

Rancho Murieta Community Services District Has Lost Public Trust



SUMMARY

Based on complaints received from the Rancho Murieta community, the Sacramento County Grand Jury (SCGJ) finds after its own investigation that the Rancho Murieta Community Services District (District) Board has lost the public trust by:

- Failing to perform its fiduciary responsibility to the community,
- Failing to raise fees over time to cover the increasing costs of security,
- Failing to adequately fund its required Capital Reserves,
- Failing to recognize that the removal of key accounting staff resulted in collapse of its billing and accounting systems,
- Failing to take immediate action to replace the poorly functioning accounting system,
- Failing to follow appropriate labor practices resulting in threats of litigation against the District, and
- Failing to provide the data needed to perform legally required accounting audits for the last two fiscal years.

These and other lapses in leadership created a high pressure and “stressful” work environment among staff, resulting in unusually high staff turnover. As a result of these and other failures, the District has lost the public trust, exposed itself to a high risk of financial fraud, and failed to meet its current and future financial obligations.

The District has begun to take actions to address the problems noted above but has been late in starting that process. This report provides findings and recommendations to assist the District to address these failures, allowing the District to be compliant with its legally mandated role in serving the Rancho Murieta community.

BACKGROUND

History

Rancho Murieta is a gated community about twenty-five miles east of Sacramento off of Highway 16. A feasibility study done by the Local Agency Formation Commission (LAFCo) recommended that a Community Services District be formed under California Law to be responsible for the services needed to support this developing community.

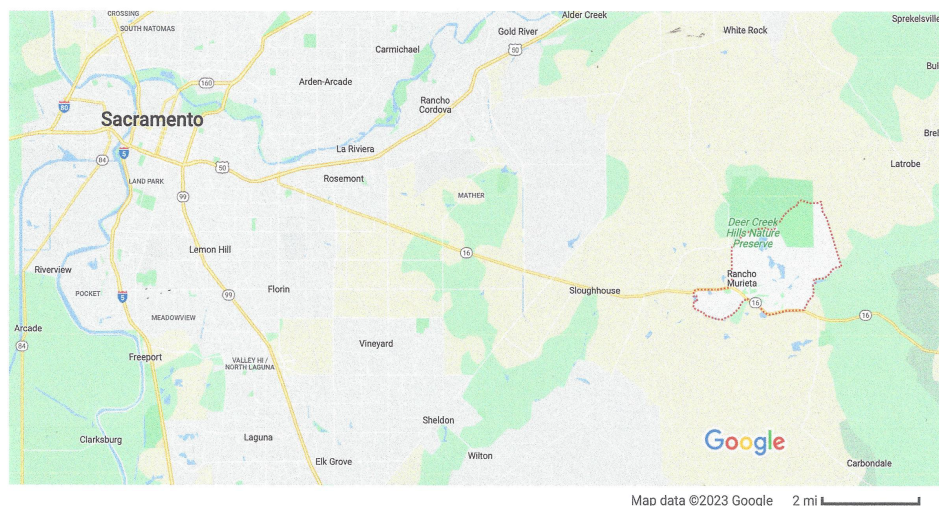
In June 1982 the Rancho Murieta Community Services District (District) was formed. The District is about 3,500 acres with residential acreage of 1,920 acres.

Rancho Murieta was a private development that later resulted in establishing the Rancho Murieta Association (RMA) and Murieta Townhouse, Inc. (MTI) in the early 1970s. There is an overlapping relationship between the District; Rancho Murieta Association (RMA), which is a homeowner's association; and the Rancho Murieta Country Club (RMCC), which operates two golf courses in the community.

The District performs five vital functions for this gated community of about 5,000 people. Those functions are water, sewer, garbage, drainage, and security. Fees are assessed for each of these services in monthly billings to property owners. The District Board is responsible for the performance of these services and has a fiduciary responsibility to properly account for the expenditure of these funds collected to provide these services.

There are 5,189 single family, townhouse, and mobile home units. The 2010 census shows the population as 5,488. The District holds over \$56 million in operation plant, property, and equipment assets.

Figure 1
Rancho Murieta Community Services District



Governance

The District is governed by a locally elected five-member board. The Board members can receive up to \$300.00 per month depending on how many meetings they attend. District Board members often have served as Board members of the other two organizations. Actions taken by the District have led to perceptions of conflict of interest with the RMA and RMCC.

The District's 2022-23 fiscal year operating budget is about \$8.3 million. It has about forty (40) employees. Approximately 87% of the funds collected by District are fees for specific services. The District also receives \$775,000.00 in County property taxes each year. The District provides the following services:

1. Water supply collection, treatment, and distribution;
2. Wastewater collection, treatment, and reuse;
3. Storm drainage collection, disposal, and flood control;
4. Security for this gated community; and
5. Solid waste collection and disposal.

Administration

The District has a General Manager who supervises the operations and financial aspects of all District functions. The General Manager has a staff of about 39 people who report to him through the Director of Administration, Security Supervisor, and Director of Operations.

METHODOLOGY

The Grand Jury received three complaints regarding the District. The issues identified are interrelated. They included concerns about the status of annual financial audits, high turnover among District staff, unusually high annual fee increases proposed by the District's Board, and the questionable use of District funds.

During its investigation the Grand Jury obtained information from, but not limited to:

Documents:

1. Three citizen complaints which were submitted to the Sacramento County Grand Jury;
2. Correspondence, emails, and documentation received by the Grand Jury;
3. The District's public website (www.ranchohurietacs.com).
4. District meeting agendas, meeting board agenda packets, and minutes (FY 2021, 2022, and 2023);
5. Agreement and amendment for availability and use of reclaimed water between the District and the RMCC (1988 and 1994);
6. Water rights agreement between Cosumnes Irrigation Association, Rancho Murieta Properties, Inc., and Rancho Murieta Community Services District (RMCCSD) (1987);
7. Professional services agreement between the District and The Pun Group, a privately held CPA firm with offices in Sacramento and other cities (FY 2022);
8. District audited financial statements including FY 2018-19 and FY 2019-20;
9. A loan agreement between the District and RMCC to repair a reclaimed water pump (FY 2021); and

10. District annual budgets from FY 2013-14 through FY 2022-23.

Interviews:

1. Interviews with ten individuals, including the complainants, District staff, and others.

Observation:

1. District Board meeting audio recordings (FY 2022).

DISCUSSION

Financial Structure and Issues

The District serves five major functions: water development, treatment, and distribution; sewer water collection and treatment to recycled water standards; solid waste garbage collection and disposal; storm drainage, collection, and disposal; and security.

The first three functions are funded by general taxes assessed each month to property owners, governed under Proposition 218 provisions. This allows for annual increases in those fees, unless over 50% of those who are charged oppose the increase.

The last two functions are funded by special taxes governed under Proposition 13, which only allows increases of a limited amount each year, depending on the authorizing legislation that established those taxes. For example, Measure J, which established the taxes for security in Rancho Murieta allows for increases of up to 2% each year.

Each tax must be billed, collected, and accounted for separately. The funds for each service must be spent only on those services for which the tax was collected. This can be a complicated process from an accounting standpoint, but is typically accomplished with appropriate accounting structures and management oversight. The District also receives county property taxes billed to each property owner by the County on a semiannual basis.

An example of how money is collected is shown in the 2022-23 budget as shown below. In the adopted budgets the District uses the term “sales” to represent the fees it receives in taxes it assesses for the services it provides to both residential and commercial customers. We use the term “fees” in this report for these sources of funds to alleviate possible misunderstandings. The revenue budget represents the income expected from the bills that are sent out each month to landowners for each of the five services provided by the District.

Figure 2
District Revenue Sources

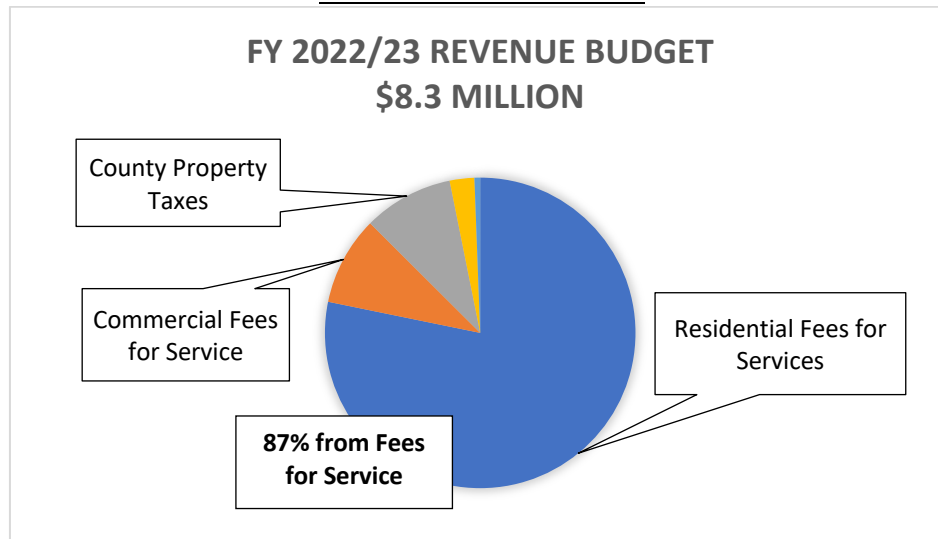


Table 1

ADOPTED BUDGET FY 2022-23 Revenue Summary

Category	Amount in Dollars
Sales Residential Service	6,470,917
Sales Commercial Service	765,678
Property Tax	775,000
Other Income	212,370
<u>Interest Earnings</u>	<u>49,150</u>
Total	8,273,115

FY 2022-23 Expense Summary

Expenditures by Fund Source	Amount in Dollars
Administration	1,977,780
Water	2,076,091
Sewer	1,372,539
Drainage	247,781
Solid Waste	1,032,280
<u>Security</u>	<u>1,438,206</u>
Total Expenditures	8,144,683

*Rancho Murieta Community Services District FY 2022-2023
Adopted Budget from RMCSD Website*

The tables show 87.5% of the District's income comes from the bills that are sent out each month for the five services provided by the District. As these bills are sent out and payments are received, California law requires that the District accounting system keep these fund sources separate and track expenditures during the year to each fund source.

The only fund source that can be allocated to support any of the five services (and the general administration of the District) are the County property taxes that the District receives during the year. These County taxes are approximately 10% of the annual budget.

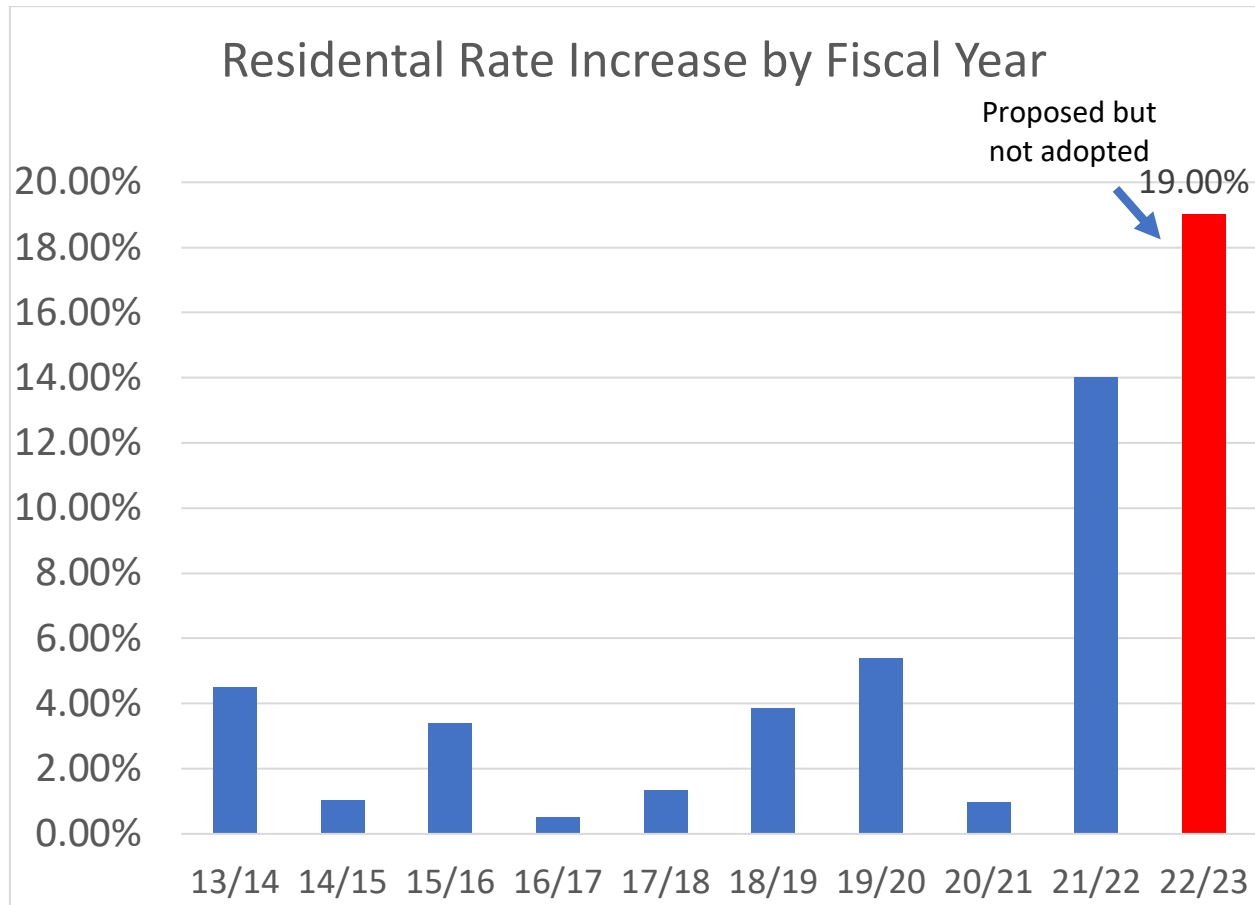
Accounting systems can be set up to perform the detailed accounting of income and expenses separately for each service provided by the District to comply with California law. The District's accounting system does not perform this function automatically. It is a time consuming and manual process. The expected expenditures for Administration in FY 2022-23 are over twice that of previous years due to the large amount of work needed to update the accounting data and system.

Outside auditors have found that the District has developed a series of spreadsheets that do not link to the general ledger. These spreadsheets required multiple entries and extensive knowledge to maintain. This has made the operation of the District's accounting system and the production of accounting reports complex. As a result, annual financial audits have not been completed for the past two fiscal years.

Insufficient Rate Increases

The District fiscal year is from July 1 to June 30. A review of the District budgets shows that they have increased fees slightly over time. Figure 3 shows the average annual Residential Rate Increases for the five services the District provides for nine fiscal years, FY 13-14 through FY 20-22. It also shows the rate increase proposed for FY 22-23 but was not implemented. The average annual rate increase for the eight years FY 13-14 through 20-21 was 2.6% with a compounded rate increase over those eight years of 22.85%.

Figure 3
Average Annual Residential Rate Increases
(from District Adopted Annual Budgets)



In early 2021, the District proposed a rate increase of approximately 14%. This rate was accepted by the customers of the District. By early 2022, when the District proposed another large rate increase of about 19%, the customers of the District then organized and rejected the increase. The 2022 proposed rate increase was in response to the fact that the District had been subsidizing security costs with approximately \$500,000.00 per year in County property tax revenue and not appropriately funding its needed capital reserves.

Audit Concerns

Community Services Districts are required by California law to have an independent financial audit performed each year. Historically, District staff has been able to produce reliable accounting data from its complex accounting system to conduct these audits. The most recent audits for the District finances were conducted for 2018-19 by Larry Bain, CPA Accounting Firm and 2019-20 by Richardson and Company. The audit for fiscal year ending June 2020 noted five material weaknesses that created a reasonable possibility that a material misstatement of the entities financial statement could occur. The same audit noted five other significant deficiencies

in internal controls that were less severe than material weaknesses, yet important enough to merit attention. In addition, the management letter attached to the 2019-20 audit noted 13 findings that needed to be addressed. A few of the significant findings are summarized below:

1. Accounts Payable:
The District did not prepare a listing of what makes up the accounts payable imbalance on June 30, 2020 and upon review during the audit, it was determined that certain amounts were incorrectly accrued.
2. Billing System Integration:
The District's billing system does not currently interface with the general ledger, resulting in the District preparing extensive spreadsheets each month to record the customer billings and payments in the general ledger. The auditors recommended the District consider a new system that includes the billing system as a module within the general ledger system.
3. Procedure Manuals:
Procedures manuals have not been updated since 2010. An updated procedure manual aids proper internal control and continuity with turnover of positions.
4. Reserves and Reserve Policy:
The district has not funded adequate reserves considered standard practice of Special Districts. The District does not have a current Capitol Reserve Policy. Several of the reserve accounts were in a negative position. These include: Water Capital Improvement Fee Reserve, Water Treatment Plant Construction Fund Reserve, and Security Capital Improvement Fee Reserve.
5. General Fund Allocations:
The District maintains a General Fund in their accounting system. For financial recording purposes, this fund is not identified as a line item in the balance sheet or income statement. These general fund allocations require a cumbersome process to reconcile financial statements. The allocation process from the general fund to other accounts is performed outside the accounting system, creating discrepancies in audits.

The audit also stated that: "The District recognizes the limitation in the current financial system and is working to set up the correct accounts to ensure proper fund accounting. The District is looking into implementing a new Enterprise Resource Planning (ERP) system that is specifically designed for governmental fund accounting. The District anticipates the new ERP implementation for the FY 2021-22."

District Responses to Financial Issues

The new accounting system was not implemented in FY 2021-22. Although the District has retained outside consultants to help with accounting, it has yet to implement an integrated accounting system to address the flaws in their current system. The current accounting system has not produced reliable data to allow the 2020-21 audit to start on time. From 2021 to at least January 2023, the District has not produced financial reports because of a loss of confidence that their accounting system was able to produce reliable data.

The District has attempted to hire consultants to conduct the 2020-21 audit. At the May 18, 2022 Board meeting, a CPA firm (Eide Bailly) was contracted to perform external accounting services. This firm resigned the account, citing "capacity and risk concerns".

Administration Issues

The 2019-20 audit noted that the District had a high turnover in key accounting staff and was having trouble hiring accounting staff to keep the system functioning properly. This was exacerbated by the COVID-19 pandemic. The current system is complex to operate and labor intensive. The workload for existing staff is excessive and stressful. This system has contributed to the high turnover rate, about twelve permanent staff in two years. This does not include a similar number of temporary staff members who have rotated through the District during the same time period.

The problems with the accounting system started in late 2018 with the removal of a key long-time accounting staff person that "held the keys to the accounting system". This resulted in the resignation of another key accounting staff person who had critical information on how the accounting system worked. The District has no succession plan to prepare for what followed.

The new staff that came on board had little training in this complex system and was hampered by outdated accounting manuals. These new staff employees did all they could to keep daily accounting operations functioning. The resulting workplace was stressful with ongoing tension between accounting staff and District management.

In addition, during the interviews with current and former employees, our investigation uncovered three questionable adverse actions against employees. Two were dismissals, one of which resulted in a settlement of the wrongful termination for \$250,000. The other is a claim of wrongful termination seeking \$1.8 Million in damages. The status of the latter is unknown. In all cases, the district did not appear to follow proper review of those actions before they were taken. Had those actions been reviewed by an objective person familiar with proper human resource procedures, it is likely they would not have been taken.

In September 2022, the District entered into a contract with the Pun Group, a CPA accounting firm, to accurately revise its accounting data. The Pun Group is working with District staff to prepare the FY 2020-2021 and FY 2021-22 accounting data to allow for the external audits of those years to begin. The FY 2020-21 audit will likely not be completed until April 1, 2023 at the earliest, about 16 months late.

The extensive review, correction, and preparation of the accounting data for FY 2021-22 has not begun and it will take months before that audit can start. These audits will be performed by Richardson and Company, CPAs.

The audits are described as high risk due to the current condition of the District's accounting system and data. The District's audits for both years are past due. The late audits, combined with the unreliable existing accounting system, have created an environment that exposes the District to a high risk of fraud.

The District is working with Tyler Technologies to implement an Enterprise Resource Planning system known as Tyler Incode to integrate the District's accounting information into a modern easier to manage system that addresses the issues from prior audits. Implementation of that new accounting system will be an extensive process. Certain modules of that system may come on-line in early 2023, but the earliest expected date to fully implement the system is the end of 2023. Tyler Technologies will train staff on this new system, develop training manuals, and establish new procedures.

Subsidizing Security Costs

The total number of positions for gate and patrol staff has stayed the same from 2013 through 2021, at 17 positions. This is approximately 45% of the total staff of the District of 37.5 positions in 2021. The distributed administrative overhead for security services was assessed at 20% of the total administrative costs until recently. A Cost Allocation Study (CAS) in 2020 indicated that the appropriate percentage of security funds allocated to administrative costs should be increased to 32% beginning in FY 2020-21.

The direct cost for security for the Gate and Patrol Services has increased from \$963,000 in the FY 2013-14 to \$1.5 million in the FY 2021-22, a 56% increase over nine years. The 2% increase allowed under Measure J does not cover those increases. The District has resorted to subsidizing security costs with the use of approximately \$500,000 per year from the County taxes it receives.

Capital Reserve Fund Issues

Prudent capital reserves make for sound budgeting. For countless families, saving for a rainy day is common sense. For special districts, like that of the RMCSD, reserve funds are not just money in a bank, they are fundamental resources for ensuring reliable core services and community security. Critical infrastructure like that managed by the District needs to be repaired or replaced from time to time. Special districts designate money toward capital reserves in order to respond to emergencies and repair and replace critical infrastructure. This can stabilize rates for rate payers and save them money in the long run. A special district can either implement a policy to have those funds on hand when needed or go into debt and pay interest payments to meet those needs. It is a case of "pay me now or pay me more later".

The existing District capital reserve policies do not provide clarity to the public so that the public may provide proper oversight of the District's reserve funds. The reserve accounts are woefully underfunded. Current reserve balances were estimated to be between \$8.5 and \$10.9 million in the capital reserve study that was done in a recent finance report presented to the District Board. The actual Capital Reserves on hand are under review as the financial system is being upgraded.

Capital assets are valued at \$32 million to \$36 million¹. A reserve fund for repair and replacement of 60% of those assets would be a little over \$20 million. A reserve fund report to the District prepared by Association Reserves™ (a company specializing in guiding capital asset management) recommended that such a fund should be at least 70% of capital assets. However, Board minutes indicate the desire to have reserves funded at 60%. This goal is not stated in the

¹ The 2020-2021 Budget notes capital assets of plants, equipment and property at \$65 million. Excluding property, the assets that are subject to repair and replacement needs are estimated at about \$32 to \$36 million.

current District Reserve policy. With the current funds believed to be on hand, the District has less than one-half of what it needs to reach even the 60% goal.

In 2022, when the District tried to achieve the goal of funding reserves equaling 60% of the value of capital assets, the rate payers rejected this proposal. The District proposed a new tax under Proposition 13, to fully fund its security costs in the form of Measure R for the November 2022 ballot. If Measure R had passed, the District would have been able to stop subsidizing the growing security costs with its County property tax funds and use those property taxes to help rebuild the Capital Reserve accounts. Since Measure R did not pass in November 2022, the District must find an acceptable solution for the Capital Reserve funding needs of the District.

Perceived Conflicts of Interest

Rancho Murieta is a development community. The District was formed to provide public services to this development. The Rancho Murieta Association (RMA) is the homeowner's association that oversees the Covenants, Conditions, and Restrictions (CC&Rs) for the community. The Rancho Murieta Country Club (RMCC) with two 18-hole golf courses provides open space and recreation for the community. The developers of property within Rancho Murieta are an influential group within the community.

The Boards that oversee these various organizations in the community are largely volunteer. Board members may serve on any one of these boards, and some have served on multiple boards over time. Board members from one organization may at times move to govern the other organizations. While this participation across various boards might help with overall understanding of the communities' needs, it also creates perceptions of conflicts of interest when it comes to funding certain projects or of special treatment of one organization by another.

A good example of such a perceived conflict of interest is the \$115,816 loan the District provided to RMCC in 2021 to repair the pumps the Country Club uses to obtain reclaimed water provided to it by the District. RMCC is responsible for the maintenance of these pumps, but lacked the funds to repair them. The repayment of this five-year loan is at not less than 2% annual interest. It is reasonable to question why such a long-term loan was given and why RMCC did not procure its own loan when the District was not sufficiently funding its own capital reserves.

While this loan expedited the repairs, it could have been done in a more transparent fashion and at more favorable terms for the District. RMCC does not pay anything for the reclaimed water provided to it by the District. This reclaimed water is a valuable commodity and is critical for the operation of the golf courses. We know of no other water agency in California and certainly not in the Central Valley that does not charge a reasonable fee for the commercial use of reclaimed water.

For example, the Sacramento County Water Agency (SCWA) charges for the use of its reclaimed water at 70% of its irrigation rates. Using this basis, the District could generate revenue of over \$100,000 per year for the reclaimed water used on the two RMCC golf courses. While this loan may not be an actual conflict of interest, it does raise the perception of a conflict of interest in the community. The District Board and staff need to be sensitive to those perceptions and avoid them in their fiduciary responsibilities.

FINDINGS

- F1** The District Board has lost the trust of the community to make prudent financial decisions.
- F2** The current accounting system is inadequate to meet the legal requirements related to financial reporting to the public which has resulted in two legally required financial audits being overdue.
- F3** The late audits, combined with the unreliable existing accounting system, have created an environment that exposes the District to a high risk of fraud.
- F4** The District Board cannot expect to recover public trust sufficient to propose any tax/fee increases until it replaces its antiquated billing and accounting system to produce reliable billings and financial records.
- F5** The District has at times taken actions against staff that has interfered with the operation of the District.
- F6** High employee turnover indicates poor employee retention that has interfered with the operation of the District.
- F7** The lack of an effective succession strategy has impaired the ability of the District to maintain adequate competent staff which has resulted in the loss of critical accounting system knowledge among the District staff.
- F8** The lack of an updated Capital Reserve Policy has contributed to poor management and inadequate Capital Reserve.
- F9** The use of County Property Tax funds to subsidize its growing security costs without raising the security fees has jeopardized the financial stability of the District.
- F10** The Capital Reserves are underfunded by over \$10 million, jeopardizing the financial stability of the District.
- F11** The District has inappropriately subsidized the cost of reclaimed water to RMCC.
- F12** A perceived conflict of interest exists in the community due to a close relationship between the District, the RMA and the RMCC and their respective Board members.

RECOMMENDATIONS

- R1** The District board should upgrade the District's billing and accounting system with the new Enterprise Resource Planning (ERP) accounting system by January 1, 2024.
- R2** The District Board should insure that the audit for 2020-21 is completed no later than April 1, 2023, and the FY 2021-22 audit by September 1, 2023.

- R3** The District Board should task its ERP consultant to implement a program to fully train District accounting staff on this new accounting system and prepare new accounting manuals acceptable to the General Manager or designee by January 1, 2024.
- R4** The District Board should retain a controller to ensure proper accounting procedures are followed and the integrity of the accounting data is maintained by January 1, 2024.
- R5** The District needs to ensure invoices are tracked within the accounting system and that the accounts payable listing be generated on a monthly basis by September 1, 2023.
- R6** The District should create an ongoing training program for the Board and staff regarding the Brown Act compliance, accounting procedures, and work place practices and behaviors including prevention of harassment in the work environment. This should be fully implemented in 2024.
- R7** The District should adopt a policy to ensure that proposed personnel adverse actions are reviewed by someone not in the chain of command to ensure that proper procedures are followed. In the case of proposed adverse actions by executive staff this could be accomplished through the use of an outside expert in personnel matters or legal counsel.
- R8** The District Board should require administration to report quarterly on staff development and staff identified concerns beginning October 1, 2023.
- R9** The District should reduce its security services funding to a level that is supported by fees paid by residents specific to fund security services.
- R10** Effectively immediately, County tax funds currently allocated to security services, should be redirected to the Capital Reserves.
- R11** The District Board should revise its current capitol reserve fund policy to identify specific funding goals for each capitol asset category with supporting fees sufficient to meet the long-term infrastructure needs of the District.
- R12** The District Board should revise its agreement with the RMCC and begin charging for the use of reclaimed water on the RMCC golf courses at rates typical in the Sacramento area by January 1, 2024.
- R13** The District Board and staff should avoid perceptions of conflicts of interest in their fiduciary responsibilities to protect the interests of the District and its rate payers.

Required Responses

Pursuant to Penal Code sections 933 and 933.05, the Grand Jury requests responses as follows:
From the following elected officials within 60 days:

Tim Maybee, President, Board of Directors
Rancho Murieta Community Services District
15160 Jackson Road
Rancho Murieta, CA 95683

Invited Responses

Board of Directors
Rancho Murieta Community Services District
15160 Jackson Road
Rancho Murieta, CA 95683

Mr. Neil McCormick, Chief Executive Officer
Office California Special Districts Association
1112 I Street, Suite 200
Sacramento, CA 95814

Ms. Sue Frost, Board Member of District 4
Sacramento County Board of Supervisors
700 H Street
Sacramento, CA 95814

Mail or deliver a hard copy response to:

The Honorable Michael Bowman
Presiding Judge
Sacramento County Superior Court
720 9th St.
Sacramento, CA 95814

Please email a copy of this response to:

Ms. Erendira Tapia-Bouthillier, Grand Jury Coordinator
Sacramento County Superior Court
Email: TapiaE@saccourt.ca.gov



2022 – 2023
Grand Jury of Sacramento County