



SOUTH SAN LUIS OBISPO COUNTY SANITATION DISTRICT

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RECEIVED
SLO COUNTY GRAND JURY

August 22, 2011

Hon. Charles S. Crandall
SUPERIOR COURT OF CALIFORNIA
1035 Palm Street, Room 385
San Luis Obispo, CA 93408

RE: South San Luis Obispo County Sanitation District
Grand Jury Report of May 31, 2011

Dear Judge Crandall:

Please accept this correspondence as a response by the South San Luis Obispo County Sanitation District ("SSLOCSD") regarding the Grand Jury Report dated May 31, 2011. This response addresses the principal components of the Grand Jury Report as follows:

- Response to Introductory Comments and General Narrative
- Response to Findings
- Response to Recommendations
- Concluding Remarks

Response to Introductory Comments and General Narrative:

Respectfully, the SSLOCSD Board of Directors strongly believes that the Grand Jury commentary, assertions, and conclusions were largely inaccurate. Since 1986, the District has contracted with an outside engineering company (Wallace Group) to provide the administration and engineering services to the District. The duties, responsibilities, rights and obligations of each party, (District and the engineering group), were set forth in the initial contract and have been further refined over time. Services of this nature provided to a special district are not uncommon. This form of contractual relationship was reviewed and affirmed by a Grand Jury in a 1993 report in its examination of the San Simeon Community Services District. A copy of this report is attached for your reference.

The 1992-93 Grand Jury submitted the following finding:

"Based upon the provisions of Government codes 1090 and 87100, the Grand Jury finds SSCSD free of any conflicts of interest. The General Manager receives income from the District under the terms of his employment but he does not affect any decisions that enhance or increase his economic position" (Grand Jury Report, January 25, 1993, at page 3).

The SSLOCSD Board of Directors is charged by the rate payers in Arroyo Grande, Grover Beach, and Oceano, with the responsibility to ensure that the Sanitation District operates efficiently. As such, the Board has determined that the District does not require a full-time salaried Administrator. It does however, require general administrative oversight and budget management, as well as civil engineering expertise specific to water and waste water systems. For many years, the Board has opted to contract with Mr. Wallace to perform general administrative duties, and to employ the Wallace Group on a contractual basis to perform civil engineering duties necessary to sustain daily operations at the Sanitation Plant. Together, these contractual relationships provide the best means of achieving and maintaining efficient and economical operations at the District.

It is important to note that because the District Administrator and District Engineer are contractors, the Board of Directors has recognized the need to be the primary authority for the approval of all engineering services. This has been the practice of the District since the original contract was put into effect in 1986. The Board further determines which Capital Projects should be included in the annual budget based upon staff's input as well as the District's Long Range Plan. The Board also approves projects and services necessary to meet the District's NPDES permit requirements. Once budgeted, each project returns to the Board for final approval. The Board is kept informed of the status of each ongoing project routinely at scheduled Board meetings. Project status information includes a summary of the total budget amount, project costs to date, as well as requests and justification for additional project related funding should it become necessary.

The SSLOCSD Board of Directors believes that this form of oversight provides for "*continued vigilance*" in a manner consistent with the recommendation in the 1993 Grand Jury Report. (GJR 1/23/93 at page 4)

It should be noted that the original 1986 contract was between the District and John Wallace & Associates (JWA). JWA has in recent years, become legally reconstituted as the Wallace Group. Both Mr. Wallace and the Wallace Group serve at the pleasure of the District Board. The Board at anytime, with or without cause, may, by majority vote terminate the contracts with no rights or entitlements to John Wallace or the Wallace Group.

The Board of Directors consists of the mayors, (or his or her designate), of the cities of Arroyo Grande and Grover Beach, and the president, (or his or her designate), of the Oceano Community Services District. The Board of Directors meets on the 1st and 3rd Wednesday of each month at the Oceano Community Services District Board Room. Additionally, Board members on occasion will visit the Sanitation Plant and view its operation.

With regard to the Board of Directors, the Grand Jury Report inaccurately asserts the following: *"the Board is dependent solely on the District Administrator for information or reviews in order to fulfill its oversight role and to make policy decisions,"* The Board typically asks questions or seeks clarification from the Plant Superintendent as well as other District employees who frequently attend meetings. In many instances, the District Administrator will defer to the Plant Superintendent on matters pertaining to plant operations. It is important to note that the Plant Superintendent is the licensed operator of the Sanitation Plant and as such routinely provides the Board with important information that assists them in determining budget priorities or District policy.

The Grand Jury's depiction of the Board of Directors as being generally *"unaware"* is both inaccurate and offensive. The Board believes that the most compelling evidence of the success of both the contractual relationships at the District as well as the Board's oversight role can be found in the current rate structure. Service rates for the District are the lowest in San Luis Obispo County. Despite the unfortunate spill that occurred during the height of the storm season last December, the District has the fewest number of operational violations of any sanitation plant in San Luis Obispo County.

Upon receipt of the Grand Jury's Report (May, 2011), the Board conducted a public hearing at their next regularly scheduled Board meeting. During the discussion the District Counsel provided a preliminary verbal response to the Report referencing the previously mentioned 1993 Grand Jury Report, and citing its findings as being contrary to those set forth in the current Report specific to conflicts of interest. The Grand Jury Foreperson attended this meeting. During public comment, the Foreperson stated that the Grand Jury was instructed to disregard previous reports or references and to focus their findings only on their interpretation of current conditions or situations.

The current Grand Jury Handbook at page 36 refutes this statement: *"The reports of previous Grand Juries are a useful source of information."* Had the Foreperson and other members of the Grand Jury expanded their research and referenced this earlier report, they may well have reached a different conclusion and altered their findings accordingly.

On pages 21 through 23 of the Grand Jury Report, certain "determinations" have been made with regard to the reports prepared for the District by Thomas Investigations. The Board, along with District Counsel contracted with Thomas Investigations to thoroughly investigate allegations made against the Wallace Group by a former employee. These allegations falsely characterized the Wallace Groups' involvement in (2) capital projects. The Grand Jury apparently relied solely upon Meeting Minutes and Agendas regarding the two projects in question. The Grand Jury formulated their determinations without referencing the accompanying Staff Reports to the Board concerning these projects. Had they done so, the history and complexity of these projects would have been clear. Further, the Grand Jury Report did not consider or reflect the number of meetings and budget cycles in which those projects were discussed. A complete review of the documents provided to the Grand Jury would have established that the Board received project updates over three (3) budgetary cycles.

As such, the Grand Jury reached the conclusion that the Board was "*not made aware of the total cost*" of the projects and that the Thomas investigation was not thorough in its examination of the matter. This conclusion is patently false. The Grand Jury went further in their determinations, inferring that Mr. Wallace may have intentionally tried to withhold budget information from the Board. The tone and context of the Grand Jury narrative in this instance was completely inappropriate and potentially damaging to the District, Mr. Wallace, and the Wallace Group. Unsubstantiated determinations of this nature can result in severe consequences for the parties involved and they have no place in a Grand Jury Report.

Response to Findings:

The Board of Directors of the South San Luis Obispo County Sanitation District responds to the Grand Jury Findings as follows:

1. The service contract between the District and the District Administrator has been in effect since 1986 and has not been modified except to increase hourly billing rates.

District Response:

The 1986 Contract between the District and John Wallace / Wallace Group was and is in the process of being updated and bifurcated. This bifurcation now separates the District Administration and District Engineering into two contracts. This action resulted from a Board Directive given months before the Grand Jury submitted its report. Members of the Grand Jury were at the meeting when the Board gave direction to District Counsel and Board Member Ferrara to begin the

bifurcation process. There is no mention of these actions in the Grand Jury Finding.

2. The District Administrator is the majority owner of the Wallace Group.

District Response:

The District Board of Directors was and is fully aware of the fact that John Wallace was the majority owner of John L. Wallace and Associates, and is now the majority owner of the Wallace Group.

3. The contract allows the District Administrator to provide the District with Engineering and Administrative services by means of assigning work to the Wallace Group.

District Response:

The District Administrator assigns work to the Wallace Group as necessary to fulfill his administrative duties. Such tasks include the preparation of bid documents, construction / project management, preparing regulatory compliance documents, and other related tasks necessary for the daily operation of District facilities. These assignments are included in the professional services contract budget as well as specific project budgets, and are routinely reviewed by the Board. The Board is fully aware of the need for expedient, economical, and professional engineering services for routine work. That is and was the intent of the professional services contract. It should be noted that under the new agreement, the Wallace Group cannot be compensated for any form of engineering, to include routine work, without Board approval.

4. The District Bylaws provide that the District Administrator also supervises the District's facilities and services, and supervises the District's finances.

District Response:

The District's Policy Manual defines the role of the District Administrator as stated in Finding #4. However, it also provides for specific job descriptions for District employees. It should be noted that the Policy Manual is very clear with regard to responsibilities. As indicated earlier, the Plant Superintendent is the licensed operator of the Plant and has direct supervision over District employees as well as overall plant operations. The District Administrator provides general policy guidance for the Plant Superintendent and manages the District's finances in a manner consistent with approved Board policies as well as the provisions of his contract.

5. The District Administrator maintains the budget and expenditures records and provides the Board with the budget and budget tracking information it uses to manage the budget.

District Response:

The Board concurs with this finding. The District Administrator also prepares the annual budget and provides regular financial updates for the Board at each Board meeting. Additionally, all payments for services are processed through the County Auditor Controller. As those payments are made, the County reconciles each transaction with the District's budget. Additionally, the District staff also reconciles the District's accounting records with the County's financial reports on a monthly basis. The District's budget is audited annually by an accredited auditing firm, the results of which have repeatedly demonstrated professional and acceptable budget practices.

6. The District's Board is dependent on the District Administrator for the information it reviews in order to make policy decisions. The Board has limited resources to verify or evaluate this information independently.

District Response:

This finding is grossly inaccurate. The Board does rely on the District Administrator for information. However it also relies on information from the District Counsel, the Plant Superintendent, as well as from regulatory agencies. Additionally, the Board periodically consults with other Special Districts as well as their own jurisdictions regarding major policy decisions.

7. The District Administrator has a conflict of interest because of his dual simultaneous roles with the District and the Wallace Group.

District Response:

The Board disagrees with this finding and cites the 1993 Grand Jury Report regarding the allegation of a conflict of interest at the San Simeon Community Services District. A copy of this report is attached for your reference.

8. The contract provides the District with some ability to mitigate a conflict of interest by means of the following clause: "Services rendered pursuant to the Agreement shall be at the direction and request of the District's Board of Directors."

District Response:

The Board disagrees with this finding and cites the 1993 Grand Jury Report regarding the allegation of a conflict of interest at the San Simeon Community Services District. A copy of this report is attached for your reference. Additionally, the clause cited in the finding is precisely the reason why a conflict of interest doesn't exist.

9. The budget and payment processes do not currently provide the information necessary for the Board to mitigate the District Administrator's conflict of interest.

District Response:

The Board disagrees with this finding and cites the 1993 Grand Jury Report regarding the allegation of a conflict of interest at the San Simeon Community Services District. A copy of this report is attached for your reference. It should be noted that the annual budget is reviewed by the Board in specific detail during the budget adoption process. Expenditures are reviewed through the warrant approval process at each Board meeting. Updates are provided quarterly and financial reports are provided to the Board at each meeting. These budget and accounting practices are more detailed and thorough than many special districts of similar size. Further, the new bifurcated contracts provide even more stringent controls with regard to budget and finances. The Board recognizes that these controls will assist in mitigating the public's perception regarding conflicts of interest.

10. The Board does not recognize that the dual roles of the District Administrator create a conflict of interest.

District Response:

The Board disagrees with this finding and cites the 1993 Grand Jury Report regarding the allegation of a conflict of interest at the San Simeon Community Services District. A copy of this report is attached for your reference. (Refer to Finding #8).

11. The Investigation Report commissioned by the Board to investigate allegations of unnecessary Wallace Group work being charged to a District project concluded the allegation was false.

District Response:

The Board concurs with this finding.

12. The limited facts presented in the Investigation Report were not adequate to support the report's conclusions

District Response:

The Board disagrees with this finding. The Grand Jury received a redacted copy of the Report submitted to the Board by Thomas Investigations. Additional information supporting the Report's conclusions also made reference to on-going personnel matters. Information of this nature is confidential and reserved for closed session discussion. It cannot be made public, nor could it be made available to the Grand Jury. During the course of his investigation, Mr. Thomas interviewed all employees of the District. The Grand Jury did not do this. Mr. Thomas carefully researched the professional services contract under which the Wallace Group was operating. He also reviewed the budget information, staff reports, purchase orders and billing for the life of these projects. The Grand Jury either did not do this, or didn't comprehend the scope of information they were reviewing. The conclusion in the Thomas Report relating to the alleged conflict of interest is supported by Mr. Thomas's detailed research as well as the 1993 Grand Jury Report. (Refer to Finding #7). The Board believes that it is, in fact, the Grand Jury that relied on limited facts to support its conclusions.

13. The Investigation Report supporting documentation includes evidence that the budget process did not inform the Board of the total Wallace Group costs charged to the maintenance roof capital project.

District Response:

The Board disagrees with this finding. (Refer to narrative on Page 4).

14. The County of San Luis Obispo's Audit Division has the right to audit the accounts and records of the District.

District Response:

The Board concurs with this finding. (Refer to Finding #5).

15. The same audit principals have audited the District's financial statements since 1998.

District Response:

The Board concurs with this finding. (Refer to Finding #5).

Response to Recommendations:

1. As long as the District Administrator has a conflict of interest, the District's budget/payment process should be modified to provide the Board with the specific Wallace Group information it needs to mitigate the conflict.
(Addresses Findings 2-13)

District Response:

The Board does not believe the District Administrator has a conflict of interest and cites the 1993 Grand Jury Report regarding the allegation of a conflict of interest at the San Simeon Community Services District. Also, please refer to the District's responses to Findings 2-13. Further, the Board of Directors commissioned a "top to bottom" best practices peer review at the same meeting in which the bifurcation of contracts was discussed and approved. Outside agencies participating in this review are in the process of developing a list of recommendations that will include action steps that address the "perception" of a conflict of interest, specific to the budget and payment process. Once again, members of the Grand Jury were in the audience when this action was taken yet there was no mention of it in their report.

2. The budget/payment process changes required and the manner and timing of reporting Wallace Group charges must be determined independently of the District Administrator. (Addresses Findings 2-13)

District Response:

The Board does not concur with this conclusion. Please refer to the District's responses to Findings 2-13.

3. The Board should consider hiring independent management for the District in order to eliminate the current District Administrator conflict of interest and to begin the process to review and evaluate the organizational structure of the District. (Addresses Findings 1-7, and 10)

District Response:

The Board does not concur with this conclusion. Please refer to the District's responses to Findings 1-7 and 10).

4. The Board should evaluate and compare all operational alternatives for the District. This review should include all services provided to the District

below the level of the state-mandated Board of Directors. (Addresses Findings 1-7)

District Response:

The Board is aware of many alternatives regarding administrative oversight and engineering services. The Board believes that the current table of organization and policies at the District do not constitute a conflict of interest. Further, the Board believes that it retains by contract the best skilled, most knowledgeable, and economically feasible administrative and engineering services available in the County. Further, it should be noted that the District relies on outside engineering firms to augment daily operations. Other firms bid on and are awarded larger projects. The District's Long Range Plan along with accompanying cost projections was prepared by an outside firm. Please refer to the District's responses to Findings 1-7.

5. The Board must review operational alternatives independently of the District Administrator because of his conflict of interest. (Addresses Findings 1-7)

District Response:

The Board does not concur with this conclusion. Please refer to the District's responses to Conclusions 3 and 4.

6. The County of San Luis Obispo's Audit Division should consider conducting an audit of the District that would include an independent professional assessment of whether the District has the controls in place to mitigate the financial risks inherent in a conflict of interest. (Addresses Findings 5, 9, and 14).

District Response:

While the Board does not agree with the Grand Jury's determination of a conflict of interest, it does concur with the recommended involvement of the services of the County Auditor Controller. It should be noted that a member of the Board of Directors along with the District Counsel contacted the Auditor Controller within 2 business days after receipt of the Grand Jury Report. The Auditor's Office has agreed to review the new bifurcated contracts to ensure that they are consistent with acceptable special district budget related practices. The Auditor, along with the involvement of members of his staff is welcomed by the Board.

7. The Board should adopt the practice of rotating the District's principal auditor every five years. (Addresses Finding 15)

District Response:

The Board concurs with this conclusion. However, the decision to rotate the District's principal auditor was made months prior to the issuance of the Grand Jury Report. Once again, members of the Grand Jury were present in the audience at the Board meeting where this was discussed. Following a presentation of the 2010 audit results, Board members remarked about the public's perception of the repetitive use of the same auditor to conduct and prepare municipal audits. The Board referred to the problems associated with the City of Bell, and directed the District Administrator to solicit bids from other accounting firms for the 2011 District Audit. Again, there was no mention of this previous action in the Grand Jury Report.

Concluding Remarks:

The District respects the San Luis Obispo County Grand Jury program and process. City and Special District representatives that comprise the South San Luis Obispo County Sanitation District have publicly recognized through annual honorary proclamations the volunteer effort and commitment put forth by Jurors who serve.

While we disagree with many of the findings and conclusions set forth in the 2010-11 Grand Jury Report, we do wish to commend the men and women who served as jurors. As indicated, the District has taken steps consistent with some of the recommendations of the Grand Jury, to improve District operations and to address the public's perception of the alleged conflict of interest.

Our previous experience with Grand Jury reports has been largely positive. We appreciate the fact that most reports offer both constructive criticism and recommendations for improvement that are generally beneficial for all parties.

However, it is the opinion of the District that the unsubstantiated assertions and accusations made in this Grand Jury report against parties associated with the District were both unprofessional and offensive. Further, they are potentially damaging in content and context to the character and reputations of the District's member agencies as well as professional organizations affiliated with the District.

The District is hopeful that the newly seated Grand Jury will seek broader sources of information on matters they are reviewing and/or investigating, including but not limited to, previous Grand Jury Reports regarding the same subject matter. The District believes that had the 2010-2011 Grand Jury done so, they may well have altered their findings, and as a result, reached different conclusions.

In summary, the District and Board have responded to the Grand Jury findings and conclusions as follows:

1. The Board will "continue to be vigilant" on matters relating to the public's perception of a conflict of interest.
2. The Board has bifurcated the contracts for the District Administrator and the District Engineer and integrated additional control and oversight measures into them. (Note: This action was taken well before the Grand Jury Report was published).
3. The Board will likely implement forthcoming recommendations from an Outside Agency Peer Review specific to the budget and payment process to address the public's perception of a conflict of interest. (Note: The action commissioning the peer review was taken well before the Grand Jury Report was published.)
4. The District is preparing bid notices for other auditing firms to review the District's finances for the coming year. (Note: This action was taken well before the Grand Jury Report was published).
5. The District will also continue its budget and financial relationship with the County Auditor Controller.

The Board is hopeful that the Court will accept these actions collectively, as a constructive and "good faith" response to Grand Jury Report. The District sincerely wishes to move past this matter and thus, allow our very dedicated employees to continue their exemplary service to the District and its rate-payers, free from controversy.

Respectfully,

A handwritten signature in dark ink, appearing to read "Bill Nicolls", written in a cursive style.

BILL NICOLLS, Chairman of the Board

1036.013



GRAND JURY
COUNTY GOVERNMENT CENTER
SAN LUIS OBISPO, CALIFORNIA 93408

FILED

FEB 3 1993

FRANCIS M. COONEY, COUNTY CLERK
BY *[Signature]*
DEPUTY CLERK

January 25, 1993

Attached herewith for immediate release is a copy of the
1992-93 Grand Jury Final Report on:

Conflict of Interest / San Simeon Community Services District

[Signature]

Foreman

FINAL REPORT
CONFLICT OF INTEREST/SAN SIMEON COMMUNITY SERVICES DISTRICT (SSCCD)

Complaint:

The complaint alleges: a conflict of interest on the part of the San Simeon Community Services District (SSCCD) Board in its relationship with its General Manager and a conflict of interest on the part of the General Manager in connection with his private business. The complaint further charges that the Board and the General Manager are not, to the best of their ability, seeking additional water for San Simeon and are thereby unnecessarily prolonging the moratorium on water hookups, in force since 1989.

Procedure:

The Grand Jury has interviewed the Chairman and the Vice Chairman of the SSCSD Board, as well as the SSCSD General Manager. The Grand Jury has reviewed all documents pertinent to the complaints, including Conflict of Interest forms 730 of the SSCSD board members and General Manager; 1992 Budget and audit report, and the waiting list for water hookups. The Grand Jury further examined past and present efforts to relieve water shortages in the District; reviewed the list of contractors, consultants and firms which provide services to the District in the search for and conservation of water resources. The Grand Jury also consulted with the San Luis Obispo District Attorney's Office, the attorney for the SSCSD and the Fair Political Practices Commission in Sacramento.

Findings:

In 1986 the SSCSD Board hired a professional engineer to serve as both General Manager and District Engineer. It is a part-time position and is paid an hourly rate which has not changed in seven years. The funds budgeted for the position equate to twenty-six hours a month. We found the incumbent far exceeds this allocated time, but he does not charge for the extra hours he works. The General Manager's engineering firm provides services for many other special districts in the County, as well as SSCSD; however, the bulk of his firm's business is with private contractors and developers. The fees his firm has earned from the District represent a small fraction of the District's total engineering budget and a very small portion of his total business interests.

The SSCSD expresses complete confidence in its General Manager/Engineer. A 1992 independent audit found the District's accounting and bookkeeping procedures in compliance with accepted methods.

All documents requested and examined by the Grand Jury were found to be proper and correct. Lists of water hookup requests were found to be up-to-date and accurate. All requests prior to the moratorium

date, some dating back to 1975, could have gone forward if the applicant had wished to proceed.

District budgets are prepared by the board and staff then presented for public input and discussion at general meetings. This conforms to legal budgetary procedures for public agencies.

The Grand Jury has documentation confirming that the SSCSD and its General Manager have made vigorous, consistent and continuing efforts to enhance existing and add new water sources. The goal of these efforts is to solve San Simeon's water shortage and remove the building moratorium at the earliest possible date. In view of the drought of the past six years, it appears everything possible has and is being done to address the District's water problems.

After examining all the Forms 730 and other pertinent documents, the Grand Jury finds no conflicts of interest on the part of any of the SSCSD board members or employees.

Conclusions:

The SSCSD Board and General Manager have been diligent and inventive in their efforts to find new sources and to enhance present water supplies. They have been open and above board in their District activities. By retro-fitting all water fittings with low flow devices, the District has saved fifty-one acre feet of water per year. An acre foot equals approximately 300,000 gallons. This is significant, as due to low flow and salt water intrusion, Pico Creek, the main source of water, has only had seventy-eight acre feet available of approximately one hundred forty acre feet allocated the District.

The legal counsel for the District is vigilant in advising the District Board and General Manager in all legal matters, especially insofar as conflicts of interest are concerned and finds no such violations in the District.

Based on the provisions of Government Codes 1090 and 87100, the Grand Jury finds SSCSD free of any conflicts of interest. The General Manager receives income from the district under the terms of his employment, but he does not affect any decisions that enhance or increase his economic position.

The Grand Jury concludes there are no conflicts of interest as alleged in the complaint and every effort is being made to solve the District's water problems.

Recommendations:

The Grand Jury recommends:

1. The SSCSD Board continue its vigilance in its dealings with all employees.

- 3
2. The SSCSD Board continue adhering to legal counsel. In the case of doubts regarding conflict of interest, the Fair Political Practices Commission in Sacramento is ready to assist.
 3. The SSCSD Board annually review Government Code 1090 and 87100 dealing with conflicts of interest and record such review in Board Minutes.
 4. The SSCSD Board continue to vigorously seek new and enhance existing water sources.