



October 16, 2019

Letter Report 2019-806

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

This letter report provides a statutorily required update on our assessment of the status of the city of Hemet (Hemet) as a high-risk entity under the California State Auditor (State Auditor) high-risk local government agency audit program. In August 2016, we issued Report 2015-806, which detailed the results of our audit of Hemet and concluded that Hemet's issues related to its finances and organization renders the city at high risk. State regulations require a local entity that the State Auditor has designated as high risk to submit written updates and supporting information regarding its progress in addressing the areas of risk identified in the report to us within six months of the date the report is published and every six months thereafter. State law also requires us to issue a report at least once every three years with recommendations for improvement until we determine that the local entity has addressed the areas of risk identified and is no longer high risk.

In the three years since we issued the August 2016 audit report, Hemet has provided just three updates, one each in August 2016, May 2017, and August 2017. Following our receipt of the August 2017 update, the city underwent several changes in leadership. Significantly, the city manager in place at the time of the August 2017 update resigned that same month. The city hired a new city manager, who failed to provide any requested updates on the city's progress, even though we made several requests for further updates. In March 2019, the city council terminated his contract and Hemet's deputy city manager is currently serving as the interim city manager until the city can recruit and hire another new permanent city manager. We met with the interim city manager in May 2019 to discuss the status of Hemet's actions to address the areas of risk we identified in our August 2016 report, and we reviewed documents that Hemet provided in response to our inquiries. Despite the continued turnover in the city manager position—an area of risk that we identified in our audit report—Hemet has made some progress in addressing our audit's identified areas of risk. We discuss here that progress and the areas in which the city must still work to mitigate risk factors.

Risk Area: Expenditures Continue to Outpace Revenue, Impeding Hemet's Ability to Meet Its Financial Obligations

In June 2019, the city council approved Hemet's fiscal year 2019–20 budget. Due in part to a transfer to the general fund of \$1.2 million of its Measure U revenue—an addition of one cent to the sales tax that voters approved in 2016 to raise funds for public safety—Hemet balanced its general fund budget. Although Measure U is a general tax that the city can use for any purpose, the city council adopted a non-binding resolution that the city may only use Measure U proceeds

to fund its public safety costs. The city also set up a Measure U oversight board to ensure that the city uses the funds for their intended purpose. The interim city manager proposed the transfer of Measure U funds to the general fund in the city's fiscal year 2019–20 budget, and the oversight board approved it. Without several other, smaller transfers from other city funds and the Measure U transfer to offset public safety costs, Hemet's general fund budgeted expenditures would have exceeded its revenues.

In our August 2016 report, we noted that the city's five-year expenditure and revenue projections in use at the time of our audit were inaccurate and overly optimistic. We recommended that Hemet reassess its projections and revise them as necessary. When the interim city manager submitted the proposed fiscal year 2019–20 budget to the city council, he also reported that it was important for the city to develop a financial model to project general fund expenditures over the next several years. He explained that although the city has balanced its fiscal year 2019–20 budget, most of the one-time revenues—such as some of the fund balance transfers—will not be available to balance future years' budgets. The interim city manager indicated that the financial model would incorporate increased costs due to staff compensation and pension costs, among other things, in order to accurately project the city's future expenses. As guidance from the Government Finance Officers Association indicates, it is essential for a local government to prepare multi-year expenditure projections in order to determine whether its projected expenditure levels are sustainable, new programs are affordable, and current and future costs of programs are acceptable compared to the benefits and the anticipated available revenue. Accordingly, and in line with our original recommendation to reassess and revise its expenditure and revenue projections, we believe it is critical that Hemet develop a financial model to project accurately its future expenditures before the city develops its fiscal year 2020–21 budget.

Risk Area: Ineffective and Inefficient Organizational Management Negatively Affects Hemet's Provision of Public Services

In our August 2016 report, we identified inconsistencies in Hemet's outsourcing of maintenance activities as an area of risk. As of August 2017, the last update the city provided to us, the city had yet to take action to address this area of risk. We also identified in our previous report that the city may be able to recover some of its costs associated with providing emergency medical services by charging a fee that did not exceed the cost of providing those services. As a part of reviewing the fiscal year 2019–20 budget, the city council directed staff in May 2019 to explore the cost savings or revenue generating potential of multiple items, some of which were based on the areas of risk that we identified as a part of our audit. For example, the council directed staff to explore outsourcing the maintenance of parks, streetscapes, and the library, and to review the feasibility of charging fees to recover the cost for emergency medical services.

We further recommended in our report that the city reorganize its government structure in order to better align similar functions and provide opportunities to leverage staff resources. For instance, we identified that Hemet could consider shifting its code enforcement operations from the community development department to the police or fire departments in order to better help the city address public safety concerns. As a part of its review of the fiscal year 2019–20 budget, the city council directed staff to explore a citywide organizational assessment that would improve productivity and enhance efficiencies in order to identify potential savings or revenue generation opportunities.

Hemet has recently initiated steps to address the areas of risk we identified in our report, but—as we show in the table—it has not made sufficient progress for us to remove the high risk designation. Although the city council has recently directed staff to explore the feasibility of various actions we recommended, as of September 2019, the interim city manager confirmed that staff has not completed its analysis and the city has not yet determined what actions—if any—it will take. For other specific risks about which the city has previously provided us updates, we have assessed those efforts to address the risks as *pending*¹ or *partially addressed*, and, in one instance, as *no action taken*. Accordingly, we look forward to receiving Hemet’s next corrective action plan and working further with the city as it continues to address the areas of risk that our August 2016 report identified.

Table

State Auditor Assessment of Hemet’s Progress in Addressing Areas of Risk

AREA OF RISK	ASSESSMENT	
	AUGUST 3, 2017	OCTOBER 16, 2019
Expenditures Continue to Outpace Revenue, Impeding Hemet’s Ability to Meet Its Financial Obligations		
Ongoing budget deficit	Pending	Pending
Rising pension cost	Partially addressed	Partially addressed
Use of city-supported library by nonresidents	No action taken	No action taken
Significant retiree medical costs and unfunded liability	Partially addressed	Partially addressed
Ineffective and Inefficient Organizational Management Negatively Affects Hemet’s Provision of Public Services		
Underfunded fire department	Partially addressed	Partially addressed
Lack of coordinated approach to promote community engagement	Pending	Pending
Inefficient structure of city government	Pending	Pending
Turnover of key positions and lack of consistent leadership	Pending	Pending
Inconsistencies in outsourcing maintenance activities	No action taken	Pending

Source: Analysis of financial and other documents provided by Hemet.

Respectfully submitted,



ELAINE M. HOWLE, CPA
California State Auditor

For questions regarding the contents of this report, please contact
Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

¹ We identify an area of risk as *pending* if the entity has identified action it plans to take to address the area of risk but has not yet completed any of the steps in its plan. For example, we identify in the table the risk area of “lack of coordinated approach to promote community engagement” as pending because Hemet stated in its previous updates that it would create a plan for community engagement, but it has not yet taken steps to do so.