

Date of Hearing: June 13, 2018

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT  
Cecilia Aguiar-Curry, Chair  
SB 963 (Allen) – As Amended June 4, 2018

**SENATE VOTE:** 37-0

**SUBJECT:** Water replenishment districts.

**SUMMARY:** Repeals certain limitations on the reserve funds of the Water Replenishment District of Southern California (WRD). Specifically, **this bill:**

- 1) Deletes provisions in existing law that require WRD to establish an annual reserve fund in an amount not to exceed \$10 million commencing with the 2000-01 fiscal year (FY), and deletes provisions related to limitations on that reserve.
- 2) Requires WRD to order, review, and maintain on file an independent, audited financial statement not later than 180 days from the conclusion of WRD's FY (instead of current law which specifies that this must happen not later than *60 days*).
- 3) Revises the requirement in existing law that requires WRD's independent audited financial statement to be consistent with certain accounting standards to reflect current standards.
- 4) Deletes provisions that specify what must be included in the independent audited financial statement, including:
  - a) The balances in all accounts established for the maintenance of WRD's funds;
  - b) A report describing the amount of district funds to be expended for any capital improvement project authorized to be constructed or funded by WRD and a detailed description of the capital improvement project;
  - c) A report detailing the source of funds to be expended on any authorized capital improvement project, and whether the source of funds is the water replenishment assessment, as specified;
  - d) A report describing the propriety of WRD's operating expenses;
  - e) A summary of independent audited financial statement exceptions and management improvement recommendations; and,
  - f) A description of correction or plan of correction to be incorporated in the financial statement, describing the specific actions that are planned to be taken, or that have been taken, to correct the problem identified by the auditor, as specified.
- 5) Requires the financial statement to include, regardless of whether the State Auditor reports separately, including separate reports bound in the same document, any findings or findings involving deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse. Requires WRD to include its written

comments in response to findings that provide the perspectives of the responsible officials of WRD and the corrective actions they plan to take.

- 6) Requires the revised independent auditor financial statement to be submitted to the Governor, the Senate Committee on Governance and Finance or its successor, the Assembly Committee on Local Government or its successor, and the State Auditor on or before December 31 of each year.
- 7) Requires WRD to also provide information on expenditures relating to capital improvement projects planned to be undertaken.
- 8) Makes other conforming changes.

**EXISTING LAW:**

- 1) Authorizes WRD, for the purposes of replenishing the groundwater supplies within the district, to:
  - a) Buy and sell water;
  - b) Exchange water;
  - c) Distribute water to persons in exchange for ceasing or reducing groundwater extractions;
  - d) Spread, sink, and inject water into the underground;
  - e) Store, transport, recapture, recycle, purify, treat, or otherwise manage and control water for the beneficial use of persons or property within the district; and,
  - f) Build the necessary works to achieve groundwater replenishment.
- 2) Limits the annual reserve fund of WRD to \$10 million, as adjusted annually to reflect percentage increases or decreases in the blended cost of water from district supply sources.
- 3) Requires, beginning in the 2019–20 fiscal year, a minimum of 80% of the reserve to be used for water purchases.
- 4) Excepts from this limitation the unexpended balance of any appropriated funds in a capital improvement project construction account established to pay the cost of a project or projects under construction.
- 5) Requires WRD to order, review, and maintain on file an independent, audited financial statement not later than 60 days from the conclusion of the district’s fiscal year and require copies of the statements to be submitted to the Governor, the Legislature, and the California State Auditor on or before November 1 of each year.

**FISCAL EFFECT:** None

**COMMENTS:**

- 1) **Background.** State law allows the formation of water replenishment districts to recharge water into groundwater basins for later withdrawal by water purveyors. In 1959, the voters of Los Angeles County established WRD, which is the state's sole water replenishment district. It earns revenue by charging water replenishment assessments to the agencies, utilities, and companies that pump groundwater. The District also gets property tax revenues from its share of the 1% property tax rate. WRD uses these funds to secure water – by purchasing imported water and constructing projects that produce local water supplies – that percolates into the groundwater basin.

WRD has been the subject of considerable local controversy over its water rates, fund balances, capital projects, and administrative practices. A December 1999 State Auditor's report found that WRD did not exercise strict fiscal controls. Among other issues, the State Auditor found that the WRD had established an operating reserve of \$20 million – twice what the Auditor estimated was necessary to ensure prudent reserves.

In response to the audit, the Legislature amended the Water Replenishment District Act to install a host of restrictions over the WRD's finances. Specifically, SB 1979 (Escutia), Chapter 894, Statutes of 2000:

- a) Limited the WRD's annual reserve fund to a maximum of \$10 million, adjusted annually to reflect changes in the cost of purchased water. Reserves appropriated for capital improvements under construction are not subject to this limit;
- b) Required 80% of the WRD's reserves to go to water purchases.
- c) Mandated that the WRD annually commission an independent, audited financial statement that lists fund balances, includes specified reports on capital projects, and records the WRD's response to any management recommendations from the State Auditor; and,
- d) Required the above financial statements to be submitted to the Governor, the Legislature, and the State Auditor annually by November 1.

The Legislature also established rules for contracting and constructing capital projects, and required follow-up audits of the WRD by the State Auditor in 2002 [AB 1834, (Havice), Chapter 888, Statutes of 2000] and 2004 [AB 1163, (Calderon), Chapter 941, Statutes of 2002]. Those audits found that although the WRD had implemented many of the recommendations in previous audits, its reserve policies continued to raise questions.

Over time, the manner by which the WRD replaces pumped groundwater has changed. When it was originally formed, the WRD purchased 100% of the water it used for replenishment from imported sources. In the 1960s, the WRD began a steady shift towards developing local sources of water, such as captured stormwater and recycled water. As a result, the WRD relied less on purchasing water and more on building its own capital projects. In 2013, the WRD sought relief from some of the fiscal controls imposed by the Legislature. The WRD argued that these controls threatened its financial viability and prevented it from investing in local sources of water. In response, the Legislature temporarily repealed the requirement that 80% of reserves must be spent on water purchases

until the 2019-20 fiscal year [SB 620, (Wright), Chapter 638, Statutes of 2013]. In order to continue some oversight of the WRD's reserves, SB 620 also required the establishment of a budget advisory committee, composed of the WRD's ratepayers, to review and make recommendations on any replenishment assessment levied by the WRD and the WRD's operating budget and reserves. SB 620 further contained intent language that records of the recommendations from the budget advisory committee should be used to evaluate the permanent repeal of the 80% requirement.

By 2015, only 20% of the water used for replenishment came from imported water purchases, and in 2018 and going forward, the District expects to rely entirely on local sources. In order to continue its independence from imported water purchases, the WRD's officials want more flexibility to spend the District's reserves.

- 2) **Bill Summary.** This bill repeals provisions that currently require WRD to establish an annual reserve fund in an amount not to exceed \$10 million, and also strikes provisions related to limitations on that reserve. The bill strikes provisions that specify what must be included in WRD's independent audited financial statement, but maintains the requirement that WRD continue to provide this audited financial statement to the Governor, State Auditor, and relevant committees in the Legislature. The financial statement must also include any findings or findings involving deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and requires WRD to include its written comments in response to the findings.

The bill is sponsored by WRD.

- 3) **Author's Statement.** According to the author, "In the year 2000, responding to a State Auditor's report regarding WRD, the Legislature added language to the Water Code placing a \$10 million cap on the general reserves of a water replenishment district, and requiring that a minimum of 80 percent of the reserve fund be expended specifically for water purchases. "The reserve restrictions prevented the WRD from accumulating unnecessarily higher reserve levels, and the water purchase requirement made sense at the time. However, times and groundwater replenishment best practices have changed. Fluctuations in cost and the reliability of supply have convinced the WRD of the financial and practical need to become independent of imported water, shifting instead to the production of local, reliable supplies for purposes of replenishing the Central and West Coast groundwater basins.

"In October 2016, the WRD Board of Directors approved an agreement with the State Water Resources Control Board that provides WRD \$95 million in funding for the construction of the Groundwater Reliability Improvement Project (GRIP), an advanced water treatment facility currently under construction in the City of Pico Rivera. GRIP is the final and most significant project within WRD's Water Independence Now (WIN) program that aims to eliminate WRD's need to purchase imported water from Northern California and the Colorado River for groundwater replenishment. Once built, the WRD region's groundwater basins will be completely locally sustainable.

"The move from buying to producing water means that the WRD will need additional operating reserves for issues related to managing its own facilities. Along with operations, there are large replacement costs associated with items such as microfiltration units, reverse

osmosis membranes and ultra-violet light bulbs. The District will need greater reserve balances to cover these infrastructure costs when items need to be replaced.

“SB 963 gives the WRD ability to shift away from outdated reliability on water imports to a modern model of local sustainability, while planning for substantial operating costs it will incur in financing its advanced water treatment facilities. The bill will limit the ultimate price to taxpayers, by permitting costs to be addressed on a pay-as-you-go basis rather than through more expensive debt financing.”

- 4) **Technical Amendment.** Section 3 of the bill dealing with the independent audited financial statement contains a reference to the State Auditor making findings, which is incorrect. This reference to the State Auditor should be replaced with “certified public accountant or public accountant” who prepared the audited financial statement, to ensure consistency with terminology used previously.
- 5) **Arguments in Support.** Supporters argue that moving from purchasing water to producing water using advanced water treatment science and techniques will require greater flexibility in budget practices to enable WRD to appropriately operate and maintain its facilities.
- 6) **Arguments in Opposition.** None on file.

#### **REGISTERED SUPPORT / OPPOSITION:**

##### **Support**

Water Replenishment District of Southern California [SPONSOR]  
Orange County Water District  
Budget Advisory Committee, Water Replenishment District of Southern California

##### **Opposition**

None on file

**Analysis Prepared by:** Debbie Michel / L. GOV. / (916) 319-3958