

County of Santa Clara

Board of Supervisors

County Government Center, East Wing

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LIMITED SCOPE MANAGEMENT AUDIT OF COUNTY SANITATION DISTRICT 2-3

AUDIT SYNOPSIS

This limited scope management audit contains six findings and nine recommendations, which, if implemented, would stabilize sewer rates in the District, bring the District budget into compliance with California County Budget Act requirements and improve transparency, better represent ratepayers' interests, ensure that the District uses a public process to hire vendors for District work and issues contracts to vendors, and that the District pays only those wastewater treatment charges necessary for the safe collection, treatment and disposal of District wastewater.

KEY FINDINGS

- The District has an agreement for treatment and disposal of the District's sewage with the cities of San Jose and Santa Clara that own and operate a regional wastewater plant (Plant). Plant officials approved a 10-Year Funding Plan for long-term capital improvements at the Plant. That Plan calls for the District to pay \$7.6 million for Plant improvements in that 10-year period. District management has attempted to fund these long-term capital improvements solely by increasing sewer rates and retaining cash in the short term. This violates best practices in funding of capital improvements, whereby costs are matched to the period of the benefit from the projects. The District Board of Directors should exercise the District's authority under State law to borrow funds for long-term capital improvements, particularly for the Plant charges, as opposed to allowing the District management to seek to fund these costs on a pay-as-you-go cash basis through large sewer rate increases.
- The vast majority of District customers are single-family homeowners that pay an annual rate which is currently equal to \$47.50 per month. This rate is based on the District's budgeted annual expenditures, not its actual costs. For several years, District budgets have been grossly overestimated. The Board of Directors should adopt policies related to working capital, reserves, and use of debt for large capital projects.
- As a result of the combination of Plant capital cost increases and the District having fewer ratepayers, over the last decade, the estimated Plant capital cost per ratepayer has increased 1,423 percent from 78 cents per month to \$11.87 per month. We recommend that the District Board of Directors continue to work to preclude paying any portion of Plant charges for functions that are not required for the safe collection, treatment and disposal of District wastewater. In addition, the District Board should appoint a participant to serve on the Plant's Advisory Committee, which establishes its budget and thus the charges to the District for wastewater treatment.
- Although it is a dependent District of the County, District 2-3 is not overseen by County administration and does not receive assistance from the County with procurement or budgeting and receives limited assistance with respect to financial management. The District Board of Directors should either establish greater control and oversight of the District, or explore options for permitting the District to be governed independently, such as through consolidation with an existing, independent district.
- Inconsistent with best practices, the District lacks a comprehensive capital improvement plan, and – aside from raising sewer rates – has no capital improvement funding strategy. This is likely a factor in the District's high rate of sewer spills relative to other sewer systems in the County. The Board should direct the District to develop and annually update a comprehensive Capital Improvement Plan for its review and approval.
- Unlike the County of Santa Clara, the County Sanitation District 2-3 has no policies approved by the District Board of Directors governing procurement or contracting. The Board should adopt comprehensive procurement policies that govern solicitation of vendors, obtaining quotes for projects, issuance of contracts for work and minimum requirements for contractors. This would improve the District's internal control over the cost and quality of contract work.

A copy of the full report is available at:

<http://www.sccgov.org/managementauditor>

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