

NGK+E
AUDIT
3/3/97

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3 JOHN OSSIFF, STATE BAR NO. 120149
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JAN 28 1997

LISA TAMR

By _____ Deputy

COPY

Attorneys for
CHINO BASIN WATERMASTER

8 SUPERIOR COURT OF THE STATE OF CALIFORNIA
9 FOR THE COUNTY OF SAN BERNARDINO - WEST DISTRICT

11 CHINO BASIN MUNICIPAL WATER)
12 DISTRICT;)

13 Plaintiff,)

14 v.)

15 CITY OF CHINO,)

16 Defendant.)

Case No. RCV 51010

) NOTICE OF MOTION AND MOTION
) FOR ORDER OF COURT THAT
) AUDIT COMMISSIONED BY THE
) CHINO BASIN MUNICIPAL WATER
) DISTRICT BOARD IS NOT A
) WATERMASTER EXPENSE;
) DECLARATION OF TRACI STEWART

) DATE: March 3, 1997

) TIME: 8:30 a.m.

) PLACE: Department H

) Specially assigned to the Honorable
) Judge J. Michael Gunn

22 _____)
23 NOTICE IS HEREBY GIVEN that on March 3, 1997, at 8:30 a.m., or as
24 soon thereafter as the matter may be heard, in Department H of the above entitled
25 court, located at 8303 North Haven Avenue, Rancho Cucamonga, California 91730-
26 3862, the Court will be requested to issue an order declaring that the costs of an audit
27 of Watermaster Services commissioned by the Board of the Chino Basin Municipal
28 Water District, acting at special meetings of the Chino Basin Watermaster on January

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 IN SUPPORT OF MOTION

3
4 I. INTRODUCTION.

5 An order of the Court is hereby sought declaring that the costs of an audit
6 of Watermaster Services commissioned by the Board of the Chino Basin Municipal
7 Water District (the "District") at meetings of the District Board on January 14 and
8 January 23, 1997, which were called as special Watermaster meetings on less than
9 30 days notice, are not properly Watermaster expenses. The Advisory Committee, by a
10 91.43% majority vote has directed Watermaster counsel to seek such an order because
11 the actions of the District Board in directing the audit were in violation of the
12 requirements of the Judgment and the Rules and Regulations of Watermaster.

13 In particular, the actions of the District Board are directly contrary to
14 mandated action by the Advisory Committee. The Judgment states that the
15 Watermaster Board may not take action contrary to mandated action unless and until
16 there has been a noticed motion before this Court and the Court has authorized action
17 contrary to mandated action. (Judgment, ¶ 38(c).) No such motion was filed, or even
18 requested.

19 The actions of the District Board failed to comply with the requirements of
20 the Judgment regarding notice of intended action by the Watermaster Board. If the
21 Watermaster Board wishes to take any discretionary action other than approval or
22 disapproval of Pool Committee action or recommendation properly transmitted, or to
23 execute any agreement not theretofore within the scope of an Advisory Committee
24 recommendation, the Judgment requires that notice of such intended action must be
25 served on the Advisory Committee and its members at least 30 days before the
26 Watermaster meeting at which such action is finally authorized. (Judgment, ¶ 38(b)(2).)
27 Less than 30 days notice was given of the intended action to direct that an audit be
28 conducted and to hire an auditor for that purpose.

1 been drawn upon Watermaster's bank account. Upon discovering this information, the
2 Chief of Watermaster Services immediately informed the bank and law enforcement
3 authorities. A different checking account was established and subsequently all funds
4 which were fraudulently transferred were restored by the bank. (Stewart Decl. ¶¶ 2, 3.)
5 The information was brought to the attention of the Advisory Committee which further
6 considered the situation at an Advisory Committee meeting on January 8, 1997. At that
7 meeting, the Advisory Committee was informed by a representative of the San
8 Bernardino County Sheriff's Department, which was investigating the matter, that
9 fraudulent activity of this type was not uncommon and could occur even if proper
10 procedures were in place. The Advisory Committee was informed that the amount that
11 had been fraudulently transferred, approximately \$26,000, had been fully restored by
12 the bank, and that an audit of Watermaster services could cost as much as \$30,000 to
13 \$35,000. (Stewart Decl. ¶ 4.)

14 The Advisory Committee decided that before expending so much money
15 on an audit, it would be prudent to gather together a group of financial experts from the
16 members of the Advisory Committee, the entities which supply the funds to
17 Watermaster which were subject to the fraudulent activity, to evaluate the issue. The
18 members of this Ad Hoc Finance Committee would participate without cost or expense
19 to Watermaster. They would examine Watermaster procedures and make
20 recommendations. The Ad Hoc Finance Committee was asked to make a
21 recommendation as to whether an audit was necessary or appropriate, and if so, what
22 the proper scope of such an audit would be.

23 At that January 8, 1997, meeting the Advisory Committee took the
24 following actions:

25 (1) It established, by a 91.43% majority vote, an Ad Hoc Finance
26 Committee to examine the financial procedures of Watermaster. If, after review, that
27 Committee determines an independent audit is necessary, that recommendation will be
28 forwarded to the Advisory Committee together with a delineation of the appropriate

1 On January 17th, the District gave notice of a January 23, 1997 special
2 Watermaster meeting to select an auditor and award a contract. (Steward Decl. ¶ 9.)

3 The Advisory Committee met again on January 22, 1997 and by a 91.43%
4 majority vote, voted to direct Watermaster counsel to advise the Watermaster Board of
5 the position of the Advisory Committee and to file this motion if the District Board took
6 action purportedly as Watermaster to retain an auditor.^{1/} On January 22, 1997,
7 Watermaster counsel sent a letter to the Watermaster Board advising the Watermaster
8 Board of the actions of the Advisory Committee and of the limitations on Watermaster
9 action in light of the mandated action by the Advisory Committee. (Stewart Decl. ¶ 10.)
10 A copy of the January 22, 1997, letter from Watermaster counsel is attached hereto as
11 Exhibit D.

12 At the January 23, 1997, special Watermaster meeting, the District Board
13 was again advised by Watermaster counsel that in light of the Advisory Committee
14 mandated action, the Watermaster Board did not have the authority to take the actions
15 which were being considered at that meeting. The District Board nevertheless
16 proceeded to take action. (Stewart Decl. ¶ 11.)

17 At the January 23, 1997, special Watermaster meeting, the District Board
18 announced that it had received proposals from several accounting firms. Mr. Larry
19 Rudder, the Chief Financial Officer of the District, reported that he had reviewed the
20 proposals and that he recommended that the firm of Soren, McAdam Bartells be hired.
21 The contact by the District with the various accounting firms had been done without any
22 input from Advisory Committee, Pool Committees or any parties other than Chino Basin

23
24 ^{1/} As was briefed and discussed before this Court in the motions last June, the
25 Advisory Committee is recognized as the chief decision making and policy
26 making body under the Judgment. The Watermaster itself functions in large part
27 as an executive officer, who acts subject to the direction of the Advisory
28 Committee. Watermaster counsel has been instructed to act in accordance with
the direction of the Chief of Watermaster Services, who in turn has been directed
to act at the direction of the Advisory Committee.

1 Water District never took action on this matter and never named a person to be its
2 representative. The other two districts did name representatives. (Stewart Decl. ¶ 12.)

3 The parties continued to meet to discuss alternatives at Pool Committee
4 meetings, Advisory Committee meetings and at special workshops called for the
5 purpose of discussing that issue. During this time, actions continued to transition to a
6 new Watermaster. Separate facilities, insurance, and retirement plan contracts were
7 acquired or initiated for Watermaster. (Stewart Decl. ¶ 12.)

8 A workshop to consider the issue of a new Watermaster is scheduled for
9 January 29, 1997, and an Advisory Committee meeting to take final action on the issue
10 is schedule for January 30, 1997. A motion for Court approval of a new Watermaster,
11 replacing Chino Basin Municipal Water District, may be filed with the Court in the
12 immediate future. (Stewart Decl. ¶ 12.)

13
14 **III. THE ACTIONS OF WATERMASTER WHICH ARE AT ISSUE HERE ARE IN**
15 **VIOLATIONS OF THE REQUIREMENTS OF THE JUDGMENT.**

16 **A. The Advisory Committee Is the Policy Making Body Under the**
17 **Judgment.**

18 The Judgment imposes clear conditions on the exercise of any powers of
19 Watermaster which have not been approved in advance by the Advisory Committee. If
20 the Watermaster wishes to take discretionary action which is not the subject of an
21 Advisory Committee recommendation, the Watermaster must give 30 days notice of the
22 meeting at which Watermaster intends to take action. (Judgment, ¶ 38(b)(2).) Section
23 38(b)(2) of the Judgment states:

24 "In the event Watermaster proposes to take any
25 discretionary action, other than approval or disapproval of
26 a Pool Committee action or recommendation properly
27 transmitted, or execute any agreement not theretofore
28 within the scope of an Advisory Committee

1 by CBMWD in its contract to provide services and facilities to Watermaster.^{2/} That
2 contract directs CBMWD employees who are working on Watermaster matters, which
3 includes the Chief of Watermaster Services, to take direction from and report to the
4 Advisory Committee. It states:

5 "Any district staff working on or providing assistance to
6 the Watermaster program shall receive their direction
7 from and report to the Advisory Committee." (Amended
8 Services and Facilities Contract, August 5, 1992, ¶ 6.)

9 Since the District Board did not follow required procedures, it lacked
10 authority to take action as Watermaster. It could not commit Watermaster funds.^{3/}

11 **B. The Actions of The District Board Acting as Watermaster With**
12 **Respect to Directing the Audit Be Conducted, Are Outside the**
13 **Scope of Authority of the Watermaster Under the Judgment.**

14 The Advisory Committee by a vote of over 80% mandated that
15 Watermaster take no action with respect to directing that an audit be conducted. The
16 Advisory Committee had determined that it would consider whether an audit was
17 necessary and if so what the proper scope of that audit would be, after receiving the
18 report from the Ad Hoc Finance Committee which the Advisory Committee had
19 appointed.^{4/} Despite this mandate, the District Board, at the special Watermaster

20
21 ^{2/} Watermaster staff is currently in the process of transitioning to a status
22 completely independent of Chino Basin Municipal Water District operations.

23 ^{3/} The funds of Watermaster are collected from assessments on the parties to the
24 Judgment. They are completely separate from funds of the Chino Basin
25 Municipal Water District. It is for this reason that the Judgment so clearly places
26 ultimate control over the use of those funds in the Advisory Committee, whose
27 members actually make the payments, and not in Watermaster.

28 ^{4/} The Ad Hoc Finance Committee has met. With respect to the issue of an audit, it
has indicated that its recommendation would be that instead of a separate audit,
the annual audit be expanded to include issues regarding Watermaster
procedures.

DECLARATION OF TRACI STEWART

I, Traci Stewart, declare as follows:

1. I am the Chief of Watermaster Services for the Chino Basin Watermaster ("Watermaster"). I have held that position since August 1994. In that position I am familiar with the records and operations of Watermaster. In addition, I serve as Secretary to the Advisory Committee which was established pursuant to the Judgment herein. I am familiar with the records and operations of the Advisory Committee. From February 1994 to August 1994, I assisted the Watermaster Committees as the Acting Director of Water Resources and as Water Resources Engineer for the Chino Basin Municipal Water District ("CBMWD"). From January 1992 through August 1994, I was employed as the Water Resources Engineer for the CBMWD. This Declaration is based upon my own knowledge of Watermaster and Advisory Committee records and operations, the operations of CBMWD, and my own personal knowledge.

2. In December 1996, I was contacted by a New York bank regarding a check which had been presented to the bank. The check was drawn upon the Watermaster account with the Bank of America. I was able to confirm that the check was a forgery. I immediately contacted Watermaster's bank, stopped payment on the forged check, closed the Watermaster checking account, informed the bank of the problem, and informed law enforcement agencies, including the San Bernardino County Sheriff's Department and the Federal Bureau of Investigation.

3. The funds which had been fraudulently transferred were restored in full by the Bank. This was confirmed in a letter from the Bank dated January 7, 1997, a copy of which is attached hereto as Exhibit A.

4. On January 8, 1997, a meeting was held of the Chino Basin Watermaster Advisory Committee. At that meeting information concerning the

1 (c) It defeated a motion that was made to recommend to the
2 Watermaster that the Board of Directors of the District conduct an examination and
3 review of the internal procedures utilized by Watermaster Services. This motion failed
4 by a 91.43% vote.

5 6. At the special Watermaster meeting on January 9th, the
6 Watermaster Board was informed that the Advisory Committee had recommended by
7 more than an 80% vote that Watermaster take no action with regard to seeking an
8 independent audit of Watermaster Services. The District Board took no action at the
9 January 9th special Watermaster meeting. Later on January 9th, the District requested
10 Watermaster staff to send out notice of a special Watermaster meeting for January
11 14th, to consider the issue of an audit.

12 7. On January 10th, Watermaster counsel sent a letter to the Vice
13 Chairman of the Board regarding the January 14, 1997, meeting. A copy of the letter is
14 attached hereto as Exhibit C.

15 8. At the January 14, 1997, special Watermaster meeting, the Board
16 met in closed session. It then, in open session, voted to conduct an audit immediately.

17 9. On January 17th, the District requested Watermaster staff to give
18 notice of a January 23, 1997 special Watermaster meeting to select an auditor and
19 award a contract.

20 10. The Advisory Committee met on January 22, 1997. At that
21 meeting, by a 91.43% majority vote, the Advisory Committee voted to direct
22 Watermaster counsel to advise the Watermaster Board of the position of the Advisory
23 Committee and if the District Board took action purportedly as Watermaster to retain an
24 auditor to file a motion for an order that the costs of such audit were not a Watermaster
25 expense. On January 22, 1997, Watermaster counsel sent a letter to the Watermaster
26 Board advising the Watermaster Board of the actions of the Advisory Committee. A
27 copy of that letter is attached hereto as Exhibit D.

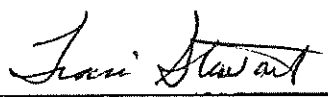
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January 29, 1997, and an Advisory Committee meeting to take final action on the issue is schedule for January 30, 1997.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

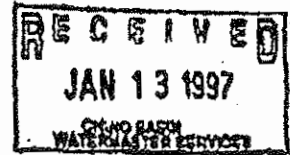
Executed on January 27, 1997, at Rancho Cucamonga, California.



Traci Stewart



Bank of America



****SPECIAL NOTICE****

Affidavit of Forgery Dept #20071
P.O. Box 3609
Los Angeles, CA 90051

January 7, 1997

CHINO BASIN WATERMASTER
8632 ARCHIBALD AVE SUITE 109
RANCHO CUCAMONGA, CA, 91730

We have completed an investigation on the Affidavit of Claimant form you recently submitted to Bank of America. On January 7, 1997 we credited your CHECKING account number for \$ 25,908.60.

We regret any inconvenience you may have experienced.

If you wish to discuss this matter, please call 1-800-317-6345 Monday through Thursday between 8:00 a.m. and 6:00 p.m., Friday between 8:00 a.m. and 7:00 p.m., and Saturday between 9:00 a.m. and 2:00 p.m.

Reference #2289-04DEC96
AS105

LSYZ:520 (D ADARCR:ADARCR23258)

Bank of America National Trust and Savings Association

EXHIBIT A



CHINO BASIN WATERMASTER

8632 Archibald Ave., Suite 109, Rancho Cucamonga, CA 91730
TEL: (909) 484-3888 • FAX: (909) 484-3890

TRACI STEWART

Chief of Watermaster Services

DATE: January 10, 1997
TO: Watermaster Committee Members
FROM: Traci Stewart
Chief of Watermaster Services
SUBJECT: Ad Hoc Finance Committee

At the Special Chino Basin Watermaster Advisory Committee meeting held on January 8, 1997, the Advisory Committee created an Ad Hoc Finance Committee to review the internal financial procedures and policies of the Chino Basin Watermaster. In creating this committee, Watermaster Committee Members volunteered the Chief Financial Officers, Controllers, or Accounting Managers from their respective cities, companies, or other entities to participate on the Ad Hoc Committee. A representative from the Chino Basin Municipal Water District, who serves as the current Watermaster, is also anticipated to participate and participation is open to all parties to the adjudication.

It is anticipated that this Ad Hoc Committee will be able to convene more quickly and provide a review in a more timely manner than it would be possible to retain a new, independent auditor. If the Committee concludes an audit is necessary, it will make that recommendation to the Advisory Committee.

The Ad Hoc Committee will work primarily with the Watermaster Controller, Alice Licht, to conduct the review. It is also anticipated the Committee will review the procedures and circumstances surrounding the recent fraudulent activity on the Watermaster accounts, will assist the Watermaster Controller and the Chief of Watermaster Services with decisions regarding future bank account control requirements suitable for an entity of the size and financial nature of the Chino Basin Watermaster and will assist with formulation of the scope for an RFP for a full and comprehensive audit should one be recommended. We are hopeful that among those who participate there will be a CPA or CMA as this was a primary concern of some of the committee members. The Committee is anticipated to conduct its meetings and develop a report and recommendation to be presented to the Advisory Committee at its next regularly scheduled meeting on February 13, 1997.

If you will be sending a representative to participate on the Ad Hoc Financial Committee, please call Watermaster Services on Monday, January 13, 1997, with the name and phone number of the representative. Watermaster Services will prepare a list of committee members and contact all designated representatives on Monday and Tuesday in an effort to hold the first committee meeting either the 15th or 16th of January, 1997.

Thank you in advance for your timely response and for sending a representative to participate on the Watermaster Ad Hoc Finance Committee.

TS:dc(ADHOCFIN.MEM)

EXHIBIT B

WATERMASTER ADVISORY COMMITTEE

AD HOC FINANCE COMMITTEE

1:30 p.m. - January 16, 1997

AGENDA

1. Review anticipated task list for completeness.
2. Schedule future meetings in an effort to complete tasks before February 13, 1997.
3. Time permitting, begin Task 1.

Anticipated tasks:

1. Review circumstances and facts surrounding fraudulent activity on Watermaster account.
2. Evaluate current internal financial policies, procedures and practices.
3. Make a recommendation to the Advisory Committee covering:
 - a. Can Watermaster Services do anything differently that will prevent fraudulent activity of this nature from happening in the future?
 - b. Are there any internal financial policies, procedures or practices that should be changed? If so to what?
4. Assist Watermaster Controller with decisions regarding type of new account and levels of controls necessary, if any.
5. Make a recommendation to the Advisory Committee as to whether a special audit is necessary.
6. Assist Watermaster Controller with developing the scope of an RFP to procure audit services for Watermaster for the annual audit, and for a special audit if one is recommended.

EXHIBIT B

LAW OFFICES
NOSSAMAN, GUTHNER, KNOX & ELLIOTT, LLP

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(1886-1264)

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915 L STREET
SACRAMENTO, CA 95814-3701
(916) 442-8888

REFER TO FILE NUMBER

January 10, 1997

Mr. George Borba
Acting Chairman
Chino Basin Municipal Water District
9400 Cherry Avenue
Building A
Fontana, CA 92335

Re: January 14, 1997 Special Watermaster Meeting

Dear Mr. Borba:

Watermaster has noticed a special meeting for January 14, 1997, to discuss in closed session, anticipated litigation and fraudulent activities on Watermaster accounts and related requests for audit. As counsel for Watermaster we believe it incumbent upon us to advise you of the following.

Section 38(b)(2) limits the action which Watermaster may take which is not within the scope of an Advisory Committee recommendation. Specifically, that section states:

"In the event Watermaster proposes to take any discretionary action, other than approval or disapproval of a Pool Committee action or recommendation properly transmitted, or execute any agreement not theretofore within the scope of an Advisory Committee recommendation, notice of such intended action shall be served on the Advisory Committee and its members at least thirty (30) days before the Watermaster meeting at which such action is finally authorized."

LAW OFFICES
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REFER TO FILE NUMBER

030719-001

January 22, 1997

VIA FACSIMILE AND U.S. MAIL

Mr. John L. Anderson
Chairman
Chino Basin Municipal Water District
9400 Cherry Avenue, Building A
Fontana, California 92335

RE: January 14, 1997 CBMWD Action re Independent Audit of Watermaster Services

Dear Mr. Anderson:

Our firm has been requested by the Chino Basin Watermaster Advisory Committee pursuant to a 91.43% vote, to explain the factual background and clarify its position relative to the above-referenced action of Chino Basin Municipal Water District ("CBMWD") as interim Watermaster. The intent of this letter is to foster better communication between the Advisory Committee and the interim Watermaster Board on this issue hopefully to avoid a dispute which might lead otherwise to extensive and time consuming court action.

On January 8, 1997, special meetings of the Watermaster Pool and Advisory Committees were held at which time a number of motions were considered relative to the recent fraudulent activity on Watermaster bank accounts. On this occasion the Advisory Committee took the following actions:

(1) Established an Ad Hoc Financial Committee to examine the financial procedures of Watermaster. If, after review, the Committee determines that an independent audit is necessary, that recommendation will be forwarded to the Advisory Committee together with a delineation of the appropriate scope of such audit. This motion carried by a 91.43% majority.

Mr. John L. Anderson
January 22, 1997
Page 3

As you know, the interim Watermaster has met on January 9 and January 14, 1997 on the subject of the independent audit. At the meeting of the Chino Basin Watermaster Board on January 9, 1997, the Board was informed that the Advisory Committee had recommended by more than an 80% vote that Watermaster take no action with regard to seeking an independent audit of Watermaster Services. Prior to the January 14 meeting CBMWD received a letter from our office to the effect that Watermaster may not take action which is not within the scope of an Advisory Committee recommendation without at least 30 days notice and that all meetings of Watermaster, whether regular or special, shall be open to the public. These comments were repeated by Mr. John Ossiff of our office who was in attendance at the January 14 meeting.

On January 14, 1997 Chino Basin purporting to act as the interim Watermaster determined after a closed session to conduct an independent audit of Watermaster Services, by a three to two vote. This action was in direct contravention of the Judgment Paragraph 38(b)[1] (relating to mandated actions), Judgment Paragraph 38(b)[2] (relating to the 30 days notice requirement), and Rule 2.06 of Watermaster Rules and Regulations (requiring that meetings shall be open to the public). In that Watermaster, as an instrument of the Court, is bound to adhere strictly to the terms and conditions of the Judgment and its own Rules and Regulations, Watermaster action in pursuing an independent audit is not justified and no Watermaster funds can be expended therefor.

It should be emphasized, however, that CBMWD, as a party to the Judgment has every right to hire an auditor and conduct an audit of Watermaster Services' practices. The Advisory Committee has no objection to such an audit and would welcome the District's participation on the Ad Hoc Finance Committee or its conduct of an independent audit, so long as the expense of that audit is borne by the District and not Watermaster.

I have been directed by a 91.43% vote of the Advisory Committee to seek a Court order declaring that any audit conducted by Chino Basin Municipal Water District, purporting to act as the interim Watermaster, is not an appropriate expense under the terms of the Judgment. Hopefully, CBMWD will conclude that it is not necessary to pursue such a course of action as the interim Watermaster, given the actions that the Advisory Committee has already taken and the opportunities open to CBMWD to participate in an evaluation of Watermaster Services' procedures. It is my sincere hope that another highly divisive court battle can be avoided and that the issues relating to the fraudulent activity on the Watermaster accounts can be addressed in a cooperative and nonconfrontational manner.

EXHIBIT D