

A CURRENT LOOK AT NID

REASON FOR INVESTIGATION

Nevada Irrigation District (NID) is the largest Special District in Nevada County and is responsible for providing water for both household and agricultural use in portions of Western Nevada County and parts of Placer, Yuba and Sutter Counties. California Penal Code Section 933.5 authorizes all civil grand juries with oversight of special districts. The Nevada County Civil Grand Jury was concerned by the continuation of annual rate increases combined with the acknowledged large reserves retained by NID.

BACKGROUND

The Nevada Irrigation District is an independent Special District operated for the landowners within its 287,000 acre boundaries which include portions of Western Nevada County and Northwestern Placer County. NID has approximately 160 employees who provide service to some 22,000 customers of both raw (agricultural) and treated (household) water. NID also supplies raw water to Grass Valley and Nevada City. NID is managed by a five member Board of Directors elected by district voters.

NID operates dams, reservoirs, flumes, ditches, and pipelines to store and transport water as well as eight water treatment plants and seven hydroelectric plants. NID provides recreational facilities at Rollins and Scotts Flat reservoirs as well as at Faucherie and Jackson Meadows.

METHOD OF INVESTIGATION

The Grand Jury interviewed senior management of NID including the General Manager and the Finance Manager and members of the Board of Directors. Grand Jury members also attended four Board of Directors meetings at which both the proposed 2006 rate increase and the proposed 2006 budget were discussed and at which the public was given the opportunity to comment on both the rate increase and the budget.

The Grand Jury reviewed financial and operational data for the period from 1999 through 2006 provided by NID. These included proposed and approved budgets, actual financial results, audit reports and construction plans.

The Grand Jury reviewed previous Grand Jury reports issued in 1999, 2001 and 2003.

FINDINGS

1. NID has made substantial changes to its budgeting process in recent years. The major change was made in the 2005-2007 budget when separate budgets were created for Operations and Maintenance (O&M) and Capital. The O&M budget supports normal day-to-day service and repair work. The Capital budget supports construction of new facilities including treatment plants and pipelines.
2. The annual NID budget includes specific line items for withdrawals from or deposits to reserves.
3. NID has repeatedly reported that expenses continue to exceed revenues for the O&M portion of the budget resulting in increased rates for both agricultural and treated water in each of the last five years.
4. In each year from 1999 to 2004, the original approved NID budget substantially underestimated revenues. The total amount of the underestimation of revenue for the six year period was \$24,000,000, which represents an average of 20% of budgeted revenues over the same time period.
5. For 2004, the amount of the underestimation of revenues was \$3,100,000. NID staff stated at a Board of Directors meeting that a 1% change in rates is roughly equivalent to \$150,000 in revenues. Therefore, the \$3,100,000 underestimation has an equivalent impact of a 20% rate increase.
6. During recent public hearings on the rate increase process, NID did not clearly state the amount of additional revenues required to balance the budget or the amount intended to be raised by the proposed rate increase.
7. In 2006, NID formally made proactively expanding water services to the existing and new customers within its service territory its top priority.
8. NID has been charging all labor costs to the O&M budget even if the labor was related to the Capital budget. As part of the 2006 proposed rate increase process, NID stated that the amount of labor that should be assigned to Capital rather than O&M was \$1,200,000 for 2006.
9. According to NID, the State of California took approximately \$1,600,000 in assessment revenues from NID in 2004, \$3,200,000 in 2005, and will take an additional \$1,600,000 in 2006. The money transferred from NID to the State amounts to approximately \$6,400,000.
10. Under current NID procedures, if a construction project cannot be completed on schedule, the moneys assigned to the project remain unspent resulting in under running current year capital outlays.

11. More than 50% of NID projects over the last five years have not been completed on schedule.
12. The costs of construction materials and labor have continued to increase over the last five years.

CONCLUSIONS

1. NID's \$24,000,000 underestimation of revenues over the last six years has had a substantial impact on the rate setting process.
2. Delays in completing more than 50% of scheduled projects have resulted in increasing the cost of projects.
3. The current NID practice of under-running the Capital budget due to delays in project schedules has contributed significantly to year end surpluses.
4. A perceived under-funding of the Operations and Maintenance (O&M) budget has been the basis of much of NID's proposed rate increases.
5. The recently adopted process of budgeting day-to-day operations separately from construction program requirements appears to be a valid way to manage and control revenues and expenses.

RECOMMENDATIONS

1. NID should review the process used to estimate water sale revenues, service connections and interest revenues to ensure that budgeted revenues more closely approximate actual revenues.
2. NID should implement a tighter control over construction projects including a documented five year construction program complete with a list of current year approved projects with schedules and budgets.
3. NID needs to improve overall management of its construction program in order to accomplish work identified in the Capital budget in a timely manner.
4. NID should allocate day-to-day labor costs to the O&M budget and labor associated with construction projects to the Capital budget to support the process of setting rates to properly support associated costs.
5. NID rate increases should be tied directly to the need for balancing revenues against expenses.

REQUIRED RESPONSE

NID Board of Directors – July 18, 2006

NID Nevada Irrigation District

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September 20, 2006

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SEP 21 2006 HLB

Honorable Albert P. Dover
Presiding Judge of the Superior Court
201 Church Street
Nevada City, CA 95959

RE: Response to the Grand Jury's Report dated April 17, 2006

To the Honorable Judge Dover:

The District wishes to thank the Grand Jury for its recommendations. Our required response is as follows:

FINDINGS

1. NID has made substantial changes to its budgeting process in recent years. The major change was made in the 2005-2007 budget when separate budgets were created for Operations and Maintenance (O&M) and Capital. The O&M budget supports normal day-to-day service and repair work. The Capital budget supports construction of new facilities including treatment plants and pipelines.

Agree

NID continues to refine and improve its budgeting process. The Capital budget supports construction of new facilities including treatment plants and pipelines AND major repairs and replacement of existing infrastructure.

2. The annual NID budget includes specific line items for withdrawals from or deposits to reserves.

Agree

The annual NID budget does include specific line items for withdrawals from or deposits to reserves.

The District will provide a dependable, quality water supply, strive to be good stewards of the watersheds and conserve the available resources.

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287,000 ACRES SITUATED IN NEVADA, PLACER, SIERRA & YUBA COUNTIES

3. NID has repeatedly reported that expenses continue to exceed revenues for the O&M portion of the budget resulting in increased rates for both agricultural and treated water in each of the last five years.

Agree

In accordance with the information included on the attached Exhibit A, NID's externally audited financial statements support this statement.

4. In each year from 1999 to 2004, the original approved NID budget substantially underestimated revenues. The total amount of the underestimation of revenue for the six year period was \$24,000,000, which represents an average of 20% of budgeted revenues over the same time period.

Disagree

The statement "the original approved NID budget substantially underestimated revenues" is a dichotomy. The analysis compares an estimated budgeted revenue amount calculated in December of one fiscal year to an actual amount finalized in December of the following fiscal year. Budgets are evolving documents. The use of the word "substantially" is very subjective. Additionally, the assertion that the individual "annual" underestimations can or should be accumulated is incorrect. Annual budget underestimations are not cumulative. Audited operating losses are, however, cumulative. It should be noted that for the year ended December 31, 2005, NID's budgeted water revenues were within four percent (4%) of actual water sales. It is estimated that NID's budgeted water revenues will be within ten percent (10%) of actual water sales for the year ended December 31, 2006.

5. For 2004, the amount of the underestimation of revenues was \$3,100,000. NID staff stated at a Board of Directors meeting that a 1% change in rates is roughly equivalent to \$150,000 in revenues. Therefore, the \$3,100,000 underestimation has an equivalent impact of a 20% rate increase.

Partially agree

The amount of the total underestimation of the originally budgeted revenues for 2004 was \$3,041,000. However, only \$1.1 million of the \$3.0 million related directly to water sales. The statement that "a 1% change in rates is roughly equivalent to \$150,000 in revenues" cannot not be directly correlated to the conclusion it is "an equivalent impact of a 20% rate increase". The mathematical model utilized by the District to project future revenues consists of a variety of assumptions and factors some of which are known and many of which are assumed. The number of new connections, the quantity of water consumed by

each type of customer and weather conditions are all very subjective yet critical factors in predicting "future water revenues". NID generated losses on its operations, after depreciation, for each of the six years in the period from 1999 to 2004. Additionally, the District experienced a net operating loss, after depreciation, of \$2.3 million in fiscal year ended 2005. Continued actual operating losses compelled the District to raise its operating water sales rates. In fact, as recommended by the Grand Jury in 1999, the District hired a consultant to perform a cost of service study and has been phasing in the recommendations from that study with the goal of balancing operating revenues with operating expenses.

6. During recent public hearings on the rate increase process, NID did not clearly state the amount of additional revenues required to balance the budget or the amount intended to be raised by the proposed rate increase.

Disagree

At the October 12, 2005 Board meeting, it was stated the "operations and maintenance revenues are increasing 4.1% and expenditures are increasing 5.1%". At the October 26, 2005 Board meeting "Ms. Andrews reviewed the treated water rate blocks and the number of customers affected by each block. Very few customers are at the 1 hcf level per month (average consumption). The proposed rate increase for this block is 4%. A majority of the District's customers fall into the 2 to 30 hcf block (average monthly consumption). The proposed rate increase for this block is 9%. The average increase for a 5/8-inch meter based on usage is \$2.13 per month, including mandated fees. The average increase for a 3/4-inch meter based on usage is \$2.61 per month, including mandated fees".

7. In 2006, NID formally made proactively expanding water services to the existing and new customers within its service territory its top priority.

Agree

8. NID has been charging all labor costs to the O&M budget even if the labor was related to the Capital budget. As part of the 2006 proposed rate increase process, NID stated that the amount of labor that should be assigned to Capital rather than O&M was \$1,200,000 for 2006.

Partially agree

The 2006 NID adopted budget reflects \$720,000 of estimated salary and related benefits expenditures to be transferred from the O & M budget to the capital budget. While the District "began" to reflect the capitalization of its internal

salaries to projects on the 2006 budget, the District has been capitalizing the actual salaries in its audited financial statements for many years.

9. According to NID, the State of California took approximately \$1,600,000 in assessment revenues from NID in 2004, \$3,200,000 in 2005, and will take an additional \$1,600,000 in 2006. The money transferred from NID to the State amounts to approximately \$6,400,000.

Agree

The amount of ERAF III (education revenue augmentation fund) revenue withheld was \$1,620,924, \$3,241,848 and \$1,620,924 for each of the fiscal years 2004, 2005 and 2006, respectively.

10. Under current NID procedures, if a construction project cannot be completed on schedule, the moneys assigned to the project remain unspent resulting in under running current year capital outlays.

Partially agree

The term "under running" is not understood. If a construction project cannot be completed on schedule, the money assigned to the project remains unspent. This results in reduced capital outlays during the year in which the project is not completed.

11. More than 50% of NID projects over the last five years have not been completed on schedule.

Agree

The primary reason for the delays has been directly related to the rapidly expanding and ever increasing regulatory arena over which the District has very little control. Complying with new environmental regulations, considering public opinion/input and overcoming unanticipated obstacles has severely hampered the District's ability to complete many of its forecasted projects in a timely manner.

12. The costs of construction materials and labor have continued to increase over the last five years.

Agree

RECOMMENDATIONS

1. NID should review the process used to estimate water sale revenues, service connections and interest revenues to ensure that budgeted revenues more closely approximate actual revenues.

The recommendation has not yet been implemented but will begin to be with the preparation of its 2007 – 2009 budget. The District is exploring new and different ways to more accurately estimate water sales, service connections and interest revenues. The District expresses its commitment to produce its best estimates during the annual budget process.

2. NID should implement a tighter control over construction projects including a documented five year construction program complete with a list of current year approved projects with schedules and budgets.

The recommendation has not yet been implemented but will begin to be with the preparation of its 2007 – 2009 budget. The District is in the process of investigating different alternatives to improve its construction projects projection procedures including the purchase of project management software and training. The District is of the opinion this will take approximately three years to acquire, implement and complete such a model.

3. NID needs to improve overall management of its construction program in order to accomplish work identified in the Capital budget in a timely manner.

The recommendation has not yet been implemented but will begin to be with the preparation of its 2007 – 2009 budget. Please see the response immediately above. The recent adoption of a strategic plan by the Board of Directors identifies the District's intent to define its goals and objectives and the means by which to accomplish those goals and objectives.

4. NID should allocate day-to-day labor costs to the O&M budget and labor associated with construction projects to the Capital budget to support the process of setting rates to properly support associated costs.

The recommendation was attempted to be implemented during the preparation of the 2006 – 2008 budget and will continue to be improved during the preparation of its 2007 – 2009 budget.

5. NID rate increases should be tied directly to the need for balancing revenues against expenses.

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Presiding Judge of the Superior Court
September 20, 2006
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The recommendation is currently in place. NID rate increases are tied directly to the need for balancing revenues against expenses. The District has engaged in several cost of service studies over the years and has implemented recommended rate increases as necessary. The audited financial statements of the District over the last seven years clearly shows that operating expenditures have consistently exceeded operating revenues generating net operating losses.

The Grand Jury concluded that recently adopted budgeting practices of segregating and allocating costs between operations and capital budgeting appear to be appropriate. It is the District's intent to continue to improve upon these processes, implementing tighter management, supervision and reporting controls to ensure timely completion of such projects.

In closing, and in addition to the commitments made above, the District will strive to provide understandable, transparent and consistent descriptions of all of the District's business activities.

Sincerely,

NEVADA IRRIGATION DISTRICT



Ron Nelson
General Manager

cc: NID Board of Directors
Marie G. Owens

NEVADA IRRIGATION DISTRICT
Water Fund
Statement of Operating Revenues versus Operating Expenses
Years Ended December 31, 2005, 2004, 2003, 2002, 2001, 2000 and 1999

	12/31/2005	12/31/2004	12/31/2003	12/31/2002	12/31/2001	12/31/2000	12/31/1999
	Water Actual	Water Actual	Water Actual	Water Actual	Water Actual	Water Actual	Water Actual
Operating revenues:							
Water sales	\$ 14,017,291	\$ 13,390,812	\$ 11,821,502	\$ 10,992,386	\$ 10,830,458	\$ 10,121,388	\$ 9,839,801
Standby charges	150,201	135,848	145,590	150,732	226,843	94,926	166,475
Insurance settlements & refunds	-	-	-	-	-	1,264,372	34,781
Capacity fees	2,044,108	916,016	1,545,827	1,154,484	872,439	523,138	1,001,161
Reimbursable costs	7,032	4,350	1,301	14,017	2,998	5,029	2,759
New connections and installations	496,762	442,201	455,418	412,049	336,623	365,704	500,441
Campgrounds	534,001	536,557	549,410	-	-	-	-
Other income	232,600	228,886	211,262	712,739	693,648	718,102	697,059
Total operating revenues	17,481,995	15,654,670	14,730,310	13,436,407	12,963,009	13,092,659	12,242,477
Operating expenses:							
Departments	4,690,618	4,584,374	3,509,980	3,172,355	5,705,868	4,709,483	-
Canals	5,170,680	6,366,713	4,494,413	4,728,075	3,373,025	3,076,977	-
Treatment plant costs	2,097,426	2,357,184	2,091,803	1,331,409	1,636,985	1,247,583	-
Treated water systems	2,406,452	3,206,855	2,978,419	3,139,400	2,056,970	1,322,337	-
Other facilities	583,386	611,529	575,794	440,085	641,434	218,279	-
Routine maintenance	74,657	35,105	15,267	1,700	-	-	-
Administration	30,448	8,241	6,964	3,842	11,751	6,424	783,402
Depreciation and amortization	4,120,693	3,927,073	3,350,910	2,268,329	2,129,364	2,551,996	2,360,555
Campgrounds	633,866	594,120	597,780	-	-	-	-
Salaries and Wages	-	-	-	-	-	-	4,767,074
Employee Benefits	-	-	-	-	-	-	2,134,237
Materials and Supplies	-	-	-	-	-	-	1,535,085
Outside services and fees	-	-	-	-	-	-	300,085
Other expenses	-	-	(186,178)	627,035	608,142	619,842	656,788
Total operating expenses	19,808,226	21,691,194	17,435,152	15,712,230	16,163,539	13,752,921	12,537,226
Net Operating Loss	\$ (2,326,231)	\$ (6,036,524)	\$ (2,704,842)	\$ (2,275,823)	\$ (3,200,530)	\$ (660,262)	\$ (294,749)

November 26, 2003

Approved the Offer of Dedication with Marianne Combs for the Mount Vernon Road Waterline Extension. M/S/C Leipzig/Williams

WATER RATES - 2004

The President of the Board opened the hearing for public comments.

Finance Manager, Tess Andrews, presented the Water Rates Committee proposed recommendation to the District's Schedules of Water Rates and Charges as follows:

1. That the water rates be increased by:
 - a. Treated Water = 2.5% in the minimum
= 9% in usage – block 2
= 11% in usage – block 3
= 15% in usage – block 4
 - b. Raw Water = 7% First Miner's Inch
= 7% Additional Miner's Inches
2.
 - a. Treated Water - Inside = 6.43% (from 4.35% change of 2.08%)
 - b. Treated Water – Outside = 5.04% (from 3.00% change of 2.04%)
 - c. Raw Water – Inside = 3.01% (from 1.47% change of 1.54%)
 - d. Raw Water – Outside = 1.62% (from 0.11% change of 1.51%)
3. That the following schedules be changed by reviewing actual costs:
 - a. Schedule 4-A Treated Water System Installation Fees
 - b. Schedule 5-B Raw Water Service Outlet Installation
 - c. Schedule 8-A Public Fire Hydrants
 - d. Schedule 8-B Private Fire Service Installation
 - e. Schedule 8-C & D Private Fire Service – Bi-monthly Charges
 - f. Schedule 9-B Backflow Prevention Device – Installation Charges
 - g. Schedule 9-C & D Backflow Prevention Device – Bi-monthly Charges
 - h. Schedule 10-A District Constructed Mainline Extensions

Note: Schedule 4-A Treated Water System Capacity Fees were adopted on August 27, 2003 to be effective January 1, 2004.

The Finance Manager quoted the new treated water system connection fees for a 5/8-inch meter with capacity plus installation going from \$3,990 to \$5,600. The projection for a low-use customer conserving water and using 5 hcf (hundred cubic feet) of water would see a monthly increase of about \$1.59, or 5.16 percent. A more typical customer, using 30 hcf, would see a bi-monthly increase of \$5.02 or 8.78 percent.

Irrigation water customers would see an across the board increase of 7 percent plus added fees for state and federal mandated programs, for an average increase of 8.6 percent.