California State Auditor

March 2018

South Orange County Wastewater Authority

It Should Continue to Improve Its Accounting of Member Agencies' Funds and Determine Whether Members Are Responsible for Its Unfunded Liabilities

Report 2017-113

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March 22, 2018 2017-113

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 presents this audit report concerning the financial management practices and governance structure of the South Orange County Wastewater Authority (SOCWA).

This report concludes that until recently, SOCWA did not adequately account for cash it collected from its member agencies, resulting in a $354,000 discrepancy in the amount of cash collected but not yet spent between its audited financial statements and its accounting records. SOCWA is still investigating this discrepancy and plans to present the final results to its board of directors for resolution. In addition to the concerns regarding its accounting practices, we determined that SOCWA's joint powers authority (JPA) agreement does not expressly hold its members liable for unfunded obligations for employee retirement benefits. As of fiscal year 2016–17 SOCWA's unfunded obligations for retirement benefits totaled $18 million, and if it were to dissolve and did not have sufficient assets to pay those obligations it is unclear whether the plan beneficiaries would have their retirement benefits reduced.

Also, from its formation in 2001 through fiscal year 2015–16, SOCWA has had financial reporting issues such as understating the value of certain assets and failing to file audited financial statements when required. In addition, SOCWA has been slow to correct deficiencies in internal controls identified by external auditors during their audits of SOCWA's financial statements for fiscal years 2012–13 through 2015–16. Finally, elements of SOCWA's governance structure are generally similar to that of other wastewater and water JPAs in California.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

Selected Abbreviations Used in This Report

CalPERS	California Public Employees' Retirement System
GFOA	Government Finance Officers Association
JPA	Joint powers authority
O&M	Operation and maintenance
SOCWA	South Orange County Wastewater Authority

CONTENTS

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SUMMARY

South Orange County Wastewater Authority (SOCWA) is a joint powers authority (JPA) composed of 10 member agencies (members) consisting of local water and service districts and cities. SOCWA facilitates and manages the collection, transmission, treatment, and disposal of wastewater, as well as the production of recycled water for irrigation and commercial usage, for approximately 500,000 homes and businesses across the southern portion of Orange County. SOCWA has no taxing authority, and nearly all funding for its operation comes directly from the contributions of its members. This audit report concludes the following:

SOCWA's Practices to Track Available Cash by Member Were Inadequate

Page 13

In the past, SOCWA did not adequately account for members' individual shares of its available cash or reconcile the amount of available cash derived from its audited financial statements with the amount of cash that it recorded in its accounting records. In July 2017, SOCWA took steps to reconcile its available cash and found that the balance derived from its fiscal year 2015–16 audited financial statements was approximately $354,000 higher than the amount supported by its accounting records. SOCWA is still investigating this discrepancy and plans to present the final results of its reconciliation of members' available cash to its board of directors (board). Subsequently, SOCWA will establish new beginning available cash balances and begin reporting cash balances to members each month.

Responsibility for SOCWA's Unfunded Retirement Benefits Is Unclear

Page 17

SOCWA's JPA agreement specifies that it is a separate entity established under Government Code section 6500 et seq. and is distinct from its 10 members. In addition, SOCWA's JPA agreement does not expressly hold its members liable for its unfunded obligations for retirement benefits for its employees, specifically pensions and other postemployment benefits totaling approximately $18 million as of June 2017. We asked SOCWA officials whether the members would be liable for these amounts if SOCWA were to dissolve and did not have sufficient assets to pay these obligations, and they believed the members would be liable. However, the JPA agreement is unclear and the officials did not have a firm legal opinion or an express guarantee from the members to support this belief. If members did not act to pay SOCWA's outstanding retirement debts, the courts might have to resolve the matter. Alternatively, the California Public Employees' Retirement System (CalPERS) might have to reduce the retirement benefits provided to SOCWA's retirees.

In addition, according to a quarterly report prepared by CalPERS staff and presented to CalPERS' Finance and Administration Committee in December 2017, only 10 of 149 JPAs with CalPERS plans contained provisions in their JPA agreements that would make agency members liable for the JPA's financial liabilities, including unfunded pension obligations. Consequently, the employees of the 139 JPAs whose members are not expressly liable could be at risk of having their pension benefits reduced if their respective JPAs were to dissolve with outstanding unfunded pension obligations.

Page 21

SOCWA Has Taken Steps to Remedy Historical Financial Reporting Issues

Until recently, SOCWA's financial statements were missing certain land, building, and infrastructure assets. In addition, for four of the last five fiscal years, SOCWA did not meet its JPA agreement requirement to file its audited financial statements with the State Controller's Office, Orange County Auditor-Controller, and each member within six months of its fiscal year-end. SOCWA has recently developed a plan and related procedures to ensure that future fiscal year-end financial statements are prepared in a timely manner. SOCWA has also been slow to correct deficiencies in internal controls that were identified by its external auditors during their audits of SOCWA's financial statements for fiscal years 2012–13 through 2015–16. SOCWA's internal control deficiencies likely occurred because it did not have sufficient documented policies and procedures for its accounting functions until recently. Finally, SOCWA's current policy for selecting an external auditor does not reduce audit costs by requiring multiyear contracts with its external audit firm, nor does it comply with a new state law that requires it to rotate its external auditor every six years.

Page 29

SOCWA's Governance Structure Is Generally Similar to That of Other Wastewater and Water JPAs

Elements of SOCWA's governance structure are generally similar to that of other wastewater and water JPAs in California that we reviewed. In addition, the board's method of distributing voting rights to members, with each member having one vote regardless of the member's contribution level, is generally similar to that of the majority of the nine other wastewater and water JPAs we reviewed.

Other Areas We Reviewed

We found that SOCWA's policy and procedures do not comply with certain requirements of the California Public Records Act (Public Records Act). In addition, SOCWA has not updated its policy since 2007 to account for changes in the Public Records Act.

Summary of Recommendations

Legislature

The Legislature should require new JPA agreements to hold the members responsible for the JPA's unfunded pension and other postemployment benefits obligations and to specify the manner of apportioning these liabilities.

In addition, the Legislature should require all existing JPAs to disclose annually as part of any regularly scheduled communication to their pension and other postemployment benefits plan participants, whether the JPA's members are liable for the JPA's unfunded retirement obligations.

SOCWA

SOCWA should finish investigating the difference in available cash balances per its audited financial statements and its accounting records, and then develop a methodology that is agreeable to its members for allocating any additional cash it identifies to the credit of its members.

To prevent future discrepancies in available cash balances, SOCWA should implement its improved procedures to better account for members' cash contributions and provide monthly reports of available cash balances to members.

SOCWA and its members should amend the current JPA agreement to expressly state whether members will be responsible for SOCWA's retirement benefits liabilities in the event it is not able to meet those obligations and then it should inform plan participants of that provision.

To better ensure the timely release of future financial statements, SOCWA should enhance its new procedures for preparing its financial statements by developing and following a timeline with specific deadlines for completing each of its planned year-end tasks.

To better ensure the reliability of its financial reporting, the effectiveness and efficiency of its operations, and its compliance with laws and regulations, SOCWA should establish a policy requiring it to correct within six months any future internal control deficiencies that its external auditor may identify.

To reduce future audit costs, SOCWA should amend its policy on professional service procurements to specify that it should enter into agreements of at least five years with its competitively procured external audit firms. It should also develop a policy to rotate its external auditor when state law requires.

To ensure that it fully complies with the Public Records Act, SOCWA should do the following:

- Update its policy on the Public Records Act at least annually to ensure that it keeps pace with any changes in the law.

- Develop more detailed procedures to ensure that it responds to requests for records in full compliance with the Public Records Act.

- Establish a policy to retain accurate records and supporting documentation to demonstrate that it fully complies with all requirements of the Public Records Act.

Agency Comments

SOCWA agrees with the findings and recommendations in our report.

INTRODUCTION

Background

South Orange County Wastewater Authority (SOCWA) is a joint powers authority (JPA) founded in 2001 by 10 member agencies (members) consisting of local water and service districts and cities. Previously, all of these 10 members had been participants, to varying degrees, in three predecessor JPAs, the South East Regional Reclamation Authority, Aliso Water Management Agency, and South Orange County Reclamation Authority. A JPA is a partnership between two or more public agencies to jointly exercise common powers. The mission of SOCWA is to collect, treat, beneficially reuse, and dispose of wastewater in a manner that protects and respects the environment; maintains the public's health; and meets local, state, and federal regulations. SOCWA facilitates and manages the collection, transmission, treatment, and disposal of wastewater, as well as the production of recycled water for irrigation and commercial usage, for approximately 500,000 homes and businesses across the southern portion of Orange County. Figure 1 on the following page depicts SOCWA's service area.

SOCWA's Governance and Funding Structure

SOCWA's board of directors (board) is made up of one representative from each of SOCWA's 10 members, and each has one vote regardless of their individual levels of contribution to SOCWA's revenues or the size of the population or territory they serve. Among other functions, the board is responsible for approving SOCWA's budget, appointing its general manager, and taking other administrative actions. While SOCWA's board governs matters that affect SOCWA as a whole, members enter into agreements with each other to establish project committees to serve their specific needs. According to SOCWA's JPA agreement, members may choose to leave SOCWA on the last day of a specified fiscal year, as long as they provide the other members with a written notice at least 120 days in advance; however, leaving SOCWA does not absolve a member of its obligations under any ongoing project committee agreements.

A project committee forms when members enter into agreements to share the cost of an existing SOCWA wastewater processing facility or to construct a new facility in exchange for their use of the facility for processing their wastewater products or for other purposes. By entering into these agreements, members establish a right to a certain amount of capacity in a SOCWA facility; *capacity* here refers to the member's right to use the facility to process wastewater liquids and solids or to perform advanced water treatment. Project committee agreements and budgets express these capacities as a percentage of the total capacity of the facility for its different functions. As shown in Table 1, SOCWA currently has 10 project committees.

Figure 1
SOCWA's Service Area

Source: https://www.socwa.com/about-socwa/service-area/

Table 1
SOCWA's Project Committees and Participating Members

PROJECT COMMITTEE		
PROJECT COMMITTEE NUMBER	NAME	PARTICIPATING MEMBERS
2	Jay B. Latham Treatment Plant	City of San Juan Capistrano Moulton Niguel Santa Margarita Water District South Coast Water District
5	San Juan Creek Ocean Outfall*	City of San Juan Capistrano City of San Clemente Moulton Niguel Santa Margarita Water District South Coast Water District
8	Pretreatment Program	City of Laguna Beach City of San Clemente City of San Juan Capistrano El Toro Water District Emerald Bay Service District Irvine Ranch Water District Moulton Niguel Santa Margarita Water District South Coast Water District
10	San Clemente Land Outfall*	City of San Clemente
12	Regional Waste Discharge Permit	City of San Juan Capistrano El Toro Water District Irvine Ranch Water District Moulton Niguel Santa Margarita Water District South Coast Water District Trabuco Canyon Water District
15	Coastal Treatment Plant (CTP)	City of Laguna Beach Emerald Bay Service District Moulton Niguel South Coast Water District
17	Regional Treatment Plant	City of Laguna Beach El Toro Water District Emerald Bay Service District Moulton Niguel South Coast Water District
21	Effluent Transmission Main	REACHES†: B/C/D El Toro Water District Irvine Ranch Water District REACH†: E El Toro Water District Irvine Ranch Water District Moulton Niguel
23	North Coast Interceptor‡	City of Laguna Beach Emerald Bay Service District
24	Aliso Creek Ocean Outfall*	City of Laguna Beach El Toro Water District Emerald Bay Service District Irvine Ranch Water District Moulton Niguel South Coast Water District

Source: SOCWA's project committee list.

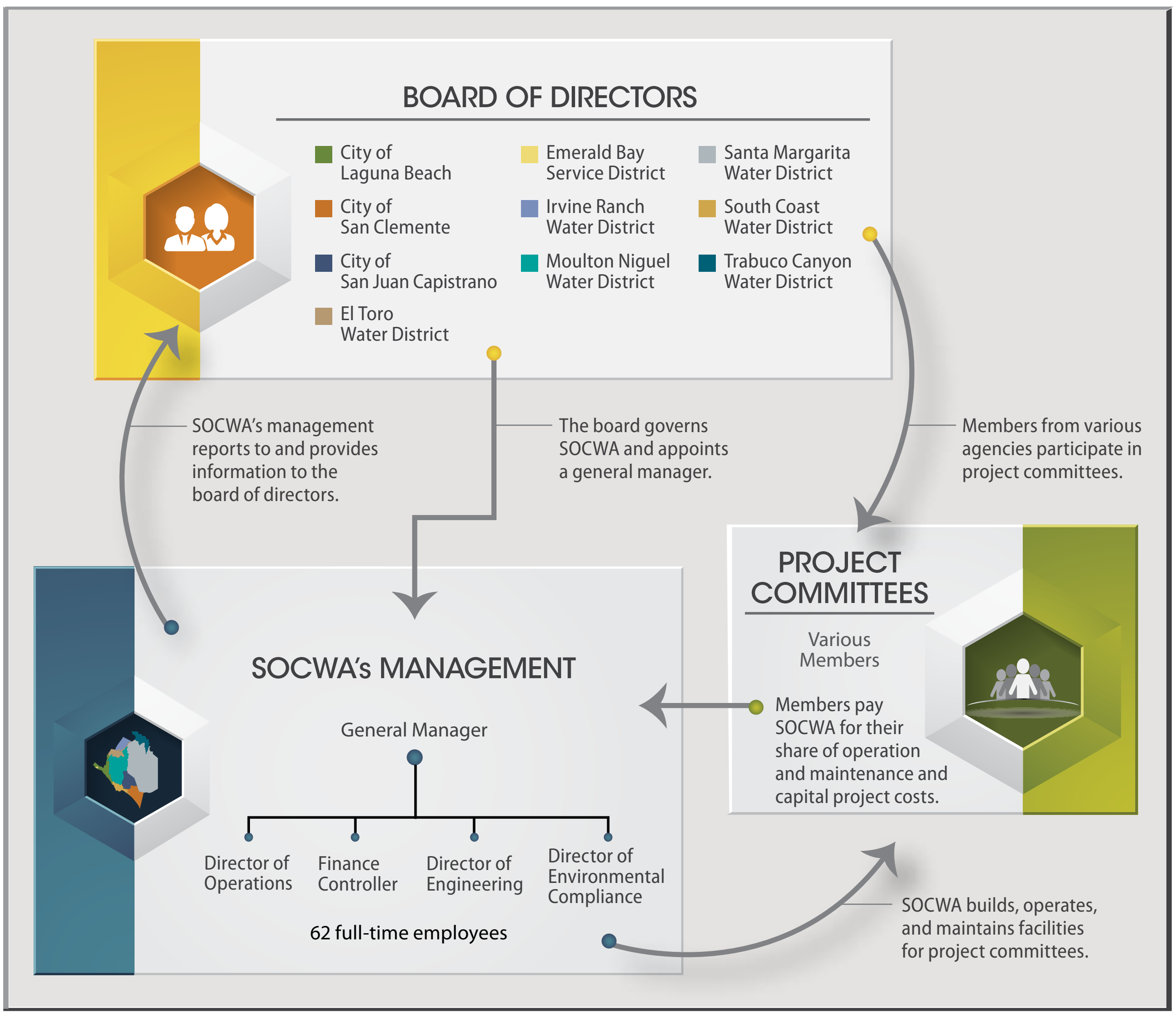
* Outfall: A pipeline that carries treated wastewater from one or more treatment facilities to a discharge point, such as a body of water or reuse site.

† Reach: A section of pipeline between two points.

‡ Interceptor: A large pipeline that receives flows from a number of sewers and directs the flows to a treatment facility.

Voting at the project committee level also follows a one-member-one-vote structure, and members of a project committee vote on matters directly related to that project committee, including budgets to maintain or expand the facility. Members of project committees are bound by the terms of their agreements to pay their share of project costs. Members may only be relieved of this obligation by the mutual consent of all participating members of the particular project committee. Figure 2 depicts SOCWA's current governance structure and the relationship between its board, project committees, and management.

Figure 2
SOCWA's Governance Structure

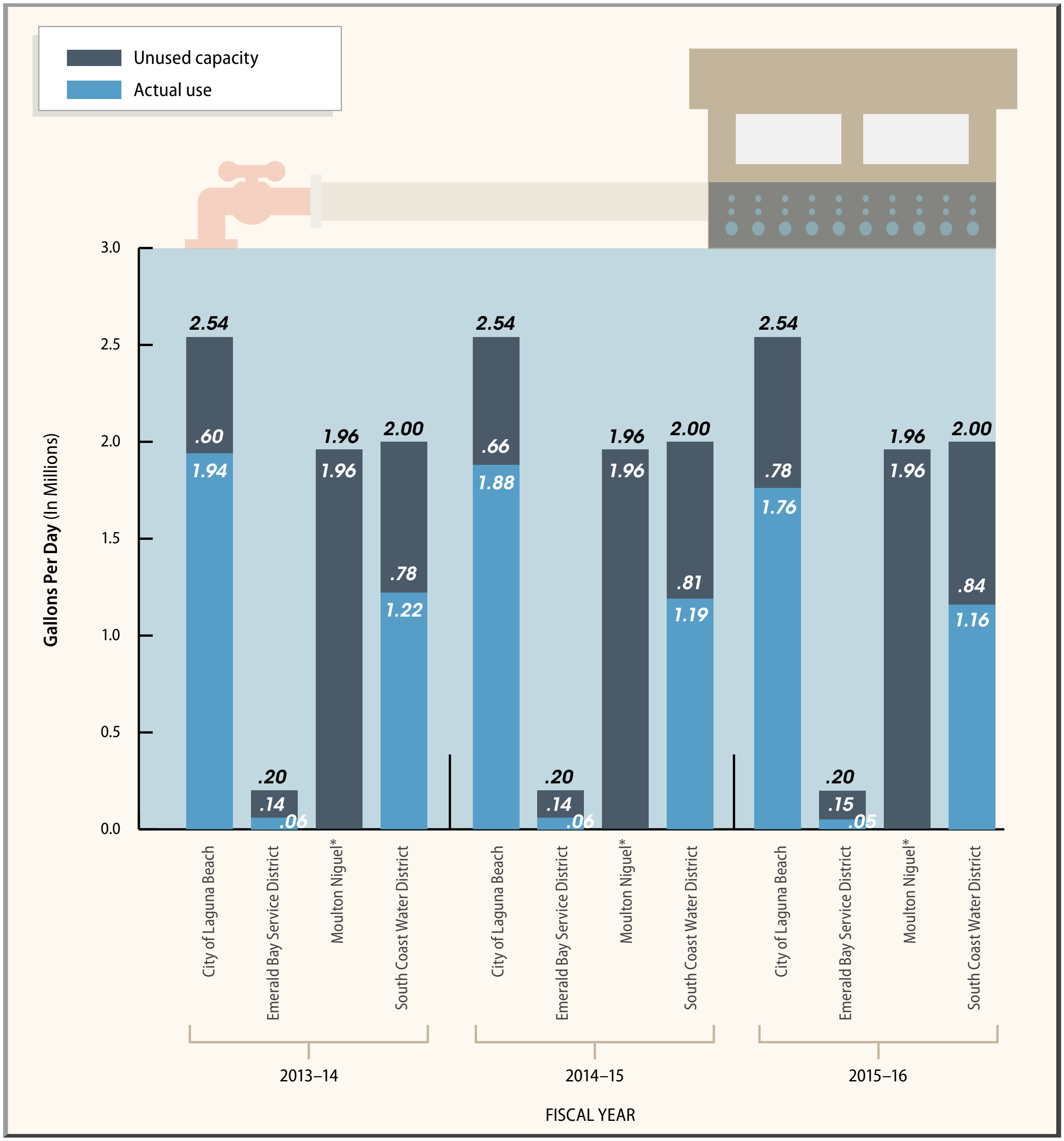


Sources: SOCWA JPA agreement, organization chart, and project committee agreements.

SOCWA has no taxing authority, and nearly all funding for its operations comes directly from the contributions of members. SOCWA bills project committee members for their share of SOCWA's costs to construct, operate, and maintain the facilities the project committees use. Project committee agreements establish each participating member's share of operation and maintenance (O&M) costs and capital project costs generally based on the member's level of usage or capacity rights. O&M costs represent the cost of using the facility to process wastewater; members pay these costs based on either their actual use of the facility to process liquids and solids or their share of capacity rights for common costs. Included in these cost categories are expenses for personnel, electricity, and chemicals used in the facility. Capital project costs include expenses for construction activities to maintain or improve facilities; members pay these costs based on their rights to a specified share of each facility's total capacity—not on their actual use of the facility. Figure 3 on the following page depicts members' capacity rights to process wastewater liquids, and actual use of those rights, for an example facility during fiscal years 2013–14 through 2015–16.

In accordance with its JPA agreement, SOCWA annually prepares a budget based on estimated costs to maintain or replace its facilities as well as incidental accounting and administrative costs associated with operating those facilities. The budget is subject to review by the finance committee—a subcommittee of the board—and final approval rests with the board or the participating directors. The approved budget represents an estimate of O&M and capital project costs that each member will be responsible for in the next fiscal year. SOCWA invoices members quarterly for these estimated costs, and it reconciles cash collected from members in various cycles depending on the type of expenditures. For O&M costs, it performs an annual audit of members' budgeted contributions to cover expenses compared to actual costs based on their use of the facilities. This annual reconciliation may result in amounts due to or due from a member depending on whether the member's proportional use of the facilities is greater or less than expected when the budget was developed. Cash collected from members for capital project costs, however, is not reconciled to actual costs until the completion of the project, which can often span multiple years.

Figure 3
Example of Members' Capacity Ownership and Usage in a Project Committee
Coastal Treatment Plant—Liquids
Project Committee 15



Sources: SOCWA's annual audits of members' budget versus actual expenses for fiscal years 2013–14 through 2015–16 and a project committee cost allocation report issued in 2012.

Note: The CTP also performs advanced water treatment. South Coast Water District owns 100 percent of this capacity and pays all associated costs.

* Moulton Niguel did not use any of its capacity for the three fiscal years according to the documents noted in the sources above.

SOCWA's Legal Action Against a Member

In May 2017, SOCWA, along with three of its members, filed a lawsuit alleging that one of its members—Moulton Niguel—had failed to pay its contractual share of project costs for the CTP. Moulton Niguel entered into a project committee agreement with the City of Laguna Beach, the South Coast Water District, and the Emerald Bay Service District in 1999 to use CTP's capacity to process up to 1.96 million gallons per day of its wastewater products. In response to the lawsuit, Moulton Niguel filed an answer and a cross‑complaint in August 2017. Among Moulton Niguel's significant claims that relate to our audit objectives is the claim that SOCWA is unable to identify the capital improvement funds it holds for the CTP, including how much was contributed by each member and what the intended uses of those funds are. Moulton Niguel also claims that SOCWA's management has engaged in questionable financial practices, fiscal improprieties, and poor retention of financial records. As of March 14, 2018, this litigation was ongoing.

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SOCWA's Practices to Track Available Cash by Member Were Inadequate

Key Point:

- Until recently, SOCWA did not adequately account for cash it collected from members, resulting in a discrepancy in the amount of cash collected but not yet spent (available cash) between its audited financial statements and its accounting records.

In the past, SOCWA did not adequately account for members' individual shares of available cash or reconcile the amount of available cash derived from its audited financial statements with the amount of cash recorded in its accounting records. SOCWA also did not maintain all of its accounting records within its accounting system, Financial Edge. Rather, accounting staff maintained many of SOCWA's detailed accounting records in separate Excel spreadsheets. For example, for invoicing purposes, SOCWA calculated billing schedules in an Excel file for each capital project that allocated costs to individual members. However, when it received members' subsequent payments, SOCWA recorded the cash in Financial Edge by member and project committee, without identifying the specific project for which the payment was made (project committees can include multiple individual projects). Conversely, SOCWA recorded project expenditures in Financial Edge by both the project committee and the specific project.

To determine each member's share of remaining available cash for a specific capital project, SOCWA compares payments received from members to related expenditures. However, in order to do this in the past, SOCWA had to extract the payments information (in other words, cash collections) from the Excel file and the expenditure data from Financial Edge because, as noted, Financial Edge contained expenditure information at the project level but did not include information on payments received from members at the project level. Moreover, SOCWA did not have documented procedures for accounting for each member's share of available cash, and it did not regularly confirm available cash balances for capital projects with members themselves.

In July 2017, SOCWA took steps to reconcile the \$2.8 million available cash balance derived from its fiscal year 2015–16 audited financial statements with its accounting records. Specifically, for all large capital projects, SOCWA calculated available cash balances by identifying members' contributions and the related expenditures from accounting records contained in Financial Edge and its Excel files for fiscal years 2012–13 through 2015–16. As shown in Table 2 on page 15, SOCWA also identified available cash for small capital projects and amounts due from members for large capital projects that were completed in fiscal year 2015–16. Members' contributions for O&M costs were not part of this exercise because SOCWA separately reconciles cash collected for budgeted O&M with actual expenditures, and it either collects additional cash from members to cover excess costs or refunds members any cash collected that exceeds actual expenditures. This reconciliation of O&M cash occurs at the end of each fiscal year as described in the Introduction.

Based on its accounting records, SOCWA determined that a total of $2.5 million in cash had been collected for capital projects but not spent or refunded as of June 30, 2016; it also calculated each member's share of this total. As shown in Table 2, the total cash based on SOCWA's accounting records was approximately $354,000 lower than the amount of available cash based on SOCWA's fiscal year 2015–16 audited financial statements. However, this difference is not significant as it equals less than 1 percent of the total $42.8 million that members contributed in fiscal year 2015–16. One way to resolve this difference would be to allocate the additional money to members based on their existing proportions of available capital project cash as we illustrate in the last column of Table 2.

SOCWA determined that a total of $2.5 million in cash had been collected for capital projects but not spent or refunded as of June 30, 2016.

We reviewed SOCWA's reconciliation of members' available cash by testing a selection of 29 member contributions and 29 expenditures for fiscal years 2012–13 through 2015–16. We also reviewed other items in SOCWA's cash reconciliation worksheet, including amounts refunded or collected for closed projects. We found that its reconciliation methodology was generally sound. Although we did identify seven clerical errors, the net amount of these errors was $22,000, slightly reducing the $354,000 discrepancy identified by SOCWA. We also reviewed the fiscal year 2012–13 beginning balance that SOCWA used in its cash reconciliation worksheet and found an error of approximately $50,000, which would further reduce SOCWA's $354,000 discrepancy. After we communicated the results of our review with SOCWA, its finance controller informed us that she planned to continue investigating the remaining discrepancy to search for any other reconciling items from sources other than those included in her cash reconciliation worksheet, such as interest income for fiscal year 2015–16. She said that SOCWA plans to present the final results of its reconciliation of members' available cash for capital projects to its board after the completion of our audit. After the board determines how to resolve the remaining discrepancy in SOCWA's cash balances, SOCWA will establish new beginning available cash balances for large capital projects and begin calculating and reporting project cash balances to members each month as described below. As part of its new process, SOCWA will also reconcile cash balances per the accounting records to the audited financial statements each year.

Table 2
SOCWA's Reconciliation of Members' Available Cash Balances for Capital Projects as of June 30, 2016
(Dollars in Thousands)

SOCWA's calculation of difference in available cash between its audited financial statements and its accounting records:

		AVAILABLE CASH BALANCE
Derived from SOCWA's audited financial statements*		**$2,845**
Per SOCWA's accounting records		
Large capital projects†	$2,150	
Completed projects‡	212	
Small capital carryover§	129	
Total		**$2,491**
Difference (additional cash)		**$354**

Potential distribution of difference to members based on SOCWA's calculation of members' share of available cash balances:

	LARGE CAPITAL PROJECTS†	COMPLETED PROJECTS‡	SMALL CAPITAL PROJECTS§	TOTAL	PERCENTAGE SHARE	POTENTIAL DISTRIBUTION OF DIFFERENCE TO MEMBERS
City of Laguna Beach	$404	$55	$0	$459	18.4%	$65
City of San Clemente	29	0	0	29	1.2	4
City of San Juan Capistrano	145	0	39	184	7.4	26
El Toro Water District	36	0	0	36	1.4	5
Emerald Bay Service District	31	5	0	36	1.4	5
Irvine Ranch Water District	16	0	0	16	0.6	2
Moulton Niguel	773	109	29	911	36.6	130
Santa Margarita Water District	326	0	29	355	14.3	51
South Coast Water District	390	43	32	465	18.7	66
GRAND TOTALS	$2,150	$212	$129	$2,491		$354

Sources: SOCWA's audited annual financial statements (fiscal year 2015–16) and accounting records (fiscal years 2012–13 through 2015–16).

Note: SOCWA is composed of 10 members but only nine participate in project committees with capital projects.

* This amount represents available cash and investments per audited financial statements as adjusted for other current assets and liabilities, such as uncollected member contributions, refunds to members, unpaid invoices, and payroll.

† Cash collected for large capital projects but not yet spent.

‡ Cash due from members for large capital projects completed in fiscal year 2015–16.

§ Cash collected for small capital projects but not yet spent.

SOCWA has recently improved its procedures to better account for members' large capital project contributions and to prevent future discrepancies in members' available cash balances. Starting in fiscal year 2016–17, SOCWA began recording payments received for capital projects in Financial Edge with project-level detail. Additionally, SOCWA has developed a monthly process for calculating and reporting available cash balances to members. SOCWA is now able to use reports from Financial Edge to compare cash collected with cash spent for each project and to present the remaining available cash balances to members in a monthly report. We believe this monthly reporting process is reasonable, and if implemented, it should be sufficient to prevent future discrepancies in available cash balances.

Recommendations

SOCWA

SOCWA should finish investigating the difference in available cash balances per its audited financial statements and its accounting records, and then develop a methodology that is agreeable to its members for allocating any additional cash it identifies to the credit of its members. For example, it could allocate this money to members based on each member's existing proportion of available cash per SOCWA's accounting records.

To prevent future discrepancies in available cash balances, SOCWA should implement its improved procedures to better account for members' cash contributions and provide monthly reports of available cash balances to members.

Responsibility for SOCWA's Unfunded Retirement Benefits Is Unclear

Key Point:

- SOCWA's JPA agreement does not expressly hold its members liable for its unfunded obligations for retirement benefits for its employees if SOCWA were to dissolve and did not have sufficient assets to pay those obligations. Those obligations totaled $18 million as of fiscal year 2016–17.

SOCWA is a public entity that is separate from its members. SOCWA holds its assets, including project facilities that it acquires or constructs, in its own name. Members that withdraw from SOCWA cannot transfer any rights in those facilities without the consent of other members. In the event of SOCWA's termination or dissolution, remaining funds and project facilities in its possession would be distributed in kind or sold with the proceeds distributed to participating members as described in SOCWA's JPA agreement. However, that agreement also states that, with limited exceptions, the members are not responsible for SOCWA's debts, liabilities, or obligations. This contractual arrangement calls into question what would happen to SOCWA's outstanding liabilities in the event it were dissolved and did not have sufficient assets to fund all of those obligations.

SOCWA's largest liabilities are for unfunded retirement benefits for its employees, specifically, pensions and other postemployment benefits totaling approximately $18 million, according to its audited financial statements for fiscal year 2016–17. SOCWA offers its employees a *defined* benefit pension plan through the California Public Employees' Retirement System (CalPERS), which computes employee pension benefits upon retirement using a formula that considers such factors as length of employment and salary history. SOCWA is required to make minimum contributions to fund the pension benefits its employees earn during the year as well as a portion of the benefits that its employees earned in previous years that remain unfunded, as a condition of continued participation in CalPERS. SOCWA's employees are also required to contribute to the cost of their pensions, and their contribution rates are expressed as a percentage of their pay ranging from 6.25 percent to 8 percent, depending on their CalPERS status. Defined benefit plans expose employers to the risk that the combination of employer and employee contributions plus investment earnings may be insufficient to pay promised benefits, in which case the employer is obligated to make up the difference.

According to its fiscal year 2016–17 financial statements, SOCWA's pension plan assets were sufficient to fund 74 percent of its total pension liability, resulting in an $11.5 million unfunded pension liability. Most members have separate pension plans for their own employees that are also partially unfunded. For example, based on publicly available financial statements for eight of SOCWA's 10 members, we found that the funding ratios of these members' pension plans ranged from 65 percent to 95 percent.

Additionally, according to its fiscal year 2016–17 financial statements, SOCWA also has an unfunded obligation for other postemployment benefits of $6.9 million, which equates to a funding ratio of only 35 percent. The other postemployment benefit is health insurance.

Member contributions are SOCWA's primary source of revenue. SOCWA bills members for expenses included in its annual operating expenses and capital budget. SOCWA passes its costs for employee salaries and fringe benefits, including retirement benefits, to members through the budget process based in part on each member's projected use of SOCWA's facilities. However, SOCWA's JPA agreement does not expressly hold its members liable for its unfunded obligations for employee retirement benefits in the event that SOCWA were to terminate or dissolve and did not have sufficient assets to pay these unfunded obligations. When we asked SOCWA officials what would occur under these circumstances, they believed that the members would be liable. However, the JPA agreement is unclear and the officials did not have a firm legal opinion or an express guarantee from the members to support this belief. Therefore, we concluded that plan beneficiaries lack the assurance they deserve, and if members did not act to pay for SOCWA's outstanding retirement debts, the courts might have to resolve the matter.

SOCWA's JPA agreement does not expressly hold its members liable for its unfunded obligations for employee retirement benefits.

Alternatively, CalPERS might have to reduce the pension benefits of SOCWA's pension plan beneficiaries. In March 2017, CalPERS declared another JPA, the East San Gabriel Valley Human Services Consortium, which had previously lost a major contract and closed its headquarters, in default of its pension obligations. CalPERS terminated its contract with that JPA after multiple attempts to collect outstanding amounts due from the JPA and from its four member cities. Consequently, according to CalPERS, if the JPA fails to pay the amount due to CalPERS, the pension benefits for 191 member employees of that JPA will be reduced by approximately 63 percent, while the benefits of another six member employees hired after pension reform went into effect in 2013 will be reduced by 24 percent, effective July 2017. CalPERS first notified employees and retirees in January 2017 that the JPA had failed to pay the amount due and that retirement benefit reductions could follow.

Similarly, if SOCWA were unable to meet its obligations for retiree health benefits, then CalPERS might reduce these benefits as well.

In addition, according to a quarterly report prepared by CalPERS staff and presented to CalPERS' Finance and Administration Committee in December 2017, only 10 of 149 JPAs with CalPERS plans contained provisions in their JPA agreements that would make their agency members liable for the JPA's financial liabilities, including unfunded pension obligations. Consequently, the employees of the 139 JPAs whose members are not expressly liable for the liabilities of the JPA could be at risk of having their pension benefits reduced if their respective JPAs were to dissolve with outstanding unfunded pension obligations.

Recommendations

Legislature

The Legislature should require new JPA agreements to hold the members responsible for the JPA's unfunded pension and other postemployment benefits obligations and to specify the manner of apportioning those liabilities.

In addition, the Legislature should require all existing JPAs to disclose annually as part of any regularly scheduled communication to their pension and other postemployment benefits plan participants whether the JPA's members are liable for the JPA's unfunded retirement obligations.

SOCWA

SOCWA and its members should amend the current JPA agreement to expressly state whether members will be responsible for SOCWA's retirement benefits liabilities in the event it is not able to meet those obligations and then it should inform plan participants of that provision.

SOCWA Has Taken Steps to Remedy Historical Financial Reporting Issues

Key Points:

- Until recently, SOCWA's financial statements were missing certain land, building, and infrastructure assets.
- SOCWA did not meet its JPA agreement requirement to file its audited financial statements with its members, the State Controller's Office, and the Orange County Auditor-Controller within six months of its fiscal year-end for four of the last five fiscal years.
- SOCWA's management did not promptly address deficiencies in its internal controls that its external auditors identified during their audits of SOCWA's financial statements for fiscal years 2012–13 through 2015–16.
- Although its process for selecting an external auditor meets most best practices, SOCWA's policy does not require multiyear contracts with its external auditor or rotation of its external auditor.

SOCWA's Past Financial Statements Did Not Include All of Its Capital Assets

From its formation in 2001 through fiscal year 2015–16, SOCWA's financial statements understated the value of its capital assets, including its land, buildings, and infrastructure. SOCWA's external auditor issued a qualified opinion[1] on SOCWA's financial statements for fiscal year 2014–15 because certain capital assets were not recorded in SOCWA's financial statements and the value of those assets was unknown as of June 30, 2015. The external auditor qualified its opinion because accounting principles require all capital assets to be recorded in the financial statements. According to SOCWA's finance controller, in fiscal year 2015–16 she discovered that certain land, building, and infrastructure assets were missing from its financial statements. However, SOCWA did not discover this problem in time to inventory and value these assets for inclusion in its fiscal year 2014–15 financial statements, resulting in a qualified opinion for that year. The finance controller found that the notes to the previous years' audited financial statements referred to these assets as being reported in the financial statements of members, which may be the reason that these assets were not included in SOCWA's past financial statements.

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1 A *qualified opinion* indicates that the external auditor has identified concerns regarding the entity's financial statements; however, the concerns are not serious enough to cause the statements to be misleading.

To determine the value of these capital assets, SOCWA hired a valuation firm in August 2016. However, this firm only appraised SOCWA's land and buildings; it did not appraise the infrastructure assets, such as chemical tanks and piping. Consequently, to calculate the value of these infrastructure assets for inclusion in its fiscal year 2015–16 financial statements, SOCWA subtracted the appraised values of the land and buildings from the total historical cost of all of the previously unreported assets found in older financial records. As a result, it restated the beginning balance of its capital assets for fiscal year 2015–16 to include an approximate $38.9 million increase. Infrastructure assets accounted for approximately $23.6 million of this increase. However, because SOCWA could not provide a detailed listing of those assets, its external auditor issued another qualified opinion on its financial statements for fiscal year 2015–16.

In September 2017, SOCWA hired an engineering firm to determine the value of the infrastructure assets so that SOCWA could properly include them in its fiscal year 2016–17 financial statements. The engineering firm completed its valuation of these assets in December 2017, and SOCWA adjusted its financial statements to incorporate the results of this valuation. The external auditor was satisfied with SOCWA's adjustments to its capital asset balances and issued an unqualified opinion on SOCWA's fiscal year 2016–17 financial statements.

SOCWA Had Not Been Filing Its Audited Financial Statements Within the Time Frame Its JPA Agreement Requires

SOCWA did not meet its JPA agreement requirement to file its audited financial statements with the State Controller's Office, Orange County Auditor-Controller, and each member within six months of fiscal year-end for four of the last five fiscal years. SOCWA's fiscal year ends on June 30 so it should file its audited financial statements by December 31 to comply with the terms of its JPA agreement. However, for fiscal years 2012–13 through 2015–16, SOCWA filed its audited financial statements with the State Controller's Office and the Orange County Auditor-Controller late, ranging from 131 days to 182 days after that deadline. Additionally, for fiscal years 2013–14 through 2015–16, SOCWA filed its audited financial statements with members late, ranging from 36 days to 180 days after the deadline.

According to SOCWA's general manager, extenuating circumstances resulted in the late completion of the external audits for fiscal years 2014–15 and 2015–16, which led to SOCWA's late filing of those audited financial statements. Specifically, towards the very end of fiscal year 2014–15, SOCWA's management decided to reorganize the budget to include detailed costs by project committee and member. In addition, SOCWA designed a new chart of accounts for Financial Edge to record and track financial information. This work was a part of the implementation of a new database to support SOCWA's full use of Financial Edge. These changes required SOCWA staff to perform additional accounting work, including reviewing and transferring financial records previously kept in Excel into Financial Edge, thereby delaying the availability of the financial data needed for the fiscal year 2014–15 audit. It was during this time that SOCWA also discovered its financial statements were missing the assets discussed above. The general manager explained that SOCWA's fiscal year 2015–16 audited financial statements were delayed because it took time for SOCWA to investigate these missing assets, which included hiring a firm to determine their value, as we described earlier. Finally, she does not know why the audited financial statements for fiscal years 2012–13 and 2013–14 were filed late because neither she nor the finance controller were employed by SOCWA during those fiscal years.

SOCWA has recently developed a plan to ensure that it files its future audited financial statements by the December deadline. The plan identifies procedures for preparing the financial statements and assigns responsibilities to various SOCWA staff for completing each task. However, the plan does not include dates for completing these key tasks. For example, the plan specifies that accounting entries related to employee retirement benefits should be recorded in Financial Edge before the financial statements are prepared, but it does not specify a time frame for completing this task. SOCWA could better ensure the timely release of its financial statements if it developed a timeline with specific deadlines for completing each of these year-end procedures. SOCWA did file its fiscal year 2016–17 audited financial statements with all necessary recipients by the December 31, 2017, deadline.

SOCWA Has Been Slow to Resolve Deficiencies in Its Financial Policies and Procedures

SOCWA's management did not promptly address the deficiencies in its internal controls that its external auditors identified. Strong internal controls help ensure the reliability of an entity's financial reporting, the effectiveness and efficiency of its operations, and its compliance with applicable laws and regulations. A deficiency in internal control exists when the design or operation of a control does not enable management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct financial misstatements in a timely manner.

The external auditors identified and reported to SOCWA's board numerous deficiencies in internal controls during their audits of SOCWA's financial statements for fiscal years 2012–13 through 2015–16. For example, the external auditors found that SOCWA needed to improve controls over capital assets and payroll processing, and that its actual cost allocations differed from the allocation methodology specified in project committee agreements. In addition, the external auditors identified improper controls over inventory and ineffective communication between SOCWA's engineering and accounting staff that resulted in assets being placed in service during the year (for example, a completed building that was put into service) without being properly recorded in SOCWA's financial statements. Some of these deficiencies resulted in the need for the external auditors to make various adjustments to account balances in the financial statements.

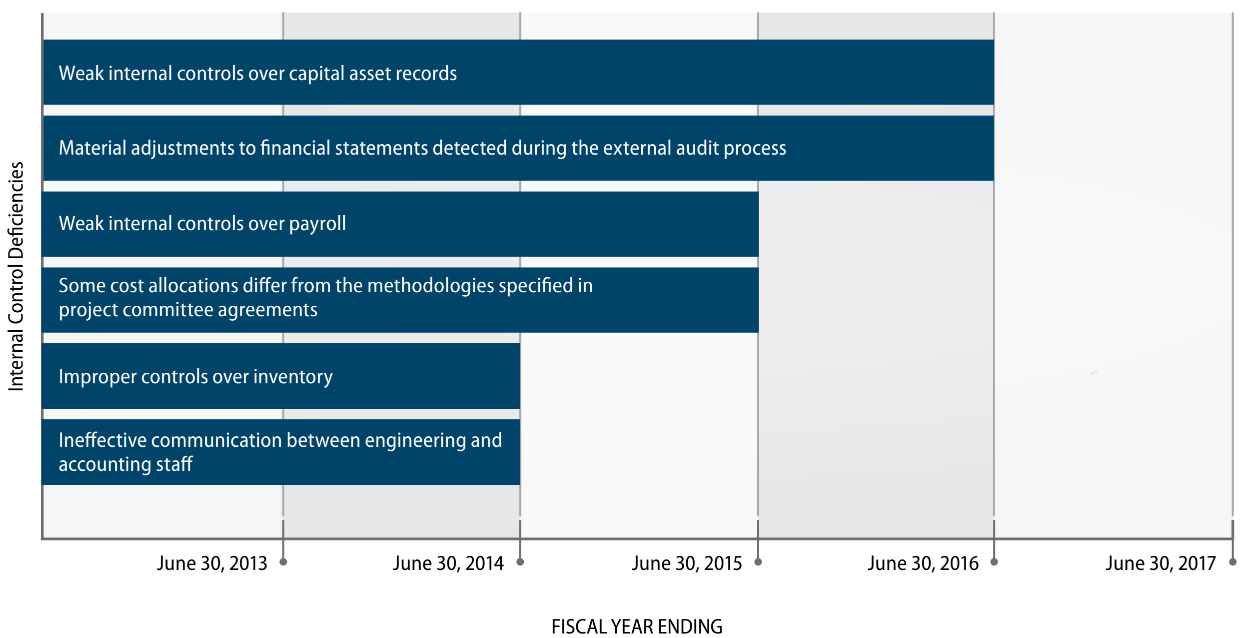
The external auditors found that its actual cost allocations differed from the allocation methodology specified in project committee agreements.

As shown in Figure 4, many of these deficiencies carried over to subsequent years. For example, during the audit of SOCWA's financial statements for fiscal year 2012–13, the external auditor identified a deficiency in SOCWA's internal controls over payroll. Specifically, the external auditor noted that SOCWA's accountant II was responsible for processing payroll and could also make changes to the payroll master file (that is, add or delete employees and change pay rates) and to the direct deposit information, which created the opportunity for this employee to process fraudulent payroll transactions without detection. The external auditor recommended that accounting staff should process payroll and that human resources staff should make any changes to the payroll master file. Alternatively, if it was not possible to segregate those duties, the individual responsible for reviewing payroll should also review a payroll master file change report each pay period to ensure that there had been no unauthorized changes. However, in the following two years, the external auditors repeated this finding and made similar recommendations because SOCWA's management did not correct this internal control weakness, which could have resulted in fraudulent payroll transactions.

The external auditor also continued to report a problem with SOCWA's internal controls over capital assets through fiscal year 2015–16. Specifically, the external auditor had to make an adjustment to move certain capital assets out of the *construction in progress* account and reflect them in the financial statements as being *in service*. However, SOCWA apparently resolved this remaining weakness in its internal controls as the external auditor did not report any deficiencies in SOCWA's internal controls during its audit of SOCWA's financial statements for fiscal year 2016–17.

SOCWA's internal control deficiencies likely occurred because it did not have sufficient documented policies and procedures for its accounting functions until recently. For example, as explained earlier, SOCWA did not previously have written procedures for accounting and reporting members' available cash balances, leading to discrepancies and inconsistent sharing of this information with members.

Figure 4
SOCWA Did Not Resolve Deficiencies in Its Internal Controls in a Timely Manner



Sources: Reports issued by external auditors regarding their consideration of internal controls when auditing SOCWA's financial statements for fiscal years 2012–13 through 2016–17.

Examples of Recently Developed Accounting Procedures and Their Purposes

Cash Flow Process—To record and track cash in the accounting system to allow periodic reconciliation with members and bank statements.

Invoice Generation Process—To bill members for budgeted costs for capital projects and operations and maintenance using data in Financial Edge.

Cost Allocation Process—To record and track detailed cost allocation data for capital and noncapital projects in Financial Edge.

Capital Asset Procedures for Identifying Completed Projects—To better ensure the proper application of SOCWA's capitalization policy.

Segregation of Duties Matrix—To separate incompatible activities for key accounting functions.

Financial Reporting Procedures—To ensure the monthly reporting of financial information to SOCWA's board, and the timely preparation of financial statements at year-end.

Accounts Payable Invoice Processing—To describe the steps in the purchasing cycle.

Budget Process—To guide its efforts during its annual budget process.

Sources: SOCWA's financial policies and procedures.

SOCWA's finance controller began developing additional written accounting policies and procedures in fiscal year 2015–16. Among these new procedures is its process for recording, tracking, and reconciling members' contributions, related expenses, and available cash for capital projects, as discussed previously. They also include formal procedures for preparing invoices in accordance with approved budgets and recording invoice information in Financial Edge with sufficient detail to allow tracking of billed amounts by member, and a new form that the engineering department will use to notify accounting when projects are completed and the related capital assets are placed in service. Examples of SOCWA's recently developed accounting procedures are listed in the text box.

Although SOCWA's newly developed policies and procedures are improvements, they lack step-by-step instructions that will enable staff unfamiliar with the processes to effectively complete the underlying tasks. For instance, the financial reporting procedures provide examples of monthly financial reports that are to be prepared for SOCWA's finance committee and board, but they do not contain instructions for staff on how to generate these reports. The Government Finance Officers Association (GFOA), an organization that promotes best practices in government financial management, recommends that every government entity formally document its accounting policies and procedures, which we believe should include step-by-step instructions.

Although Its Process for Selecting an External Auditor Meets Most Best Practices, SOCWA's Policy Does Not Require Multiyear Contracts With Its External Auditor or Rotation of Its Auditor

SOCWA's practices for selecting its external audit firm are mostly reasonable and prudent. For its fiscal year 2016–17 audit, SOCWA appropriately used a competitive process to engage an external audit firm. In May 2017, SOCWA created a detailed request for proposals (RFP) and published it through its electronic procurement system. SOCWA's RFP included opportunities for fact-finding, provisions for responders to ask questions, and a final bid submission date. The evaluation criteria in the RFP included provisions for scoring based on the qualifications of the firms, staffing and project organization, audit work plans, cost, and quality of presentations.

In July 2017, SOCWA issued a second RFP because it did not receive any responses to its May 2017 solicitation. SOCWA worked with its members to identify six accounting firms with industry experience and reached out to those firms directly by sending them RFPs in order to receive a sufficient number of responses for a competitive process. As a result of these efforts, SOCWA received three responses to its requests. After following its competitive evaluation process as detailed in its RFP, SOCWA ultimately chose an external audit firm for its fiscal year 2016–17 financial audit. The GFOA provides guidance on how government entities should obtain audit services, and it suggests that government entities undertake a full-scale competitive process for the selection of an external auditor at the end of the term of each audit contract and that the principle factor in the selection of an external auditor be the auditor's ability to perform a quality audit. The process SOCWA followed to select its external auditor is described in its policy on procurement of professional services and is in line with these best practices.

However, SOCWA's policy does not align with the GFOA best practice that states that government entities should enter into agreements with external auditors of no less than five years in duration. SOCWA's agreement with its current external auditor is for one year with an option for two additional years. The GFOA states that multiyear agreements can help to reduce audit costs by allowing external auditors to recover certain startup costs over several years; consequently, it recommends that government entities enter into agreements of at least five years in duration when obtaining the services of external auditors. SOCWA should amend its policy and seek to enter into agreements of at least five years with competitively procured external audit firms to save on audit cost, especially given the difficulty it had in hiring its current external auditor.

In addition, SOCWA's policy does not require rotation of the external audit partners having primary responsibility for the audit. Government Code section 12410.6 states that commencing with fiscal year 2013–14, a local agency shall not employ a public accounting firm to provide audit services if the lead audit partner or coordinating audit partner having primary responsibility for the audit, or the audit partner responsible for reviewing the audit, has performed audit services for that local agency for six consecutive fiscal years. Although SOCWA is subject to the requirements of this law, it has not yet developed a policy or formal process for complying with this law in the future (that is, at a point when it has employed the same firm for six years).

Recommendations

SOCWA

To better ensure the timely release of future financial statements, SOCWA should enhance its new procedures for preparing its financial statements by developing and following a timeline with specific deadlines for completing each of its planned year-end tasks.

To better ensure the reliability of its financial reporting, the effectiveness and efficiency of its operations, and its compliance with laws and regulations, SOCWA should establish a policy requiring it to correct within six months any future internal control deficiencies that its external auditor may identify.

To enable staff who may be unfamiliar with SOCWA's various accounting procedures to effectively complete their assigned tasks, SOCWA should further develop its accounting procedures by including step-by-step instructions.

To reduce future audit costs, SOCWA should amend its policy on professional service procurements to specify that it should enter into agreements of at least five years with its competitively procured external audit firms. It should also develop a policy to rotate its external auditor when state law requires.

SOCWA's Governance Structure Is Generally Similar to That of Other Wastewater and Water Joint Powers Authorities

Key Point:

- Elements of SOCWA's governance structure are generally similar to that of other wastewater and water JPAs in California that we reviewed. In addition, the board's method of distributing voting rights to members, with each member having one vote regardless of the member's contribution level, is generally similar to that of the majority of the other wastewater and water JPAs we reviewed.

SOCWA's JPA agreement specifies that it is a public entity established under Government Code section 6500 et seq., and is distinct from its 10 members. We reviewed the governance structures of a selection of other wastewater and water JPAs and found that they shared features of SOCWA's governance structure. Like SOCWA, other JPAs formed under Section 6500 et seq. exercise considerable flexibility in how they govern themselves. The governing body of each JPA is ultimately responsible for the governance of the organization over which it presides. This system allows JPAs to maintain the flexibility they need to ensure that they are meeting their stated purposes and providing efficient services to their members. In Table 3 on the following page, we list the various ways in which SOCWA and four other wastewater and water JPAs have chosen to configure their organizations and the choices they have made regarding their governance structures.

One key element in JPAs' governance structures is the distribution of votes each member can cast. As described in the Introduction, each SOCWA member has one representative that serves on the board of directors. With a one-member-one-vote structure, members enjoy an equal opportunity to affect the operations of SOCWA, regardless of their individual contributions to SOCWA's revenues. In October 2016, the board considered other voting structures, such as changing the weighting of votes among members, but it elected not to take action at that time.

We reviewed how nine other wastewater and water JPAs distributed their voting rights and found that most of them distributed voting rights equally among their respective members, generally similar to SOCWA. Specifically, six of the nine generally distributed voting rights to members by granting either one vote or two votes to each member. However, some of the JPAs we reviewed used a voting structure that distributed votes on a weighted basis, resulting in some members receiving a larger share of the voting rights and having a greater say in the governance of their respective JPAs. For example, those JPAs using a weighted voting structure may distribute votes based on a member's historical use of facilities, based on population, or based on a member's right to capacity. In Table 4 on the following page, we list the entities we reviewed and how they distribute votes to their members.

Table 3
Comparison of SOCWA's and Other Wastewater and Water JPAs' Governance Structures and Select Elements of Their Agreements

	JOINT POWERS AUTHORITIES				
	SOCWA	CENTRAL MARIN SANITATION AGENCY	MONTEREY ONE WATER	SEWERAGE AGENCY OF SOUTHERN MARIN	SWEETWATER AUTHORITY
GOVERNING BODY	Board of Directors	Commission	Board of Directors	Commission	Board of Directors
NUMBER OF MEMBERS	10	4	11	6	2
ASSETS OWNERSHIP	Owned by the JPA—JPA owns and may operate facilities	Ownership of assets varies—depending on use or funding	Similar to SOCWA	Similar to SOCWA	Similar to SOCWA
OBLIGATION FOR JPA LIABILITIES	Rests with the JPA (with limited exceptions)	Similar to SOCWA	Similar to SOCWA	Similar to SOCWA	Similar to SOCWA
MAJOR REVENUE SOURCE	Members	Members	Wastewater user fees	Members	Water users
MEMBER WITHDRAWAL FROM JPA	Any member may withdraw by giving other members advance written notice, but leaving does not relieve a member of its obligations to SOCWA	Members may withdraw with the affirmative vote of 5 of 6 of the commissioners	JPA agreement does not address	Members may withdraw with the unanimous consent of remaining members. In the absence of unanimous consent, a member may withdraw only if the JPA's continued existence would not be jeopardized and the member pays for all costs incurred by reason of the member's withdrawal and the value of any economic detriment suffered by the JPA due to the withdrawal	JPA may be terminated by mutual consent or by either member upon providing the other member one year's advance written notice. However, the JPA cannot be terminated until all of its revenue bonds are paid or provision for such payment has been made
DISSOLUTION / TERMINATION	May be terminated by written consent of all members	May be dissolved with the affirmative vote of 5 of the 6 commissioners	May be terminated by a 2/3 vote of the board of directors, ratified by 2/3 of the members. However, all revenue bond debt must be retired or refinanced by a successor entity before dissolution	May be dissolved by unanimous consent of members	May be terminated by mutual consent or by either member upon providing the other member one year's advance written notice. However, the JPA cannot be terminated until all of its revenue bonds are paid or provision for such payment has been made

Sources: JPA agreements of entities listed.

Table 4
Voting Structure of Various JPAs

	ENTITY	VOTE APPORTIONMENT METHOD: ONE VOTE PER MEMBER (1:1)	VOTE APPORTIONMENT METHOD: WEIGHTED
	South Orange County Wastewater Authority	●	
OTHER JPAS WE REVIEWED	Central Marin Sanitation Agency		●*
OTHER JPAS WE REVIEWED	Monterey One Water	●†	
OTHER JPAS WE REVIEWED	Sweetwater Authority		●‡
OTHER JPAS WE REVIEWED	Encina Wastewater Authority	●§	
OTHER JPAS WE REVIEWED	Metro Wastewater Joint Powers Authority	●	
OTHER JPAS WE REVIEWED	San Elijo Joint Powers Authority	●II	
OTHER JPAS WE REVIEWED	Sewer Authority Mid-Coastside		●#
OTHER JPAS WE REVIEWED	Sewerage Agency of Southern Marin	●	
OTHER JPAS WE REVIEWED	Victor Valley Wastewater Reclamation Authority	●	

Sources: JPA agreements for each entity in the table.

* The commission consist of six commissioners, two appointed by the governing board of Sanitary District Number 1 of Marin County, two appointed by the governing board of San Rafael Sanitation District, one appointed by the governing board of Sanitary District Number 2 of Marin County, and one appointed by the City Council of the City of Larkspur. Member representation on the commission is based on each member's historical use of the Central Marin Sanitation Agency wastewater treatment plant. Each commissioner is empowered to cast one vote on any given measure.

† Each board member has one vote. However, any board member may request that a weighted voting formula apply for any vote to be taken by the board with each member having one or more votes based upon the population of the city, district, agency or unincorporated county area that such member represents.

‡ Five members of the board represent the South Bay Irrigation District while two board members represent National City. When we contacted Sweetwater's general manager, she told us that due to the long passage of time since the formation of the JPA she was unable to explain the basis for this voting structure.

§ Each member agency has two representatives on the Board and the affirmative vote of a majority of a quorum is required for the approval of any action. However, when voting on a matter relating to the treatment plant or ocean outfall, any member of the board may call for a weighted vote. In this case, members' votes are based on their share of capacity ownership in each of these facilities. For example, a member who owns 40 percent of the capacity would receive 40 percent of the votes.

II Each member agency appoints two directors.

\# Each of the three member agencies appoint two directors to the board. However, each director from the City of Half Moon Bay is entitled to two votes, while each director from the Montara Sanitary District and the Granada Sanitary District are only entitled to one vote.

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OTHER AREAS WE REVIEWED

We reviewed SOCWA's compliance with the California Public Records Act (Public Records Act) to address concerns regarding its handling of such requests. Below are the results of our review.

SOCWA Should Strengthen Its Policy and Procedures for Complying With the Public Records Act

The purpose of the Public Records Act is to provide members of the public access to information that enables them to monitor the functioning of their government. However, we found that SOCWA's policy and procedures do not clearly address certain requirements of the Public Records Act. The act requires that initial responses to Public Records Act requests (requests) occur within 10 days of receiving the request and that responses include a determination as to whether the agency possesses disclosable public records; the reasons for that determination; and if applicable, the estimated date and time when the records will be made available. SOCWA's policy and procedures do not address these required elements of the initial 10-day response. In addition, SOCWA's policy requires that requests be made in writing, but the Public Records Act does not require that requests be made in writing; instead, it allows members of the public to make requests in writing using paper or electronic form, or orally in person or by phone.

Moreover, SOCWA has not adequately updated its Public Records Act policy although language in the policy states that the policy "will be maintained and revised by the executive staff in consultation with the Authority's legal counsel." The policy also states that "revisions (to the policy) will occur whenever applicable federal, state or local regulations change or otherwise as the need arises." SOCWA's board reviewed and adopted the policy in June 2005, and SOCWA last revised it in October 2007. We reviewed the Public Records Act and found that some aspects of the law have changed since then. For example, effective January 1, 2017, Assembly Bill 2853 of 2016 added subdivision (f) to Government Code section 6253, which requires state and local agencies to provide copies of public records even if they are available on the website if the requester cannot access or copy them from the website. What is more, Assembly Bill 2843 of 2016 amended Government Code section 6254.3 to add personal cell phone numbers and birth dates to the list of information about public agency employees that is confidential.

In addition, SOCWA does not maintain sufficient supporting documentation to demonstrate that it is complying with the requirements of the Public Records Act. SOCWA tracks

Public Records Act requests (such as requests for purchasing records, engineering documents, and salary information) in Excel and maintains copies of the electronic records associated with those requests in its shared file system. We reviewed SOCWA's tracking spreadsheet and found the information it contains was not always accurate and substantiated by the supporting documentation. We reviewed 10 of the 64 requests that SOCWA listed on its tracking spreadsheet as received from 2012 through 2017. For six of 10 requests, we found that SOCWA's documentation did not support that its initial responses met the requirements of the Public Records Act because it either did not provide information to the requesters as to whether it possessed disclosable public records, the reasons for the determinations or, if applicable, the estimated date and time when the records would be available. For two of the 10 requests, we were also unable to match the date of the request included in SOCWA's spreadsheet with the supporting documents. In addition, for two of the requests, we were unable to match the date on which SOCWA produced its initial response according to its spreadsheet with information in its supporting documents. For two requests, we were also unable to match the date SOCWA produced the requested records per its spreadsheet with its supporting documents. Finally, SOCWA did not keep a listing of the documents it provided or withheld in response to each of the 10 requests we reviewed, which limited our ability to assess whether it responded to requesters with sufficient documentation to meet the Public Records Act's requirements. Consequently, SOCWA could be unprepared to respond to potential litigation resulting from Public Records Act requests. In addition, there is an increased risk that SOCWA will violate the Public Records Act and as a result leave its members and the public unable to monitor its performance.

Recommendations

To ensure that it fully complies with the Public Records Act, SOCWA should do the following:

- Update its policy on the Public Records Act at least annually to ensure that it keeps pace with any changes in the law.

- Develop more detailed procedures to ensure that it responds to requests for records in full compliance with the Public Records Act.

- Establish a policy to retain accurate records and supporting documentation to demonstrate that it fully complies with all requirements of the Public Records Act.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (Audit Committee) requested that the California State Auditor examine the financial management and governance structure of SOCWA. Table 5 lists the objectives that the Audit Committee approved and the methods we used to address them.

Table 5
Audit Objectives and the Methods Used to Address Them

	AUDIT OBJECTIVE	METHOD
1	Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant laws, rules, and regulations.
2	For the most recent three fiscal years, assess SOCWA's compliance with general accounting principles and its organizational financial policies and agreements.	• Reviewed SOCWA's audited financial statements and the external auditors' reports for fiscal years 2012–13 through 2016–17. We also reviewed the external auditors' reports on consideration of internal controls for those fiscal years. • Interviewed SOCWA officials about SOCWA's accounting practices, including financial policies and procedures. • Obtained and reviewed SOCWA's financial policies, procedures, and agreements. • Reviewed GFOA best practices for documentation of accounting policies and procedures.
3	For fiscal years 2012–13 through 2016–17, to the extent possible, determine whether discrepancies exist in SOCWA's accounting for members' cash on hand and determine the cause of any discrepancies. Review and assess SOCWA's procedures for determining proper accounting of cash on hand as deposited by members as well as for identifying assets and liabilities by members.	• Interviewed SOCWA officials about SOCWA's accounting of members' cash contributions and related expenditures. • Obtained and reviewed SOCWA's procedures for cash accounting to determine their appropriateness and reasonableness. • Obtained and reviewed SOCWA's reconciliation of available cash per its accounting records with available cash derived from its fiscal year 2015–16 financial statements. • Examined accounting records for 29 randomly selected member contributions and 29 randomly selected capital project expenditures for fiscal years 2012–13 through 2015–16 from SOCWA's reconciliation of available cash per its accounting records with available cash derived from its fiscal year 2015–16 financial statements. For items other than member contributions and expenditures, we reviewed supporting documents and interviewed SOCWA officials to ensure accuracy and completeness of all reconciling items. • Reviewed SOCWA's JPA agreement to identify any language regarding the allocation of SOCWA's assets and liabilities to members.
4	Identify and evaluate SOCWA's practices for auditor selection, assessment, and rotation. Review management's responses to recent audit recommendations pertaining to accounting principles and financial policies.	• Reviewed SOCWA's policy on professional services procurement and compared the policy with best practices. • Reviewed SOCWA's policy on auditor rotation and compared the policy with best practices. • Reviewed SOCWA's procurement of its fiscal year 2016–17 external auditor for compliance with state law and GFOA best practices. • Reviewed management's responses to deficiencies in internal controls identified by external auditors.

continued on next page . . .

	AUDIT OBJECTIVE	METHOD
5	Review the SOCWA JPA's current governance structure and determine whether it is effective in balancing the interests of members. Identify and assess governance structures for similarly situated JPAs to determine whether there are more suitable structures or mechanisms that SOCWA and its members should consider.	• Reviewed and analyzed SOCWA's JPA agreement. • Reviewed and analyzed JPA agreements of similarly situated JPAs and compared those agreements to SOCWA's. • Interviewed officials of some of the JPAs that use a weighted voting structure to determine how they distributed votes to their respective JPA members. • Reviewed SOCWA board minutes regarding a change that was considered in weighting of votes among members.
6	Review and assess any other issues that are significant to the audit.	• Reviewed SOCWA's policy regarding the Public Records Act. • Analyzed SOCWA's responsiveness to requests under the Public Records Act. • Tested a selection of records from SOCWA's tracking sheet of requests for compliance with elements of the Public Records Act. We did not test the reliability of the data on the tracking sheet and we were unable to determine whether the population from which we pulled the selection was complete.

Sources: California State Auditor's analysis of the Audit Committee's audit request number 2017-113 and information and documentation identified in the table column titled *Method*.

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 and Methodology 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

ELAINE M. HOWLE, CPA
State Auditor

Date: March 22, 2018

Staff: Mike Tilden, CPA, Audit Principal
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For questions regarding the contents of this report, please contact
Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

SOCWA
South Orange County Wastewater Authority

March 1, 2018

Elaine Howle
California State Auditor
Office of the State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Re: South Orange County Wastewater Authority Response to State Audit

Dear Ms. Howle:

Thank you for the opportunity to respond to the State Audit report for the South Orange County Wastewater Authority (SOCWA). The Board of Directors of South Orange County Wastewater Authority appreciates the time and commitment of your staff to accomplish the scope of the Audit as presented.

The report confirms that the governance structure at SOCWA is comparable to many joint powers agencies across California. We concur that our member agency participants in SOCWA's project committees do have ongoing obligations unless otherwise agreed to by the other project participants.

The report also confirms the actions taken by the SOCWA Board to improve the financial and reporting practices of our agency. The Board determined in 2014 to establish a goal for improved financial planning and accountability. The report substantiates that progress is underway and continuing, and we are prepared to address remaining issues.

The recommendations speak to issues with CalPERS funding for SOCWA and other JPA agencies. We agree that the recommendations to the State Legislature are worthy of further consideration. We acknowledge that the audit recommendations may be useful to many other like agencies. SOCWA will consider further clarification of the JPA documents and policies that may impact this issue.

The report identifies opportunities for SOCWA to further improve our organizational practices and procedures and the Board of Directors values the recommendations and will follow through to see that improved practices and procedures will be put in place in the coming months. The Board of Directors will be directing staff to prepare up to date policies and procedures consistent with the report recommendations and State law for Board consideration.

We sincerely appreciate the work of the well qualified team that assisted SOCWA from the State Auditor Offices. They were professional and courteous to our staff throughout the process of the audit and report preparation.

Sincerely,
SOCWA Board of Directors

Chairman Dan Ferons

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