforcement actions due to sewer spills, and financial hardship due to mismanagement. These systemic problems led to serious public concerns with the oversight, management, and leadership at the District. Though much work remains, the Board is pleased to note that the last two years reflect significant progress to improve regulatory compliance, achieve fiscal stability, overhaul the District's capital improvement program, restore local government relations, resolve legal disputes and reign in excessive legal fees, and improve management and oversight of RVSD. The recommendations of the State audit will help continue this recent progress.

The RVSD Board appreciates the professional and thorough work of the audit team, and looks forward to reporting its timely implementation of the recommendations.

Sincerely,

Thomas Gaffney
President
RVSD Board of Directors

ROSS VALLEY SANITARIY DISTRICT; LETTER RESPONSE TO THE CALIFORNIA STATE AUDITORS REPORT

ATTACHMENT A

STATE AUDIT RECOMMENDATIONS SUMMARY:	RVSD RESPONSE:
<p>1. The District should fully implement all of the external auditor’s outstanding recommendations by June 30th 2015, ensure staff follow related policies, and implement a plan for monitoring its system of controls</p> <p>2. The district should strengthen its financial and administrative policies to:</p> <ul style="list-style-type: none"> a. Make it clear that the activities of approving invoices, recording invoices, preparing checks, and reconciling bank statements should be performed by separate individuals. b. Make it clear who is responsible for reviewing and approving monthly bank reconciliations. c. Limit California lodging costs to the rate set by the state of California for its employees, and limit any out-of-state lodging costs to rates set by the federal government for its employees. In addition, the district should remove from its travel policy the reimbursement for exercise equipment use. d. Require periodic reporting of financial information to the board. e. Require a periodic review to ensure that only appropriate personnel are included as authorized signers on financial accounts. f. Establish an appropriate system for tracking and valuing inventory. g. Require employees to obtain their supervisor’s approval before working paid overtime. h. Require all employees, including managers, to complete timesheets to track time worked and any compensated time off. i. Develop and document a process for reviewing and monitoring designated employees’ and board members’ filing of Form 700. j. Develop and document a policy that requires board members and designated employees to attend ethics training biannually and a process for monitoring attendance. 	<p>District will have all of the external financial audit recommendations implemented by June 30th 2015. These will be codified in a new Financial Practices and Controls Policy (FPC Policy), which will be developed and approved within Q1 of the new FY 2015-16. Future financial audit scopes will include steps to monitor compliance with the new FPC Policy.</p> <ul style="list-style-type: none"> a. Standard practice implemented. New Financial Practices and Controls Policy will be developed to codify the practice. b. Will include in new Financial Practices and Controls Policy (FPC Policy). c. Will update recently adopted reimbursement policy to clarify the lodging limits and remove reimbursement for exercise equipment use. d. Standard practice for past two years. Board receives monthly, quarterly, and annual reports. Will codify this practice in the new FPC Policy. e. Will include in new FPC Policy. f. In progress. Expect to have recommended inventory controls by end of FY 2015-16. g. Will implement new overtime approval policy by FY 2015-16. h. In progress. New electronic time sheet system for all employees to be in use by start of FY 2015-16 (July 2015). i. Will include in new / revised Conflict of Interest policy, by Q1 of FY 2015-16. j. Will include in new/revised Conflict of Interest policy.

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ATTACHMENT A

STATE AUDIT RECOMMENDATIONS SUMMARY:	RVSD RESPONSE:
<p>3. To clarify the roles and responsibilities of board members, the district should</p> <ul style="list-style-type: none"> a. Create a more comprehensive board member manual, addressing best practices in the <i>Special District Board Member/Trustee Handbook</i>. b. Provide training for board members and clarify Board roles and responsibilities. 	<ul style="list-style-type: none"> a. Board Member Orientation Binder will be revised to include the California Special Districts Association (CSDA) Handbook. b. Board policies will be updated to add a Board Director duties and responsibilities, similar to a job description. c. Professional development and minimum required training will be added in Board policy to address Board roles in financial management, public contracting, human resources, and other key areas.
<p>4. The District should address the following compensation and benefits issues:</p> <ul style="list-style-type: none"> a. Reduce salary ranges for all positions to be more closely aligned with industry averages. b. Cost of Living Adjustments (COLA's) should tie to an appropriate cost-of-living index. c. Compensation changes should be tied to merit and performance. d. Longevity pay should clearly justified for retention or other legitimate purposes, or ended. e. The district should revise its employee retirement contribution policy, and require all employees to contribute an appropriate amount to their pensions. f. The district should discontinue paying its employees \$300 annual gym memberships. 	<p>The Board will direct the General Manager and Human Resources to consider these goals for both AFSCME represented and all non-represented employees. The existing agreement with AFSCME expires at the end of June 2015.</p>

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STATE AUDIT RECOMMENDATIONS SUMMARY:	RVSD RESPONSE:
5. The Board should develop robust policies that outline how it will establish future compensation for all district positions, including salary surveys for comparable public agencies.	The Board will develop and adopt a Compensation Policy, outlining the goals, objectives, and methodology used to establish RVSD compensation levels for all positions. This will be adopted by Q1 of FY 2015-16.
6. The district should develop a policy that establishes the criteria to be used when evaluating the general manager's performance and for determining any merit-based compensation increases.	A new "General Manager Contracting, Performance Review, and Compensation Policy" will be developed to codify the recent practices used in the last contract and compensation updates, as reviewed by the State audit team.
7. The board should reapprove all emergencies at each board meeting, terminate emergency declarations as soon as possible, to ensure competitive bidding for non-emergency work.	The Board and management will take all necessary actions to ensure compliance with this state legal requirement, as it has done for all emergency contracting done in the past two fiscal years.
8. The district should use a competitive process when contracting for professional services, and justify its use of non-competitive (sole source) procurement for professional services when used.	The District's recently approved procurement policy will be updated to include clear guidelines for professional services contracting and factors considered in justifying sole source professional services.
9. The District should obtain a written estimate of services and costs for legal counsel, before engaging in litigation.	Although the District has not always done this in the past, it is currently following the recommendation.
10. The district should ensure that it has access to qualified human resources professionals. The current HR recommendations (Table 3) should be implemented, including <ul style="list-style-type: none"> a. Improve its performance management system to ensure staff receive required annual performance evaluations. b. Develop and document a policy that requires board members and supervisors to attend bi-annual harassment prevention training. 	The District will continue the work it began in late 2013 to make sure that professional human resources management resources are available and used effectively. The Table 3 recommendations are being implemented currently, with further progress and completion expected on the timelines listed in Table 3.