

THE SOUTH SAN LUIS OBISPO COUNTY SANITATION DISTRICT

INTRODUCTION

The Grand Jury initiated this investigation as the result of several citizen complaints and numerous published articles and editorials in local newspapers alleging mismanagement and other problems at the South San Luis Obispo County Sanitation District (District).

During its investigation, the Grand Jury learned that the State Water Resources Board (Water Board) was also investigating some of the allegations. The Grand Jury subsequently learned that the Water Board had issued various reprimands to the District and was actively engaged in monitoring District remedial actions. Other allegations concerning the District were the subject of ongoing legal proceedings. The Grand Jury decided not to pursue further the allegations that were already being investigated or litigated in other forums.

However, the Grand Jury's initial review of the multiple allegations concerning the District revealed other concerns that warranted further investigation. Three major issues emerged:

1. The District Administrator has a conflict of interest in his dual, simultaneous roles as administrator of the District's facilities and operations, **and** as the majority owner of a company, Wallace Group, that supplies a major share of contracted services to the District without benefit of competitive bidding for such services.

2. The District's Board of Directors (Board) has failed to recognize the existence of this conflict of interest, which has resulted in a further failure of the Board to take action necessary either to eliminate or properly mitigate the conflict.
3. The contract under which the District Administrator and his majority-owned company perform services for the District is 25 years old. During this period, the contract has never been evaluated, re-bid or modified in any way, except for approved increases in the hourly billing rates that can be charged by the District Administrator and his employees for services provided to the District.

The Grand Jury also learned that the Board had hired an investigator to review some of the allegations of misconduct. The investigator's report indicated he had found the allegations to be false. The Board viewed this as evidence that District operations were quite satisfactory. The Grand Jury's review of this same investigation determined it had been ineptly performed and the investigator's conclusions were not substantiated.

The Grand Jury concludes that the Board and the District are exposed to a number of financial, legal and public trust issues. These issues are a result of the District Administrator's conflict of interest, the Board's failure to recognize and eliminate or mitigate the conflict, and the Board's failure to evaluate, re-bid or modify its contract with the District Administrator for more than 25 years.

The Grand Jury recommends that the Board consider hiring independent management and that it evaluate and compare and evaluate organizational and operational alternatives for the District. In addition, as long as the District Administrator's conflict of interest continues to exist, the Grand Jury recommends that the Board demand sufficient budget and cost detail to allow it to mitigate this conflict. The Grand Jury further recommends that an independent audit of the District's accounts and records be performed by the County of San Luis Obispo's Audit Division.

This report describes the Grand Jury investigation, its conclusions and findings, and includes recommendations for actions the Board should take or consider.

Addendum to Introduction:

This report is the result of a long and detailed Grand Jury investigation and analysis of the South San Luis Obispo County Sanitation District. The investigation and report were completed in April, 2011. While the report was being edited and reviewed for final publication, the Grand Jury received several unsolicited letters from District representatives describing various changes that have been or will be made in District policies, procedures and/or operations. The letters indicate that changes are being made as a result of District “self- examination” after considering the issues raised and questions asked by the Grand Jury during its investigation.

The Grand Jury acknowledges the receipt of these letters but will not otherwise describe or respond to them in this report. The letters appear to be an attempt by the District to influence or modify the Grand Jury report before it is published. Such an attempt reflects a misunderstanding of the Grand Jury process. State law requires or permits the Grand Jury to investigate the operations of governmental agencies. It is then authorized to issue reports that include the findings of its investigations and such recommendations concerning the operations of the governmental agency as the Grand Jury deems proper and fit. If and when the Grand Jury publishes its report, State law then mandates the manner and form in which the governmental agency is required to respond to any findings and recommendations of the Grand Jury.

This report sets forth the findings and recommendations of the Grand Jury concerning the operations of the District as they were being conducted during the time of the Grand Jury investigation. The required responses of the District to these findings and recommendations are the proper place for the District to describe what, if any changes it has made or will make to its policies, procedures or operations in response to the Grand Jury findings and recommendations. The public will have to decide the validity of these Grand Jury findings and recommendations and the adequacy of the District’s required responses.

TABLE OF CONTENTS

INTRODUCTION	1
TABLE OF CONTENTS	4
PROCEDURE	6
BACKGROUND	6
Formation of the District	6
District Board of Directors: Structure and Composition	6
NARRATIVE	8
Current Operation and Structure of the District	9
Role of the Board	9
Delegation of Management to the District Administrator.....	9
District Administrator Contract Terms and Scope	9
Additional Roles Assigned to the District Administrators	11
Functions Performed by Wallace Group Employees	11
Functions Performed by District Operations Employees	12
Use of Competitive Bidding	12
Issues Identified in Current Operations	12
Board Dependence on the District Administrative for Information	12
District Administrator Conflict of Interest	13
Inadequacy of the Budget/Payment Process to Ensure the	
Conflict of Interest is Mitigated	14
The O & M Part of the Budget	16
The Capital Projects Part of the Budget	16
What Happens When the Board Asks for More Budget Detail?	19
The Budget/Payment Process Inadequacies in Summary	20
Consequences of the Failure of the Board to Recognize	

the Conflict of Interest	20
Inadequacy of the Investigation to Determine the Reasonableness of Wallace Group Charges	21
Responsibility to Audit the District's Accounts and Records	23
CONCLUSIONS	24
FINDINGS	25
RECOMMENDATIONS	27
REQUIRED RESPONSES	28
ATTACHMENTS	29

PROCEDURE

The Grand Jury obtained information for this report from the following sources:

- Interviews with the three members of the District Board of Directors
- Interview with the District Administrator
- Tour of the District wastewater processing plant
- Attendance at District Board meetings
- Extensive documentation provided by the District Board and the District Administrator.
- The redacted Thomas Consulting investigation report, together with documents referenced in the report that were provided separately to the Grand Jury by the District legal counsel
- The District's audited financial statements
- Documents obtained from the State Water Resources Board concerning District operations
- Documents obtained from the County of San Luis Obispo Office of the Auditor-Controller

BACKGROUND

Formation of the District

The San Luis Obispo County Board of Supervisors formed the District in 1963. The District provides wastewater treatment and disposal to approximately 39,000 residents of Arroyo Grande, Grover Beach and Oceano. The plant facilities consist of a wastewater processing plant located in Oceano, trunk lines that carry wastewater from the three communities to the processing plant, and a 4,400-foot pipe that discharges the processed wastewater into the ocean.

District Board of Directors: Structure and Composition

A Board of Directors oversees District operations. The current Board consists of three members, one from each city or community the District serves: Arroyo Grande, Grover Beach and Oceano.

Each Director is an elected official of his or her respective city or community. Directors are appointed under state law governing sanitation districts; they are not selected because they have any special knowledge or qualifications regarding operation of a county sanitation district or wastewater plant. Over the past 10 years, there have been 15 different directors on the Board, 5 of whom served only 1 year or less.

District Board duties are not the primary activity for any of the current Board members. In addition to their City Council or Community Services District activities, Board members have other public and private organization memberships, duties, and/or employment.

NARRATIVE

Current Operation and Structure of the District

The table below graphically summarizes the services performed to operate and manage the District. The remainder of this section of the report describes in more detail the various roles and services that are required to operate and manage the District. It further explains who executes the roles and provides the services, and describes how those services are provided to the District.

Summary Table of Services Performed to Operate and Manage the District ¹

SERVICE	PERFORMED BY
Set Policies	Board of Directors; Advised by District Administrator
Goals & Objectives	Board of Directors; Advised by District Administrator
Set Customer Rates	Board of Directors; Adv. by Distr. Admin. & Consultant
Develop Budget	District Administrator
Approve Budget & Amendments	Board of Directors; Advised by District Administrator
Approve Expenditures	Board of Directors; Advised by District Administrator
Engineering Services	District Administrator/ Wallace Group
Administration	District Administrator/ Wallace Group
Contract Administration	District Administrator/ Wallace Group
Maintain Budget & Expense Records	District Administrator/ Wallace Group
Chief Finance Officer	District Administrator
Treasurer	District Administrator
Operation of Wastewater Facility	District Employees/ District Administrator Supervises
Major Engineering Projects/ Studies	Normally Bid, Sometimes Assigned to Wallace Group
Capital Project Construction	Bid out; Some Small Projects to District Employees

¹ Sources for this chart include the following: SSLOCSD Fiscal Year Budget 2010-2011, Table of Organization, p.11 and Exhibit A, p. 97; SSLOCSD Sewer System Management Plan, adopted July 15, 2009; SSLOCSD Bylaws approved March 2, 2011

Role of the Board

The Bylaws of the District explain the responsibilities of the Board of Directors: “The primary responsibility of the Board of Directors is the formulation and evaluation of policy. Routine matters concerning the operational aspects of the District are to be delegated to professional staff members of the District.” In addition, the Board is responsible for approval of the budget and expenditures in conformity with the budget.

The Board meets twice a month. Until recently, the Board meeting duration was an hour or less. Board members are paid \$100 per meeting.

Board members are almost totally dependent on the District Administrator for the day-to-day management decisions, engineering, planning, budgeting, and administration of the District. As the Bylaws state, there are no expectations that the Board members have the time or expertise to become involved in daily management of District operations. The District Administrator provides management and is the conduit through which the Board receives most District information.

Delegation of Management to the District Administrator

District Administrator Contract Terms and Scope

The District contracts for the services of a District Administrator who is the Chief Executive Officer of the District. Twenty-five years ago, John L. Wallace signed a 3-page contract with the District to provide these services (Attachment 1). According to an interview, the only revisions to this contract during the last 25 years have been periodic increases in the hourly rates charged by Mr. Wallace and employees of The Wallace Group for services provided to the District. There is no available evidence indicating that the structure, cost or effectiveness of this contract has ever been reevaluated or reconsidered by the Board or a qualified independent consultant.

The contract is between the District and Mr. Wallace as an individual. The stated purpose of the contract is to engage the services of Mr. Wallace to act as the District Administrator. Mr. Wallace has also been appointed to serve the District in other capacities, including District

Engineer, District Finance Officer and Treasurer. There are no written agreements between him and the District for his services in any of these other capacities.²

The services provided by Mr. Wallace under the contract are very broad and include the following:

- General administration and management of the District
- General supervision and direction of District staff (District staff is not defined in the Agreement but presumably includes all employees of the District)
- General engineering advice to and on behalf of the District staff
- Design, document preparation, contract administration, and inspection for District projects including, but not limited to, water, sewer, drainage, and wastewater treatment projects

While the word “design” is also not defined in the contract, it appears to include engineering for the defined utility and public works projects. The breadth of the contract essentially gives Mr. Wallace the right to provide all administration, management and engineering services required by the District. The only services he does not provide are the services required actually to operate the District’s wastewater treatment plant. District employees who are managed and supervised by Mr. Wallace provide these services.

The contract authorizes Mr. Wallace to engage the services of his company’s employees as “**HE MAY DEEM PROPER**” [emphasis added]. Absent any other limitation, this provision gives Mr. Wallace unlimited discretion to assign the performance of any or all of the services under the contract to his own company employees. In addition, Mr. Wallace is authorized to charge the cost of these services at hourly rates specified in the contract and its subsequent amendments.

The only contract provision that limits or regulates the number of hours that may be charged is the statement, “Services rendered pursuant to this Agreement shall be at the direction and request of the District’s Board of Directors.” The contract has no term and remains in effect indefinitely

² SSLOCSD Bylaws approved March 2, 2011, p.6; Fiscal Year Budget 2010-2011, Exhibit A, p. 97

unless or until terminated by either party. Either party with thirty (30) days prior written notice to the other party can terminate the contract.

Additional Roles Assigned to the District Administrator

In addition to the engineering and administrative services described in the contract, the District Bylaws describe other responsibilities of the District Administrator:³

“The District Administrator shall be responsible for all of the following:

- The implementation of the policies established by the Board of Directors for the operation of the District
- The appointment, supervision, discipline, and dismissal of the District’s employees, consistent with the District’s Personnel Policies as established by the Board of Directors
- The supervision of the District’s facilities and services
- The supervision of the District’s finances”

As part of his administrative duties, the District Administrator provides the Board with an annual budget, subject to its approval, as well as the subsequent budget and expenditure reports that the Board reviews and approves.

Functions Performed by Wallace Group Employees

The District Administrator assigns many of the engineering and administration services for which he is responsible to Wallace Group employees. To illustrate the financial significance of these assignments, information provided to the Grand Jury by the District Administrator indicates that the Wallace Group charged the District \$836,000 for its services in Fiscal Year 2009-2010. The personnel expenses for the District’s nine employees in this same period totaled \$842,004.⁴ Therefore, approximately one-half of the District's total labor costs in FY 2009-2010 were either paid to Mr. Wallace or resulted from his assignment of services to Wallace Group employees.

³ SSLOCSB Bylaws approved March 2, 2011, p. 6

⁴ Fiscal Year Budget 2010-2011, actual personnel expenses for 2009-2010, p. 21

Functions Performed by District Operations Employees

Nine District employees handle the day-to-day wastewater plant operations and maintenance and may also undertake smaller projects that otherwise would have to be completed by an outside vendor or contractor.⁵ This employee group is under the general supervision of the District Administrator; it also includes a Plant Superintendent responsible for supervision of the other eight employees.

Use of Competitive Bidding

Construction work is competitively bid. If a job or project requires specialized expertise that the Wallace Group does not have, it is always put out to bid. Large-scale studies or projects, for example, are normally competitively bid.

There is no dollar limit policy for what is assigned to the Wallace Group and what is competitively bid. For example, the District Administrator assigned much of the engineering and administration work for a recent centrifuge project to the Wallace Group rather than putting it out for competitive bid. As of November 2010, Wallace Group costs for this uncompleted project were \$336,000 (Attachment 2).

Issues Identified in Current Operations

Board Dependence on the District Administrator for Information

The Board is dependent on the District Administrator for the information it reviews in order to fulfill its oversight role and make policy decisions. He gathers and provides the critical budget and cost information to the Board. The Board, however, has limited knowledge or ability to independently verify or evaluate information from this single source.

This situation is a matter of concern because independent information is particularly important when the primary source of information has a conflict of interest. The District Administrator manages, controls or assigns virtually every service performed for the District and is the primary

⁵ SSLOCSD Fiscal Year Budget 2010-2011, Table of Organization, p. 11

source of information for the Board about these activities. This dependency is increased by the fact that the Wallace Group performs so much of the District's work. The District Administrator, who is the majority owner of the Wallace Group, then evaluates this work. In addition, when outside consultants are used, the District Administrator guides the Board in determining who is hired.

Under the Brown Act, Board members can only discuss amongst themselves District activities at Board meetings. Therefore, by observing the interaction between the Board members and the District Administrator at these meetings, one can observe the extent to which the Board depends on the District Administrator for information.

District Administrator Conflict of Interest

A conflict of interest exists when an individual is in a position to exploit a professional capacity for his or her personal or corporate benefit. Someone with a conflict of interest may deny that a conflict exists because he or she did not act improperly. However, the conflict still exists because the **conflict of roles** still exists. Such a conflict should either be eliminated or mitigated. Mitigation requires that internal controls be in place to ensure that the conflict does not have a detrimental impact on the entity affected by the conflict.

The District Administrator has a conflict of interest between his personal financial interest, as the majority owner of the Wallace Group to whom he assigns much of the District's work, and his duty as the District Administrator to control and minimize the administrative and engineering costs of the District. However, neither the Board's current Chairman nor its legal counsel recognizes that a conflict of interest exists. In addition, they do not recognize that the District Administrator does not provide the Board with the detailed information required in order to control or mitigate the conflict of interest. As a result, the Board has neither the inclination nor the information needed to control or manage the conflict of interest.

The statements that follow underscore the publicly stated positions of the District Board Chairman and the District's legal counsel. The Board minutes of January 5, 2011 include the following:

“Chairman Nicholls stated that while he could appreciate that there were those who might believe there is an appearance of conflict of interest, he had not seen any conflict himself with the way the contract is currently written.”

In a letter dated July 22, 2010, responding to a public information request, the District's legal counsel stated:

“...the District Administrator has very limited ability to self-direct work to Wallace Group. Rather, any work that is going to be performed by Wallace Group as a part of any function at the District is approved by the Board of Directors and they are kept apprised of [sic] each meeting in regards to the costs associated with each project.”

The only safeguard in the contract that could mitigate the conflict of interest is the provision that services will only be provided by Mr. Wallace or his employees at the “direction and request” of the Board. However, the Board's budget and payment controls are effective mitigation of conflict of interest only if: 1) the Board fully understands what Wallace Group costs are in the budget; 2) the Board determines that these costs are reasonable for the work required; and 3) the Board determines that amounts paid to the Wallace Group conform to the budget. Such controls are ineffective or do not exist. The financial protection that was intended to be provided for the District by requiring the Board to “direct and request” Wallace Group services is illusory.

The facts show that the Board is not being provided with the information necessary to mitigate the Wallace conflict of interest and that the Board is not focused on managing a conflict of interest. The facts also demonstrate that the District Administrator has considerable ability to “self-direct work to Wallace Group,” despite the statement of District legal counsel to the contrary.

Inadequacy of the Budget/Payment Process to Ensure the Conflict of Interest is Mitigated

The Board's approval of the budget and the invoice payments made in accordance with the budget are the internal controls by which the Board could manage the Wallace Group costs and mitigate the conflict of interest. The Grand Jury has concluded that the intended internal controls are not effective because the Board has neither the interest nor the information necessary to carry out this responsibility.

The budget is composed of two parts: an operations and maintenance (O&M) expense budget and a capital projects (Major Budget Items) budget comprised of major facilities replacement and expansion projects. The cost control reporting problems in these budgets are as follows:

- O&M budget section: Cumulative monthly and annual cost reports do not specify Wallace Group costs in each account
- Capital project budget sections: Costs for multi-year capital projects are not presented in a way that allows the Board to see the cumulative Wallace Group costs for each project. Prior year Wallace Group costs simply drop from sight
- Periodic budget reviews and adjustment requests provide little if any information about Wallace Group cost overages within any account or capital project

In a normal situation, where the District Administrator does not assign District work to his own company, the budget detail provided to the Board is probably adequate, with the exception of the lack of prior cost information for multi-year projects. In this situation, however, it is crucial that the cost accounting fully documents the cumulative charges billed by the District Administrator and his company to each account by month, fiscal year and capital project or expense account. This is the information that matters for the Board to ensure that the Wallace conflict of interest is not financially detrimental to the District. To illustrate this, the following discussion will examine the budget presentation and payment of Wallace Group costs for the most recently completed FY 2009-2010.

The table below is based upon information provided to the Grand Jury by the District Administrator and indicates actual FY 2009-2010 Wallace Group charges:

Administration expense account	\$169,000 (original budget \$150,000)
Engineering expense account	109,000 (original budget \$90,000)
Other O&M accounts charged by Wallace Group	159,000
Capital Project costs	<u>399,000</u>
Total FY 2009-2010: Wallace Group	\$836,000

The O&M Part of the Budget

Even though the \$278,000 for Administrative and Engineering accounts exceeded the original budget, the budget made it clear these were Wallace Group costs.⁶ However, the \$159,000 charged to various other O&M accounts is a different matter. There is no detail in the approved budget that would identify these charges as Wallace Group costs. The explanation provided to the Grand Jury by the District Administrator for this was as follows: “Other line items are not specifically budgeted between Wallace Group and others but are executed by Wallace Group on an as needed or Board directed basis.” In other words, there are dollar amounts scattered throughout the budget that the District Administrator, at his discretion, assigns to the Wallace Group. The Board approves such payments because there is money in the budget. There is no budget or expense summary report that informs the Board how many of these budget dollars have subsequently been allocated to Wallace Group work.

The Capital Projects Part of the Budget

Wallace Group costs charged to capital projects for Fiscal Year 2009-2010 totaled \$399,000. There is nothing in the individual capital projects in the Annual Budget that identifies the Wallace Group cost component.⁷ The explanation provided to the Grand Jury by the District

⁶ Fiscal Year Budget 2010-2011, District Administration, Engineering expenses for 2009-2010, p. 22

⁷ Fiscal Year Budget 2009-2010

Administrator was as follows: “Budgets for Design and Contract Administration services to be provided by Wallace Group are determined when the Major Budget Item (MBI) is presented to the Board for authorization to initiate project award of consultant and construction contracts, etc.” The Grand Jury agrees it is a reasonable budget practice to have a placeholder amount in the capital budget until the project is actually initiated. At that time, the Board approves a detailed project budget. It then becomes crucial to manage Wallace Group costs to that detailed budget and it is here the District’s capital budget process fails to meet the Board’s needs.

The Grand Jury has a particular concern that the budget/payment process does not inform the Board of the total Wallace Group costs for multi-year projects. The documents the Grand Jury reviewed simply dropped Wallace Group cost detail for prior years. One of these projects is the District’s project to replace a centrifuge. This project is still ongoing. As of November 2010, the Wallace Group charges to this project were \$336,000. (Attachment 2)

In February, the Grand Jury asked the Board to explain how the District Administrator kept it apprised of Wallace charges to multi-year projects.

In March, the Board provided a response prepared by the District Administrator that included the explanation given in the following two paragraphs:

“In FY 2009-10, in an effort to provide a more comprehensive presentation of each MBIs, a total budget (all years) was introduced into the District Budget. Staff gathered expenditures from FY 06-07 through FY 08-09 to develop the past project costs. The past project costs added to the projected project costs is what makes up the total budget (all years). This format was carried forward and included in the FY 2010-2011 District Budget.”

“When an action item for an MBI is presented to the Board for consideration, a table is included under the funding section of the staff report that outlines expenditures to date, proposed expenditures, and resulting totals. Therefore, no additional special reports are

created to review multi-year cumulative project costs versus budget from inception to completion. The District Budget and MBI staff reports continue to present this information to the Board as the MBI's progress through project development."

In order to validate this response, the Grand Jury examined the March staff report the District Administrator had provided to the Board for the Centrifuge project. This report is included here as Attachment 3. A review of this document shows that it is impossible to tell the Wallace Group charges for this project total at least \$336,000. The total budget number is a single amount of \$1,904,081, shown on page 2, without details as to what portion represents Wallace Group costs. In other words, it showed the explanation the Board had provided the Grand Jury was incorrect.

The Grand Jury notes with a sense of irony that there is a section on page two of this same staff report that provides very detailed budget information on \$36,959 of outside contractor costs charged to this project. The Wallace Group prepared this budget detail, which exemplifies the type of detail needed but not provided to the Board for the Wallace Group's own charges.

It is noteworthy that in April the District Administrator revised the report format and now provides detailed cumulative costs similar to what the Board told the Grand Jury it had started doing a year ago (Attachment 4). This revised format reveals the Centrifuge project actual Contract Administration costs are \$70,557 and the Design and Survey costs are \$479,665, for a total of \$550,222. Are these two accounts composed totally of Wallace Group charges and/or do some of the other accounts listed also include Wallace Group charges? Even with this new format, it is impossible for the Board to determine.

Therefore, it is unclear if the Centrifuge project includes Wallace Group charges of \$336,000 or \$550,222, something in between or something more. Had the Board realized the extent of these charges and allowed this work not to be competitively bid, it would indicate a relationship between the Board and the District Administrator that is too comfortable, to the possible

detriment of ratepayers. At the least, the evidence examined by the Grand Jury shows the budget/payment process fails to provide the Board with the Wallace Group information it needs.

Capital budget issues of concern are not limited to multi-year projects. The Grand Jury saw no evidence that actual Wallace Group charges to a capital project are explicitly identified as long as the project total cost stays within the project budget. This lack of transparency allows the possibility of Wallace Group cost overruns in any project that is under budget. The information reviewed by the Board during the budget/payment process would not reveal any such overrun.

What Happens When the Board Asks for More Budget Detail?

The Grand Jury observed at a Board meeting what happened when a Board member asked for more detail about the budget process from the District Administrator. The following exchange is from the minutes of the December 15, 2010 Board meeting:

“Director Hill questioned the Wallace Group invoice with regards to the line item for Major Budget Items. Administrator Wallace replied that the charges incurred were for Major Budget Item expenses previously approved through the 2010/2011 budget process and through subsequent Board authorizations for projects. He added that detailed invoices for all warrants (authorizations to pay) are available for review at the meetings. Director Hill stated that his specific question was whether the engineering services performed by Wallace Group for individual projects were included in the budget amount as a line item or just assigned. Administrator Wallace replied that the work performed by Wallace Group is approved through directions from the Board and the overall contract the District has with Wallace Group. The majority of the work entails smaller projects with major engineering work contracted out to other engineering firms such as Kennedy/Jenks Consultants.”

The Grand Jury concluded that the District Administrator simply did not answer the question asked regarding where the Wallace Group charges were included in the budget. It is certainly an interesting non-response to a direct question from a Director who has an obligation to mitigate or even eliminate the District Administrator’s conflict of interest.

The Budget/Payment Process Inadequacies in Summary

Although Wallace Group receives individual payments on the basis that the money is “in the budget,” the Board has no clear idea what the Wallace Group budget is by line item, by capital project or in total. This deficiency of budget information and the lack of a subsequent budget tracking process allow the District Administrator wide flexibility to assign District work to his company without reasonable scrutiny. The District Administrator’s assertion of Board approval of Wallace Group charges is misleading. The Board approval process does not mitigate the conflict of interest because it is not based on an **informed** approval.

Consequences of the Failure of the Board to Recognize the Conflict of Interest

If the Board does not recognize the conflict of interest and it is not eliminated or mitigated, the District is exposed to a number of risks, as follows:

- A long-term contractual relationship that is never subject to competitive bid or other evaluation and enables a continuing conflict of interest that is not mitigated may result in a “too comfortable” situation that lacks the rigorous oversight and reasonable controls the District ratepayers deserve
- Over the 25-year period of the contract, the District organization may have been molded to conform to the services provided by the District Administrator and the Wallace Group
- If the information and analysis the Board requires to fulfill its stewardship obligations come primarily from or through a conflicted source, the Board is at risk for making inappropriate decisions
- The Board may lack the independent information necessary to evaluate the Wallace Group’s performance
- The District may not obtain the best quality and reasonable cost from contract service providers
- The Board may be subject to continuing public mistrust
- The Board may be subject to legal liability for not properly fulfilling its stewardship obligations
- The conflicted party has the potential to act improperly

Inadequacy of the Investigation to Determine the Reasonableness of Wallace Group Charges

A Word document found on a District computer contained allegations that the Wallace Group had done unnecessary work on two capital projects. The document was given to the Board, which responded by hiring a private investigator to investigate the charges. The resulting investigation report is included here as Attachment 5. There were redactions in the original report released to the public by the District. The Grand Jury has further redacted the names of individuals who were not a subject of this investigation.

The Grand Jury addresses this investigation in its report for two reasons. One is the Grand Jury's strong impression that the Board believes the investigation report is proof that the Wallace Group charges are reasonable and appropriate, and therefore no conflict of interest exists. The other is that a careful examination of the evidence reveals another example where the budget/payment process did not inform the Board of the aggregated Wallace Group charges for the project investigated, resulting in an uninformed Board approval of Wallace Group costs.

The capital project of interest to the Grand Jury was repainting the roof of the maintenance building. The painting job was competitively bid and the contract was completed in 2009 at a cost of approximately \$39,000. The private investigator found that the Wallace Group had charged the District \$16,921 related to the paint job for specifications and structural review, bidding tasks and contract management. His investigation report reached the following conclusion:

“This investigation found no reason to suspect that (Wallace) or his firm would take advantage of the District in billing unnecessary work.”

The report states that the sources of the facts uncovered in this investigation were interviews with the Plant Superintendent and the District Administrator, as well as the available related documentation. The Plant Superintendent is quoted by the investigator as saying he “...has never questioned the need for the work performed.” That left the District Administrator as the only interviewed source of evidence regarding the necessity of the work he assigned to his own company.

The investigator also failed to evaluate whether the Board was provided the information to determine if Wallace Group charges to this project were reasonable and appropriate. The final section of the report titled *General Comments* states:

“...the arrangement of John Wallace being both the District Administrator and his firm providing engineering and project management services to the District presents an easy target to critics (on District Staff and the community), and can provide the ‘appearance’ of a conflict of interest.”

The report then deals with the Board’s management of this potential conflict in a single sentence: “The investigation into this matter reveals that the project was completed within regulations and District policy with full Board approval.” The facts indicate something quite different.

The \$16,921 paid to the Wallace Group was made in a series of seven individual payments occurring over a two fiscal year period. The project was budgeted and the Board authorized payments as follows:

Budget		Actual Charges	
Fiscal Year 2007-08: Original budget	\$40,000	Wallace Group charges	\$10,007
		Total Charges: FY 2008-09	\$10,007
Fiscal Year 2008-09: Amended budget	\$47,672	Wallace Group charges	6,914
		Total painting contract	38,812
		Total Miscellaneous charges	1,894
Budget	\$47,672	Total Charges: FY 2008-09	\$47,620
		Total: All years	\$57,627

As can be seen from this table, the project total charges exceeded the amended budget by approximately \$10,000. However, the Board did not realize this because, when approving the \$47,672 as the amended budget in FY 2008-09, it was not given the information that \$10,007

had been paid the prior year to the Wallace Group. The budget and payment process never informed the Board at any point in time that total Wallace Group costs were \$16,921. The investigation states the Wallace Group payments were made with “full Board approval,” but fails to recognize or understand that the budget and payment process did not inform the Board what the total Wallace Group actual charges were.

A meaningful investigation is one performed by an independent expert who is technically qualified to look at the design and management work the Wallace Group performed and render an opinion whether the work and related billings are appropriate and reasonable. That is precisely what this investigation did not do.

Responsibility to Audit the District's Accounts and Records

Among the primary functions of the County of San Luis Obispo Office of Auditor-Controller (Audit Division) is the audit of accounts and records of County Special Districts. In recent years, the Audit Division has fulfilled this responsibility by obtaining a copy of the District's financial statements as certified by an external auditor and maintaining a copy of the statements in its files. The Audit Division is authorized to conduct an audit of the District, if it chooses to do so, in order to carry out this responsibility.

The same principal auditor has audited the District's financial statements since 1998. Federal law (Sarbanes-Oxley act of 2002) mandates that the principal auditor be rotated every five years. Although this mandate applies to publicly owned companies, local government agencies have also followed this standard. One of the reasons for this is so that a longer-term association does not compromise the auditor's independence.

CONCLUSIONS

Three issues emerged from the Grand Jury's investigation of District operations. The first issue is the District Administrator's conflict of interest and conflict of roles between his duties as District Administrator and his simultaneous role as majority owner of the Wallace Group.

The second issue is the Board's failure to acknowledge that this conflict of interest exists. As a result, it has not taken the steps necessary to eliminate, control or mitigate the conflict. The Board may have high regard for the personal integrity of the District Administrator, but that regard is not adequate to safeguard the interests of the District ratepayers.

The third issue is that the 25 year-old contract to manage the District may not provide the best organizational alternative for the District and there has been no independent evaluation of the situation.

After examining the facts related to these issues, the Grand Jury has reached the following conclusions:

1. The District Administrator, John Wallace, and his company, the Wallace Group, have a pervasive presence in all facets of the District's operation, from executing Board policy and exercising oversight responsibility for daily operations and to providing numerous financial services, including budget preparation and financial reporting. There are few District activities that the District Administrator or the Wallace Group does not manage, provide or control.
2. The Board should consider independent management for the District. An independent District Administrator could become familiar with District operations and finances, and then develop and recommend to the Board an organizational structure and plan to transition to the new organization.
3. As long as the District Administrator's conflict of interest exists, the Board must demand and receive a level of information that allows it to manage and mitigate the conflict.

Because this conflict of interest has not been a focus of the Board, the current budget and budget tracking process is not adequate to mitigate it. The budget and budget monitoring process provides inadequate information about Wallace Group charges. Appropriate controls should be designed, independent of the District Administrator. The District Administrator has had 25 years to put appropriate budget controls in place and has not done so.

4. The Board should evaluate and compare operational alternatives for the District. This would include a review of all services provided to operate the District below the level of the Board. The District and Wallace Group have been molded together for 25 years, with no independent evaluation of what has evolved. This review should be done independently of the involvement or influence of the District Administrator because of his conflict of interest.
5. The County's Audit Division would provide considerable benefit to the District and the public if it were to conduct an audit. The result would be an independent professional opinion regarding the adequacy of the District's internal controls to mitigate a conflict of interest.

FINDINGS

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 the hourly billing rates.
2. The District Administrator is 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.
4. The District Bylaws provide that the District Administrator also supervises the District's facilities and services, and supervises the District's finances.

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.
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.
7. The District Administrator has a conflict of interest because of his dual simultaneous roles with the District and the Wallace Group.
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 this Agreement shall be at the direction and request of the District's Board of Directors."
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.
10. The Board does not recognize that the dual roles of the District Administrator create a conflict of interest.
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.
12. The limited facts presented in the Investigation Report were not adequate to support the report's conclusion.

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 building roof capital project.
14. The County of San Luis Obispo's Audit Division has the right to audit the accounts and records of the District.
15. The same audit principal has audited the District's financial statements since 1998.

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

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

REQUIRED RESPONSES

The **South San Luis Obispo County Sanitation District Board of Directors** is required to respond to all Findings and Recommendations with the exceptions of Finding 14 and Recommendation 6. The responses shall be submitted to the Presiding Judge of the San Luis Obispo County Superior Court by **August 29, 2011**. Please provide a paper copy and an electronic version of all responses to the Grand Jury

The County of San Luis Obispo Office of Auditor-Controller is required to respond to Finding 14 and Recommendation 6. The responses shall be submitted to the Presiding Judge of the San Luis Obispo County Superior Court by **August 2, 2011**. Please provide a paper copy and an electronic version of all responses to the Grand Jury.

The mailing addresses for delivery are:

Presiding Judge	Grand Jury
Presiding Judge Charles S. Crandall Superior Court of California 1050 Monterey Street San Luis Obispo, CA 93408	San Luis Obispo County Grand Jury P.O. Box 4910 San Luis Obispo, CA 93402

The email address for the Grand Jury is: GrandJury@co.slo.ca.us

ATTACHMENT 1

AGREEMENT

THIS AGREEMENT made and entered into this 19 day of MARCH, 1986, by and between the South San Luis Obispo County Sanitation District, a political subdivision of the State of California, hereinafter referred to as "DISTRICT", and John L. Wallace of John L. Wallace and Associates, hereinafter referred to as "ENGINEER".

WITNESSETH:

WHEREAS, the DISTRICT desires to engage the service of a registered civil engineer to act for the DISTRICT as and in the capacity of the District Administrator as provided by the District's ordinances and regulations, and

WHEREAS, the ENGINEER is a registered civil engineer licensed to practice in the State of California and desires to render these professional services to the DISTRICT pursuant to the terms and conditions herein set forth.

NOW THEREFORE, in consideration of the promises and mutual covenants and agreements herein contained, the parties do mutually agree as follows:

SECTION 1. SCOPE OF SERVICES

Pursuant to this agreement, ENGINEER shall provide the following services as requested by the DISTRICT:

- a. General administration and management of on-going DISTRICT affairs;
- b. General supervision and direction to DISTRICT staff;
- c. General engineering advice to and on the behalf of DISTRICT staff;
- d. Representation of DISTRICT at meetings as necessary to properly execute the duties and/or provide the services listed herein;
- e. Review and checking of various maps, plans permits and other documents;
- f. Design, document preparation, contract administration and inspection for DISTRICT utility and public works projects including but not limited to water, sewer, drainage and wastewater treatment projects;

- g. Other services as requested by DISTRICT and mutually agreeable to both parties.

SECTION 2. USE OF ASSISTANTS/EMPLOYEES

To the extent reasonably necessary to enable ENGINEER to perform his duties hereunder, the ENGINEER shall be authorized to engage the services of his assistants or employees which he may deem proper. The cost of the services to the DISTRICT of such assistants or employees shall be chargeable to the DISTRICT in accordance with the schedule of fees shown herein or as mutually agreeable to DISTRICT and ENGINEER.

SECTION 3. DIRECTION OF DUTIES TO BE PERFORMED BY ENGINEER

Services rendered pursuant to this Agreement shall be at the direction and request of the District's Board of Directors.

SECTION 4. ENGINEER'S FEES

The DISTRICT hereby agrees to pay the ENGINEER, as compensation for his services, fees according to the following:

- a. Principal \$45.00/hr.
- b. Registered Civil Engineer \$37.50/hr.
- c. Associate Civil Engineer \$32.50/hr.
- d. Construction Inspector. \$30.00/hr.
- e. Draftsmen and other Engineering
Technicians \$25.00/hr.
- f. Two Man Survey Crew \$80.00/hr.
- g. Secretary/Bookkeeping/Word Processing . \$25.00/hr.
- h. Secretary \$15.00/hr.
- i. Actual costs of direct expenses incurred for work
and services requested by the DISTRICT, including
but not limited to:
 - additional insurance coverage if required by the
DISTRICT
 - automobile at \$0.25 per mile
 - lodging and meals
 - long distance telephone, telegraph
 - postage
 - cost for outside professional consultants required
for the work, if retained and paid for by ENGINEER
on DISTRICT's behalf, plus 15% administrative costs
 - materials required for the job and used in drafting
and allied activities, including printing and
reproduction costs.

SECTION 5. INDEMNITY

DISTRICT agrees to defend, indemnify and hold harmless ENGINEER from any and all claims, disputes, controversies or lawsuits arising from or relating to work or services performed by ENGINEER pursuant to the terms of this Agreement while he is serving in the capacity of the Consulting District Administrator except in the case of his willful negligence. Further, the DISTRICT shall include the ENGINEER under any Officers and Directors insurance policy it may obtain.

SECTION 6. ENTIRE AGREEMENT

This agreement supersedes any and all other agreements, either oral or in writing, between the parties hereto with respect to the subject matter hereof, and no other agreement, statement, or promise relating to the subject matter of this Agreement which is not contained herein shall be valid or binding.

SECTION 7. AMENDMENTS TO AGREEMENT

This agreement may be amended from time to time by the mutual written consent of the DISTRICT and the ENGINEER.

SECTION 8. ASSIGNMENT

Neither this agreement nor any duties or obligations hereunder shall be assignable by the ENGINEER without the prior written consent of the DISTRICT.

SECTION 9. TERMINATION

Either party may terminate this Agreement with thirty (30) days prior written notice provided to the other party.

SECTION 10. ATTORNEY'S FEES

If any action of law or in equity is brought to enforce or interpret the provisions of this Agreement, the prevailing party shall be entitled to reasonable attorney's fees in addition to any other relief to which he may be entitled.

SECTION 11. NOTICES

Any notice required to be given pursuant to the terms and provisions hereof shall be in writing and shall be sent by first class mail to the DISTRICT at:

SSLOCSD
P.O. Box 339
Oceanside, CA 93445

and to the ENGINEER at:

1329 Chorro Street
San Luis Obispo, CA 93401

IN WITNESS WHEREOF, DISTRICT and the ENGINEER have executed
this Agreement of the day and year first hereinabove set forth.

SSLOCSD

By: Ruth E. Brackett
Ruth Brackett, Chairman, Board of
Directors

By: John L. Wallace
John L. Wallace for
John L. Wallace and Associates

ATTEST:

APPROVED AS TO FORM:

Gerald W. Shipsey
Gerald Shipsey, District Attorney

ATTACHMENT 2

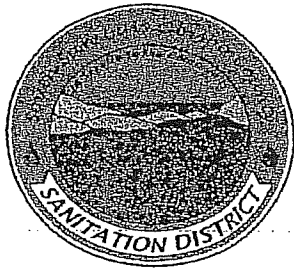
RECAP OF CENTRIFUGE PROJECT
BUDGET AND ACTUAL COSTS BY FISCAL YEARS

FISCAL YEAR	BUDGET NUMBER	BUDGET AMOUNT	WALLACE GROUP COST	OTHER COST	TOTAL COST
2006-07	C16	\$1,500,000	\$12,428		\$12,428
2007-08	C14	\$1,500,000	\$39,868	\$438	\$40,306
2008-09	05MBI06	\$499,000	\$76,043	\$2,154	\$78,197
2009-10	05MBI06	\$1,519,340	\$150,048	\$368,475	\$518,523
2010-11*	05MBI06	\$1,104,422	<u>\$57,938</u>	<u>\$15,880</u>	<u>\$73,820</u>
TOTAL			<u>\$336,325</u>	<u>\$386,947</u>	<u>\$723,274</u>

*Note: 2010 costs are as of November, 2010.

All budget and actual cost figures were provided by
the Wallace Group.

ATTACHMENT 3



SOUTH SAN LUIS OBISPO COUNTY SANITATION DISTRICT

Post Office Box 339 Oceano, California 93475-0339

1600 Aloha Oceano, California 93445-9735

Telephone (805) 489-6666 FAX (805) 489-2765

<http://sslocsd.org/>

Staff Report

To: Board of Directors

From: John Wallace, *District Administrator*

Date: March 2, 2011

Subject: New Centrifuge 2A, Brough Construction Progress Payment No. 4 and payment to Earth Systems Pacific

Recommendation:

1. Approve Progress Payment No. 4 to Brough Construction, Inc. in the amount of \$36,959.50. (\$33,263.55 without retention)
2. Approve Payment to Earth Systems Pacific in the amount of \$758.25.

Funding:

The FY 2010-11 Budget includes the Major Budget Item 05 MBI 06 – *New Centrifuge 2A* – in the amount of \$1,104,422.

Brough Construction was retained by a September 1, 2010 Board action for the lump sum amount of \$827,134.00 to provide construction services for the project. The revised contract amount after Change Orders 1, 2, 3, 4, and 6 is \$882,902.00 (Change order No. 5 was not accepted).

Earth Systems Pacific was retained by a November 17, 2010 Board action for the time and materials contract to perform materials testing services during construction of the Centrifuge 2A Project. The submitted invoices totaling \$758.25 are for professional services including: concrete sampling, concrete compression strength testing, and for bolt inspection.

	Expenditures to date (FY 10/11)	Proposed expenditures	Totals
Budget (A)	\$ 1,104,422.00	\$ -	\$ 1,104,422.00
Equipment Expenditures (B)	\$ -	\$ -	\$ -
Design expenditures (C)	\$ 46,479.12	\$ -	\$ 46,479.12
Testing/Troubleshooting (D)	\$ 4,218.13	\$ 758.25	\$ 4,976.38
Construction expenditures (E)	\$ 323,886.42	\$ 36,959.50	\$ 360,845.92
PG&E Utility Services (F)	\$ 15,659.32	\$ -	\$ 15,659.32
CA expenditures (G)	\$ 57,914.18	\$ -	\$ 57,914.18
Retainage (H): (E-10%)	\$ (32,388.64)	\$ (3,695.95)	\$ (36,084.59)
Payments (B+C+D+E+F+G-H)	\$ 415,768.53	\$ 34,021.80	\$ 449,790.33
Subtotal (I): {B+C+D+E+F+G} (includes retainage)	\$ 448,157.17	\$ 37,717.75	\$ 521,959.51
Balance to Complete (A-I)	\$ 656,264.83	\$ -	\$ 582,462.49

Total Project Budget - All Fiscal Years		Expenditures to Date (Total Project)	Proposed Expenditures	Balance to Complete
		\$ 1,283,901.02	\$ 37,717.75	\$ 582,462.49

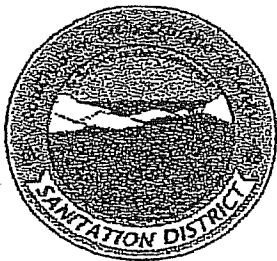
Discussion:

Monthly progress payment No. 4 includes payment for the month of February on work associated with this contract. Based upon the work that has been completed by Brough, Staff believes this payment is equivalent to the amount of work performed during this period. Tasks and percentage complete for this period are listed in the following table. Staff has closely monitored work performed under this contract and believes the invoice reflects the actual work performed by Brough Construction.

Item Description	Quantity	Unit	Unit Price	Contract Amount	% Complete	Cost This Period
Reinforced Concrete Retaining / Bin Wall	147	LF	\$440.00	\$64,680.00	0.3%	\$132.00
CMU Flood Wall	150	LF	\$62.50	\$9,375.00	100%	\$9,375.00
Pre-Engineered Metal Building	1	LS	\$54,840.00	\$54,840.00	10%	\$5,484.00
3" Glass Lined Sludge Pipe	2	LF	\$1,543.00	\$3,086.00	25%	\$771.50
Sludge Feed Pump, VFD Panel and Appurtenances	1	LS	\$10,200.00	\$10,200.00	25%	\$2,550.00
Local Power Distribution Panel	1	LS	\$14,770.00	\$14,770.00	10%	\$1,477.00
Power and Communications Wiring (H&M Building)	1	LS	\$20,400.00	\$20,400.00	5%	\$1,020.00
Power and Communications Wiring (W/In New Building)	1	LS	\$17,000.00	\$17,000.00	35%	\$5,950.00
Design, Install and test SCADA System	1	LS	\$102,000.00	\$102,000.00	10%	\$10,200.00
Sub-total (Job to date)						\$36,959.50
Retainage (10%)						(\$3,695.95)
Net Total						\$33,263.55

Staff recommends approval of Progress Payment No. 4 in the amount of \$36,959.50. A 10% retainage of \$3,695.95 is withheld resulting in a net payable amount of \$33,263.55.

ATTACHMENT 4



SOUTH SAN LUIS OBISPO COUNTY SANITATION DISTRICT

Post Office Box 339 Oceano, California 93475-0339

1600 Aloha Oceano, California 93445-9735

Telephone (805) 489-6666 FAX (805) 489-2765

<http://sslocsd.org/>

Staff Report

To: Board of Directors
From: John Wallace, District Administrator *OW*
Date: April 6, 2011

Subject: New Centrifuge 2A, Brough Construction Progress Payment No. 5

Recommendation:

1. Approve Progress Payment No. 5 to Brough Construction, Inc. in the amount of \$86,333.80. (\$77,700.42 with retention deducted), authorize three Contract Change Orders (CCO) No. 13 in the amount of \$18,700.00, CCO No. 14 in the amount of -\$2,300.00, and CCO No. 16 in the amount of -\$92.00, for a net contract change of \$16,300.
2. Approve payment to Earth Systems Pacific in the amount of \$287.00 for inspection services completed.

Funding:

The FY 2010-11 Budget includes the Major Budget Item 05 MBI 06 – *New Centrifuge 2A* – in the amount of \$1,104,422. The overall budget for all fiscal years is \$1,904,081.

Brough Construction was retained by a September 1, 2010 Board action for the lump sum amount of \$827,134.00 to provide construction services for the project. The revised contract amount after CCOs 1-6, 13, 14, and 16 is \$899,210.00 (See attachments for a list of CCOs).

	Prior FY's	Current FY as of 03-16-11	Total All FYs	Proposed This Staff Report
Budget	\$ 799,659	\$ 1,104,422	\$ 1,904,081	\$ -
<u>Expenditures</u>			\$ -	\$ -
Capital Equipment	\$ 320,814	\$ -	\$ 320,814	\$ -
Studies	\$ -	\$ -	\$ -	\$ -
Testing / Troubleshooting	\$ -	\$ 4,976	\$ 4,976	\$ 287
Design & Survey	\$ 433,186	\$ 46,479	\$ 479,665	\$ -
Contract Administration	\$ 3,007	\$ 67,549	\$ 70,557	\$ 12,000
Const Contingencies	\$ -	\$ 40,764	\$ 40,764	\$ 16,307
PG&E Utility Service	\$ -	\$ 15,659	\$ 15,659	\$ -
<u>Construction</u>	\$ 42,652	\$ 283,997	\$ 326,649	\$ 70,027
Total Expenditures	\$ 799,659	\$ 459,426	\$ 1,259,085	\$ 98,621
Remaining Budget			\$ 644,996	\$ 546,375

ATTACHMENT 5

WORKPLACE INVESTIGATIONS

Date: April 2, 2010

To: Michael Seitz
Attorney – SSLOCSD

From: Richard Thomas – Thomas Consulting *Richard Thomas*

Re: Investigation of Allegations – Maintenance Roof Coating, and Chemical Tank Replacements

Thomas Consulting (TC) was retained by Michael Seitz, Attorney for the SSLOCSD, to investigate two allegations contained in a Microsoft Word document (Doc 2) found on one of the SSLOCSD computers. The computer is located in an area at the plant office that is accessible by all employees.

The document was titled "Dear Board Members" and is five pages in length and contains a blank signature box with the words "Thank You, Regards, [REDACTED]". The source of the document has not been verified as actually being written by [REDACTED].

The following are excerpts from the document:

Allegation 1: Maintenance Roof Coating

[REDACTED]

Allegation 2: Chemical Tanks

"... A few examples of these would be the recent purchase of two District chemical tanks, one entirely handled in house and purchased at a cost to the tax payers of approximately \$16,000. This was placed in service as the new Sodium Hypochlorite tank. It was then observed the District was in need of a new Ferric Chloride tank which the Wallace Group unnecessarily handled. This was the same basic tank however the cost to the tax payers was some \$32,000. There was no reason to "engineer" another tank purchase..." (Excerpt from bottom page 3 and top page 4 of Doc 2).

An investigation into these two allegations was conducted and the result of that investigation follows.

Contained with this report is a series of documents related to these issues that were gathered in the course of this investigation. The documents are labeled Document 1-10 and will be referred to throughout this report.

WORKPLACE INVESTIGATIONS

Allegation 1: Maintenance Roof Coating

[REDACTED]
[REDACTED]

I interviewed the Plant Superintendent [REDACTED] and the District Administrator about this allegation. I also reviewed the available documentation related to this project.

Both [REDACTED] and Wallace told me that the Maintenance Building roof was in need of recoating and the project was included in the annual budget and approved by the Board – MBI No. C24 (\$40,000).

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

After it was determined a formal bid process was required, Wallace Group initiated the necessary advertising and processing of the bids. Two bids were received. The lowest bid was rejected as non-responsive to the totality of the work required for the project (see Doc 8c – Board Meeting minutes dated 5/21/08 and Doc 8b – Staff report dated 5/21/08), and the project was awarded to Ingham Painting in the amount of \$38,812.

The project commenced on July 7, 2008 and was completed on August 1, 2008 (see Doc 8c Board minutes dated 8/20/08). This was an extensive project which included power washing the roof surfaces, repairing a corner section of the roof siding and then applying two layers of an industrial coating system.

In addition to the work completed by the contractor - Ingham Painting, there was other work and charges related to this project. These costs are detailed in the following table. The total cost of the project was \$58,027.23.

WORKPLACE INVESTIGATIONS

Maintenance Building Roof Coating Charges		
Item	Cost	Totals
Wallace Group		
WG through March 07-08 FY	\$ 2,539.38	
WG April 07-08 FY	\$ 2,244.42	
WG May 07-08 FY	\$ 4,848.71	
WG June 07-08 FY	\$ 374.00	
WG 8/20/08	\$ 5,580.17	
WG 9/17/08	\$ 867.05	
WG 1/21/09	\$ 467.50	
Sub-total	\$ 16,921.23	\$ 16,921.23
SLO Newspapers 5/23/08	\$ 980.20	\$ 980.20
Bobcat Rain Gutters Inc.	\$ 914.00	\$ 914.00
Ingham Painting	\$ 34,930.80	
Ingham Painting	\$ 3,881.00	
Sub-total	\$ 38,811.80	\$ 38,811.80
Project Total		\$ 57,627.23

All documents collected by TC that relate to the roof coating can be found under Tab 8.

Allegation 2: Chemical Tanks

The District replaced two chemical tanks. The allegation purports that the Sodium Hypochlorite tank was handled entirely by the District Staff at a cost of \$16,000 and the Ferric Chloride tank, handled by the Wallace Group, cost \$32,000 for essentially the same basic tank. The allegation insinuates that because Wallace Group was involved in the second purchase, the engineering fees charged, doubled the cost of the project.

The facts contained in the allegation are not supported by the evidence gathered by TC. In making this determination I interviewed the Plant Superintendent [REDACTED] and the District Administrator about this allegation. I also interviewed the District's Bookkeeper/Secretary [REDACTED] and collected documents from both Wallace Group and the District. The documents collected are filed under Tabs 9 and 10.

WORKPLACE INVESTIGATIONS

The investigation details follow.

Sodium Hypochlorite Tank

John Wallace stated the tank was showing signs of deterioration including the failure of one of the lifting points, and District Staff recommended the tank be replaced. District Staff initiated an informal bidding process and received three quotes. The lowest bid from Harrington Plastics in the amount of \$11,331.91 was awarded.

Plant Superintendent [REDACTED] stated that the bid process was handled by District Staff, and the tank did require replacement.

The Board minutes from 9/3/08 reflect the approval for the purchase of the Sodium Hypochlorite tank out of the FY 2008-09 budgetary funds. The accompanying staff report prepared by Wallace shows the three bids received by District Staff ranged from \$11,331.91 to 12,790.00 with Harrington as the lowest bid.

District records confirm (see tab 9) the bid amounts, and Harrington Plastics was paid \$11,556.44 on 11/07/2008. According to Spears the \$224.53 above the quoted price covered the cost to protective wrap the tank for shipping. There were no charges from Wallace Group associated with this project.

Ferric Chloride Tank

The District Staff recognized the need to replace the Ferric Chloride Tank and included a major budget item in the 2008-2009 FY Budget – 08 MBI 23 Chemical Tank Replacement. Initially District Staff (Scott Mascolo) set about getting quotes to replace the existing 4000 gallon tank. He received two quotes; one from Harrington Industrial Plastics and the other from Keith Bailey (Snyder). Records related to this first round of quotes are contained in a set of documents received from John Wallace (labeled 10a).

Following the receipt of these two quotes it was determined that the District would benefit from replacing the 4000 gallon tank with a 6600 gallon tank. Plant Superintendent [REDACTED] explained that a 4000 gallon tank is not able to accept a "full load" of ferric chloride and it would be more economical for the District to have a 6600 gallon tank that could accept a full load.

District Staff then sought quotes for a 6600 gallon tank. Three quotes were included in a set of documents (labeled 10d) received from [REDACTED]. Harrington Industrial Plastics, Core-Rosion Products, and Snyder Direct furnished quotes and Core-Rosion was the lowest at \$10,996.43.

[REDACTED] then forwarded a Staff Report dated 3/24/09 (contained in the set of documents labeled 10d) to John Wallace. The staff report was presented by Wallace to the Board on 4/1/09 and the purchase from Core-Rosion was approved. The Board also approved an additional cost of approximately \$200 to have the tank protection wrapped for shipment (see set of documents labeled 10b).

District records received from [REDACTED] indicate the total project expenses related to the replacement of the Ferric Chlorite tank totaled \$11,586.51 (Doc 10c). Core-Rosion Products was paid \$11,166.17 of that amount. There were no payments to Wallace Group.

WORKPLACE INVESTIGATIONS

In regard to the allegation that there were significant charges for Wallace Group services; the allegation is false. Further, records from the District and from Wallace Group show the project, including quotes, was handled by District Staff and Wallace Group engineering staff played no role in the purchase or installation of the Ferric Chloride tank. No charges for the Ferric Chloride tank were paid to Wallace Group.

Wallace Group charges were related to preparing specifications, bidding tasks, contract administration, structural review and miscellaneous expenses. Wallace Group furnished an accounting of their expenses (see Doc 8d).

In determining the costs associated with this project, TC collected records from both Wallace Group, and from SSLOCSB Bookkeeper/Secretary [REDACTED]. The records from both sources are consistent. The statements made by Appleton and Wallace regarding this project are also consistent.

The investigation into this matter reveals that the project was completed within regulations and District policy with full Board approval. The matter related to the initial informal bid by a relative of a District employee was addressed as an internal personnel matter.

Conclusion – Allegation 2

The allegations contained in the document suspected to be written by [REDACTED] are false. The replacement of both tanks was handled by District Staff with no fees paid to Wallace Group. The amounts cited in the allegation are inaccurate. Both tanks were replaced for approximately \$11,500 each. These amounts do not include the District Staff time dedicated to developing specifications, collecting quotes, selecting the vendor, administering the contract payments, and installing the tanks.

General Comments

Mr. John Wallace and his firm Wallace Group enjoy a great reputation. This investigation found no reason to suspect that Wallace or his firm would take advantage of the District in billing unnecessary work. The Plan Superintendent [REDACTED] is very complimentary of Wallace Group and the services they provide and states that he has never questioned the need for the work performed. [REDACTED] stated that Wallace is one of the most ethical men I know.

On the other hand, the arrangement of John Wallace being both the District Administrator and his firm providing engineering and project management services to the District presents an easy target to critics (on District Staff and the community), and can provide the “appearance” of a conflict of interest.

The decision to contract with John Wallace as District Administrator and with his firm to provide engineering and project management services is within the purview of the District’s Board of Directors. Clearly this is not a unique arrangement but may subject the District to continuing questions of impropriety. It must be stated though, that nothing in this investigation has lead TC to question the veracity of John Wallace or his firm, Wallace Group.