



FACT SHEET

Date: June 28, 2012

Report: 2011-131

The California State Auditor released the following report today:

City of Vernon

Although Reform Is Ongoing, Past Poor Decision Making Threatens Its Financial Stability

BACKGROUND

With a population of only 112 people, the City of Vernon (city) is home to more than 1,800 businesses that provide nearly 55,000 jobs. In response to past scandals involving three former city executives, allegations of corruption, misspending and mismanagement, the Legislature introduced a bill that, if enacted, would have disincorporated the city. The city spent more than \$3.5 million to lobby members of the Legislature regarding the disincorporation bill and other proposed legislation. Although the disincorporation bill was not enacted, the city agreed to implement numerous governance reforms. Besides the disincorporation efforts, several former city officials have been convicted of crimes, and the city has been subjected to several external reviews over the past several years. Moreover, the city's general fund—the primary operating fund used to account for all revenues and expenditures necessary to carry out many basic governmental activities—receives much of its revenue from taxes, but a significant portion of its expenditures are paid through one-time revenues, transfers from other city funds, and other smaller revenue sources, which are dwindling. As such, the city is facing financial difficulties—in fiscal year 2010–11, its general fund expenditures exceeded revenues by \$28 million.

KEY FINDINGS

During our review of the city's management and finances, including its Light & Power Department (power department), we noted the following:

- Although the city is making progress in enacting reforms, it has not developed policies and procedures to implement some reforms and for others—such as removing the requirement that city employees serve at the will of the city council—it will take years to achieve the reform's full benefit.
- The city has not properly managed its executive positions and has been without a director of human resources since July 2009.
 - ✓ It lacks clearly written, comprehensive processes for hiring and evaluating its executives and it has not established minimum qualifications for the city administrator, city treasurer, and city clerk.
 - ✓ The salary survey the city completed to set executive salaries did not consider important factors such as the organizational size and structure of cities or the education and experience of the individuals it compared itself to. Further, when the council voted to reduce salaries, it decided to wait until the completion of the members' terms to fully reduce the salaries—thus, salaries remain high.
 - ✓ Even though it faces financial difficulties, the city continues to provide a significant number of its long-time employees longevity payments from a discontinued program—an additional monthly compensation based on length of service, which can amount to 25 percent of the employee's monthly salary.
 - ✓ Some current and past city executives have received legally questionable retirement benefits.
- The city has poor practices for developing, awarding, and making payments on contracts. Of the 25 contracts we reviewed—including eight that were active as of March 2012—we noted problems with 21 including:



- ✓ Some contracts were awarded without a competitive bidding process. In one instance, the city council approved contracting with a specific real estate consultant for assistance in acquiring and selling industrial real estate. With no evidence of rebidding and without requiring invoices, the city extended this contract four times over a three-year period before letting it expire. The city ultimately paid the consultant \$775,000.
 - ✓ Thirteen of these 25 contracts did not include limits on the amount it would pay contractors—over a nearly six and a half-year period, the city paid these 13 contractors more than \$105 million.
 - ✓ Over this same period, the city paid nearly \$62 million to 10 contractors with contracts that had no ending dates stipulated in the contract.
 - ✓ Eleven contracts contained poorly defined scopes of work or deliverables and the city frequently approved and paid invoices that were not sufficiently detailed about the work performed—one law firm’s invoice only included a statement “review of city administrative matters” as support for charges of more than \$530,000.
- The city generally has not required its consultants to file statements of economic interests even though it uses several consultants to provide advice on significant financial transactions, such as bond issues, city financing, and purchasing assets.
 - The city’s general fund has operated at a structural deficit for more than 20 years and over the last five years has reached its highest level—with deficits ranging from \$21 million and \$33 million each year. The yearly deficits worsened as revenues declined and expenditures began to significantly increase largely due to the increased costs of salaries and benefits for police and fire staff, increased benefit costs for other employees, and the cost of legal and professional services focused mainly on the city’s efforts to combat disincorporation.
 - The city does not have a policy to guide and provide transparency in its decisions to issue debt—since 2004 the city issued more than \$1.3 billion in bond debt primarily from its power department, approximately \$571 million of which is still outstanding.
 - Most of the debt service payments of more than \$60 million a year for the next 10 years will come from the power department, which has struggled to manage its debt burden while maintaining competitive electric rates—rates that will likely increase due to a \$24 million forecasted deficit in its light and power fund during the next fiscal year.
 - In using interest rate swaps—a form of a financial derivative—to hedge the risks associated with issuing bonds, the city exposed itself to financial risks that have proven to be costly. The city has since terminated all but two of the swaps at a cost of \$33.4 million.
 - The city lacks a clear energy strategy—the city sold its electrical power plant shortly after completing its construction and less than two years after it purchased a 15-year prepaid supply of natural gas to fuel it.

KEY RECOMMENDATIONS

Among the numerous recommendations we make, we recommend the city:

- Increase the accountability and transparency in its governance, including that it develop complete and appropriate personnel policies and procedures for hiring, setting salaries, and evaluating executives.
- Exercise better control over contract expenses and ensure the best value for services it purchases.
- Comply with its conflict-of-interest policy to ensure that designated individuals are identified and file their statements of economic interests and determine which consultants should file such statements.
- Address the structural deficit in the city’s general fund and encourage the city to seek long-term solutions, prepare budgets in accordance with the Vernon City Code and best practices, and to regularly monitor and report on the budget.
- Establish a comprehensive debt policy to guide decisions for issuing debt and to ensure the council has the information needed to make informed decisions about debt, develop strategies for terminating outstanding swaps, and ensure sufficient analyses are documented to support its energy-related transactions.

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