

# San Joaquin County Civil Grand Jury



## San Joaquin County Self-Governing Special Districts *Who is Watching the Cookie Jar?* 2016-2017 Case No. 0416

**(AMENDED REPORT)**

### Summary

The Escalon Cemetery District was a victim of employee embezzlement in 2014. This prompted the interest of the San Joaquin County Grand Jury (Grand Jury). The Grand Jury was surprised to discover the number and variety of special districts within San Joaquin County.

One of the main functions of the Grand Jury is to serve as a sentinel within the county for which it serves. Members are charged to identify instances of dishonest, inefficient or illegal actions and to make recommendations to correct those shortcomings.

Of the two types of special districts in the county, the Grand Jury concentrated on the independent self-governing special districts who only answer to their elected or appointed Board of Directors and applicable state laws. The lack of financial oversight and policies/procedures were found to be prevalent. The focus of the investigation centered around who is watching and who is in control of the special district funds.

## **Glossary**

### **Footnotes**

Explanatory and supplemental notes that accompany financial statements.

### **CA Government Code**

A general set of statutes that outlines the responsibilities and provides legal parameters for governance bodies within the State of California. The Government Code is one of the 29 codes currently in effect.

## **Background**

This report focuses on independent self-governing special districts, which by definition are outside the purview of the San Joaquin County Board of Supervisors. These districts only answer to their elected or appointed Board of Directors and applicable state laws.

There are over 200 special districts in San Joaquin County, including 106 independent self-governing special districts. The remaining districts fall under the authority of the San Joaquin County Board of Supervisors with specific financial requirements and mandated guidelines.

Independent self-governing special districts are agencies within the county performing governmental or proprietary functions within limited boundaries. These districts can include a county service area, a maintenance district or area, an improvement district or zone, or any other area where a property tax rate is levied to pay for a service or improvement benefitting that region.

Funding for special districts in San Joaquin County is primarily acquired through property tax apportionment. These are public funds and should be guarded from potential fraud and abuse. Although financial protections are in place, misuses can and have taken place. Dishonesty cannot be totally prevented but can be anticipated and safeguarded against. Using best practices and good financial oversight can mitigate theft. The Grand Jury investigation focused on audits, fraud and best practices in financial oversight and management.

The Grand Jury expanded its research to include a sampling of self-governing special districts' policies/procedures to find other instances of misuse of funds.

The San Joaquin County independent self-governing special districts and their functions are listed below:

<b>Type of District</b>	<b>Number of Districts`</b>	<b>Function of District</b>
Reclamation	52	Levee maintenance
Fire	18	Fire suppression
Irrigation	7	Water provision
Water Agencies	8	Provide potable water
Drainage	3	Flood control
Cemetery	2	Cemetery maintenance
Community Services	2	General services
Sanitation	2	Sewer services
Levee	1	Flood control
Mosquito Abatement	1	Vector control
Stockton Port	1	Port administration
Resource Conservation	1	Conservation promotion
Storm Drainage	1	Flood control
Miscellaneous Districts	6	Variety of services

## Reason for Investigation

The Grand Jury initiated an investigation of the special districts of San Joaquin County prompted by news coverage of the Escalon Cemetery District embezzlement case. An Escalon Cemetery District employee was convicted of fraud and embezzlement.

This was not an isolated incident. The table covers the last three years of publicized fraud and embezzlement of public funds, not exclusive to special districts.

District Involved	Tax Payer Dollars Embezzled
Escalon Cemetery District	Over \$100,000
Panoche Water District, Fresno	Over \$100,000
Health Plan of San Joaquin	Over \$100,000
Kern County College District	\$16,400,000
Kern County School District	\$2,600,000
Mokelumne Fire District	\$11,500

## Method of Investigation

### Materials Reviewed:

- Voucher reports from the San Joaquin County Auditor-Controller;
- California Government Code sections 26881, 26909 and 29741; and
- The Record, April 17, 2015, "*Escalon Cemetery District Manager accused of embezzlement.*"

### Interviews Conducted:

- San Joaquin County Auditor-Controller Staff;
- LAFCo staff; and
- Three Certified Public Accountants.

### Site Visits:

- Escalon and Tracy Cemetery Board meetings

## **Discussions, Findings and Recommendations**

### **1.0 Audits**

The San Joaquin County Auditor-Controller is the repository for accounts of the various independent self-governing special districts in the county and is charged with disbursement of these funds. Districts with more than \$150,000 on account are required to undergo external, annual audits. Districts with less than \$150,000 on account can submit external audits in one, two or five year intervals, reporting on all years within that time frame. Independent certified public accounting firms are contracted by the individual district to conduct these audits.

As a result of the county's budget crisis, severe staff cuts were made in many county departments. Ten years ago, the Auditor-Controller had six auditors on payroll, currently there are only two. Due to staff size, time constraints and workload, only minimal internal auditing of the independent self-governing special districts is being completed and lacks detailed analysis.

By their nature, internal and external audits are not designed to expose fraud. Management letters, footnotes and other accounting tools can be used to perform a quick analysis for improprieties. The Record reported:

*“...the second time in recent history that the district attorney has prosecuted a case with the assistance of the auditor.”*

April 17, 2015 –“Escalon Cemetery District Manager accused of embezzlement.”

California Government Code section 26909 (see Appendix II) places the responsibility on the Auditor-Controller to see that independent financial audits are completed for each independent self-governing special district. Other California Government Codes exist to minimize the opportunity for theft. As demonstrated in the Escalon Cemetery independent self-governing special district example, the Auditor-Controller can be judicious in performing this function given adequate staffing.

### **Finding**

**F.1.0** The San Joaquin County Auditor-Controller performs minimal review of audits which can result in fraud being overlooked due to inadequate staffing.

### **Recommendation**

**R.1.0** The Auditor-Controller increase the number of auditors on staff within the financial audit department and budget accordingly for the subsequent fiscal year.

## **2.0 Fiduciary Responsibilities and Oversight**

Independent self-governing special districts answer only to their board of directors and must follow applicable state laws. Each district develops self-generated by-laws to guide their boards regarding the operation and oversight of their district. Guides to develop these by-laws were not found.

California Government Code section 26881(see Appendix III) states in part:

*“The county auditor shall be the chief accounting officer of the county and shall exercise a general supervision of all districts whose funds are kept in the county treasury.”*

Guidelines from the Auditor-Controller containing a list of best practices need to be developed and shared with each district. This would provide a road map for board members to understand financial documentation.

The board of directors is mandated to review financial reports and audits. No requirements for financial expertise are included in by-laws or mandated for service as a board member. Board members believed they possessed adequate knowledge to review and understand financial documents. It is presumed that board members and staff of independent self-governing special districts will follow moral and ethical standards. However, theft still occurs.

It is incumbent upon all taxpayers to attend special district meetings that are supported by tax dollars and affect their lives. Taxpayer participation at board meetings creates a culture of transparency.

### **Finding**

**F2.1** Due to the lack of tools and guidelines, there are board members who do not understand their district’s financial reports.

### **Recommendation**

**R2.1** By Dec. 31, 2017, the Auditor-Controller develop, adopt and implement a list of best practices regarding financial reports to guide board members of independent self-governing special districts.

## **3.0 Embezzlers can be creative**

Written policies/procedures are required and must be followed in order to fight fraudulent activity, both in the private and public sector. Board members of independent self-governing

special districts need to ensure that by-laws include requirements concerning receipt and disbursement of funds with adequate supporting documentation.

Special districts in the Central Valley have had several instances of embezzlement:

- Falsifying employee time sheets causing over payment;
- Creating non-existent employees;
- Authorizing payment to vendors for services or products never performed or received;
- Abusing credit cards; and
- Funneling money to friends and family for services not performed.

Circumventing written policies and procedures can lead to embezzlement. Lack of oversight by the independent self-governing special district board of directors and/or staff can have the same result. Enforcement of policy can only be accomplished by boards of directors monitoring the work of bookkeepers and general managers. When staff is not actively monitored, neglect can lead to resentment and feelings of entitlement. “I am doing all the work and deserve a bonus,” can be a personal justification to embolden someone to commit fraud.

## **Findings**

**F 3.1** The San Joaquin County independent self-governing special districts can be subject to fraud due to lack of oversight and the lack of documentation required for accounts payable.

**F 3.2** There are minimal guidelines regarding financial processes for independent self-governing special districts which may lead to fraud.

## **Recommendations**

**R 3.1** By Dec. 31, 2017, the Auditor-Controller develop and distribute to all independent self-governing boards a list of best practices including, but not limited to: profit and loss statements, balance sheets, signatory requirements and general ledger items.

**R3.2** The Board of Supervisors direct independent, self-governing special districts to review and revise fact sheets to include financial acumen of board candidates and provide financial training for all board members.

## **Conclusion**

Property tax apportionment is the primary source of funding for independent self-governing special districts. This money comes from the taxpayers within the special districts' regions; therefore, residents have some authority over these funds. Merely entrusting the appointed or elected board directors with a blind leap of faith is not good business practice. The public is allowed and should be encouraged to attend special district board meetings. When the public does not attend meetings, the board operates with impunity.

Independent self-governing special districts' functions are to protect and monitor areas that directly affect public health and safety. It is imperative that these tax dollars allocated are monitored closely and used wisely. Careful financial oversight, along with knowledgeable, trustworthy directors and staff will protect the limited funding in these independent self-governing special districts' cookie jars.

## **Disclaimer**

Grand Jury reports are based on documentary evidence and the testimony of sworn or admonished witnesses, not on conjecture or opinion. The Grand Jury is precluded by law from disclosing such evidence except upon the specific approval of the Presiding Judge of the Superior Court, or another judge appointed by the Presiding Judge (Penal Code section 911.924.1 (a) and 929). Similarly, the Grand Jury is precluded by law from disclosing the identity of witnesses except upon an order of the court for narrowly defined purposes (Penal Code sections 924.2 and 929).

## **Response Requirements**

California Penal Code sections 933 and 933.05 require that specific responses to all findings and recommendations contained in this report be submitted to the Presiding Judge of the San Joaquin County Superior Court within 90 days of receipt of the report.

The San Joaquin County Auditor Controller shall respond to all findings and recommendations in this report within 60 days of receipt of this report and the San Joaquin County Board of Supervisors shall respond to all findings and recommendations within 90 days of receipt of this report, where applicable.

Mail or hand deliver a hard copy of the response to:

Honorable José L. Alva, Presiding Judge  
Superior Court of California, County of San Joaquin  
180 E. Weber Avenue, Suite 1306  
Stockton, CA 95202

Also, please email the response to:

Ms. Trisa Martinez, Staff Secretary to the Grand Jury at [grandjury@sjcourts.org](mailto:grandjury@sjcourts.org)

## **Appendices**

### **Appendix I**

#### **California Government Code section 26881:**

The county auditor, or in counties that have the office of controller, the auditor-controller shall be the chief accounting officer of the county. Upon order of the board of supervisors, the auditor or auditor-controller shall prescribe, and shall exercise a general supervision, including the ability to review departmental and countrywide internal controls, over the accounting forms and the method of keeping the accounts of all offices, departments and institutions under the control of the board of supervisors and of all districts whose funds are kept in the county treasury.

### **Appendix II**

#### **California Government Code section 26909:**

(a)(1) The county auditor shall either make or contract with a certified public accountant or public accountant to make an annual audit of the accounts and records of every special district within the county for which an audit by a certified public accountant or public accountant is not otherwise provided. In each case, the minimum requirements of the audit shall be prescribed by the Controller and shall conform to generally accepted auditing standards.

(2) Where an audit of a special district's accounts and records is made by a certified public accountant or public accountant, the minimum requirements of the audit shall be prescribed by the Controller and shall conform to generally accepted auditing standards, and a report thereof shall be filed with the Controller and with the county auditor of the county in which the special district is located. The report shall be filed within 12 months of the end of the fiscal year or years under examination.

(3) Any costs incurred by the county auditor, including contracts with, or employment of, certified public accountants or public accountants, in making an audit of every special district pursuant to this section shall be borne by the special district and shall be a charge against any unencumbered funds of the district available for the purpose.

(4) For a special district that is located in two or more counties, the provisions of this subdivision shall apply to the auditor of the county in which the treasury is located.

(5) The county controller, or ex officio county controller, shall effect this section in those counties having a county controller, or ex officio county controller.

(b) A special district may, by unanimous request of the governing board of the special district, with unanimous approval of the board of supervisors, replace the annual audit required by this section with one of the following, performed in accordance with professional standards, as determined by the county auditor:

(1) A biennial audit covering a two-year period.

(2) An audit covering a five-year period, if the special district's annual revenues do not exceed an amount specified by the board of supervisors.

(3) An audit conducted at specific intervals, as recommended by the county auditor, that shall be completed at least once every five years.

(c)(1) A special district may, by unanimous request of the governing board of the special district, with unanimous approval of the board of supervisors, replace the annual audit required by this section with a financial review, in accordance with the appropriate professional standards, as determined by the county auditor, if the following conditions are met:

(A) All of the special district's revenues and expenditures are transacted through the county's financial system.

(B) The special district's annual revenues do not exceed one hundred fifty thousand dollars (\$150,000).

(2) If the board of supervisors is the governing board of the special district, it may, upon unanimous approval, replace the annual audit of the special district required by this section with a financial review in accordance with the appropriate professional standards, as determined by the county auditor, if the special district satisfies the requirements of subparagraphs (A) and (B) of paragraph (1).

(d) Notwithstanding the provisions of this section, a special district shall be exempt from the requirement of an annual audit if the financial statements are audited by the Controller to satisfy federal audit requirements.

### **Appendix III**

#### **California Government Code section 29741:**

The auditor shall audit and allow or reject claims in lieu of, and with the same effect as, allowance or rejection by the board of supervisors in any of the following cases:

(a) Expenditures which have been authorized by purchase orders issued by the purchasing agent or other officer authorized by the board.

(b) Expenditures which have been authorized by contract, ordinance, resolution, or order of the board.

(c) Expenditures under any statute authorizing payment of public aid or assistance which have been ordered by the board.

(d) Expenditures for charges incurred by the county pursuant to the provisions of Chapter 3 (commencing with Section 29600) of this division.

(e) Refunds of unearned business license fees, permit fees and similar fees authorized by resolution of the board of supervisors.