Rodney Craig Goodman Jr., CPA
8788 Elk Grove Blvd., Suite 1-N • Elk Grove, CA 95624
Telephone: (916) 714-6787 • Fax: (916) 714-6790

Date: July 28, 2014

To: Michael J. Miller, Auditor-Controller and
David E. Chardavoyne, General Manager of Monterey County Water Resources Agency
Cathy Paladini, Finance Manager II of Monterey County Water Resources Agency

From: Rodney Craig Goodman Jr., CPA

RE: Final Report for Monterey County Water Resources Agency (WRA) Fiscal Year 2013-2014 contract

---

The following is the final report of work performed for WRA on the fiscal year 2013-2014 contract.

This report would not have been possible without the efforts of staff members from both the Auditor-Controller's Office and the WRA. Special thanks to Cathy Paladini, Finance Manager of WRA for her efforts in this project. It has been a pleasure working with everyone in WRA.

I was not engaged to audit or review this financial information nor provide an opinion on it. Thus, I have not audited or reviewed this financial information nor have I provided an opinion on it.

Instead, it was requested that I perform the following services in accordance with the signed consulting contract:

- Review accounting design, controls and systems used to gather and report financial information
- Review fund structure of the WRA and recommend modifications
- Review accounting operations and transactions of the WRA and recommend modifications

Unfortunately, I was not able to look at specific accounting transactions of the WRA, nor was I able to review how the WRA gathers their accounting information for financial reporting purposes. However, I was able to review the fund structure of the WRA and how the revenues are reported in the budget and accounting systems and recommend modifications. I was also able to read the Hayashi and Wayland report and agreements between the WRA and Water Pollution Control Agency (WPCA) and provide recommendations below on potential improvements.

DISCUSSION

Three Principles of Accounting and Financial Reporting for State and Local Governments – (National Council on Governmental Accounting – Statement 1)

The first principal of accounting and financial reporting for state and local governments states that:

> "A governmental accounting system must make it possible both: (1) to present fairly and with full disclosure the funds and activities of the governmental unit in conformity with generally accepted accounting

> principles (GAAP), and (2) to determine and demonstrate compliance with finance-related legal and contractual provisions."

The second principal of accounting and financial reporting for state and local governments states that:

> "Governmental accounting systems should be organized and operated on a fund basis."
>
> "A fund is a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations"

The third principal of accounting and financial reporting for state and local governments states that:

> "Governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established, however, since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration."

Based on these three principles, my goal for analyzing the fund structure of the WRA is to determine: (1) if the proper number of funds are being used, (2) if the proper classification and types of funds are being used, (3) if the WRA can present fairly and with full disclosure the funds and activities of the WRA in conformity with GAAP, and (4) if the WRA can demonstrate compliance with finance-related legal and contractual provisions.

Another important consideration in fund structure is budgeting. Budgeting is not regulated by the principles mentioned above but is regulated by various California statutes. Nevertheless, financial reporting also requires a budget to actual comparison of funds and therefore, any recommended fund structure changes will consider the impacts on budgeting, accounting and financial reporting.

It is important to note here that accounting and budgeting requires much more detail than financial reporting. With the requirement for more details comes the need for more funds, departments, accounts, etc. Thus, I will focus on the accounting and budgeting needs of the WRA when analyzing its fund structure. For example, if you look at Monterey County's Comprehensive Annual Financial Report (CAFR) you will see that the details of the 20+ funds of WRA are rolled up into two columns on two pages of the CAFR. However, budgeting and accounting happens at the 20+ individual funds and department levels.

Fund Types and Classifications (Governmental Accounting, Auditing, and Financial Reporting – authored by Stephen J. Gauthier, published by Governmental Finance Officers' Association)

Proprietary funds are used to account for activities that receive significant support from fees and charges. There are two types of proprietary funds: (1) enterprise funds and (2) internal service funds.

Enterprise funds are used to report any activity for which a fee is charged to external users for goods or services. An enterprise fund must be used if it meets any of the following criteria: (1) there is outstanding debt that is backed solely by fees and charges, (2) Laws or regulations require that fees and charges be set to recover costs, including capital costs (depreciation or debt service), or (3) there is a pricing policy that fees and charges be set to recover costs, including capital costs (depreciation or debt service).

Governmental funds are used to account for activities primarily supported by taxes, grants, and similar revenue sources. There are five types of governmental funds: (1) general fund, (2) special revenue fund, (3) capital projects fund, (4) debt service fund and (5) permanent fund.

The general fund is the main operating fund used to account for and report all financial resources not accounted for and reported in another fund. For reporting purposes, a government can report only one general fund.

A special revenue fund is used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.

A capital projects fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.

A debt service fund is used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest.

Recommended Fund Modifications

Attached to this report is a spreadsheet entitled, "Fund and Revenue Information 2013", which identifies the proper fund classification and fund type for each WRA fund based upon an analysis of the revenues against the above definitions. The following is a summary of the attached spreadsheet:

- The yellow highlighted funds (funds 113, 117, 118, 120, 123, 125, 126, 128, and 129) could all be combined into one general fund of the WRA.

  I understand that historically each of these zones (zones 3, 5, 7, 11, 14, 15, S2, and GS) has made a claim to the ad valorem taxes attributed to each respective zone. However, the reason these zones appear to have a share of ad valorem taxes is because at the time proposition 13 was implemented these zones were considered the WRA. Thus, each of these zones was included in the applicable tax rate areas established between 1977 and 1979. I am unaware of any legal restrictions on the use of these ad valorem taxes either in California statutes or any WRA contractual agreement. Instead, the ad valorem taxes collected from these zones should be considered the discretionary revenues of the WRA. Discretionary revenues are non-earmarked moneys that may be spent as the WRA Board of Supervisors authorizes. With that said, any projects approved in these zones would require the use of these discretionary dollars because these zones do not have any other source of moneys, such as voter approved direct assessments or benefit assessments.

- The green highlighted funds (funds 111, 112, 116, 119, 121, 122, 124, 127, 131, 132, and 303) should each remain in a separate special revenue fund due to either a direct assessment or benefit assessment that the voters passed to fund some function within each of these zones (zones 1, 1A, 2B, 2C, 2Y, 2Z, 8, 9, 12, and 17).

  Direct assessments or benefit assessments are voter approved tax assessments, above the one percent ad valorem taxes, which are earmarked for a specific purpose and cannot be used for an alternate purpose. These moneys can only be used for the specific purpose approved by the voters or they violate the legal provisions of the voter approved tax assessment. Therefore, WRA must keep these moneys in their own separate fund and only use them as directed by the voters. In all cases, the assessments and benefit assessments that have been approved in WRA are zone specific.

- The blue highlighted funds (funds 114, 115, 130, and 134) should be classified as either enterprise funds or included in the general fund.

  The Salinas River Diversion Facility (fund 134) and the Hydroelectric Operations (fund 130) both initially appear to be enterprise funds because over 50% of their revenues come from customers outside the WRA for water delivery charges and hydroelectric revenue, respectively. However, if there is no outstanding debt that is backed solely by these fees and charges and/or, there is no law, regulation, or pricing policy requiring that these fees and charges be set to recover costs, then these funds may be classified as part of the WRA General Fund or an enterprise fund. It also appears that funds 114 and 115 are part of the hydroelectric operations. Thus, both funds should be combined into fund 130 if the hydroelectric operations are treated as an enterprise fund. Otherwise, both funds should be added to the WRA General Fund classification (yellow highlight above) because there are no earmarked funds to justify the creation of a special revenue fund.

- The orange highlighted funds (funds 133 and 313) should be classified as debt service funds.

  Fund 313 appears to be the primary debt service fund where current year transactions for the SVWP principal and interest debt payments are made. Fund 133 appears to exist solely for the purpose of holding next year's bond payment. The Bond documents must be read to determine if a separate fund is required for next year's bond payment. If not required, I suggest that fund 133 be closed and a restricted cash account and restricted fund balance account be established for next year's bond payment within fund 313.

- The purple highlighted funds (funds 422, 423, 425) should be classified as capital projects funds.

  Moneys for the construction of capital assets are transferred into capital projects funds from other sources such as debt proceeds. If there are remaining debt proceeds after construction of the capital assets is complete, then those moneys should be transferred to fund 313 for repayment of the debt.

Recommended Recording of Revenues

- Ad Valorem Taxes - All ad valorem property taxes should be deposited and recorded in the WRA General Fund.

Proposition 13 set forth a maximum 1% ad valorem property tax rate to be levied on all residential and commercial property in California. The County levies and collects all property taxes within the county borders. Property taxes are then distributed to each entity based on the AB 8 factors for that fiscal year. Ad valorem property taxes are discretionary moneys because there are no earmarked uses for this money. Thus, the WRA Board of Supervisors may appropriate these moneys to be spent within the WRA General Fund or authorize moneys to be transferred to other WRA funds for other purposes, such as specific projects, to pay debt service, or construct capital assets.

- Assessments and Benefit Assessments – should be recorded in the appropriate special revenue fund and spent within that same fund in accordance with the voter approved purpose(s).

- Developer Fees – should be deposited and recorded in the WRA General Fund unless specified by law or regulation to another fund.

  If the developer fees are earmarked for a specific purpose by federal, state, or local law, then those fees should be recorded in a special revenue fund. Otherwise, all developer fees should be deposited and recorded in the WRA General Fund.

- Hydroelectric Revenues and Water Delivery Charges – should be deposited and recorded in the WRA General Fund unless either must be recorded in an enterprise fund

  Enterprise funds are allowed to and should make a profit. These profits should be reinvested to maintain and improve existing capital assets and also saved for expansion projects.

- Grant Revenues – should be recorded in the fund which was awarded the grant

- Grazing Leases – should be recorded in the fund which granted the grazing lease

Any movement of the above mentioned revenue types after the initial recording must be completed by authorized transfers. This leaves a clear trail as to who was entitled to the money and where it was allocated for use. Currently, many of these revenues are being allocated to multiple funds without being transferred. This makes budgeting more difficult and it adds to the sense of entitlement to these dollars in other funds. If there is an agreement to backfill debt service charges to zones with ad valorem taxes, it would be less transactions and cleaner if the WRA General Fund just transferred the appropriate amount of ad valorem taxes to fund the debt service payment.

ADDITIONAL INFORMATION

Consider Re-writing the Agreements for Castroville Seawater Intrusion Project (CSIP), Salinas River Diversion Facility (SRDF), and Salinas Valley Reclamation Project (SVRP)

Due to the many amendments of these agreements, there are missing sections, contradictory information and in some cases WRA and WPCA are not following the agreements for various reasons. It is strongly recommended that the agreements be reviewed and re-written to clarify the responsibilities and duties of all parties and that both parties adhere to the agreement. The Hayashi and Wayland report addresses many concerns and problems with the current agreements/amendments. A sample of issues from that report is listed below:

- <u>Collection of revenues</u> - accounts receivable balances for CSIP and SRDF were approximately 40% of the billings in 2012.

- <u>Remittances of total user fees from WPCA to WRA</u> – The process cannot be confirmed as the remittance section of the Agreement is missing.

- <u>Creation of a collection policy</u> – WRA should establish a collection policy to determine the process for collecting outstanding invoices greater than 60 days. WRA should consider performing the billing and collection functions themselves to save money.

- <u>Reserves</u> – WRA should review each reserve fund held by WPCA and consider revising the Agreements to allow for the return of some of these funds to the WRA.

- <u>Indirect Costs</u> – At the time of the report, WPCA charged a flat 10% indirect cost (10% is maximum per Agreements) to all expenses, including capital asset costs. Per the Agreements, WPCA will not include in the pool of indirect costs to be paid in part by WRA any cost that should be identified as a direct cost of another activity.

- <u>Accounting System</u> – Per the Agreements, Section 7.01 requires that WPCA maintain an accounting system that is in conformity with generally accepted accounting principles (GAAP) and allows for the segregation of all revenues and direct costs related to the SVRP, the CSIP, and all other WPCA activities. The systems shall also provide the ability to track revenues and direct costs and adequately identify and allocate indirect costs of the CSIP, SRDF, and SVRP.

- <u>Expenditures</u> – The requesting and receiving of payments is not being followed as per the agreement by either WPCA or WRA.

All of these issues have an impact on WRA's cash flows and available fund balance for budget purposes, whether it is the lack of timely collection of revenues, reserve amounts exceeding the required amounts, lack of timely requests and remittances for expenses and excess cash held in operating accounts at WPCA.

<u>Indirect Cost Rate Calculation by WPCA</u>

After reading Hayashi and Wayland's report issued May 31, 2013, and the various WRA/WPCA agreements and amendments, I was asked to assist WRA in reviewing the indirect cost rate calculation submitted by WPCA. After analyzing, I have additional questions as to what constitutes a direct cost and an indirect cost per the agreements. The Hayashi and Wayland report points to sections 1.10 and 1.11 to identify other direct costs, which includes "chemicals, training costs, accounting, insurance, equipment rental, fuel, utilities, permit fees, parts, tools, document reproduction costs, and postal costs." However, some of these costs appear to be included in the WPCA's indirect cost rate calculation based on fiscal year 2012-2013 audited financial statements.

An extension of the contract timeline is needed if WRA needs further assistance in this matter. An extension is also needed if WRA is still interested in looking at specific accounting transactions and operations with a focus on gathering accounting information for financial reporting.

Monterey County Water Resources Agency
Fund Information
As of February 13, 2014

	Pajaro River Levee	Administration & General Reserve	Countywide General	Nacimiento Non-O&M	San Antonio Non-O&M	Zone 2C Dam O&M, Camp, and Admin	SVWP Bond	Lower Salinas River Channel	Merritt Lake	CSIP Transfer & Water Conservation Update	CSIP debt service fund	CSIP O&M	SVRP O&M	North Monterey County	Soledad Storm Drain	Reclamation Ditch
Adv Fund		112	111	113	114	115	116	116	117	118	119	303	131	132	120	121	122
AFIN Fund		202	201	203	205	206	207		210	215	217	424	256	257	218	219	222
AFIN BU		930	930	930	930	930	930, 934, 935		930	930	930	930	930	930	930	930	930
Zones		1	1A	CW	2	2A	2C	2C	3	5	2B (old 6)	2B (old 6)	2Y	2Z	7	8	9
Revenue Accounts																
Ad Valorem Taxes	X		X	X	X		X	X	X					X	X	X
Interest & Other Income	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X
Benefit Assessment	X	X				X	X								X	X
Assessment	X									X	X	X	X			
Bench Excavation Grant	X															
Reimburse regular project costs	X		X	X	X	X		X	X	X	X	X		X	X	X
Developer fees/permits			X	X	X											
Hydroelectric revenue			X	X	X											
Grant Revenue			X													
Grazing leases				X	X											
Royalties					X											
Transfers from					X - 114							X - 119	X - 119			
Fuel spill administrative charge						X										
Annexation fees						X										
Transfer to CSIP										X	X					
Water delivery charges												X				

	Monterey Peninsula (Carmel Valley)	San Lorenzo Creek	Arroyo Seco Area	Carnation Subdivision (Alisal - Spence Roads)	Moro Cojo Slough (Castroville/Mass Landing)	SRDF O&M	Storm Drain maintenance District #2 (Blanco drain)	Gonzales Slough Maintenance District	Hydroelectric Operating	SVWP revenue fund (next years bond payment)	SVWP debt service fund	NAC Spillway mod Construction	Diversion Facility Construction	MBRWP Construction
Adv Fund	123	124	125	126	127	134	128	129	130	133	313	422	423	425
AFIN Fund	231	232	234	235	237	not	251	252	260	204		278	279	
AFIN BU	930	930	930	930	930	used	930	930	930	930		931	931	
Zones	11	12	14	15	17	SRDF 134	S2	GS	Nacimiento Hydroelectric					
Revenue Accounts														
Ad Valorem Taxes	X	X	X	X			X	X						
Interest & Other Income	X	X	X	X	X		X	X	X					
Benefit Assessment		X			X									
Assessment														
Bench Excavation Grant														
Reimburse regular project costs	X	X			X	X	X	X	X					
Developer fees/permits														
Hydroelectric revenue									X					
Grant Revenue														
Grazing leases														
Royalties														
Transfers from						X					X			
Fuel spill administrative charge														
Annexation fees														
Transfer to CSIP														
Water delivery charges						X								

Zone 2 - Nacimiento Dam - flood protection, water conservation, and recreation opportunities (operations)
Zone 2A - San Antonio Dam - flood protection, water conservation and recreation activities (operations)
Zone 2B (old zone 6) - Castroville Irrigation Project - alternative water source due to sea water intrusion in ground wells
Zone 2C - Salinas Valley Ordinance - Operations and maintenance (Nacimiento and San Antonio Dams) - flood protection, water conservation, and recreation

RECOMMENDATIONS
1 - Fund structure

(yellow)	Consider consolidating into one administrative fund (GF - for WRA). All ad valorem taxes should be first deposited into this fund. If these revenues are committed to another fund use a transfer to move the funds
(green)	Maintain each special revenue fund to track assessments and benefit assessments to the applicable zones
(blue)	Consider using enterprise funds. Special revenue funds may also be an option. These functions rely on revenue generated by these funds or developer fees.
(orange)	Consider using debt service funds
(lavender)	Consider using capital projects funds

2 - Revenues

Revenues should be deposited to a revenue account in the fund that receives them. If revenues are committed to another fund, they should be transferred out/in to that fund in a separate transaction.
This provides a cleaner trail in who earned the revenues and where they are subsequently spent