



San Luis Obispo Local Agency Formation Commission

TO: MEMBERS OF THE COMMISSION

FROM: ROB FITZROY, EXECUTIVE OFFICER
MORGAN BING, ANALYST

DATE: DECEMBER 18, 2025

SUBJECT: STATUS UPDATE ON THE UPPER SALINAS – LAS TABLAS RESOURCE CONSERVATION DISTRICT’S OUTSTANDING FINANCIAL AUDITS AND OPTIONS FOR DISTRICT GOVERNANCE STRUCTURE CHANGES

RECOMMENDATION

Action 1: Receive and file an informational report regarding the status of Upper Salinas – Las Tablas Resource Conservation District’s outstanding financial audits and the process for a LAFCO-initiated change of organization.

Action 2: Direct staff to return with the Upper Salinas – Las Tablas Resource Conservation District Municipal Service Review and Sphere of Influence Study for approval, by resolution, including determinations that document financial deficiencies with a condition of approval requiring:

1. A 12-month remediation period for the District to complete financial audits for Fiscal Years 2023-24 and 2024-2025.
2. A directive for LAFCO staff to report back to the Commission at the conclusion of the 12-month period with an update and options for further consideration of a change of organization if the Commission deems remediation efforts unsatisfactory.

OVERVIEW

Background: State law requires Local Agency Formation Commissions (LAFCOs) to regularly prepare Municipal Service Reviews (MSRs) in conjunction with establishing and updating a local agency’s Sphere of Influence (SOI). The legislative intent of MSRs is to proactively assess the availability, capacity, transparency, financial health, and efficiency of local governmental services prior to making SOI determinations. MSRs may also lead LAFCOs to take other actions under their authority, such as forming, consolidating, or dissolving one or more local agencies.

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Consistent with the Commission's Fiscal Year (FY) 2025-26 Work Plan, staff prepared the MSR and SOI Study for the Upper Salinas – Las Tablas Resource Conservation District (USLTRCD or District) and presented the report (Attachment A) at the Commission's regular meeting on September 18, 2025. However, due to significant concerns expressed by the Commission regarding the District's financial transparency, noncompliance with audit requirements, and the findings outlined in the District's FY 2021–22 audit (Attachment B), the Commission postponed action on the MSR and SOI Study pending additional information.

At that meeting, the Commission directed LAFCO staff to return to the regular meeting on December 18, 2025, with a status update on the District's outstanding financial audits and options for District governance structure changes, including potential LAFCO-initiated consolidation with Coastal San Luis Resource Conservation District (CSLRCD). The following discussion provides additional details on the situation and outlines options available to the Commission.

Summary of Key Issues: The MSR and SOI Study and related correspondence highlight several ongoing governance and financial concerns and deficiencies:

- **Noncompliance with Government Code Section §26909**, which requires annual independent audits.
- **Disclaimer of Opinion** issued by the auditor for the District's FY 2021-22 and FY 2022-23 audits, citing various issues.
- **Attempted financial review in lieu of a required audit**, contrary to State Law and State Controller standards.
- **Delays and limited responsiveness** to repeated requests from LAFCO and the County Auditor for financial information.
- **Recent adoption of new financial controls and policies** (Attachments D – F), though required audits remain incomplete, and the effectiveness of these measures cannot yet be determined.

Timeline of Events:

April–June 2025

- **April 7:** LAFCO and District staff meet to launch the MSR and SOI Study. The District is asked to provide all outstanding audits by June 13 to meet the July hearing deadline.
- **April 24:** LAFCO notifies USLTRCD of completion of the administrative draft MSR and SOI Study (excluding the finance section due to missing audits) and requests an audit status update.
- **May 19:** LAFCO again requests an audit update; no response is received.
- **May 28:** District states FY 2022-23 audit "likely" to be ready by June 13.
- **May 30:** LAFCO transmits the administrative draft MSR and SOI Study to the District, requesting comments by June 13. No response is received.
- **June 16:** LAFCO requests an update on the FY 2022-23 audit.
- **June 19:** District informs LAFCO its CPA will prepare a *financial review* rather than an audit.

- **July 17:** County Auditor-Controller advises District that a financial review is not legally permissible under Government Code Section §26909.

July–September 2025

- **July 23:** No audit or financial review submitted. LAFCO resends the administrative draft and requests comments by August 8.
- **July 24:** District provides comments on the MSR and SOI Study administrative draft.
- **August 1:** LAFCO sends the finance section draft to the District; no feedback is received.
- **September 18:** LAFCO presents the MSR and SOI Study (Attachment A). The Commission continues the item pending audit status updates and analysis of consolidation options.

September–December 2025

- **September 25:** LAFCO formally requests audit timelines and explanations for delays (Attachment C).
- **October 31:** District submits Formal Response and Corrective Action Plan (Attachment D) stating intent to perform a *financial review* for FY 2022-23, citing concern that a full audit may result in a negative opinion affecting grant eligibility.
- **November 12:** District informs LAFCO it will instead conduct a full audit for FY 2022-23 and will provide a formal update by December 1.
- **December 1:** District provides a subsequent formal response (Attachment K) confirming intent to proceed with a financial audit for FY 2022-23, but was unable to provide an estimated timeframe for completion.
- **December 5:** District submits financial audit for FY 2022-23 (Attachment L), which resulted in another disclaimer of opinion. The District also provided its 2025 Annual Report (Attachment M) and a Letter of Support from Auten Resource Consulting (Attachment N).

Recommendation: Given the ongoing deficiencies and delays, staff recommend that the Commission adopt an MSR and SOI Study for USLTRCD documenting the deficiencies, while establishing a structured remediation period. This approach provides:

- **Structure:** A clear framework for corrective action.
- **Accountability:** Defined expectations for the District to meet statutory requirements.
- **Flexibility:** Preserves LAFCO’s authority to consider reorganization in the future – including consolidation or dissolution – should the Commission find that deficiencies persist beyond the remediation period.

AUDIT STATUS UPDATE

As directed by the Commission, LAFCO staff sent a memorandum to USLTRCD on September 25, 2025 (Attachment C), requesting a formal response from the District with firm deadlines for the completion of all outstanding audits and an explanation for the significant delays. On October 31, 2025, the District submitted a Formal Response and Corrective Action Plan (Attachment D), along with supporting documents (Attachments E-J). The documents provided were intended to address ongoing financial deficiencies and policy gaps.

In its October 31 correspondence, the District reported that after consultation with its independent Certified Public Accountant (CPA), the District had elected to conduct a Financial Review for FY 2022-23 rather than a full audit. The District's Financial Management Transformation and Improvement Plan (Attachment E) explained that pursuing an audit would likely result in a second consecutive disclaimer of opinion, which would be detrimental to the District's standing and funding prospects.

However, under Government Code Section §26909, it is widely known that all special districts are legally required to complete an annual independent audit of their financial accounts and records. Such audits must comply with Generally Accepted Auditing Standards (GAAS) and the guidelines established by the State Controller's Office. A Financial Review does not satisfy these statutory requirements, as it provides only limited assurance and does not adhere to GAAS. As noted in the timeline of events, the County Auditor-Controller's Office communicated in July 2025 that the District is not authorized to substitute a Financial Review for a required audit.

Despite this information, the District indicated that the Financial Review would be submitted to LAFCO by November 14th. This deadline was not met, and on December 1, 2025, LAFCO received a formal follow-up response (Attachment K) in which USLTRCD stated that after further consultation with various parties, the District would proceed with a full financial audit for FY 2022-23 to comply with regulatory requirements. The District was unable to identify a timeframe for completion of this audit as of December 1, 2025.

On December 5, 2025, the District unexpectedly submitted the audit for FY 2022-23, dated December 1, 2025. Similar to the District's FY 2021-22 audit, the audit for FY 2022-23 resulted in another disclaimer of opinion due to the auditor being unable to obtain auditable records to enable testing to provide a basis for an audit opinion. The audit stated that USLTRCD did not maintain adequate accounting records to support the amounts reported in the financial statements. Specifically:

- Documentation supporting revenues and expenditures was incomplete
- Bank reconciliations were not performed for major funds
- Supporting schedules for capital assets and liabilities were not available
- Internal Controls were absent

Regarding subsequent audits, the District reported that an engagement letter for the FY 2023-24 has been executed, with the audit scheduled to begin once the FY 2022-23 audit is completed. The District further stated that the FY 2024-25 audit engagement will commence following completion of the FY 2023-24 audit. Estimated completion dates were not provided for either of these audits.

| Fiscal Year | Audit Status |
|-------------|---|
| FY 2021-22 | Completed – Retained auditor was unable to obtain sufficient appropriate evidence in order to provide an opinion |
| FY 2022-23 | Completed – Retained auditor was unable to obtain auditable records to enable testing to provide a basis for an audit opinion |
| FY 2023-24 | Outstanding as of June 2025 - commenced upon completion of FY 2022-23 audit |
| FY 2024-25 | Due by June 2026 - to commence upon completion of FY 2023-24 audit |

LAFCO INITIATED CHANGE OF ORGANIZATION PROCESS

As noted above, the Commission directed staff to return with an overview of LAFCO initiated processes in context to the above situation. Under Government Code Section §56375, LAFCO holds the authority to initiate specific changes of organization, including consolidation, dissolution, merger, or the formation of a new district. For the circumstances at hand, the most applicable options are consolidation or dissolution. Under Government Code Section §56000, consolidation and dissolution refer to two distinct types of organizational changes for special districts.

Consolidation is defined under Government Code Section §56030 as the uniting or joining of two or more agencies into a single new successor agency. The result is a new district that assumes the powers, duties, and responsibilities of the former districts. This option is often pursued to improve efficiency, reduce duplication of services, and streamline governance.

Dissolution is defined in Government Code Section §56034 as the termination of the existence of a district and the cessation of all of its powers. When a district is dissolved, its responsibilities, assets, and liabilities are typically transferred to another agency (such as a county or successor district) as determined by LAFCO. This option is usually pursued when a district is inactive, financially unsustainable, or no longer needed to provide services.

The following section provides a summary of the applicable processes and a discussion of key considerations associated with any LAFCO-initiated action.

LAFCO Initiated Change of Organization per Government Code Section §56375: LAFCOs are authorized to initiate certain proposals for changes in local government organization, such as consolidation of two special districts or dissolutions, only if the proposal is consistent with recommendations or conclusions in the MSR and SOI Study or other study prepared by the Commission (Government Code Section §56378) and if the Commission makes the

determinations specified in subdivision (b) of Government Code Section §56881. A process flowchart is available as Attachment O.

Under subdivision (b) of Government Code Section §56881, LAFCO must make the following two determinations:

- 1) *Public service costs of a proposal that the commission is authorizing are likely to be less than or substantially similar to the costs of alternative means of providing the service.*
- 2) *A change of organization or reorganization that is authorized by the commission promotes public access and accountability for community services needs and financial resources.*

If a determination is made to initiate a change of organization or reorganization, the Commission may adopt a resolution of application that describes the proposal. A LAFCO-initiated proposal will be considered to be submitted on the date the LAFCO resolution of application is adopted.

Process Overview

The Commission will consider the Executive Officer's report and recommendation at a noticed public hearing. At the hearing, the Commission may adopt a resolution denying, modifying, or approving the proposed change or organization, or reorganization. If a LAFCO-initiated proposal is approved, the Commission will order the change of organization or reorganization pursuant to Government Code Section §57113.

Protest Process

For any proposal initiated by the Commission, a protest hearing will be held for the affected territory. The Commission shall order the change of organization or reorganization without an election, provided that a majority protest, or sufficient petitions requesting an election have not been filed. The Commission will order the change of organization or reorganization, subject to an election if it finds either of the following:

- If a proposal is approved, it may be subject to protest proceedings:
 - <10% protest: LAFCO may order the change without an election.
 - 10–50% protest: An election must be held.
 - ≥50% protest: The proposal is terminated.

LAFCO-Initiated Dissolution Under Government Code Section §56375.1: This dissolution process differs from that described above and generally requires a higher evidentiary bar to more appropriately justify a higher protest threshold of 25%. This process also requires a one-year remediation period to allow the affected agency to correct applicable issues. At a public hearing, based on a preponderance of the evidence, the Commission must find that more of the conditions listed below are met. In addition, the Commission must first adopt a Notice of Intent to Initiate Dissolution based on one or more of the conditions listed below. The Resolution shall provide a one-year remediation period to allow the district to remedy the situation.

1. The district has one or more documented chronic service provision deficiencies.
2. The district spent public funds in an unlawful or reckless manner.

3. The district has shown willful neglect by failing to consistently adhere to the California Public Records Act.
4. The district has failed to meet the minimum number of times required in its principal act in the prior calendar year and has taken no action to remediate the failures to ensure future meetings are conducted on a timely basis.
5. The district has consistently failed to perform timely audits in the prior three years.
6. Recent annual audits show chronic issues with the district’s fiscal controls, and the district has taken no action to remediate the issues.

(ii) If the commission finds that the district has failed to remedy the deficiencies, the commission may adopt a resolution to dissolve the district, making the determinations in paragraph (1) and in subdivision (b) of Government Code Section §56881. That is, the Commission shall determine:

1. *Public service costs of a proposal that the commission is authorizing are likely to be less than or substantially similar to the costs of alternative means of providing the service.*
2. *A change of organization or reorganization that is authorized by the commission promotes public access and accountability for community services needs and financial resources.*

Key Differences of Consolidation and Dissolution: The following table outlines the key differences between consolidation and dissolution under Government Code Section §56375 and dissolution under 56375.1.

| Topic | Consolidation (§56375) | Dissolution (§56375) | Dissolution (§56375.1) |
|--------------------------------------|---|--|---|
| Creates / Eliminates District | Consolidates and creates a new district | Eliminates district immediately after protest period | May eliminate district after 1-year remediation |
| Protest Threshold | 10% - 50% election >50% action terminated | 10% - 50% election >50% action terminated | 25% - 50% election >50% action terminated |
| Remediation Period | No | No | Yes — 1 year |
| Successor Agency Required | Not applicable, consolidation process establishes a new District | Yes | Yes |
| Best Used When | Service inefficiencies, redundancy, or financial related concerns | A district is inactive, financially unsustainable, or no longer needed to provide services | A district has any of the issues noted above in items 1-6. |
| Feasibility | Feasible, but there are important factors to consider | Feasible, but there are important factors to consider | Feasible, subject to 1 year remediation period, and there are important factors to consider |

Other Important Considerations: Any LAFCO-initiated action involves important considerations and implications beyond those previously described. The following outlines key factors that must be evaluated prior to initiation of any application for a change of organization.

Costs and Workload

If the Commission chooses to initiate a change of organization, LAFCO would be responsible for application processing costs, which include staff time and legal counsel expenses. For USLTRCD, the protest process could be particularly costly due to the large number of landowners and registered voters within the affected territory. If the protest process results in an election, LAFCO would be responsible for all election-related expenses, which could be substantial.

It is important to note that even if LAFCO initiates a change of organization, substantial staff involvement from both affected Districts may still be required. Neither USLTRCD nor CSLRCD receives property tax revenue or any other stable revenue source; both rely primarily on grant funding. External resources would likely need to be identified to support this effort.

Lastly, the LAFCO staff workload could be affected. If any LAFCO-initiated change of organization is pursued, staff recommend that the Commission revisit its adopted annual Budget and Work Plan to ensure that the effort is factored into our budget and workload planning.

Assets and Liabilities

According to the FY 2022–23 audit, the District’s current assets and liabilities remain undetermined. For any potential change of organization, it is critical to establish a clear understanding of these financial positions to enable either the transfer of assets and liabilities to a successor agency or to provide for an orderly wind-down of operations in the event of dissolution. Completing the outstanding audits will likely be necessary regardless of the chosen course of action. Therefore, allowing the District to finalize these audits is a prudent step to ensure accurate financial reporting and compliance with statutory requirements.

Successor Agencies

Consolidation does not require a successor agency because the process creates a new district altogether. Dissolution, however, does require a successor agency if services are to continue in the affected territory. In this case, the most logical successor agency may be the Coastal San Luis Resource Conservation District (CSLRCD). Following dissolution, CSLRCD would need to annex the dissolved USLTRCD territory to resume service—a process that cannot be initiated by LAFCO.

Grant Contracts

The specific terms and conditions of USLTRCD’s grant agreements are currently unknown. Additional information is required to determine whether, in the event of consolidation or dissolution, existing grants can be legally or administratively transferred to a successor agency. Further coordination with granting entities and additional time will be necessary to clarify which agency would assume responsibility under the contracts, and whether consolidation is feasible given these contractual obligations.

RECOMMENDATION

Given the need for additional information and the District's efforts to adopt and implement new financial policies, staff recommend that the Commission pursue a remediation approach rather than an immediate change of organization.

Specifically, staff propose returning in the near term with a Municipal Service Review and Sphere of Influence Study for USLTRCD that documents the financial deficiencies identified above. In addition, staff recommend including a condition of approval that requires a 12-month remediation period for the District to complete financial audits for FY 2023-24 and 2024-25. At the conclusion of the 12-month period, LAFCO staff will report back to the Commission with an update and options for further consideration of a change of organization if the Commission deems remediation efforts unsatisfactory. Overall, staff recommend this approach because it:

- Provides transparency and accountability
- Respects due process and district autonomy while addressing deficiencies
- Avoids premature structural reorganization before all information is known
- Preserves LAFCO's authority to act if deficiencies persist
- Addresses core financial concerns through documented remediation efforts
- Gives the District time to complete outstanding audits, which may be necessary regardless of future organizational changes
- Enables the Commission to make an informed decision on whether consolidation or dissolution is the most effective solution, or if alternative strategies would better resolve the deficiencies

Recommendation: Direct staff to return with the Upper Salinas – Las Tablas Resource Conservation District Municipal Service Review and Sphere of Influence Study for approval, by resolution, including determinations that document financial deficiencies with a condition of approval requiring:

1. A 12-month remediation period for the District to complete financial audits for Fiscal Years 2023-24 and 2024-2025.
2. A directive for LAFCO staff to report back to the Commission at the conclusion of the 12-month period with an update and options for further consideration of a change of organization if the Commission deems remediation efforts unsatisfactory.

Alternatives for Action

Alternative 1: Move forward with consolidation pursuant to Government Code Section §56375 in the near term.

Alternative 2: Move forward with dissolution pursuant to Government Code Section §56375 in the near term.

Alternative 3: Move forward with dissolution pursuant to Government Code Section §56375.1 (higher protest threshold and remediation period).

Alternative 4: Direct staff to return with the MSR for approval that includes determinations that document existing financial deficiencies and take no further action.

ATTACHMENTS

Attachment A: USLTRCD MSR and SOI Study Public Review Draft

Attachment B: USLTRCD Financial Statements, June 30, 2022

Attachment C: LAFCO Memorandum – Request for Additional Information Following September 18, 2025, Commission Hearing

Attachment D: USLTRCD Formal Response and Corrective Action Plan

Attachment E: USLTRCD Financial Management Transformation and Improvement Plan

Attachment F: USLTRCD Fiscal Policy and Procedure Manual

Attachment G: Resolutions Ratifying and Confirming Actions and Expenditures for the Fiscal Year Ended June 30, 2023, 2024, and 2025

Attachment H: Resolution No. 2025-08 to Rescind the Calendar Year 2025 Budget and Adopt the Fiscal Year 2025-26 Budget

Attachment I: Resolution No. 2025-09 Authorizing the Submission of the Fiscal Year 2022-2023 Reviewed Financial Statements and a Corresponding Explanatory Letter to LAFCO

Attachment J: Example of Monthly Budget-to-Actual Report – July 1 – August 31, 2025

Attachment K: USLTRCD Formal Response Update, December 1, 2025

Attachment L: USLTRCD Financial Statements, June 30, 2023

Attachment M: USLTRCD 2025 Annual Report

Attachment N: Letter of Support for the USLTRCD, Auten Resource Consulting

Attachment O: LAFCO-Initiated Change of Organization / Reorganization Flowchart