

## FINAL REPORTS 2002 Report:

### East Palo Alto Sanitary District

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#### **Summary:**

The EPASD provides sewer services to approximately 6700 residences and numerous small businesses. The district does not operate its own sewage treatment plant.

The Grand Jury finds that the EPASD needs to take immediate action to increase rates and reduce costs. Due to the district's small size it should act on the Local Area Formation Commission's (LAFCo) prior recommendations to merge the district with another entity.

In 2000, LAFCo was given significantly more power to effect its recommendations. LAFCo should pursue all of the remedies provided under the law relative to its recommendations regarding the EPASD.

**Issue:** Is the East Palo Alto Sanitary District effectively managing services in a financially sound manner that best serves the needs of its district users?

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#### **Background:**

The East Palo Alto Sanitary District (EPASD) was formed in 1939 to provide sewer services to a two square mile area, primarily east of Highway 101. Services are provided to approximately 6,700 East Palo Alto and eastern Menlo Park residences and numerous small businesses. In recent years, non-recurring sewer connection fees from new commercial development in the area east of Highway 101 have produced substantial income to EPASD.

EPASD maintains approximately 32 miles of sewer mains, and owns approximately 12 % of the capacity of the Palo Alto Sewer Treatment Plant. EPASD pays the City of Palo Alto (owner of the Palo Alto Sewer Treatment Plant) a share of plant operating costs based on the volume of sewage flow. In addition to its own improvements financed by the district, EPASD also has obligations to pay a portion of the Palo Alto Sewer Treatment Plant bonded indebtedness and to maintain specific cash flow ratios.

The Grand Jury investigated EPASD in 1986 and 1987. The reports made recommendations to improve internal accounting controls and to explore a merger of the district into the City of East Palo Alto. The focus of the current investigation is the efficiency and financial effectiveness of this district.

The Local Agency Formation Commission (LAFCo) is a state-mandated agency with countywide jurisdiction over changes in organization and boundaries of cities

and special districts. One function of the commission is "To perform and assist in studies of local government agencies with the goal of improving efficiency and reducing costs of providing urban services." In the past, LAFCo has studied the feasibility of consolidating EPASD with other entities. Under the provisions of the Cortese-Knox-Hertzberg Act of 2000, LAFCo has significantly more power to effect its recommendations than it had in prior years. LAFCo may, as provided in the Act, conduct hearings regarding its findings and, under appropriate circumstances, conduct an election to effect its recommendations.

The Grand Jury reviewed financial statements, accounting records, Board of Directors' meeting minutes, and various contracts and other obligations of EPASD. The Grand Jury interviewed directors, past and present employees, accountants and auditors for the district. It also reviewed information from LAFCo reports and resolutions, media coverage related to EPASD, and an efficiency study performed by Harvey Rose Accountancy for EPASD.

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#### **Findings:**

Sewer service fees are billed and collected with the property taxes billed by San Mateo County.

EPASD is governed by a five member elected board that meets at least two times per month to establish policy. EPASD has six full time nonprofessional employees. It fully relies on outside experts for engineering, legal, personnel policy, bookkeeping, and accounting services.

EPASD is too small to economically hire expertise in the areas of engineering, legal, personnel and bookkeeping and accounting.

Revenues from user fees are significantly lower than current operating costs.

Based upon statements of directors and accountants for the district and accounting reviews provided, the Grand Jury determined financial reserves are not sufficient to maintain solvency at its current sewer rates.

EPASD has not maintained the cash flow ratios required under the City of Palo Alto operating agreement or the district's financing agreement.

The legally required audit report for the fiscal year 2000-2001 was not completed in the required time frame because EPASD did not provide timely information necessary to the auditors. The deadline for providing the fiscal year 2001-2002 audit report has not been met.

EPASD has been involved in protracted and expensive litigation regarding contractual and personnel matters with litigation continuing at this time.

The Harvey Rose Study, issued in August 2000, reflected that the non-treatment costs of EPASD were \$30,145 per mile of sewer mains versus \$9,229 per mile in other nearby districts. The study made several recommendations to reduce costs that were never acted upon by the Board of Directors.

LAFCo has previously studied the viability of EPASD and at least since 1983 has assigned the district a sphere of influence of zero. A zero sphere of influence indicates that the district should be reorganized or combined with another entity. LAFCo recommended a merger of the district with the West Bay Sanitary District.

LAFCo will again conduct a service review and sphere of influence of EPASD during the 2002-2003 fiscal year.

EPASD has removed its website from the Internet.

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**Conclusions:**

EPASD needs to commence the process to increase rates in order to comply with its debt and operating agreement contractual obligations.

**Recommendations:**

1. EPASD immediately commence the process to increase rates to a level sufficient to comply with its contractual obligations and to continue its essential public services.
2. EPASD investigate the costs and benefits of implementing the Harvey Rose Study recommendations that can be accomplished quickly and that do not require long-term commitments.
3. The EPASD Board of Directors act on LAFCo's prior recommendations to merge the district with another entity as soon as an acceptable merger can be negotiated.
4. EPASD restore its website to better inform the public of its activities.
5. LAFCo apply the powers granted it under the Cortese-Knox-Hertzberg Act of 2000 to pursue implementation of recommendations from the 2002-2003 Service Review and Sphere of Influence studies, including an election for EPASD consolidation, as appropriate.

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**Response**

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