



## *City of Lynwood*

Poor Management Has Contributed to Its  
Financial Instability and Led to Its Failure to  
Comply With State Law

*December 2018*



REPORT 2018-803





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December 4, 2018

2018-803

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

Dear Governor and Legislative Leaders:

As approved by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the city of Lynwood (Lynwood), conducted as part of our high-risk local government agency audit program.

This report concludes that Lynwood is a high-risk city due to its financial and organizational risks. Specifically, Lynwood operated with a structural deficit for many years. Although the city projects its general fund operating revenues to exceed operating expenditures in fiscal year 2018–19, we question whether it will be able to sustain that level of financial activity due to recent salary increases and the use of one-time revenue. Additionally, the city has violated state law by using restricted funds to pay for certain personnel costs. We also identified organizational inefficiencies that limit Lynwood's ability to provide public services, such as high turnover in key leadership positions and an inability to effectively measure staffing needs. To address these concerns, we present several recommendations, such as developing policies and procedures to safeguard the city against waste, fraud, and inaccurate financial reporting. We also recommend that the city cease its inappropriate and unlawful use of restricted funds.

Respectfully submitted,

A handwritten signature in black ink that reads 'Elaine M. Howle'. The signature is written in a cursive, flowing style.

ELAINE M. HOWLE, CPA  
California State Auditor

## Selected Abbreviations Used in This Report

GFOA	Government Finance Officers Association
utility authority	Lynwood Utility Authority
Lynwood	city of Lynwood
CAFR	comprehensive annual financial report
local high-risk program	State Auditor's high-risk local government agency audit program

# HIGH RISK ISSUES

## City of Lynwood, Los Angeles County

Risk Designation: High Risk

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<ul style="list-style-type: none"> <li>Operated with a structural deficit for many years.</li> <li>Developed inaccurate fund-balance projections for its general fund, distorting its financial outlook.</li> </ul>	
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<ul style="list-style-type: none"> <li>Approved a contract amendment that significantly changed the contract's scope of services and increased city expenditures.</li> <li>Intentionally bypassed competitive bidding requirements for nearly 50 contracts through a provision in its municipal ordinance that provides city council with such discretion.</li> </ul>	
<i>Inadequate controls over its financial operations</i>	22
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<b>INEFFECTIVE ORGANIZATIONAL MANAGEMENT DIMINISHES LYNWOOD'S ABILITY TO PROVIDE PUBLIC SERVICES</b>	
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<ul style="list-style-type: none"> <li>Does not have a formal citywide plan for guiding its departments and personnel on its vision and mission.</li> <li>Allows reporting on goals, objectives, and measures through its annual budget without a uniform approach.</li> </ul>	
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<ul style="list-style-type: none"> <li>Experienced reductions in its workforce during the past decade despite increases in city services.</li> <li>Has not measured and quantified its workload need for some departments.</li> </ul>	
<i>Significant turnover in key positions and no plan for identifying future leadership</i>	28
<ul style="list-style-type: none"> <li>Experienced frequent turnover in the city manager position and among leaders of four key departments.</li> <li>Has not developed a formal plan for ensuring continuity of operations and maintaining institutional knowledge.</li> </ul>	
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## RISKS FACING THE CITY OF LYNWOOD

In October 2017, the California State Auditor (State Auditor) informed the city of Lynwood (Lynwood) that it had been selected for review under the high-risk local government agency audit program (local high-risk program). The program authorizes the State Auditor to identify local government agencies that are at high risk for potential waste, fraud, abuse, or mismanagement, or that have major challenges associated with their economy, efficiency, or effectiveness. We initially identified Lynwood, a city located in south central Los Angeles County with a population of more than 70,000, as an entity that might be classified as a high-risk local government entity based on publicly available information. The State Auditor conducted an initial assessment of Lynwood in October and November 2017 and identified concerns regarding Lynwood's persistent budget deficits, high turnover among its key leadership positions, and its lack of policies to ensure sound financial management.

In January 2018, Lynwood provided the State Auditor with an update on its progress in addressing the risk factors we identified. In particular, Lynwood cited several actions including the approval of a temporary sales tax and the hiring of a progressive, permanent finance team as steps being taken to strengthen the financial stability of the city. Further, Lynwood reported that it had hired the necessary staff citywide to address its service provision needs—specifically in its finance department—and to institute policies and procedures to ensure sound financial management. However, based on our continuing concerns regarding its financial and operational challenges, we recommended an audit of Lynwood, which the Joint Legislative Audit Committee (Audit Committee) approved in May 2018.

Between the end of fiscal years 2012–13 and 2016–17, Lynwood's general fund balance declined from approximately \$6.5 million to \$2.6 million. The city's largest expenditure has been the cost for contracting with Los Angeles County for fire and sheriff services. This expenditure—\$16 million in fiscal year 2016–17—consumed approximately 60 percent of the city's general fund revenue during that year, but it appears there is little the city can do to reduce this amount other than to reduce the services provided by the county. In July 2016, the city declared a fiscal emergency; the following November, Lynwood voters passed a measure instituting a temporary sales tax of 1 cent effective April 2017 through March 2027 to generate additional revenue for the city's general fund. According to Lynwood's fiscal year 2017–18 adopted budget, this additional revenue will allow the city to balance its fiscal year 2017–18 budget without tapping into its general fund reserves.

Lynwood, however, had significant difficulty determining the actual ending balance of its general fund for fiscal year 2016–17, which was the basis for the fund balance at the beginning of fiscal year 2017–18. Although Lynwood's fiscal year 2017–18 budget stated the city would operate with a beginning-of-year fund balance of approximately \$3.8 million, the city significantly revised this projection in March 2018—nine months into the fiscal year. By then, city staff reported to the city council that the general fund starting balance for fiscal year 2017–18 was actually closer to \$1 million. Following the revision to the beginning-of-year fund balance, Lynwood imposed a hiring freeze on nonrevenue generating positions for the remainder of fiscal year 2017–18, which was intended to reduce the drain on the city's general fund balance.

Lynwood estimates that its general fund will end fiscal year 2018–19 with a balance of \$6 million. However, we question the accuracy of the city’s beginning-of-year fund balance and the use of one-time revenue to balance its budget. Accordingly, we are concerned that Lynwood is at high risk of operating at a deficit in fiscal year 2018–19.

The city has experienced frequent turnover among its key leadership positions since fiscal year 2014–15. During this period, the city transitioned through multiple directors in four departments and changed city managers three times. Although as of October 2018 the city had no vacancies in its key leadership positions, Lynwood has not established a succession plan that would assist it in limiting the loss of institutional knowledge resulting from future leadership turnover. Without such a plan in place, we believe the city is at high risk that future turnover among the city’s key leadership positions would result in further loss of institutional knowledge and disruption of core operations, hampering its ability to provide services.

We also determined that the city is at high risk of waste, fraud, and noncompliance with state law. The city council’s discretion to frequently forego competitive bidding and its discretion to amend current contracts without any limitations places the city at risk of wasting resources by not procuring goods and services at the best value. Because it lacks adequate policies and procedures for functions such as procurement and financial reporting, the city is also at risk of being susceptible to fraud and waste in its operations and of inaccurately presenting its financial condition. Finally, the city has not complied with state law regarding its use of restricted funds because it lacks the necessary policies and procedures to guide use of these funds. Lynwood has used these funds to pay for personnel expenditures unrelated to the purpose of the funds.

To help Lynwood address the identified risk factors, we have developed numerous recommendations the city could implement, including the following:

- Developing policies and procedures to better ensure the timeliness and accuracy of its budgeting processes.
- Developing a policy that describes when and how it will increase staff salaries.
- Engaging in strategic planning, including a succession plan to mitigate the impact of leadership turnover.
- Amending its municipal code sections governing procurement to ensure the city is obtaining the best value for goods and services.
- Ceasing its inappropriate use of restricted funds.
- Developing policies and procedures to safeguard the city against waste, fraud, and inaccurate financial reporting.

#### **Agency’s Proposed Corrective Action**

Lynwood provided its initial response to our audit report in which it disagreed with several of our conclusions, including that it is at risk of not meeting its future financial obligations. Because Lynwood did not submit a corrective action plan as part of this response, we will await delivery of the plan by February 2019 to understand the specific actions it has undertaken to address the conditions that caused us to designate it as high risk.

# INADEQUATE FINANCIAL MANAGEMENT HINDERS LYNWOOD'S FISCAL STABILITY

## Lynwood Is At Risk of Not Meeting Its Future Financial Obligations

Persistent operating deficits, inaccurate general fund balance estimates, and questionable use of a one-time revenue source in its current budget place Lynwood at a high risk of being unable to meet its future financial obligations. As Table 1 shows, Lynwood's general fund balance declined from approximately \$6.5 million to \$2.6 million from the end of fiscal year 2012–13 through the conclusion of fiscal year 2016–17. Lynwood's annual expenditures consistently exceeded its revenue during this period.

Lynwood's city council reported several reasons for the ongoing decline, including limited revenue growth and increased operating costs. The city council declared a fiscal emergency in July 2016, stating in a resolution that despite its efforts to reduce spending over several fiscal years, it expected future expenditures to outpace revenue at a rate that would nearly exhaust Lynwood's general fund balance by the end of fiscal year 2016–17.

**Table 1**  
**Lynwood's General Fund Balance Declined Between Fiscal Years 2012–13 and 2016–17**  
 (in Millions)

FISCAL YEAR	ENDING GENERAL FUND BALANCE
2012–13	\$6.5
2013–14	4.6
2014–15	4.5
2015–16	2.5
2016–17	2.6

Source: Lynwood's comprehensive annual financial reports (CAFR).

To address the ongoing budget deficit, the city council approved a temporary sales tax ballot measure for the November 2016 election through which the city estimated that it could generate up to \$4.5 million in additional annual revenue. Lynwood voters subsequently approved this 10-year, 1 cent general purpose sales tax increase, and it became effective in April 2017. In part because of the additional total revenue anticipated by the tax increase, Lynwood estimated in July 2018 that its fiscal year 2017–18 operating revenue would exceed operating expenditures and that it would be able to balance its budget without tapping its general fund reserves, which would be the first time since fiscal year 2012–13 that Lynwood's spending did not outpace its income.

Throughout this report we refer to financial activity in terms of operating revenue and expenditures. There is an important difference between *operating revenue and expenditures* and *total revenue and expenditures*: Operating revenue and expenditures exclude transfers to and from other funds. As Figure 1 on the following page shows, Lynwood's operating expenditures exceeded operating revenue each fiscal year from 2013–14 through 2016–17. Given this pattern of spending behavior, we remain concerned that Lynwood's operating expenditures will exceed its operating revenue beyond fiscal year 2017–18.

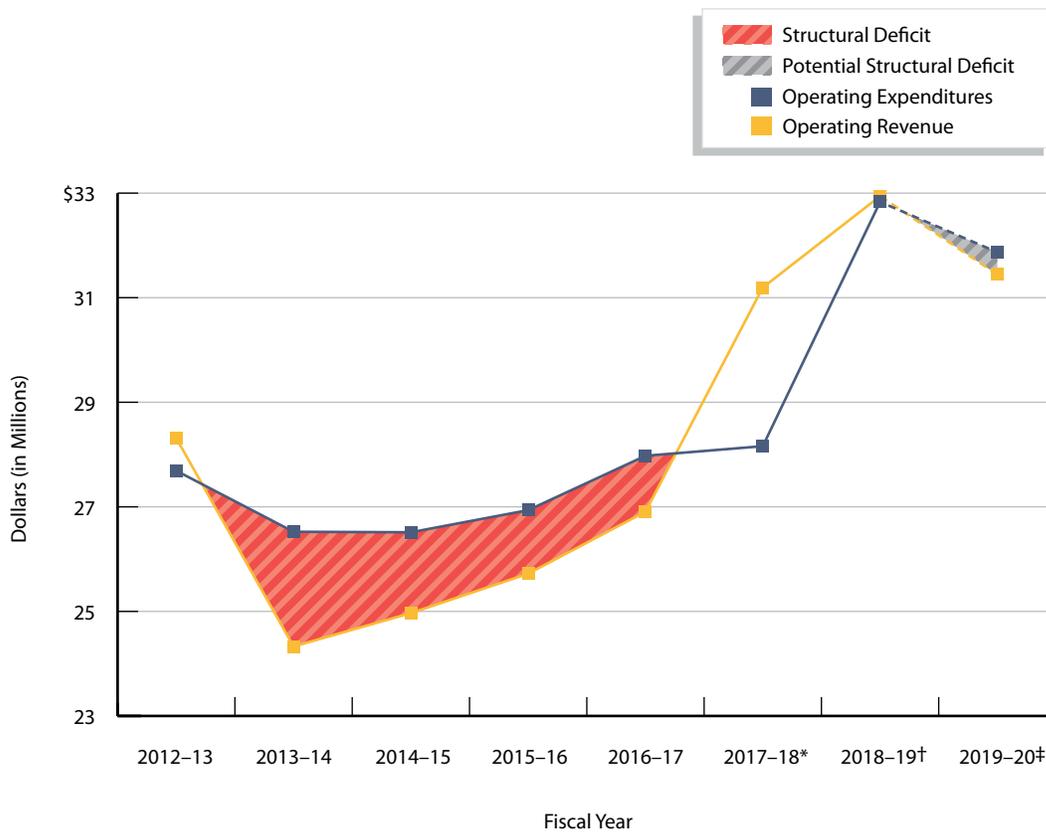
Even though Lynwood's fiscal year 2018–19 budget projects operating revenue in excess of operating expenditures, it is only by a margin of about \$100,000. This amount provides the city a narrow margin for addressing unexpected costs without relying on reserves in its general fund. Furthermore, Lynwood may not be able to sustain its level of financial activity beyond

fiscal year 2018–19, and the city’s planning leaves little room to account for faulty estimates, finance department errors, or the cessation of a one-time revenue source. In any of these potential circumstances, if Lynwood does not reduce operating expenditures or increase its operating revenue, the city may, once again, have to rely on its general fund reserves to keep the city operating.

**Fund Balance Estimates**

Because Lynwood’s finance department has made inaccurate estimates of the city’s general fund balance in previous years, it may also have overstated the beginning-of-year general fund balance for its fiscal year 2018–19 budget, thus distorting the city’s overall financial position and potentially misleading

**Figure 1**  
**Lynwood Operated With a Structural Deficit During Fiscal Years 2013–14 Through 2016–17, Which It Will Likely Experience Again in Fiscal Year 2019–20**



Source: Lynwood’s CAFRs for fiscal years 2012–13 through 2016–17 and fiscal year 2018–19 proposed budget.

\* Amounts represent projected year-end estimates for fiscal year 2017–18, as reported in the fiscal year 2018–19 budget approved by Lynwood’s city council in July 2018. Actual amounts were not available because the city had not completed its fiscal year 2017–18 CAFR.

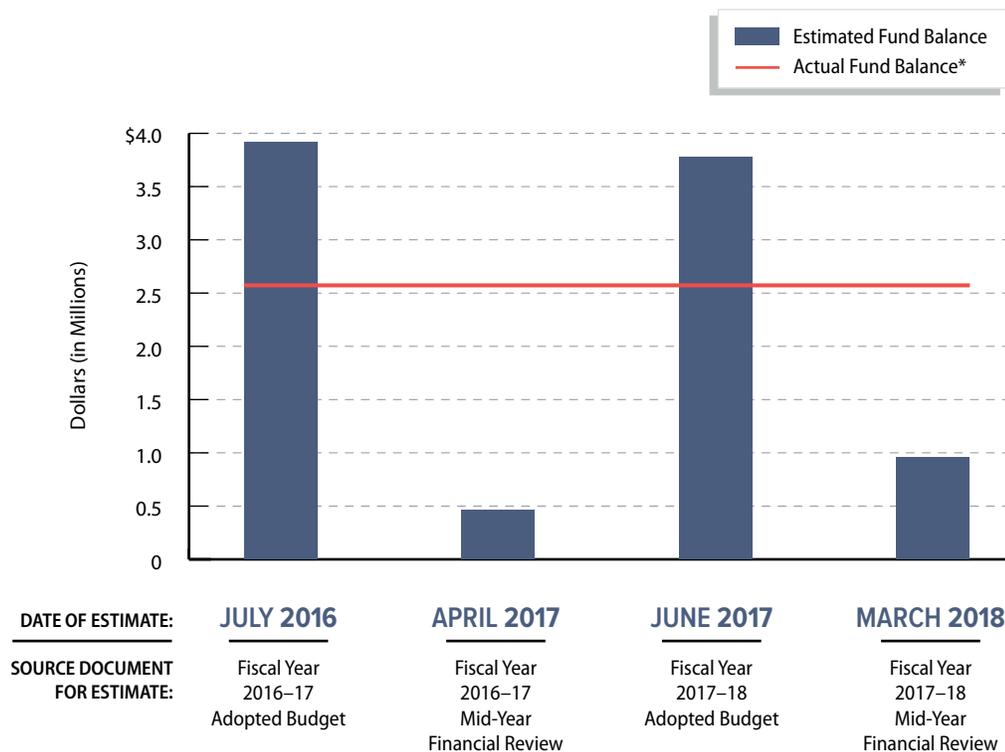
† Amounts represent proposed operating revenue and expenditures for fiscal year 2018–19, as reported in the fiscal year 2018–19 budget presented to Lynwood’s city council in July 2018, which would result in a surplus of \$100,000.

‡ Proposed operating revenue and expenditures for fiscal year 2019–20 are identical to the previous year, but with adjustments to reflect the loss of a one-time revenue source realized in fiscal year 2018–19 and two expenditures the city manager identified he could eliminate in future years, which would result in a deficit of \$425,000.

its stakeholders. The finance department made an initial estimate of the fiscal year 2016–17 ending balance in July 2016, but then changed its estimate three times: in April 2017, June 2017, and March 2018. As Figure 2 shows, the finance department estimated in April 2017 that the general fund would nearly deplete its fund balance by the end of the fiscal year, but concluded in June 2017—just two months later—that the fund balance would be significantly higher, at \$3.8 million.

In March 2018, the finance department performed a reconciliation of financial data from multiple fiscal years and adjusted its estimate of the fund balance yet again to slightly less than \$1 million. Despite performing this reconciliation nine months after adopting the fiscal year 2017–18 budget, this estimate was still inaccurate; the actual fiscal year 2016–17 general fund ending balance Lynwood reported in its audited CAFR was \$2.6 million, \$1.6 million more than the previous estimate.<sup>1</sup> According to the city manager and the finance director,

**Figure 2**  
 Lynwood's Estimates of Its Fiscal Year 2016–17 Ending General Fund Balance Have Fluctuated Wildly



Source: Lynwood's budget documents, mid-year budget updates, and fiscal year 2016–17 CAFR.

\* Lynwood's external auditor issued an unmodified opinion on the fiscal year 2016–17 financial statements, which reported \$2.6 million as the general fund ending balance.

<sup>1</sup> The city issued its audited fiscal year 2016–17 CAFR in July 2018.

the March 2018 estimate was understated primarily because the finance department recorded cash receipts late. Accurately estimating the year-end fund balance is critical because that amount establishes the starting point for future budgets and is the basis for determining whether the city has maintained a reserve of 10 percent of operating expenditures as required by its policies. Lynwood ended fiscal year 2016–17 with only 9 percent in reserve and failed to meet the reserve requirement.

Lynwood’s finance department generated inaccurate budget estimates for both fiscal years 2016–17 and 2017–18. As Table 2 shows, Lynwood overestimated its beginning-of-year fund balance for its general fund by \$2 million in its budget for fiscal year 2016–17 and again by more than \$1 million in its budget for fiscal year 2017–18. According to the finance director, his department overestimated the fiscal year 2017–18 beginning balance because it did not perform a thorough review of the expenditures it used to estimate the fund balance due to the rushed budgeting process.

Although Lynwood anticipates that its fiscal year 2018–19 general fund beginning balance will be approximately \$4.6 million, this estimate will likely be overstated if the finance department followed the same approach it used in the previous year for determining the beginning balance. During the fourth quarter of fiscal year 2016–17, finance staff calculated the fiscal year 2017–18 beginning balance by starting with the actual fund balance at the beginning of fiscal year 2016–17 and then adding estimated revenue, subtracting estimated expenditures, and adjusting for any transfers for that year, as Table 3 shows. However, we determined that the finance department’s estimates for revenue, expenditures, and transfers were inaccurate—most notably that staff underestimated expenditures by approximately \$1.5 million—thus leading to the inflated beginning balance for fiscal year 2017–18. If the finance department overestimated the beginning balance for fiscal year 2018–19 by the same amount of \$1.2 million as it did in the previous fiscal year, then Lynwood’s beginning general fund balance in fiscal year 2018–19 would actually be only \$3.4 million.

**Table 2**  
**Lynwood Significantly Overstated the Beginning-of-Year Fund Balance of Its General Fund for the Two Most Recent Fiscal Years**  
 (in Millions)

FISCAL YEAR	BEGINNING-OF-YEAR FUND BALANCE		
	ESTIMATED AMOUNT REPORTED IN ADOPTED BUDGET	ACTUAL AMOUNT REPORTED IN AUDITED CAFR	OVERSTATEMENT
2016–17	\$4.5	\$2.5	\$2.0
2017–18	3.8	2.6	1.2

Source: Lynwood’s adopted budgets and CAFRs.

**Table 3**  
**Lynwood Inaccurately Estimated Its Fiscal Year 2017–18 General Fund Starting Balance**  
 (in Millions)

	AMOUNT ESTIMATED IN ANNUAL BUDGET	AMOUNT REPORTED IN AUDITED CAFR	TOTAL AMOUNT OVERESTIMATED (UNDERESTIMATED)
Fiscal Year 2016–17 Beginning-of-Year General Fund Balance	\$2.5	\$2.5	–
+ Revenue	26.2	26.9	(\$0.7)
+ Transfers In	2.9	2.7	0.2
– Expenditures	26.5	28.0	(1.5)
– Transfers Out	1.3	1.5	(0.2)
<b>Fiscal Year 2017–18 Beginning-of-Year General Fund Balance</b>	<b>\$3.8</b>	<b>\$2.6</b>	<b>\$1.2</b>

Source: Analysis of Lynwood’s fiscal year 2017–18 adopted budget and fiscal year 2016–17 CAFR.

We further identified that the largest underestimate of expenditures was from the community development department, which underestimated its expenditures by approximately \$848,000. The current city manager, who served as the finance director during the development of the fiscal year 2017–18 budget, attributed the underestimates to the community development department’s interim director not sufficiently overseeing the budget process for his department. The city manager also stated that understaffing in the finance department and delays in reconciling financial data resulted in the department not being able to verify expenditure estimates. The current finance director additionally stated that he believed that the finance department did not verify expenditure estimates that city departments submitted for fiscal year 2017–18 because the budget process was rushed.

The finance department coordinates the city’s budget process, which Lynwood’s budget calendar identifies should begin in January—six months prior to the start of the fiscal year. However, we observed that the city manager and finance department did not

distribute budget preparation instructions to city department directors until April—three months behind schedule—for both the fiscal years 2017–18 and 2018–19 budgets. Accordingly, we are concerned that Lynwood rushed its fiscal year 2018–19 budget process similarly to how its finance director said it rushed the fiscal year 2017–18 budget process. Further, because the current finance director used the same methodology as his predecessor to calculate the beginning balance for fiscal year 2018–19, we are concerned that the general fund starting balance for the fiscal year 2018–19 budget may also be overestimated. However, we were unable to verify whether the beginning-of-year fund balance for fiscal year 2018–19 was overestimated because the city has not yet produced its audited CAFR for fiscal year 2017–18.

**One-time Revenue**

We are additionally concerned that Lynwood is using estimates of one-time revenue as a technique to balance its fiscal year 2018–19 budget. In preparing its budget, Lynwood

anticipated generating approximately \$1.5 million in one-time revenue from selling utility credits, which we define in the text box. Cities may use utility credits to pay for their own projects to move overhead utility lines underground or sell them to other cities for their use on similar projects. Selling utility credits to other cities is a long-standing practice in California.

We believe that Lynwood may have overestimated the revenue that it can generate from the sale of its utility credits. Lynwood's finance director estimated that the city will sell its utility credits for 60 percent of their value to another local government in fiscal year 2018–19. We reviewed eight other sales of utility credits for which such data was publicly reported and determined that other cities received an average of only 46 percent of their credits' value through similar sales, with the highest return being 55 percent. The city manager also said that to the best of his knowledge Lynwood has never previously sold such credits, leading us to question the city's ability to sell these credits at such a high value.

The city manager informed us in October 2018 that Lynwood had subsequently reached an informal agreement with the city of Newport Beach to purchase the credits for 60 percent of their value. However, it is not clear whether

#### Utility Credit Definition

**Utility credits:** Under the California Public Utilities Commission's Rule 20 program, utility companies provide an annual allocation of credits to municipalities to subsidize moving overhead utility lines underground.

Source: California Public Utilities Commission.

Lynwood will actually obtain revenue at the amount budgeted because it does not plan to seek the city council's approval until after the November 2018 election, at which point the new city council could decide not to sell the credits. We are accordingly concerned the city may be overstating its projected revenue for fiscal year 2018–19. As Table 4 shows, if Lynwood does not sell its credits at the intended price, it would need to sell its credits for at least 56 percent of their value—more than the highest rate of return we identified among other cities—in order for its fiscal year 2018–19 budget to remain balanced. Selling credits for less than 56 percent of their value will likely result in operating expenditures exceeding operating revenue. Moreover, if Lynwood does not sell any of its credits in fiscal year 2018–19, its operating expenditures will exceed its operating revenue by nearly \$1.4 million, and even if it does sell the credits it will still only operate with a \$100,000 operating surplus.

**Table 4**  
Lynwood Will Finish Fiscal Year 2018–19 With a Deficit if It Does Not Receive Its Projected Utility Credit Revenue (in Millions)

	IF LYNWOOD SELLS ITS UTILITY CREDITS FOR			
	60 PERCENT OF THEIR VALUE	56 PERCENT OF THEIR VALUE	46 PERCENT OF THEIR VALUE	IF LYNWOOD DOES NOT SELL ITS UTILITY CREDITS
Operating Revenue	\$32.9	\$32.8	\$32.6	\$31.4
Operating Expenditures	(32.8)	(32.8)	(32.8)	(32.8)
<b>Difference</b>	<b>\$0.1</b>	<b>\$0</b>	<b>(\$0.2)</b>	<b>(\$1.4)</b>

Source: Analysis of Lynwood's fiscal year 2018–19 budget preparation documents.

Lynwood has not developed specific actions to adjust its budget if it does not sell its utility credits in fiscal year 2018–19. After we discussed with the city manager our concern regarding the city’s potential budget deficit in future years, he informed us that he could consider reducing certain expenditures. The city manager indicated that he could eliminate two expenditures totaling approximately \$960,000 from future years’ budgets: funding in the fiscal year 2018–19 budget for a summer law enforcement team and funding for certain road maintenance and improvement projects. However, the city manager did not have a specific plan to address the remaining shortfall of approximately \$425,000, instead indicating that he expected to identify cost reductions among various city departments in their department-specific consulting and discretionary expenditures. Nevertheless, it is unclear whether any of these subsequent reductions would be for recurring costs because the city has not yet made this determination.

Further, Lynwood’s recurring expenditures are partly supported by revenue that the city will not realize in future years. As Figure 1 on page 4 shows, if Lynwood maintains the same operating revenue in fiscal year 2019–20 as in fiscal year 2018–19 but does not sell its utility credits, even if it reduces its fiscal year 2019–20 operating expenditures to account for the two expenditures the city manager identified, it would still incur a structural deficit. Best practices from the Government Finance Officers Association (GFOA), whose mission is to advance excellence in state and local government financial management, emphasize that one-time revenue cannot be relied upon in future budget periods. Therefore, although Lynwood proposes a balanced budget for fiscal year 2018–19, it does not appear that the city will be able to sustain its current level of expenditures in the future without operating at a deficit.

**Recommendations to Address This Risk**

- To improve the accuracy of the budget estimates of beginning fund balances in its general fund, the finance department should critically review the accuracy of the estimated expenditures and revenue that city departments submit for each year’s budget.
- To allow sufficient time to review revenue, expenditure, and fund balance estimates, Lynwood should begin its fiscal year 2019–20 budget process according to its planned timeline.
- When anticipating future revenue from one-time sources, Lynwood should develop realistic estimates of the timing and amount of those inflows.
- Lynwood should identify approaches for monitoring and managing the financial condition of its general fund rather than rely on one-time revenue.

**Lynwood Did Not Adhere to Many Best Practices When Preparing Its Budget**

Lynwood lacks many policies related to budgeting and does not follow best practices for budgeting that the GFOA recommends.<sup>2</sup> The GFOA has identified budgeting as one of the most important activities undertaken by governments and an operational area in which many governments are in need of guidance. The GFOA accordingly advises that government budgeting should have a long-range planning perspective in order to consider the longer-term consequences of budget decisions, including whether program and service levels can be sustained in the future. We evaluated Lynwood against recommended GFOA

<sup>2</sup> The GFOA coordinated with the National Advisory Council on State and Local Budgeting to issue *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting*.

budget best practices and found, as Table 5 shows, that it did not follow, or only partially followed, 10 of the 11 recommended practices.

The only GFOA practice that Lynwood has fully implemented addresses guidelines and instructions for preparing its budget. We identified that for each of its three most recent budget cycles, the city prepared

general policy guidelines and budget preparation instructions that it distributed to the city's department directors. However, as we previously noted, the city distributed these instructions for the fiscal year 2017–18 and 2018–19 budgets later than stipulated in its budget schedule.

**Table 5**  
Lynwood Does Not Follow Many Best Practices Pertaining to Preparing Its Budget

BUDGETING BEST PRACTICES THAT THE GFOA RECOMMENDS	EXTENT TO WHICH LYNWOOD'S EXISTING BUDGET POLICY OR PRACTICE FOLLOWS THE BEST PRACTICE
<b>Budget Policy Guidelines:</b> Prepare general policy guidelines and budget preparation instructions for each budget cycle.	<b>Fully Followed.</b>
<b>Balanced Operating Budget Policy:</b> Develop a policy that defines a balanced operating budget, encourages commitment to a balanced budget under normal circumstances, and provides for disclosure when a deviation from a balanced operating budget is planned or when it occurs.	<b>Partially Followed.</b> Although Lynwood has a policy that defines a balanced operating budget, it does not have a policy to disclose when it deviates from a balanced operating budget.
<b>Reserve Policy:</b> Develop policies to guide the creation, maintenance, and use of resources—such as a reserve—for financial stabilization purposes.	<b>Partially Followed.</b> Although Lynwood has a policy guiding the creation and use of a reserve, it does not have guidance on how the reserves should be established.
<b>Fee-Setting Policy:</b> Adopt policies that identify the manner in which fees and charges are set and the extent to which they cover the cost of the service provided.	<b>Partially Followed.</b> Lynwood does not have such a policy but it contracts for a user-fee study, which includes an analysis of the full cost of its services, projected potential fee revenue, and recommendations for fees, along with associated levels of cost recovery.
<b>Capital Asset Inventory:</b> Identify and conduct an assessment of its capital assets, including the condition of the assets and factors that could affect the need for or ability to maintain the assets in the future, and develop a process for inventorying capital assets.	<b>Partially Followed.</b> Although Lynwood has a capital asset policy, its external auditor reported as an audit finding that the city has not conducted an inventory of its capital assets.
<b>Budget Review Procedures:</b> Institute procedures to review the budget periodically, such as quarterly, and decide on actions to bring the budget into balance.	<b>Partially Followed.</b> Although Lynwood does not have documented procedures to periodically review the budget, it performed a mid-year financial review for fiscal years 2016–17 and 2017–18.
<b>One-Time Revenue Policy:</b> Adopt a policy limiting the use of one-time revenues for ongoing expenditures.	<b>Not Followed.</b>
<b>Multiyear Revenue Projections:</b> Prepare multiyear projections of revenue and other resources.	<b>Not Followed.</b>
<b>Multiyear Expenditure Projections:</b> Prepare multiyear projections of expenditures for each fund and for existing and proposed new programs.	<b>Not Followed.</b>
<b>Revenue Diversity Policy:</b> Adopt a policy that encourages a diversity of revenue sources.	<b>Not Followed.</b>
<b>Identify Unpredictable Revenue:</b> Identify major revenue sources considered unpredictable and define how this revenue may be used.	<b>Not Followed.</b>

Source: GFOA's *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting*, Lynwood finance department documents, and interviews with Lynwood finance department staff.

Further, we identified five best practices that Lynwood only partially followed. For example, the GFOA recommends that governments identify and conduct an inventory of their capital assets, including the condition of the assets and factors that could affect the need for or ability to maintain these assets in the future. Although Lynwood does have a policy requiring the finance department to conduct an annual physical inventory of the city's capital assets, in fiscal year 2015–16 Lynwood's external auditor identified that the city does not have a list of capital assets by department and does not perform a capital asset inventory. The finance director, who began working with the city in March 2018, told us that steps had not been taken yet to address this deficiency.

Finally, we identified five other best practices that the city does not follow. Notably, the finance director stated that Lynwood does not perform multiyear revenue and expenditure projections, which we believe would be beneficial toward identifying the need for resources to sustain city services. Multiyear expenditure projections can provide critical information to decision makers about whether projected expenditure levels can be sustained in the future. The finance director stated that beginning with fiscal year 2019–20, he intends to develop a two-year budget in order to better project the city's future revenue and expenditures. However, he believes that budget projections beyond two years are less accurate and less meaningful.

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## **Multiyear expenditure projections can provide critical information to decision makers.**

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Additionally, he intends to develop a five-year capital improvement plan—a document projecting the city's planned capital

improvement expenditures and funding sources, something he said Lynwood does not currently have—in fiscal year 2019–20. He further explained that he intends to develop other five-year projections for changes to citywide pension costs, the effect of statewide mandates on city expenditures, and estimated infrastructure maintenance costs. He stated that he intends to update these projections annually. We believe that developing these projections would be beneficial to the city and would better inform stakeholders and decision makers of the sustainability of future expenditures.

Lynwood's policy regarding its general fund reserve does not align with another GFOA best practice, which recommends that governments maintain an unrestricted fund balance in their general fund of not less than two months of regular general fund operating revenue or expenditures. This equates to approximately 17 percent of annual activity. Lynwood's general fund reserve policy currently requires the city to maintain a general fund reserve of 10 percent of the general fund budget, which the finance director defines as budgeted operating expenditures, an amount far less than what the GFOA recommends. Further, as we previously discussed, Lynwood's fiscal year 2016–17 CAFR shows that the city has not complied with its own policy, as the city had a general fund balance of only 9 percent of its operating expenditures at the end of fiscal year 2016–17. Without a sufficient general fund reserve, Lynwood risks not having the ability to adequately respond to a fiscal emergency or a significant budgetary reduction.

### ***Recommendations to Address This Risk***

- In order to improve the quality and accuracy of its budgeting process, Lynwood should formalize its budgeting procedures and practices to align with best practices, such as those promulgated by the GFOA.

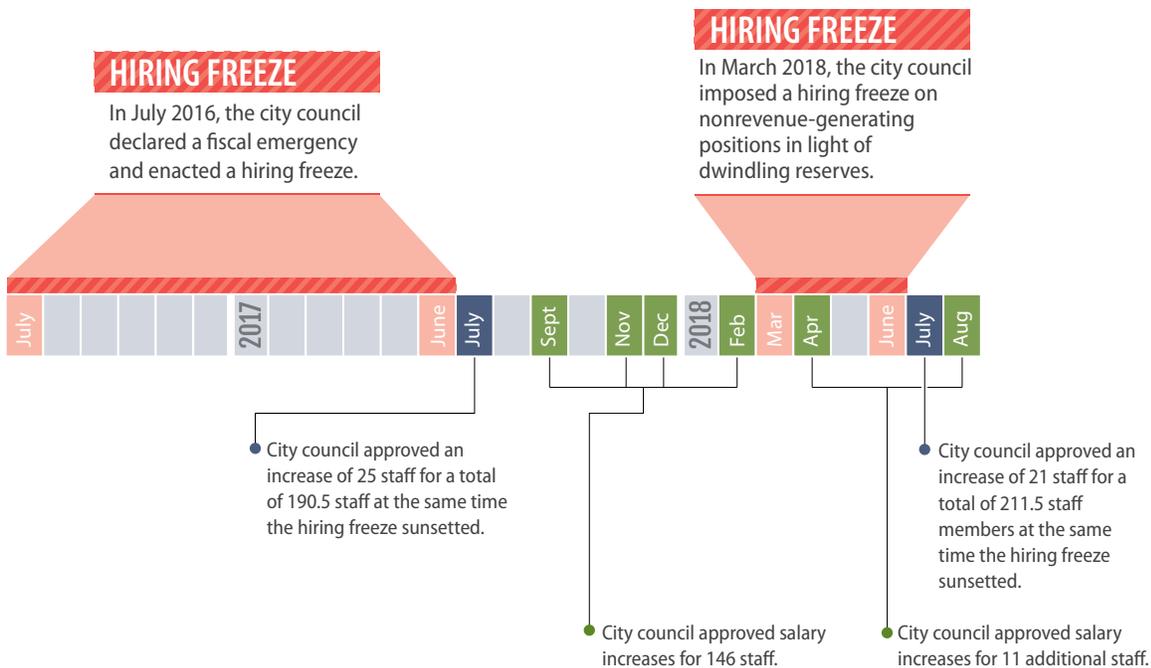
- Lynwood should revise and adhere to its general fund reserve policy to require that it maintain a general fund reserve of at least two months of operating expenditures.

**Lynwood Risked Future Deficits by Significantly Increasing the Number of Employees and Their Salaries When It Could Not Afford to Do So**

When Lynwood’s city council declared a fiscal emergency in July 2016 and took steps to reduce its structural deficit in fiscal year 2016–17, it also imposed a hiring freeze on new employees for fiscal year 2016–17. However, the city undermined its own efforts by significantly increasing personnel costs in fiscal year 2017–18 and continuing to do so in fiscal year 2018–19.

Figure 3 shows that the city decided to increase city staffing by 15 percent, from 165.5 to 190.5 full-time-equivalent staff members, in its fiscal year 2017–18 budget. Further, from September 2017 through August 2018, the city increased salaries for 40 position classifications affecting 157 employees, or three-quarters of its total staff. The city manager explained that turnover in the human resources department resulted in the city’s staggering of salary increases throughout fiscal year 2017–18. Finally, the city increased its staffing again in its fiscal year 2018–19 budget from 190.5 to 211.5 full-time-equivalent staff. Consequently, Lynwood estimates fiscal year 2018–19 personnel expenditures will be \$1.7 million greater than it incurred in fiscal year 2016–17.

**Figure 3**  
Lynwood’s City Council Continued to Approve Increased Personnel Expenditures Despite the City’s Ongoing Fiscal Problems



Source: Analysis of Lynwood’s city council resolutions, adopted budgets, and mid-year financial reviews. Staff numbers are full-time-equivalent positions.

Lynwood asserted that it increased staff salaries to provide its employees with competitive pay. According to the city manager, Lynwood increased its staff salaries because the city council believed that the city’s employees were being paid below market rate. Although Lynwood had not provided a cost-of-living salary increase to its employees since fiscal year 2013–14, we question whether increasing salaries was an appropriate decision given the city’s poor financial position and in light of its March 2018 decision to impose a hiring freeze on nonrevenue-generating positions through the end of fiscal year 2017–18.

Moreover, Lynwood was unable to justify the amounts of its salary increases and may have increased salaries higher than market rates. Lynwood’s base salary increases for each classification we reviewed ranged from 2 percent to 72 percent and averaged 27 percent overall.

According to the city manager, the city decided on these amounts using the results of a salary survey conducted by its staff and a consultant that the city contracted with for general human resources services. For each classification, the survey results consisted of a table listing the entities, classification titles, and salaries it used for the survey. The results also presented an average salary and identified the median<sup>3</sup> salary for each classification.

However, as Figure 4 shows, we question the survey’s use of cities with populations and budgets substantially larger than Lynwood. Although we did not evaluate the government structures of these cities, their significantly larger budgets, population, and geographic size suggest that their employees may have different levels of responsibility than their counterparts in Lynwood. Moreover, the city could not explain why the survey used information from

**Figure 4**  
 Lynwood Performed a Salary Survey Using 67 Cities of Which Many Were Not Comparable



Source: Cities’ CAFRs and the U.S. Census Bureau.

<sup>3</sup> Median is defined as the middle term (or average of the middle two terms) of a series arranged in order of magnitude.

any of these cities, which leads us to further question their comparability. In addition, the survey included other entities, namely school districts and counties—entities serving different purposes than Lynwood. A more reasonable approach would have been for Lynwood to use a focused survey of cities similar in population, geographic size, and expenditures.

For 10 of the 40 classifications we reviewed, affecting 21 employees, the city council approved base salaries that were above the average rates identified of those surveyed. The base salaries that the council approved for the 10 classifications ranged from \$131 to \$846 per month over the salary levels in the survey. For example, the survey results for one of the positions, *senior water service/wastewater worker*, identified the median and average base monthly salary to be \$4,073 and \$3,973, respectively. The city council, however, ultimately approved a base monthly salary of \$4,919. We are unclear as to why the city council chose to approve amounts higher than comparable salaries in the surveys. We reviewed the staff reports provided to the city council for those salary increase resolutions it approved and found the reports presented only the new recommended salary amounts without disclosing the results of the salary survey. Furthermore, the city was also unable to explain why staff presented to the city council for approval recommended amounts that were higher than those in the survey.

Lynwood may not be able to sustain its increased personnel costs given its current revenue structure. The city is currently able to support the increased personnel costs within its budget because it plans to use the equivalent of 20 percent of the revenue it estimates it will receive from its temporary sales tax to cover the general fund portion of those costs. However, after the voter-approved sales tax expires in fiscal year 2026–27, the city may find that it is committed beyond its means.

#### **Recommendation to Address This Risk**

Lynwood should develop a policy that describes when and how it will complete an employee salary survey, including the methodology it will use to determine those entities against which it will compare itself, and how it will use the results to determine increases in salaries and benefits. Further, it should provide justification to its city council when deciding to increase salaries above the amounts that a salary survey recommends.

# VIOLATIONS OF STATE LAW, WEAK OVERSIGHT, AND POLICY BREACHES MAKE LYNWOOD SUSCEPTIBLE TO FRAUD AND WASTE

## **Lynwood Violated State Law Through Its Inappropriate Use of Water and Sewer Funds**

Lynwood violated state law by using its water and sewer funds to subsidize salaries without justification, and it may have violated state law when using water and sewer funds to pay for city overhead costs and to partially fund a significant capital improvement project. Water and sewer revenue comes primarily from fees and charges paid by users and is accounted for in restricted funds. State law requires that revenue derived from a property-related fee or charge not be used for any purpose other than that for which the fee or charge was imposed. Further, state law requires that revenue derived from the fee or charge on behalf of properties in the jurisdiction receiving service not exceed the costs required to provide the service.

## ***Salary Allocations***

Lynwood has inappropriately used water and sewer revenue to fund two staff members' personnel costs, which include salaries and benefits. State law permits using these funds but only to the extent that they pay for the actual cost of support for water and sewer operations. For example, the city's practice is to fund positions in some of its departments—such as finance, technology and media services, and public works—partly with water and sewer funds because these positions perform certain functions that support these operations. Our review of Lynwood's fiscal year 2018–19 budget,

however, led us to conclude that the city is violating state law by funding two positions in its finance department entirely with water and sewer revenue even though these two positions have job responsibilities that are unrelated to the city's water and sewer operations. Lynwood budgeted \$317,000 for these two positions in fiscal year 2018–19.

We identified that Lynwood also budgeted \$389,000 for these same two positions in fiscal year 2017–18 to be paid entirely with water and sewer funds. When we questioned the city manager regarding the validity of this funding, he agreed that it was incorrect for the city to fully fund the two positions from water and sewer funds and stated that he would modify the funding sources to more accurately reflect the work they perform. We asked Lynwood's finance director when this adjustment would be made, and he stated that he would review and reassess the funding for these two positions during the fiscal year 2018–19 mid-year budget review.

Lynwood also cannot justify the amount it funds other positions through water and sewer revenue. The amount of each staff member's salary that is funded by water and sewer revenue is determined by percentages given by department directors to the finance department. However, we identified that those percentages are not based on the actual work department staff perform in support of those services. For example, according to the technology and media services director, he does not track or maintain specific details on all of the work his employees perform and

consequently uses his best approximation to determine the proportion of personnel costs that should be funded using water and sewer revenue. In fiscal year 2018–19, the city budgeted \$178,000 of the department's \$508,000 total personnel costs to be funded using water and sewer revenue.

In another example, the public works director stated that his department's use of water and sewer revenue to fund personnel costs is based on estimations rather than on actual work hours. Lynwood budgeted approximately \$1.6 million of his department's personnel costs in fiscal year 2018–19 to be funded using water and sewer revenue, but because these directors did not have documentation to support their estimates, the city cannot justify the amount of water and sewer revenue used to fund these personnel costs. Without such justification, Lynwood cannot demonstrate that it has complied with the state law requirement that revenue derived from fees or charges for property-related services not be used for any purpose other than that for which the fee or charge was imposed.

### Overhead Costs

Lynwood may have unlawfully subsidized its general fund with annual administrative support payments that it made from the water and sewer funds. Lynwood's audited financial statements include a general fund revenue category titled *administrative support*, which was reported as \$1,118,246 for each year between fiscal years 2010–11 and 2016–17. Documentation supporting its fiscal year 2018–19 budget also reports administrative support revenue in fiscal years 2017–18 and 2018–19 of almost identical amounts to those of the previous years. We determined that the source of this amount is from transfers from the city's water and sewer funds. The city manager informed us that these revenue transfers are for the water and sewer funds' share of the city's overhead

costs, such as shared administrative costs where a department incurs costs for support that it provides to other departments. The finance director provided a cost allocation plan completed in 2006 that indicated the city should allocate overhead costs of approximately \$1.1 million to the water and sewer funds.

The city manager informed us that a cost allocation plan completed by the city in July 2018 determined that Lynwood should recover only approximately \$876,000 from its water and sewer funds for overhead costs, an amount significantly less than it had recovered or budgeted to recover during each of the past nine fiscal years. The city manager was not aware of the 2006 cost allocation plan and did not know whether or when the city had completed another cost allocation plan prior to the July 2018 plan.

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## Lynwood should recover only approximately \$876,000 from its water and sewer funds for overhead costs.

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Again, state law permits the use of water and sewer revenue to fund only the costs of providing those services. Thus, for fiscal year 2018–19, Lynwood's allocation of \$1.1 million in water and sewer revenue exceeded its costs of \$876,000, which violates the law. The finance director stated that starting with the fiscal year 2019–20 budget, he plans to use the recently completed cost allocation plan as a basis for the transfer from the water and sewer funds to the general fund. However, we believe it should revise its fiscal year 2018–19 budget to align it with its current cost allocation plan to correct its violation of state law.

Moreover, Lynwood has not performed cost allocation studies as frequently as best practices suggest. According to the GFOA, a cost allocation plan should be updated at a minimum of once every three years and potentially more frequently when used to charge back costs to governmental departments. Because Lynwood appears to have used the same plan for as many as 12 years without updating the plan, it may have either overstated or understated the cost of general fund services allocated to the water and sewer funds in those years. The city manager stated that he would like the city to update its cost allocation plan every three to five years to ensure that the city is correctly recovering its costs.

#### ***Lease Agreement***

Further exacerbating the risk that Lynwood may unlawfully use revenue from its water and sewer funds is a lease arrangement it has in place over its water infrastructure with no apparent purpose other than to provide the city with the ability to use water and sewer funds to subsidize its general fund. In 2003 Lynwood and its redevelopment agency established the Lynwood Utility Authority (utility authority), a joint powers authority that agreed to lease the city's water infrastructure from the city in exchange for lease payments. Following the State's dissolution of redevelopment agencies in 2012, the city assumed the role of successor agency for its redevelopment agency. The resulting structure of the utility authority, as Figure 5 on the following page shows, created a situation in which the city is essentially leasing its own water infrastructure to itself. Although the lease agreement between the utility authority and the city stipulates that the authority make lease payments to the city, it does not establish the dollar value or timing of those payments. Rather, the lease agreement states that the source of any payments shall be from surplus revenue, which would be from the water and sewer funds. Because

state law requires that revenue derived from providing water and sewer services to properties within the jurisdiction may not exceed the cost of providing those services, and because Lynwood derives 99 percent of its water and sewer revenue from properties within its jurisdiction, there is no legal basis for accumulating surplus revenue or using the revenue to make lease payments for a purpose unrelated to providing water and sewer services. Without legal authority for these payments and because the utility authority is exclusively controlled by the city, we question the validity and necessity of the utility authority's existence.

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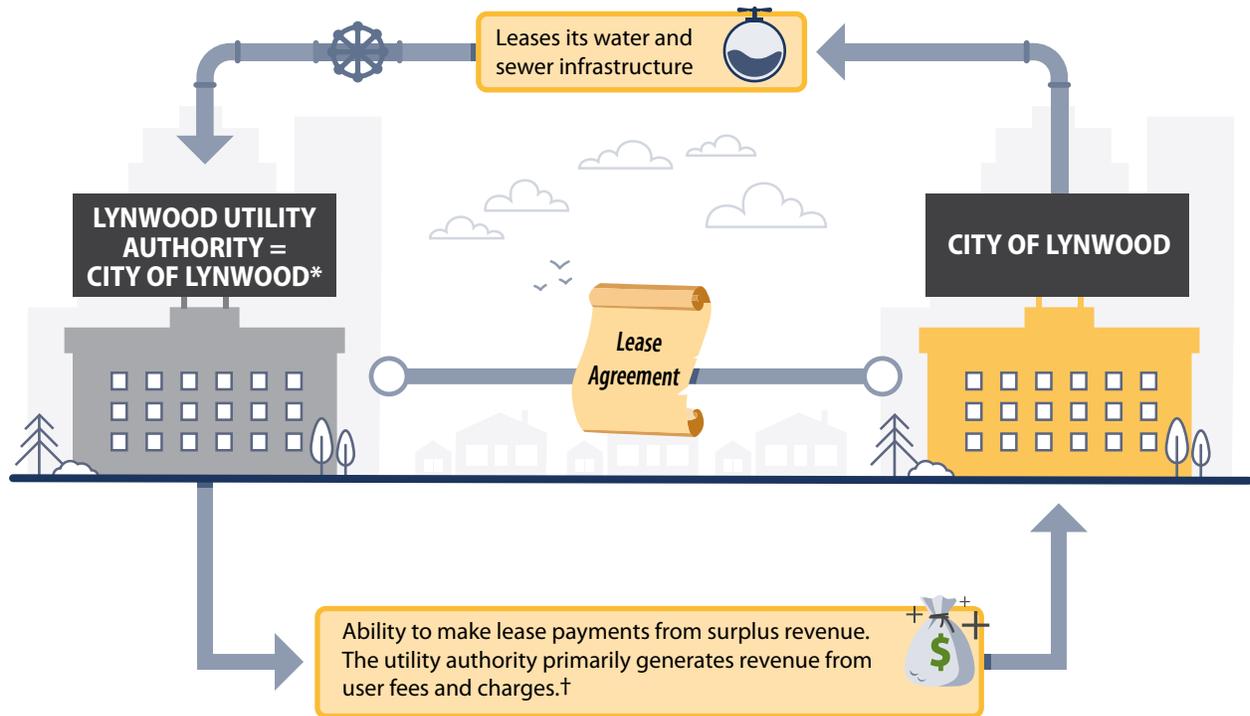
### **The resulting structure of the utility authority created a situation in which the city is essentially leasing its own water infrastructure to itself.**

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Although we did not identify any payments from the utility authority to Lynwood that were specifically referred to as lease payments, we are concerned that the lease agreement's undefined payment structure provides a mechanism in which the city could inappropriately use its water and sewer funds to subsidize its general fund. When we informed the city manager of our concern regarding the legality of Lynwood's water and sewer overhead cost payments that we discussed previously, he indicated that if the city could not legally justify the transfers as overhead cost payments, Lynwood could instead justify the transfers under the lease agreement by characterizing them as lease payments from the utility authority to the city. It is this very perspective that demonstrates how the lease agreement's undefined payment structure allows the city's management to characterize any otherwise unjustified payment or allocation from the water and sewer funds to the general fund as a lease payment.

**Figure 5**

**The Structure of the Utility Authority Lease Agreement Allows Lynwood to Lease Its Water and Sewer Infrastructure From Itself**



Source: Analysis of Lynwood's utility authority lease agreement and relevant city council resolutions.

\* The utility authority is currently comprised solely of the city of Lynwood. The utility authority was formerly comprised of Lynwood and its redevelopment agency. However, with the dissolution of redevelopment, the city assumed the role of successor agency to the redevelopment agency.

† State law requires that revenue derived from water service fees and charges in the jurisdiction not exceed the amount required to provide the service.

### Capital Projects

Lynwood may have unlawfully used water fund revenue to construct a new city hall annex that the city council approved in 2013. The budget for this project included various sources of funding, including an amount from the water fund totaling \$2.3 million that was comprised of three components: the water operation's share of construction costs and two reimbursements from the water fund to the general fund.<sup>4</sup> We question the appropriateness of the construction cost charged to the water fund—amounting to \$1.1 million—because

it was based on a consultant's analysis for a previously planned version of the new city hall annex. That version included working space for staff of the city's water operations. Lynwood subsequently reduced the planned size of the annex when it recognized that it did not have sufficient funding to pay for that version. The revised scope of the annex did not include space for water operations staff, and we observed that none of those staff are physically located in that building. Consequently, Lynwood should have determined a new amount of construction cost to charge to the water fund that reflected the revised scope of the annex.

<sup>4</sup> The issue we identified pertaining to the city hall annex involves only the water fund and not the sewer fund.

Lynwood also cannot justify the two reimbursements it made from the water fund to its general fund, amounts that were then used to pay for construction of the city hall annex. These reimbursements from the water fund, totaling \$1.2 million, were for past payments made by other city funds that the city later determined should have been made by the water fund. Lynwood was unable to provide any documentation supporting the appropriateness of the reimbursements, so it could not demonstrate its compliance with legal requirements precluding the use of water revenue for any purpose other than that for which the fee or charge was imposed.

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## **Lynwood cannot justify two reimbursements it made from the water fund to its general fund that it used to pay for construction of the city hall annex.**

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Because of our concerns with the city hall annex, we also reviewed a capital improvement project of \$1.9 million that included funding of \$900,000 from the water fund for street improvements and repairs that the city council included in its fiscal year 2017–18 budget. In this case, Lynwood was able to demonstrate that this project had budgeted water fund revenue that was reasonably related to expenditures for water. For example, one of the improvements budgeted to be paid for with water fund revenue involved the installation of pipes to existing water mains. Although Lynwood was able to justify the use of water fund revenue for this recently approved capital improvement project, both the director and the special projects manager acknowledged that the public works department did not have written guidelines for how water fund revenue can be spent on capital

improvement projects. After we called this to their attention, the public works director distributed a new policy establishing a process for how to allocate water and sewer funds to capital improvement projects. Additionally, the special projects manager stated she is not aware of a documented procedure for developing budgets for capital improvement projects for the public works department. Without documented guidance and procedures, Lynwood risks inappropriately using water fund revenue for capital improvement projects in ways that are not compliant with state law.

### ***Recommendations to Address This Risk***

- Lynwood should develop policies and procedures for using cost allocation plans, such as the one it recently completed, to recover the city's overhead costs from its funds, including the water and sewer funds. The city should review and update this plan at least once every three years.
- Lynwood should dissolve the utility authority and discontinue any activity associated with lease payments.
- Lynwood should develop and implement policies that ensure reimbursements made from its water and sewer funds to other funds are properly structured and that they are thoroughly documented to show that the reimbursement is an expenditure related to the cost of providing water and sewer service.
- Lynwood should follow its documented guidance regarding how to allocate costs for capital improvement projects to the water and sewer funds.
- Lynwood should develop policies and procedures for developing budgets for capital improvement projects, including procedures for justifying the funding sources for those projects.

### **Lynwood's Use of Competitive Bidding Exceptions Within Its Municipal Code and Insufficient Contract Management Increase Its Risk of Wasting Public Funds**

Exceptions within Lynwood's municipal code sections governing purchasing and the city's poor contract management increase the risk that the city will not obtain the best value for goods and services for which it contracts. We determined that unique provisions within Lynwood's municipal code provide opportunities for the city to avoid competitive bidding and that the city has not always executed its contracts prudently.

As an example, the city council approved a seven-year amendment to an existing contract in December 2017 for graffiti removal, which was a contract Lynwood had been using to supplement graffiti removal efforts by city staff. The amendment, valued at approximately \$400,000 in fiscal year 2018–19, significantly changed the vendor's scope of services to make it the primary graffiti remover for the city, thereby reducing the city staff's responsibilities to that of handling supplemental removal in parks. By signing this contract amendment, the city committed itself to paying \$250,000 more in fiscal year 2018–19 than it would have had the scope of services remained the same. Furthermore, the contract stipulates that the cost of service will increase annually for each of the remaining six years in accordance with the consumer price index for Los Angeles, Riverside, and Orange counties.

City management was unable to explain the rationale for this decision. Lynwood's municipal code related to purchasing requires city council approval for amendments that increase the value of the original contract amount by at least \$50,000, or 25 percent. It does not, however, specify whether a contract should be rebid through a competitive bidding process if a proposed amendment significantly changes the scope of the contract. The lack of such a requirement increases the city's susceptibility to wasting public funds because

the city council could essentially authorize a new contract without directing city staff to seek competitive bids. Had Lynwood solicited bids for comprehensive removal of graffiti throughout the city, it may have been able to obtain the service at a better value or recognized that using existing city staff could be a more cost-efficient approach to graffiti control for the city.

In addition, the text box shows that Lynwood's municipal code allows the city council to bypass its competitive bidding process through a supermajority vote of four of the five city council members. The municipal code further specifies that the city council may use this exception only if it finds that the acquisition of goods and services may be more economically and efficiently handled through the use of a procedure other than competitive bidding. We believe that the vagueness of this criteria may result in the city not consistently obtaining the best value for goods and services, particularly because the municipal code lacks a requirement for the city council to document the reasons for that determination. We identified that between June 2016 and June 2018, the city council used the exemption on at least 49 occasions for contracts that ranged between approximately

#### **Competitive Bidding Exceptions**

For contracts that are not for public works projects, no competitive bidding of any kind is required under the following circumstances:

1. When an emergency requires that an order be placed with the most available source of supply;
2. When the supplies, equipment, services, or contract could be obtained from only one source;
3. If the city council shall find, by a resolution adopted by not less than four-fifths of its members, that such an acquisition may be more economically and efficiently effected through the use of an alternate procedure; or
4. When the city is seeking a contract for garbage collection.

Source: Lynwood municipal code, section 6-3.13.

\$19,000 and \$500,000 and totaled at least \$4 million. The types of goods and services in these contracts—which included contracts for office furniture, temporary staffing in the finance department, and executive search services for city positions—are generally not specialized, and the city may have been able to obtain the goods and services at a better price and value through competitive bidding. We were also unable to determine how many contracts in total Lynwood had entered during this period because the city could not provide a complete list of its contracts as of September 2018.

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### **Between June 2016 and June 2018, the city council voted to bypass its competitive bidding process on at least 49 occasions for contracts that totaled at least \$4 million.**

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We also found an instance in which the city council did not obtain the necessary votes to exempt a contract from competitive bidding. We determined that the city council bypassed the requirement by approving a \$20,000 contract for legal services in April 2018 with only three council members voting in favor. After we brought the inappropriate approval to its attention, the city amended the contract to lower its value below the level required for competitive bidding requirements at the time it was originally approved.

Finally, we question whether Lynwood should have had city staff, along with a consultant providing Lynwood general human resources services, conduct the salary survey we discussed rather than seeking competitive bids for that service from a subject-matter expert. The existing human resources contract did not include a salary survey as part of the consultant's scope of services, nor did it specify any requirements for the survey, including

the methodology to be used, the format of the results, or the detail included in the deliverables. As we discussed previously, the consultant and city staff used many entities for its survey that do not appear comparable to Lynwood, leading us to question the value of the salary survey. Given the specialized nature of a salary survey, we find it concerning that the city directed these services to its staff and an existing consultant without seeking bids from other vendors who may have offered a better value to the city in terms of cost and quality. The city manager explained that the city did not anticipate using this consultant to complete a salary survey at the time it negotiated the contract, but subsequently assigned the duty to the consultant because it considered the consultant's role to be serving in place of city staff assigned to perform the survey. Nevertheless, Lynwood should have entered into a new contract by seeking competitive bids for the salary survey.

#### ***Recommendations to Address This Risk***

To ensure that it receives the best value for the goods and services it contracts for, Lynwood should do the following:

- Amend its municipal code to require competitive bidding when a proposed contract amendment would significantly alter a contract's scope of work and augment its municipal code to include criteria defining a significant alteration of scope.
- Amend its municipal code to require that its city council provide adequate written justification when bypassing a competitive bidding process through a supermajority vote, including defining specific circumstances when such an action is appropriate and ensuring that it receives at least four of five council member votes each time it uses the exception.
- Only assign duties to contractors that are expressly described within their contracted scope of services.

### Lynwood Has Several Recurring Control Weaknesses in Its Financial Operations That Make It Susceptible to Fraud and Waste

Lynwood's operations are susceptible to fraud and waste because it has failed to address significant recommendations made by its external auditors. When we began our fieldwork in June 2018, the city had not yet issued its CAFR for fiscal year 2016–17. Therefore, we reviewed the CAFR for the previous fiscal year—fiscal year 2015–16—that was issued in February 2017 and included the most recently reported findings and recommendations that its external auditor identified pertaining to the city's controls over financial operations. Appendix B beginning on page 33 shows that Lynwood's external auditor reported 12 findings that highlight a lack of policies and procedures governing the city's financial operations. As of June 2018, the city had addressed only one of the 12 corresponding recommendations—tracking insurance claims—even though it had been more than a year since the external auditor reported the findings. By September 2018, the city subsequently implemented six other recommendations, leaving five recommendations that the city has still not implemented. According to the city manager, the previous city manager assigned a staff member in the finance department the responsibility of coordinating the city's actions to address those findings, but that individual did not do so.

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### The city has not yet developed a plan demonstrating how and when it will resolve the remaining issues that the external auditor identified.

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Many of the external auditor's findings focused on the city's finance department and its procedures pertaining to purchasing and payroll. For example, the external auditor identified that the city issued some purchase orders after

it had made the related purchases. Without an approved purchase order, the finance department cannot ensure the transaction was authorized. To address the issue, the external auditor recommended the city create a policy that describes the procurement and cash disbursement processes that staff should follow. When we asked the current finance director, who started in March 2018, whether he had addressed that recommendation, he informed us he had not created a policy because he has been focused on preparing the city's fiscal year 2018–19 budget. However, he intends to develop relevant policies in the next six months. Without addressing this control weakness, employees could make unauthorized or fraudulent purchases that could result in the city wasting funds.

Another finding the external auditor reported, but that Lynwood has not addressed, is that the city is not conducting bank reconciliations in a timely manner. The external auditor found that bank reconciliations were not performed promptly for each of the four months that it reviewed. The external auditor also found that the city has no systemic method for ensuring timely and complete year-end closing procedures are in operation. By not establishing such procedures or completing bank reconciliations promptly, the city may not detect accounting errors, resulting in misstated account balances and creating delays in preparing financial statements.

Although the city manager informed us of his commitment to implement the external auditor's recommendations, the city has not yet developed a plan demonstrating how and when it will resolve the remaining issues that the external auditor identified. Appendix B shows that the external auditor identified many bad effects that could result if Lynwood does not address the recommendations. Without addressing the concerns identified by the external auditor, the city's poor practices and lack of oversight over its financial operations could lead to inaccurate financial reporting, fraud, or waste.

***Recommendations to Address This Risk***

- Lynwood should develop and implement a plan to address the findings in the city's fiscal year 2015–16 single audit—and any findings in its fiscal year 2016–17 single audit—including reasonable time frames for completion and a mechanism for tracking progress in addressing the findings. The city should assign responsibility to specific city staff to coordinate the city's actions.
- Lynwood should develop policies and procedures that establish how the city will track and address future audit findings.

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# INEFFECTIVE ORGANIZATIONAL MANAGEMENT DIMINISHES LYNWOOD'S ABILITY TO PROVIDE PUBLIC SERVICES

## **Lynwood's Leadership Has Not Created a Strategic Plan That Would Direct Its Departments' Goals and Objectives Towards a Unified Vision**

Lynwood lacks a comprehensive and cohesive framework, such as a strategic plan, for guiding its departments. Strategic planning is of particular importance to Lynwood as it states on its website—its vision is to create and maintain a clean, safe, attractive, well-informed, self-reliant, and pride-filled community that provides access to outstanding social, cultural, recreational, educational, and economic opportunities for residents and businesses. The GFOA recommends that all governmental entities use some form of strategic planning to provide a long-term perspective for service delivery and budgeting. The GFOA believes strategic planning establishes logical links between authorized spending and broad organizational goals. According to the GFOA, the focus of strategic planning should be on aligning organizational resources to bridge the gap between present conditions and the envisioned future.

Although Lynwood includes some elements of a strategic plan in its annual budget document, the document does not comprehensively fulfill the purpose of a strategic plan. Within its annual budget document, Lynwood includes various goals, objectives, and past achievements or outcomes for each of its departments. According to the GFOA, a city should agree on a small number of broad goals to include

in its strategic plan that address the most critical issues facing its community. Instead, Lynwood includes 185 goals in its budget document, and many do not address the critical issues the city is facing, such as its long-term financial viability. Further, the budget document does not include a clear action plan that describes how the city will implement strategies to address its goals and objectives nor does it include measurable objectives and performance measures that can clearly demonstrate whether those goals have been met—all elements that the GFOA recommends for a strategic plan. Although Lynwood does not have a comprehensive strategic plan in place, the city manager recognizes the importance of a strategic plan and would like to establish one for the city.

We believe that there are clear benefits from having a formal strategic plan in place. Specifically, a comprehensive citywide strategic plan can provide an overall framework for the city to operate within as well as articulating the goals it desires to achieve. City departments can build upon the plan by crafting their own goals and objectives, which helps to direct their delivery of public services in the most effective manner. A strategic plan can also facilitate efforts by the departments to address issues of particular concern to the city, such as the risk the city is facing that it may be unable to meet its future obligations. Finally, the strategic plan can align department goals and provide performance measures for the city to use to evaluate its success.

**Recommendation to Address This Risk**

Lynwood should assign its city manager’s office, with the support and involvement of department directors, the duty of facilitating the development of a citywide strategic plan that follows the recommendations established by the GFOA.

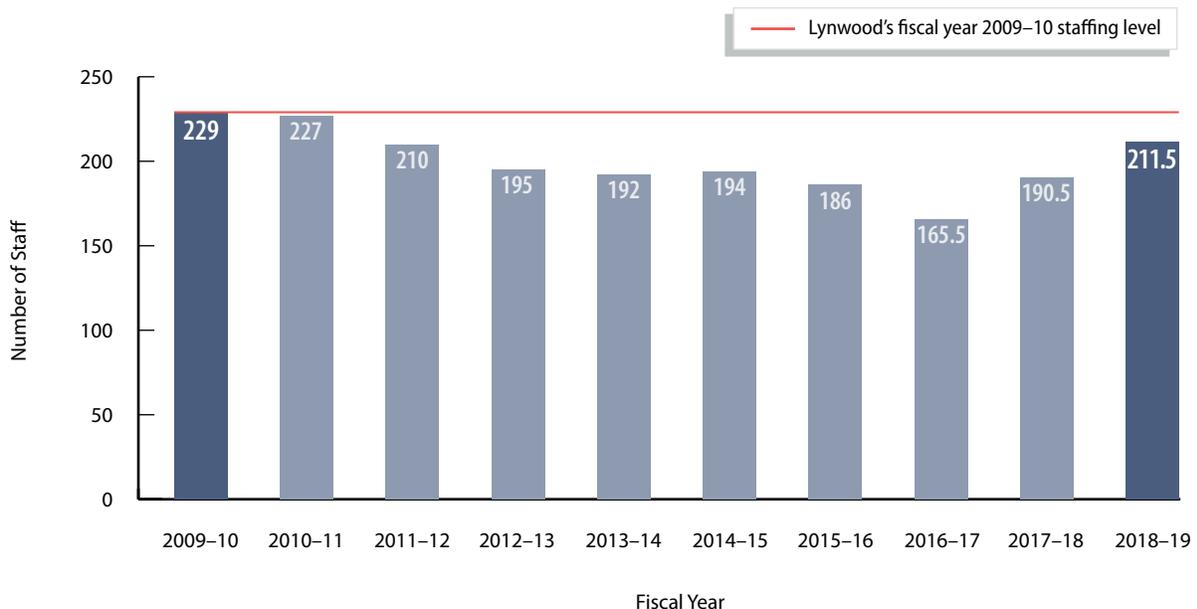
**Some of Lynwood’s Departments Claim to Be Understaffed, but Do Not Effectively Measure Their Staffing Needs**

In recent years, Lynwood has attempted to provide a greater level of service while employing fewer staff. Figure 6 shows that at the beginning of fiscal year 2009–10 the city had 229 full-time-equivalent staff, a number that declined to 165.5 full-time-equivalent employees by the end of fiscal year 2016–17. In fiscal year 2017–18, the city increased its staff to 190.5 full-time-equivalent employees and as of the beginning of fiscal year 2018–19, the city

budgeted for 211.5 full-time-equivalent staff. Even with the most recent increase, the city’s staffing level remains 8 percent below its fiscal year 2009–10 level.

According to its budget documents, however, the city has increased services in some areas over this same period and now must provide these services with fewer staff members. For example, the city has constructed three new parks since 2011. This increased the need for park maintenance throughout the city by nine acres, or 23 percent, but the number of public works staff dedicated to this duty has decreased by two, or 14 percent. In addition, the recreation and community services director had to assign more duties to the superintendent of the playgrounds and camps division to accommodate a new community center that opened in 2017. He indicated that the superintendent is now essentially working two jobs by managing both the playgrounds and camps division as well as the new community center.

**Figure 6**  
Even After Recent Increases, Lynwood’s Current Staffing Is Not at the Level It Was in Fiscal Year 2009–10



Source: Lynwood budget documents.

Some departments were able to identify for us the need to fill specific positions because of responsibilities they are currently unable to address. For example, the human resources department has a designated position assigned to administer a comprehensive risk management program that manages the city's workers' compensation policy, its insurance policies, and general liability strategies. The city eliminated this position in 2012, and the human resources director said the position's duties have been performed since then by city staff who do not have the appropriate certification needed to complete certain duties. Similarly, the finance department has three accounting positions it is currently filling with contractors but will eventually need to fill with permanent staff. Because the departments are budgeted for positions to address specific responsibilities, they are able to justify their need to hire individuals to fill the positions that are vacant or filled by temporary contractors.

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### **Some departments do not quantify how many staff members they need to complete their projected workloads in a timely manner.**

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Other departments are not as able to justify their stated needs because they do not quantify how many staff members they need to complete their projected workloads in a timely manner. A common theme of these departments is that they, or some of their divisions, are staffed with a pool of employees who perform a general range of duties. For example, the public works department has maintenance workers in multiple divisions who conduct a range of duties such as semi-skilled work in the maintenance, repair, and construction of city streets, and removal of graffiti from city facilities. According to the public works director, he relies on his supervisors' observations of staff workloads

to anecdotally determine the need for more staffing. However, for some of the department's divisions, the director has not determined the number of staff needed to complete the work they are responsible for in a timely manner.

Similarly, the technology and media services director does not track all of the work his staff completes. According to the director, he records work requests that are submitted to his staff through his department's work request computer system. However, we found that the system does not track the actual hours employees incur to complete tasks. The director informed us the system allows him to manage the day-to-day operations of his department but was not intended to provide hourly summaries. Consequently, although he believes he needs two additional staff members to address his department's workload effectively, he cannot quantify his current needs.

Without quantifying the amount of work individual staff members are able to complete or the work hours needed to complete their anticipated workloads, Lynwood's departments cannot effectively evaluate their staffing needs and are at risk of inadequately or inefficiently providing services. Given Lynwood's uncertain financial outlook discussed previously, we believe that it is important for the city to identify actual staffing needs to provide services at appropriate costs. Without this critical information, each department is at risk of being over- or understaffed, which can unnecessarily add to the city's potential structural deficit, lead to inadequate service for the public, or limit proper support for other city departments.

#### ***Recommendations to Address This Risk***

- Using the key performance measures identified as part of its strategic plan as well as relevant workload data, Lynwood should conduct a staffing analysis to determine appropriate staffing levels for each of its departments.

- After tracking its effectiveness in providing services, Lynwood should prioritize adjusting its departments' staffing levels to align with their predicted workloads.

### **Lynwood Does Not Have Adequate Succession Planning to Retain Its Institutional Knowledge When Turnover Occurs in Key Leadership Positions**

Lynwood has experienced frequent turnover in recent years among its key leadership positions including city manager and the directors of finance, human resources, and public works. As Figure 7 shows, the city has transitioned through at least three individuals in each of these positions since fiscal year 2014–15. Lynwood's mayor pro tem—who has served on the city's council since fiscal year 2003–04—indicated that the council's historical tendency to micromanage the city manager and directors is a cause for the high turnover as well as the city council's frequent tendency to terminate employees in those positions. The city has now filled its remaining leadership vacancies, and the city manager and all director positions were occupied as of September 2018.

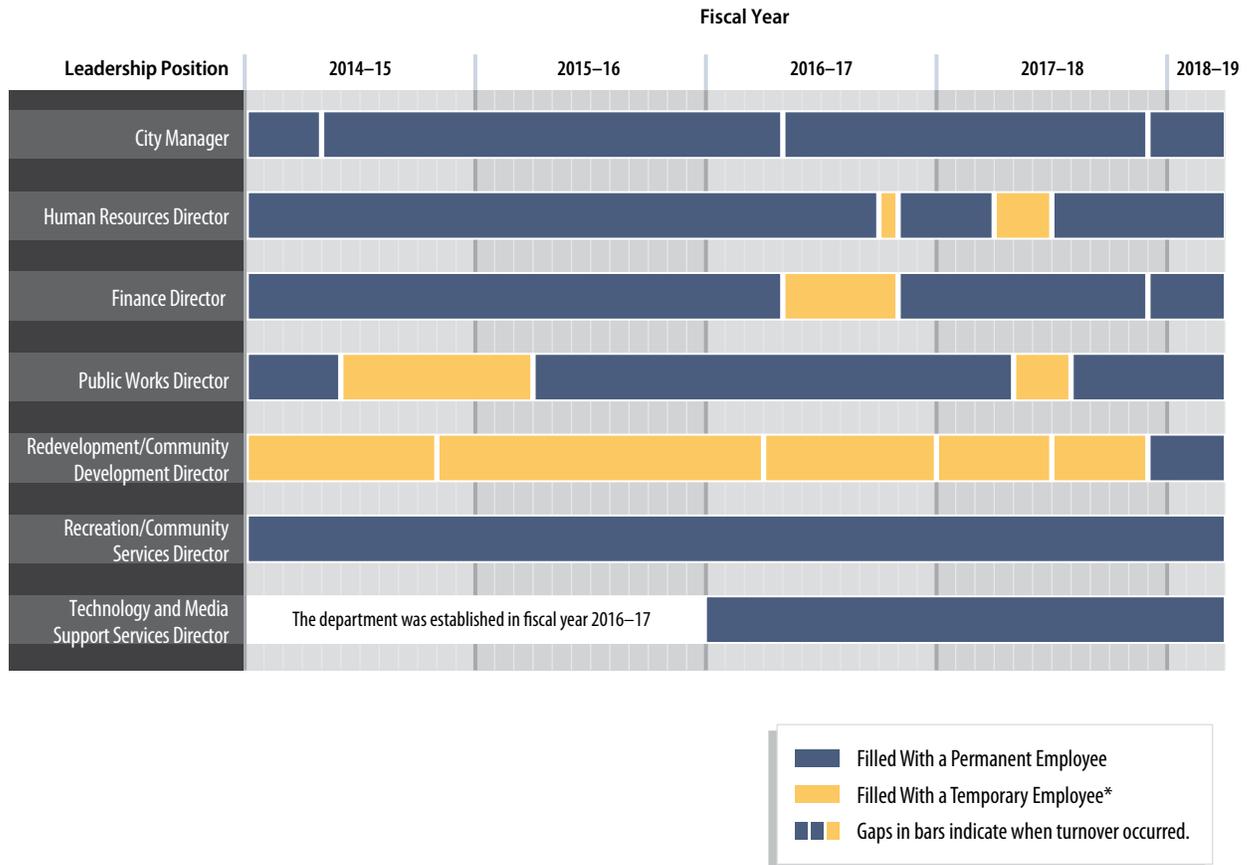
Lynwood's turnover in key leadership positions and lack of documentation of its decision-making processes have resulted in its departments having less institutional knowledge. Throughout our audit we observed that department directors could not always explain the decision processes of their predecessors. For example, the human resources director could not explain the rationale the city used when making decisions to increase salaries of numerous positions because she was not there when the decisions were made and she could not find documentation to explain the rationale. In another example, the city manager informed us that he could not explain why a previous finance director's budget estimate was incorrect. In yet another example, the city spent \$23,000 to contract with a human resources firm in 2015 to produce updated

personnel rules underlying citywide policies regarding topics such as sexual harassment. However, the human resources director said the personnel rules had not been implemented likely due to turnover. Consequently, it appears that the reason the rules were not implemented was because the department lost track of them.

Better succession planning could have helped Lynwood by ensuring the sharing of institutional knowledge that would allow current leaders to better understand past actions and carry forward operations more effectively. In fact, the GFOA suggests that governments adopt formal succession plans that identify risks and strategies and thereby provide a guiding framework for specific succession initiatives. In addition, the GFOA recommends that entities facilitate leadership development as part of their succession planning. GFOA best practices state that when leadership development occurs, the organization benefits from developing a leadership pool for other positions. Thus, a leadership pool would provide the city with more internal staff who have knowledge of the city's operations and who are qualified to replace leaders when positions become vacant.

A well-developed succession plan and policies to document decision-making processes could help Lynwood ensure continuity and consistency in the event of leadership turnover. For example, a consultant who temporarily filled the human resources director position prior to the current director acknowledged that her short tenure did not make her the ideal individual to direct the creation of a policies and procedures manual. Had the department used a city staff member from a leadership pool to assume the role of acting director, that individual may likely have had the time and been more committed to performing in the city's best interest to effectively address the issue. Similarly, if the city had required its previous finance director to document the process he used to create the April 2017 estimated balance of the general fund for

**Figure 7**  
 Lynwood Has Experienced Significant Turnover In Recent Years Among Its Key Leadership Positions



Source: Lynwood’s personnel forms and city council resolutions.  
 \* There were brief transition periods when positions may have been vacant.

fiscal year 2016–17, the city would be able to review and update that methodology based on actual fund balance activity and create more accurate fund balance estimates in future years.

Lynwood’s management recently began developing a succession plan. Although Lynwood’s human resources department included a goal in the city’s fiscal year 2017–18 budget document to create a succession plan, the department did not start this process until September 2018. According to the current human resources director, who has been in

her position since January 2018, she had not prioritized the development of such a plan because she needed to focus on addressing issues that are more critical. However, in October 2018, the city completed a draft plan it intended to submit to its city council for approval in early November 2018. By developing and adopting a formal succession plan, the city would establish a framework for recognizing, developing, and retaining key management employees. Such a plan would also identify key gaps in expertise that staff currently in leadership positions could fill through training and recruitment.

***Recommendations to Address This Risk***

- Lynwood should complete its succession plan and align it with the strategic plan we recommend the city create. Lynwood should also ensure that the succession plan establishes better continuity and provides the city with a leadership pool to draw from when management changes occur.
- Lynwood should develop a policy to require that its managers document the processes they use to make key decisions, such as the rationale for increasing salaries above the amounts determined from survey results or the methodology used to develop budget estimates, to provide continuity among leadership.

We conducted this audit under the authority vested in the California State Auditor by section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in Appendix A. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
California State Auditor

December 4, 2018

# APPENDIX A

## Scope and Methodology

In May 2018, the Audit Committee approved a proposal by the State Auditor to perform an audit of Lynwood under the local high-risk program. We conducted an initial assessment of Lynwood in October and November 2017, in which we reviewed Lynwood's financial and operating condition to determine whether it demonstrated characteristics of high risk pertaining to the following six risk factors specified in state regulations:

- The local government agency's financial condition has the potential to impair its ability to efficiently deliver services or to meet its financial or legal obligations.
- The local government agency's ability to maintain or restore its financial stability is impaired.
- The local government agency's financial reporting does not follow generally accepted government accounting principles.
- Prior audits reported findings related to financial or performance issues and the local government agency has not taken adequate corrective action.

- The local government agency uses an ineffective system to monitor and track state and local funds it receives and spends.
- An aspect of the local government agency's operation or management is ineffective or inefficient; presents the risk for waste, fraud, or abuse; or does not provide the intended level of public service.

Based on our initial assessment, we identified concerns about Lynwood's financial condition and financial stability as well as aspects of its operations that were ineffective or inefficient. Further, we identified that Lynwood has not taken adequate corrective action to address several prior audit findings, including those identifying weaknesses that could expose Lynwood to increased risk of fraud or financial mismanagement. Table A on the following page lists the resulting audit objectives and related procedures that address these risk factors. We did not identify concerns during our initial assessment pertaining to the remaining two risk factors.

**Table A**  
**Audit Objectives and the Methods Used to Address Them**

AUDIT OBJECTIVE	METHOD
<p>1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.</p>	<p>Reviewed relevant laws, regulations, and other background materials applicable to Lynwood.</p>
<p>2 Determine the causes for the fiscal year 2016–17 decline in Lynwood’s general fund balance, as well as the reasons for the significant discrepancy between the estimated and actual fund balance.</p>	<ul style="list-style-type: none"> <li>• Reviewed Lynwood’s audited financial statements for fiscal year 2016–17 and determined that its general fund balance increased rather than declined.</li> <li>• Reviewed city budgets, mid-year financial updates, and the fiscal year 2017–18 CAFR to determine the reasons for fluctuations in the fiscal year 2016–17 general fund ending fund balance estimates and obtained perspective from the city regarding the fluctuations.</li> </ul>
<p>3 Assess whether Lynwood’s departmental structures and staff levels are sufficient to effectively provide city services. Determine how changes in staffing levels and compensation will affect future personnel costs. Identify options for Lynwood to improve the efficiency and effectiveness of its staffing model.</p>	<ul style="list-style-type: none"> <li>• Interviewed department directors to determine the city’s perspective regarding its departments’ abilities to provide services with their current structures and staffing levels.</li> <li>• Analyzed departments’ current goals, objectives, and performance measures.</li> <li>• Compared the city’s staffing expenditures in fiscal year 2016–17 to the city’s proposed fiscal year 2018–19 expenditures.</li> <li>• Evaluated city documents to determine whether Lynwood could improve the efficiency and effectiveness of its staffing model.</li> </ul>
<p>4 Assess Lynwood’s processes for projecting revenue and expenditures, including whether those processes follow best practices. In doing so, also assess Lynwood’s ability to meet future costs and obligations, including increasing salary and pension costs. Identify opportunities to increase the accuracy and transparency of Lynwood’s budgeting processes and to sustainably align Lynwood’s revenue and expenditures.</p>	<ul style="list-style-type: none"> <li>• Interviewed finance department staff and reviewed procedures in order to determine Lynwood’s budget practices and processes for projecting revenue and expenditures.</li> <li>• Compared Lynwood’s budgeting practices against best practices from the GFOA.</li> <li>• Reviewed the use of one-time revenue in Lynwood’s fiscal year 2018–19 budget and its impact on Lynwood’s future budget structural deficit.</li> <li>• Reviewed the accuracy of Lynwood’s budgeted beginning general fund balance in fiscal years 2016–17 and 2017–18.</li> <li>• Determined that Lynwood has dedicated revenue that it can spend on retirement costs, and therefore we did not evaluate future pension costs as an area of high risk.</li> </ul>
<p>5 Review Lynwood’s implementation of its plans to address internal control deficiencies identified in its fiscal year 2015–16 financial audit. Also, to the extent possible, review other areas of controls not directly related to financial reporting but for which insufficient controls may create a risk of waste or abuse, such as procurement and contracting practices.</p>	<ul style="list-style-type: none"> <li>• Interviewed key department personnel and reviewed supporting documentation to determine whether the city addressed the deficiencies identified in its fiscal year 2015–16 audit, the most recent audit report available when we began our review.</li> <li>• Judgmentally selected and reviewed two contracts to determine if they presented a risk of waste or abuse.</li> <li>• Reviewed exceptions to competitive bidding in the city’s municipal code governing purchasing to determine whether the city was using these exceptions inappropriately.</li> </ul>
<p>6 Examine Lynwood’s efforts to fill key management positions and maintain organizational and leadership continuity within city operations.</p>	<ul style="list-style-type: none"> <li>• Interviewed department directors and reviewed recruitment documents to determine what process Lynwood used to fill its key management positions.</li> <li>• Interviewed the human resources director regarding citywide succession planning efforts and reviewed relevant documents.</li> <li>• Reviewed human resources documentation to identify turnover in leadership positions.</li> </ul>
<p>7 Review and assess any other issues significant to the audit.</p>	<ul style="list-style-type: none"> <li>• Reviewed how Lynwood allocated the funding of its staff salaries between city funds, including the water and sewer funds, for the fiscal year 2018–19 budget.</li> <li>• Reviewed the structure of the utility authority and, whether and how Lynwood tracked lease payments made by this entity to the city.</li> <li>• Reviewed the funding sources for the city hall annex construction project and two other capital improvement projects to determine whether it was appropriate for the city to use the water fund to help pay for these projects.</li> </ul>

Source: Analysis of documents, interviews, and data obtained from Lynwood.

# APPENDIX B

## Lynwood’s Implementation Efforts to Address Financial Audit Recommendations

As a part of our audit fieldwork, we determined the status of Lynwood’s efforts to address the recommendations from its fiscal year 2015–16 financial audit. As we discuss in our report, Lynwood has not fully addressed

several recommendations even though they were reported more than a year ago. Table B shows the status of Lynwood’s corrective action for each finding.

**Table B**  
**Lynwood Has Not Implemented Nearly Half of the Recommendations From Its Fiscal Year 2015–16 Financial Audit**

FINDING	EFFECT	RECOMMENDATION	IMPLEMENTED
<b>Lack of Claims Payable Tracking:</b> The city did not perform an analysis and accrual of insurance claims payable incurred but not reported (IBNR).	The claims payable liability might be understated without IBNR analysis and accrual.	Lynwood should perform IBNR analysis on an annual basis and accrue the additional liability if necessary.	✓
<b>Lack of Payroll Control:</b> There is a lack of internal controls over payroll and human resources.	Lack of internal control over payroll and human resources-related processes may lead to financial statement misstatements.	Lynwood should adopt a formal policy on the internal control over overall financial reporting. The policies should include the payroll and human resources-related procedures.	✓
<b>Lack of Approval of Federal Requests:</b> U.S. Department of Housing and Urban Development (HUD) drawdown requests were missing proper approvals.	Without a review process, the city may not comply with the grant requirements.	Lynwood should establish a formal policy on review procedures over federal grant drawdown requests.	✓
<b>Lack of IT Access Control:</b> Janitors had full access to the information technology (IT) server room and the cabinets were not locked. Employees are able to log in to the utility-billings terminal using other employees’ user names and passwords.	Lack of IT control in the city might result in unauthorized access to financial data.	Lynwood should adopt policies and procedures to monitor user rights and prohibit shared login.	✓
<b>Lack of Vendor Credential Verification:</b> The city did not have documentation to support it had verified that its vendors were not debarred or suspended from federally funded purchases.	Without verifying whether vendors are suspended or debarred from working on federally funded projects, the city could be contracting with vendors that are prohibited from working on federally funded projects.	Lynwood should establish proper internal control procedures to monitor compliance requirements to ensure vendors are not suspended or debarred from federally funded purchases.	✓
<b>Missed Federal Deadlines:</b> The city did not meet deadlines for Form HUD 60002 reporting.	Because of the delay in filing Form HUD 60002, a report the federal government requires the city to submit every year, the city was not in compliance with the requirements.	Lynwood should establish comprehensive policies and procedures that specify the deadlines for all required reporting.	✓

*continued on next page...*

<p><b>Federal Grant:</b> The city did not obtain HUD's approval of a request for release of funds nor did it perform an environmental review prior to the street improvement project's commencement.</p>	<p>Because the city did not obtain HUD's approval of a request for release of funds or complete environmental reviews prior to commencement of the street improvement projects, the city was not in compliance with federal regulations.</p>	<p>Lynwood should establish a comprehensive grant management policy to ensure all compliance requirements are met.</p>	
<p><b>Turnover in the Finance Department:</b> The city has significant turnover in the finance department that resulted in inadequate review, analysis, and reconciliation of financial statements to the accounting records.</p>	<p>The turnover caused a significant burden to the remaining finance staff, increased the risk for error and noncompliance, and caused a delay in closing the financial books.</p>	<p>Lynwood should reestablish a well-structured finance department and clearly define responsibilities among staff.</p>	
<p><b>Delayed Bank Reconciliations:</b> All four bank reconciliations selected for testing were not completed in a timely manner. The finance department has no method for ensuring that timely and complete year-end closing procedures are in operation.</p>	<p>Delays in processing transactions in a timely manner and delays in closing accounting periods can create accounting errors that could go undetected. This may lead financial statements to be materially misstated and create further delays in the release of audited financial statements.</p>	<p>Lynwood should establish effective monthly and year-end closing procedures that reduce the risk of accounting errors and the need for correcting journal entries after the year-end closing. These procedures would include timely review and approval by management of account reconciliations, sub-ledger transactions, cutoff review for account balances at a fund and overall government-wide level, and revenue and expenditures review. Revenue and expenditures should be compared to the prior year or prior year trends and to the budget.</p>	
<p><b>Lack of Purchase Order Control:</b> Internal control testing over procurement found that some purchase orders were issued after the purchase occurred, procurement was completed without a valid contract between the city and the vendor in one instance, and vendor invoices were held at the department level resulting in the need to rush payments through prepaid checks rather than regular check runs.</p>	<p>Lack of internal control over procurement and cash disbursement processes may lead to financial misstatements. It may also lead the city to enter into unauthorized transactions.</p>	<p>Lynwood should adopt a formal policy regarding the internal control over the overall financial reporting and each transaction class. The policies should include the procurement and cash disbursements process. Lynwood should make procurements with qualified contracts or purchase orders to prevent incurring unauthorized purchases. Furthermore, Lynwood should limit the use of prepaid checks for payments in order to make sure all disbursements go through proper review and approval.</p>	
<p><b>Lack of Capital Asset Tracking:</b> The city does not have a capital assets list at the department level and does not perform a capital asset count or tag equipment. Some assets were not recorded properly.</p>	<p>Commingling capital assets between governmental activities and business-type activities and expensing capital-related expenditures might result in material financial misstatements. Not capitalizing the infrastructure expenditures could also lead to financial misstatements and is inconsistent with standard industry practice.</p>	<p>Lynwood should adopt a capital assets policy and also perform a capital-asset expenditure analysis on an annual basis to determine whether the capital-related expenditures should be expensed or capitalized in order to fairly present the financial statements. Lynwood should also review historical records of capital assets purchased by the city in order to determine their proper classification.</p>	
<p><b>Unsupported Grant Allocations:</b> Payroll allocations to federal grants were not properly calculated, reviewed, or documented.</p>	<p>Without a review process in place to detect miscalculations and clerical errors, the city incorrectly charged payroll costs to a grant. In addition, the city did not have formal policies and procedures over the payroll process, which resulted in missing supporting documentation and incorrect payroll allocations charged to the program.</p>	<p>Lynwood should establish a proper internal control to ensure payroll allocations charged to federal grants are properly calculated, reviewed, and documented.</p>	

Source: Lynwood's fiscal year 2015–16 single audit and independent auditor's report, interviews with relevant Lynwood staff, and analysis of policy documents maintained by Lynwood.

✓ = Completed prior to June 2018

✓ = Completed after June 2018

X = Not completed

## APPENDIX C

### The State Auditor's Local High-Risk Program

California Government Code section 8546.10 authorizes the State Auditor to establish a local high risk program to identify local government agencies that are at high risk for potential waste, fraud, abuse, or mismanagement, or that have major challenges associated with their economy, efficiency, or effectiveness. Regulations that define high risk and describe the workings of the local high risk program became effective July 1, 2015. Both statute and regulations require that the State Auditor must seek approval from the Audit Committee to conduct high risk audits of local entities.

To identify local entities that may be high risk, we analyzed publicly available information, such as financial reports and prior audit reports or analyses, for more than 450 California cities. Using this analysis, we identified various cities for which we performed a more detailed financial analysis. This detailed analysis included using the financial data to calculate fiscal indicators that may be indicative of a city's fiscal stress. We also reviewed publicly available information, including financial and budgetary reports and other information that could affect the city's operations, to assess the city's fiscal outlook over the next several years. We then analyzed the results to determine whether each city is at risk for potential waste, fraud, abuse, and mismanagement, or has major challenges associated with its economy, efficiency, or effectiveness.

Based on our most recent analyses in 2017, we identified several cities, including Lynwood, which appeared to meet the criteria for being at high risk. To better understand the factors that led us to this determination, we visited each of these cities and conducted an initial assessment to determine the city's awareness of and responses to those issues, as well as to identify any other ongoing issues that could affect our determination of whether the city is high risk. After conducting our initial assessment, we concluded that Lynwood warranted an audit. In May 2018, we sought and obtained approval from the Audit Committee to conduct an audit of Lynwood.

If the local agency is designated as high risk as a result of the audit, it must submit a corrective action plan. If it is unable to provide its corrective action plan in time for inclusion in the audit report, it must provide the plan no later than 60 days after the report is published. It must then provide written updates every six months after the audit report is issued regarding its progress in implementing the corrective action plan. This corrective action plan must outline the specific actions the local agency will perform to address the conditions causing us to designate it as high risk and the proposed timing for undertaking those actions. We will remove the high risk designation when the agency has taken satisfactory corrective action.

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OFFICE OF THE  
**CITY MANAGER**  
**JOSE E. OMETEOTL**

City of  
**LYNWOOD**

Incorporated 1921

11330 Bullis Road, Lynwood, CA 90262  
(310) 603-0220 x 200



November 8, 2018

California State Auditor  
Elaine Howle  
621 Capital Mall, Suite 1200  
Sacramento, CA. 95814

Dear Ms. Howle:

Attached to this cover letter, you will find a response to the California State Draft Audit Report for the City of Lynwood – Poor Management Has Contributed to Its Financial Instability and Led to Its Failure to Comply with State Law.

The draft has been shared with all Department Directors, and have prepared a response to the areas of concern listed therein:

- Inadequate Financial Management Hinders Lynwood’s Financial Stability
- Violation of State Laws, Weak Oversight, and Policy Breaches Increase Lynwood’s Susceptibility to Fraud and Waste
- Ineffective Organizational Management Diminishes Lynwood’s Ability to Provide Public Services

Each point within the report has been addressed and a summary response to the report is enclosed.

Sincerely,

A handwritten signature in black ink, appearing to read "Jose E. Ometeotl".

Jose E. Ometeotl  
City Manager  
City of Lynwood

City of Lynwood  
 Responses to Draft State Auditor Assessment  
 Report 2018-803

① **Inadequate Financial Management Hinders Lynwood's Financial Stability** (pg 9)

- ② The City has run into deficits in the past, however, under the City Council's direction, new tax measures have been approved by the voters that will alleviate the structural problems. The fiscal year 2016-17 ended with a positive fund balance of \$2.5 million and current unaudited projections for 2017-18 indicate another increase of approximately \$1.9 million.

The City's financial projection used to estimate the ending General Fund fund balance for FY 2017-18 is tracking close to the actual year-end results. The budget projection estimated an ending fund balance of \$4.6 million and the current unaudited financial results reflect a \$4.5 million ending fund balance, a 2.17% margin.

Lynwood At Risk of Not Meeting Its Future Financial Obligations (pg 9)

- ③ The state auditor's assertion that the City is "...at Risk of Not Meeting Its Future Financial Obligations" is based on a fundamentally flawed assumption that the City would not make adjustments to its operations, as warranted by the economic conditions the agency operates in, on an on-going basis. Staff throughout the agency work with various state and federal agencies and consultants monitoring and refining projections on revenue streams to ensure funding for City services. This is evidenced by monitoring State of California's Department of Finance projections, Metropolitan Transportation Authority's projections, as well as meeting on a quarterly basis with consulting firms specializing in forecasting sales and property taxes. These sources are used to make mid-year corrections on an annual basis. This has been demonstrated in March of 2018 where an analysis on revenues was performed for the 2017-18 fiscal year. Revenue estimates were projected to come in lower than budgeted. The City implemented a hiring freeze along with departmental budget cuts to avoid any structural problems. As result, the City's General Fund's is anticipated to have an excess of revenues over expenditures of approximately \$1 million dollars based on unaudited financials, excluding transfers.
- ④

Fund Balance Estimates (pg 10)

- ⑤ The State auditors assert that the beginning Fund Balances for FY 2018-19 may be inaccurate based on prior years' reports. The Finance Department uses Audited Financial Information from the Comprehensive Annual Financial Report (CAFR) as the basis for beginning fund balances. As such, estimated ending fund balances are derived from utilizing audited fund balances, estimated revenues as well as estimated expenditures based on projections from a variety of sources including external sources such as state and local agencies, consulting firms with specific revenue type knowledge along with internal expertise from staff within the City that have many years of experience with revenues and cost. For fiscal year end 2017-18, the City unaudited actual results are coming in within \$100,000 dollars of estimates.
- ④

Table 3 (pg 12)

City of Lynwood  
Responses to Draft State Auditor Assessment  
Report 2018-803

While the Community Development Director is unable to comment on how past budget projections were forecast, she is able to comment on how it will be done in the future. The Community Development budget process kicks-offs with the updating of the department's financial forecast. This helps in determining the department's financial status and would highlight some of the major challenges the department will need to address in the future budget. Since it projects the revenues the department will receive and the expenditures it will occur in the upcoming year, it sets a starting point as to the resources available to fund necessary expenses.

The next step in the cycle is the development of the proposed budget. In developing the proposed budget each section is reviewed with the appropriate manager/supervisor. Each line item is reviewed against current budget as well as the prior budget year to determine allocation spending habits. In addition, future projects and needs are reviewed to determine if additional funding will be needed. All line items include the detail on how the funding was arrived at and will be allocated in the next year's budget.

Once the budget has been completed, then it would be reviewed with the City Manager and Finance Director to determine if the needed funding exists or if line items need to be cut or deferred to the next fiscal year.

#### Budget Calendar (pg 13)

During the fiscal year 2017-18, the 2018-19 budget calendar was delayed due to staffing issues within the Finance Department. However, the 2018-19 operational budgets were prepared in great detail to ensure integrity and accuracy with the planned operational and capital activities of the City. As such, detailed sub-schedules were prepared for every non-labor general ledger account. Further, personnel master files were prepared, breaking down labor cost on an expenditure-type basis per authorized position. These cost were then allocated to their respective departments as determined by the City's senior staff and department heads. Therefore, while the timeline for the budget development process was compressed, it was developed from a bottom up detailed approach.

For the upcoming budget season, the budget cycle will start in January culminating in the adoption and approval of the Bi-annual 2019-20, 2020-21 Operating and Capital budgets. The five year Capital Improvement Plan will begin in December of 2018.

#### One-time Revenue (pg 13)

The City is currently negotiating the exchange of restricted utility credits that are allowed under the California Public Utilities Commissions' Rule 20a program with another agency within the Southern California region. The anticipated revenue from this exchange of restricted credits will flow into the City's unrestricted General Fund. Many Cities within the state exchange these Rule 20a credits, which can only be used for very limited

City of Lynwood  
 Responses to Draft State Auditor Assessment  
 Report 2018-803

- ⑥ purposes for unrestricted monies at an exchange rate generally ranging from 50% to 60% on the dollar. The City is entitled to a \$2.7 million dollar Rule 20a credit and therefore is estimating approximately \$1.5 million of one-time monies from this exchange for FY 2018-19. In the event that the exchange is not executed, the City will continue soliciting exchange bids from other agencies. Further, the City will adjust its annual budget at mid-year if it appears unlikely to perform an exchange within the fiscal year. The state auditor's implication that the City would not adjust its budgets presents an unrealistic scenario.
- ⑦

As discussed by the City Manager, if the City did not execute an exchange agreement within the 2018-19 fiscal year, the City would eliminate two expenditures totaling approximately \$960,000 from future years budgets, reducing the summer law enforcement team and deferring certain road maintenance and improvement projects. In addition, the City would freeze current vacancies and seek departmental savings.

⑦

Lynwood Did Not Adhere to Main Best Practices When Preparing Its Budget (pg 16)

- The Finance department will be developing a multi-year budget for the City beginning with the FY 2019-20, 2020-2021 fiscal years.
  - Finance will also be developing a five year Capital Improvement Plan that will be presented to the City Council beginning with the FY 2019-20 year.
- ④
- Finance will perform a mid-year in-depth analysis and make budget recommendations to prevent any structural problems as well as to ensure that reserves levels are maintained.

GFOA Best Practices in Budgeting (pg 16)

- ⑧
- The State Auditor's draft report list out the Government Finance Officers Association's (GFOA) best practices for preparing a governmental agency's budget. However, these practices are guidelines and it is up to each agency to determine which of these practices are best suited to them based on resources and the size of the agency.
  - One of the GFOA's best practices is to develop a multiyear budget. We agree. Therefore, the Finance Department will be preparing a two year operational and capital budget starting in January 2019. In addition, Finance, in coordination with the Public Works and Community Development departments, will be preparing a five year Capital Improvement Plan (CIP). The five year CIP Plan will take six months to develop and will be incorporated into the annual budget adoption process.

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### Fund Balance Reserves

- The State Auditor's assertion that the City does not follow GFOA's best practice on General Fund balance reserves is an area that the City could improve upon. While the GFOA's guidelines on General Fund balance reserves states that the reserves should cover two months of operational expenditures, the Finance department's view on reserves is that they should be based on an extensive analysis and assessment of the City's current and future risks. Therefore, the Finance department in coordination with the City's new Risk Manager will be developing a risk assessment model to provide a comprehensive approach to setting reserve goals.
- For FY 2016-17 the City's reserves fell below the City's 10% policy, however, the City will be exceeding the 10% reserve policy for FY 2017-18.

### Lynwood Compounded Its Structural Deficit by Significantly Increasing the Number of Employees and Their Salaries When It Could Not Afford To Do So. (pg 19)

The audit stated that the City increased its total employee count in FY 19 from 190.5 to 211.5, implying that the City was deficient in its decision making. Almost all of the increases in staff were in the Parks and Community Services and Public Works departments. The increases were necessary to meet the growing demand for services. In addition, in the Public Works department, the increase in the staff was attributed to the increase in infrastructure projects mostly funded by other than the General Fund. ⑨

The report states that the City should not have given increases in light of hiring freeze that was implemented in March of 2018. However, nearly all of the increases were implemented before the "hiring freeze". In addition, the hiring freeze is a misnomer, in that the City still continued to fill critical and non-general funded. The implementation of a hiring slow-down was prudent fiscal management on the part of the City and not indicative of poor decision making. ⑩

The report states that the City increased salaries when it could not afford to do so, and therefore, compounded its financial problems. This argument is flawed and does not account for the considerable cost of employee turnover and low morale. In order to provide services to the public, the City must recruit and retain qualified staff. Even after the City provided employees with a moderate 1% Cost of Living Adjustment in 2017, the salary surveys conducted showed that nearly every City position benchmarked was below the market. Moreover, studies show that the cost of employee turnover ranges from 20% to 40% of the annual salary. This does not include the loss of productivity or the effect on morale that low salaries and high employee turnover costs the organization. A moderate raise, provided to employee to appropriately compensate them for the work ⑪

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performed generally costs the city less over the long run by decreasing turnover and increasing productivity.

Figure 4 (Salary Surveys) (pg 20)

- A significant amount of time and an analysis was spent on the salary surveys that were conducted. As explained to the auditors, there is no legal requirement that a salary survey be conducted in order to increase the salary of a classification. It was stated in the report that the City of Lynwood did not use appropriate benchmark cities in order to compare salaries, therefore, the studies were not valid. The City of Lynwood strongly disagrees with this statement. There are no formal benchmarking standards universally adopted by any governing body. Generally speaking, positions would be benchmarked from agencies within a city's relevant job market, taking into account certain factors such as similar economic challenges. Lynwood's relevant job market would extend from Los Angeles County, Orange County, and into the Inland Empire, given the mobility of Southern Californians. One of the most important factors in benchmarking positions would not be the size of the agency, but matching the job duties of the two comparable positions. Many smaller cities contract out their functions, and, as such, Lynwood cannot always benchmark its positions against smaller agencies. A review of every salary survey conducted by the City of Lynwood for FY 17-18 by an experienced HR professional did not demonstrate any comparisons that stood out as wholly inappropriate. Most where LA and Orange county cities, none of the cities were those that stood out as being excessively economically stronger, and none of the surveys showed insufficient benchmark agencies. The report went onto the state that the salary comparisons in one case used LA County and a school district. However, as stated earlier, it is important to have a good match of the work performed. LA County and a school district might have been a good comparison for that classification, given the duties analysis. Without having all of the information as to why the consultants selected certain agencies to benchmark, the conclusion reached by the report that the surveys were not valid is not justified by the facts.
- In addition, beyond external salary comparisons, Lynwood would consider the following factors when making a salary determination:
1. Internal Benchmarking/Internal Equity. Within an organization, two classifications can perform responsibilities that have the same level of independence, consequence of error, require a similar skill set to perform and are organizationally viewed as peers. In that case, in order to maintain internal equity, a city might set one salary at the same level as another, despite having a salary survey that recommends a different range.
  2. Recruitment and Retention Issues: The City might set a salary slighter higher than the market analysis if there have been historical recruitment and retention issues

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with the classification. A higher salary may attract qualified candidates, especially for those difficult to fill positions.

3. Supervisory to Subordinate Salary Compression: A salary might be set higher than was benchmarked in order to ensure that there is no compression between a subordinate and supervisor.

The report stated that for 10 of the 40 classifications benchmarked, the City Council approved salaries that were above those surveyed. This statement is disingenuous. In nearly all of the cases, the salary where the initial step was higher (Step A), the salary at the final step (Step E) was lower. The salary ranges were chosen to conform to existing salary ranges rather than create all new salary ranges, which would overcomplicate the City's compensation system. While a few new ranges were created, most were slotted into the existing compensations ranges considering the following factors:

1. Compensation (Benchmarking) Surveys
2. Internal Equity
3. Recruitment and Retention issues
4. Subordinate Salary Compression
5. Labor Negotiations.

The final factor being that salaries are a mandatory subject of bargaining and the two labor unions representing Lynwood employees contributed to the decision-making process in setting the salaries.

The report goes on to state that the City was not able to explain why staff presented to the City Council for approval, salaries that were higher than those in the survey. However, the City of Lynwood was not asked this question by the Auditor, and therefore, the conclusion reached is just supposition. For the reasons indicated above, a salary might be set higher than is benchmarked, which would still be in keeping with appropriate business practices. Moving forward, the City will work to better document decision-making.

### **Violation of State Laws, Weak Oversight, and Policy Breaches Increase Lynwood's Susceptibility to Fraud and Waste**

Lynwood Violated State Law Through Its Inappropriate Use of Water and Sewer Funds  
(pg 22)

#### *Salary Allocations*

The State Auditor asserted that the City inappropriately used water and sewer revenue to fund two staff members. To avoid any potential Proposition 218 violations, the City has transferred the cost of the two identified positions from the water and sewer funds to the

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General Fund for FY 2017-18 and reallocated their cost for FY 2018-19 as well. (See attached JE 1812082 for reallocation of cost for FY 2017-18)

Lynwood's Use of Competitive Bidding Exception Within its Municipal Code and Insufficient Contract Management Increases its Risk of Waiting for Public Funds (Pg 29)

- ⑳ The report questions the use of a contractor to conduct the salary surveys. At the time the City conducted the surveys, there was no permanent Human Resources Director, and there were two other vacant fulltime positions in the department of 5. The existing staff could not conduct wide-spread salary market analyses and still perform the day-to-day functions of an HR department such as hiring employees, managing the city's benefits and risk management programs and compliance with state and federal employment laws. It is very common for agencies to outsource HR projects to consultants and the firm used by Lynwood has been around since 2001. The firm is a JPA specifically created to assist government agencies, and was therefore qualified to assist Lynwood with its human resources functions. In addition, the city takes exception to the conclusion that the salary benchmarking fell outside the scope of services for the contract. The contract states that the firm shall provide analyses and reports for a wide variety of human resources issues. Conducting salary comparisons falls within that scope of services.

Lynwood Has Several Recurring Control Weaknesses in Its Financial Operations That Make it Susceptible to Fraud and Waste (pg 33)

- ④ Regarding the assessment that the City has not implemented half of the findings from the fiscal year 2015-16 external audit, the Finance department has made vast improvements in its internal controls since the initial findings were assessed. These include having bank reconciliations prepared on a timely basis, specific budgetary and encumbrance controls to monitor procurement processes along with monitoring budget to actuals within departments and funds. In addition, the Finance department will continue to develop and implement the remaining findings from the FY 2015-16 report.

*Specific Assertions and Comments (pg 33)*

- ㉑ ○ City does not have adequate policies and procedures addressing operational areas, such as its procurement and financial reporting functions. The City currently maintains 31 policies and procedures related to on-going operations, including cash reconciliations, purchasing and capital assets along with many more illustrated from the following table.

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City of Lynwood's Current List of Policies and Procedures	
Anti-Fraud Policy	Fund Balance Policy
Bank Reconciliation Procedures	General Reserve Policy
Bankruptcy Procedures	Internal Controls Policies for Cash
Capital Asset Policy	Lien Procedures
Capital Financing and Debt Policy	Lien procedures for Closed Accounts
Cash Policies	Lynwood Utility Authority Policy
Cash Receipt Procedures	Petty Cash Policy
Check Signing Policy	Positive Pay Procedures
Closed Accounts Collection Procedures	Posting Lien Payments Procedures
Closing the Month Procedures	Purchasing and Accounting Procedures – Eden System
Collection Procedures	Purchasing from Local Vendors
Credit Card Policy	Purchasing Policy Ordinance (New)
Demand Procedures	Receivership Procedures
Fixed Asset Policy	Refund Procedures
Foreclosure Procedures	Stale Dated Check Policy/Procedures
	Shut-Off Procedures

Purchase Order Finding (pg 33)

- The State Auditor restating an audit finding from the City's external auditor's FY 2015-16 audit report regarding purchase orders made subsequent to the related purchase has already been address with new internal control procedures. During the development of the FY 2018-19 budget, the Finance department developed detailed lists of activities for every non-labor general ledger account. The primary purpose of these documents are to prevent over commitments of funds. Further, the accounts payable section of finance will not process an invoice without an authorized purchase order. This procedure is expressly stated within in the City's Purchasing Policies and therefore, this was an instance (exception) of non-compliance due to staff turnover within the Finance Department. (4)

Timely Bank Reconciliations (pg 34)

- During the City's FY 2015-16 financial audit, the City's external auditor's identified instances of bank reconciliations that were not completed in a timely manner. While the State auditor's restatement of the findings from two years ago, has already been addressed during the 2017-18 fiscal year, the State auditors have continued to list an outdated finding. (22)

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Year End Financial Closing Procedures (pg 34)

- ④ ○ The State Auditor has identified as a finding that the Finance Department does not have a documented procedure for closing the City's financial system and therefore may prevent the timely production of accurate financial statements. We agree that procedures for closing the financial system should be documented as an internal control. Therefore, the Finance Department will be developing documented procedures in fiscal year 2018-19.

Future Audit Findings (pg 34)

- ④ ○ The State auditor has recommended developing plans for resolving issues and findings that may arise during future audits. The Finance department agrees. Therefore, a listing of any future findings from an annual audit will be scheduled out and assigned to the appropriate staff to resolve within the subsequent fiscal year and a status report will be submitted to the City Manager annually.

**Ineffective Organizational Management Diminishes Lynwood's Ability to Provide Public Services**

Lynwood's Leadership Has Not Created a Strategic Plan that Would Direct Its Departments' Goals and Objectives Towards a Unified Vision (pg 36)

- ②③ The State Auditor's has indicated that the City has not developed any strategic plans. This is incorrect. The City Administration along with Executive met with City Council members to develop an overall long term vision and plan for the City in February 2017. The strategic goals of the meeting were grouped into specific areas such as infrastructure, economic development, public safety, financial & infrastructure planning and strengthening the City organization.

Subsequent and complimentary to this process, the City Manager and all department directors and key management personnel met for a day long retreat on May 3, 2018. Out of this retreat, the team identified challenges and threats to accomplishing the organizational goals and established specific solutions for addressing the challenges. A formal document was produced from this session and shared with the management team and the City Council. While a formal Strategic Plan has not been created, Lynwood has a solid foundation onto which a more formal long-range plan can be adopted and the departments are currently operating with broad goals established by the City Council. Copies of these work plans reside with the City's Human Resource Department.

Moreover, the City will be developing strategic work plans for all departments as part of the two-year budget process for fiscal years 2019-20 and 2020-21. Lack of strategic plan. Approach (uniformity) to report on goals, objectives and measures through the City's

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annual budget. For the upcoming bi-annual budget, reports on goals and objectives will be measured against the adopted departmental work plans to benchmark performance goals.

The audit stated that the City did not have a formal succession plan. However, a formal Succession Plan was adopted by the Lynwood City Council at its November 6, 2018, meeting. In addition, the City Council allocated \$10,000 for a consultant to create a leadership and development program specifically designed to groom and develop future leaders within the organization. Lynwood has not only adopted a formal Succession Plan, we are our way to implementing the components of the plan.

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## COMMENTS

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CITY OF LYNWOOD

To provide clarity and perspective, we are commenting on Lynwood's response to the audit. The numbers below correspond to the numbers we have placed in the margin of its response.

Lynwood's response uses page number references from a draft copy of our report. Since we provided Lynwood the draft copy, page numbers have shifted.

We disagree with Lynwood's statement that its new tax measures will alleviate the city's structural budget deficit. As depicted in Figure 1 on page 4, Lynwood projects that even with its approved new tax revenue and one-time revenue from selling utility credits, the city's operating revenue for fiscal year 2018–19 will outpace its operating expenditures by only \$100,000. As we state on page 3, this amount provides the city a narrow margin for addressing unexpected costs without relying on reserves in its general fund. Further, Figure 1 shows our projection of the city's financial outlook for fiscal year 2019–20 after the one-time revenue goes away, but still accounts for the new tax revenue. Our fiscal year 2019–20 projection highlights an operating deficit of \$425,000, which as we state on page 9, the city has not yet developed a specific plan to address.

We stand by our conclusion that Lynwood is at risk of not meeting its future financial obligations. Although Lynwood indicates that it would make adjustments to its operations as warranted by the economic conditions, we are concerned that it will still be unable to meet these obligations for the following reasons. As we show in Table 1 on page 3, the city has a history of relying on its general fund reserve to balance budget deficits, and consequently it seems reasonable the city may return to this practice. Additionally, as we discuss on pages 5 through 7, the city had difficulty estimating its general fund starting balances for its budgets. Lynwood's difficulty in developing these estimates causes us to question whether the city has an accurate understanding of its current financial position.

Throughout its response, Lynwood asserts that it has established new policies, procedures, and financial estimates that will address our findings and recommendations. We look forward to reviewing Lynwood's corrective action plan, due in February 2019, which we expect will include additional details to demonstrate how it has addressed the risk factors we identified.

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- ⑤ Lynwood's statement is inaccurate. We determined that the city did not use its CAFR as the basis for developing the beginning fund balance in its budgets for fiscal years 2017–18 or 2018–19. As we note in the footnote on page 5, Lynwood did not issue its fiscal year 2016–17 CAFR until July 2018, more than a year after it prepared its fiscal year 2017–18 budget. Further, Lynwood was unable to use audited financial information for developing its fiscal year 2018–19 budget because it had not yet issued its fiscal year 2017–18 CAFR. Consequently, it would not have been able to use audited financial information from the CAFR to develop that budget as it claims. Moreover, if Lynwood improves the accuracy of its estimates of beginning fund balance, as we recommend on page 9, it would not need to rely on its external auditor to determine its actual fund balance.
- ⑥ Although Lynwood describes that Rule 20A credits are generally exchanged at a rate ranging from 50 percent to 60 percent on the dollar, as we note on page 8, we found that eight cities received an average of only 46 percent of their credits' value through similar sales, with the highest return being 55 percent. Therefore, we believe that Lynwood may have overestimated the revenue it will generate from selling its utility credits. Table 4 on page 8 shows that Lynwood needs to sell the credits for at least 56 percent to balance its budget for fiscal year 2018–19.
- ⑦ Lynwood mischaracterizes our concern. We acknowledge on page 9 that the city manager expected to make cost reductions among various city departments to address the projected shortfall we identified. However, our concern focuses on the city manager not having a specific plan to address the shortfall. Although the city stated that the reductions would be made to department-specific consulting and discretionary expenditures, it is unclear whether any subsequent reductions would be for recurring costs because the city has not yet made this determination. Further, we question Lynwood's statement that it could adjust its fiscal year 2018–19 budget by reducing the summer law enforcement team because the city council approved this expenditure to occur during the summer 2018, which was the first quarter of Lynwood's fiscal year 2018–19. Thus, if this expenditure has occurred, the city would not be able to eliminate it to help balance its budget.
- ⑧ The city's statement that the GFOA's best practices are guidelines is inaccurate. Rather, as the GFOA describes on its website, these budgeting best practices are a comprehensive set of processes and procedures that define an accepted budget process. Further, as we state on page 9, the GFOA has identified budgeting as one of the most important activities undertaken by governments and

an operational area in which many governments are in need of guidance. Given the concerns we reported starting on page 3 pertaining to Lynwood’s budgeting practices, we believe that the GFOA’s best practices represent suitable activities that the city should adhere to when preparing its budget.

We do not say or imply that Lynwood was deficient in its decision making when increasing its staffing. Rather, as we state on page 26, we concluded that some departments claim to be under staffed but they do not effectively measure their staffing needs. For example, the public works director indicated to us that he relies on his supervisors’ observations of staff workloads to anecdotally determine the need for more staffing. Therefore, we recommended on page 27 and 28 that Lynwood should conduct a staffing analysis to determine appropriate staffing levels for each of its departments, then adjust its departments’ staffing levels to align with their predicted workloads.

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The city’s statement that nearly all of its salary increases were implemented before the hiring freeze is misleading. As Figure 3 on page 12 shows, the city implemented a hiring freeze for fiscal year 2016–17 and implemented another hiring freeze from March 2018 to June 2018. *Between those two hiring freezes*, the city council approved salary increases for 146 staff as Figure 3 shows. Further, we find it peculiar that Lynwood characterizes the term *hiring freeze* as “a misnomer” because the city’s finance department used this specific phrase in a fiscal year 2016–17 city resolution, as well as when it presented the action as a recommendation to its city council in a March 2018 staff report.

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We stand by our conclusion that Lynwood made a questionable decision to increase salaries given its poor financial condition and its two hiring freezes. As we describe on page 14, by increasing its staff salaries, Lynwood has committed itself to increased personnel costs that it may not be able to sustain given its current revenue structure. Further, we disagree with Lynwood’s characterization of the salary increases as *a moderate raise*, given our conclusion on page 13 that the salary increases we reviewed ranged from 2 to 72 percent and averaged 27 percent overall.

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Lynwood has mischaracterized our conclusion. On pages 13 and 14, we describe that the city could not explain why its survey used information from cities with populations and budgets substantially larger than Lynwood, leading us to question their comparability. Moreover, many of the cities Lynwood included in its survey are located outside of the relevant job market it describes in its response.

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- ⑬ Although Lynwood indicates that matching the job duties of comparable positions is an important factor in determining whether to modify salaries of its classifications, the city did not provide us with any analysis demonstrating that it performed such matching. In addition, Lynwood did not provide us with any evidence that an experienced human resources professional reviewed the comparability of positions. Further, we are unclear about Lynwood's statement that none of the cities used in the survey stood out as being excessively economically stronger. Figure 4 on page 13 shows that we evaluated cities' economies by comparing their total expenditures and found 27 cities in the survey that had expenditures at least three times greater than Lynwood's expenditures. In fact, one city's expenditures were 268 times greater than Lynwood's.
- ⑭ Lynwood's statement is inaccurate. We state on page 14 that the salary survey included other entities, namely school districts and counties, which serve different purposes than Lynwood. However, we do not specify that the salary comparisons in one case used Los Angeles County and a school district. Moreover, we stand by our conclusion on page 14 that a more reasonable approach would have been for Lynwood to use a focused survey of cities that were similar in population, geographic size, and expenditures.
- ⑮ Lynwood misstates our report's conclusion. As noted on page 13, we concluded that the city was unable to justify the amounts of its salary increases and may have increased salaries higher than market rates. We believe our conclusion is justified based on the information the city provided to us.
- ⑯ Although Lynwood describes in its response other factors it would consider when making a salary determination, it did not provide us with any evidence substantiating its consideration of these factors when making those decisions.
- ⑰ Lynwood is wrong. When reviewing salary increases, we evaluated the change in both the initial step and the highest step of each range and found that both steps increased in all but one of the 40 position classifications we evaluated. We determined that the initial step increased by an average of 27 percent—as we state on page 13—and the highest step increased by an average of 26 percent. After providing Lynwood with the draft audit report, we subsequently revised the text on page 14 to clarify that the city council approved base salaries that were above the average rates identified of those in the survey.
- ⑱ Lynwood is incorrect in its statement that we did not question the city about why it presented to the city council for approval salaries that were higher than those in the survey. On the contrary, we asked

the mayor, city manager, and the city's human resources director about the reason for these higher salaries, but none of them were able to provide us an explanation.

After we informed Lynwood about the inappropriate funding of the two staff members, the city responded by reallocating these personnel costs for fiscal year 2017–18 from the water and sewer funds to the general fund. However, it did not provide evidence that it had performed a similar reallocation of the costs pertaining to fiscal year 2018–19. Nonetheless, we stand by our conclusion on page 15 that the city violated state law by budgeting the personnel costs of two finance department staff members to be paid from its water and sewer funds in both fiscal years 2017–18 and 2018–19.

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To clarify, as we note on page 21, we question the reasonableness of Lynwood using its consultant to conduct the salary survey given the fact that the consultant's scope of services did not include performing this work. We believe that the city should have sought bids from other vendors who may have offered a better value to the city in terms of cost and quality.

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Lynwood's statement does not directly address the concerns expressed in our report. In Appendix B on page 34, we identified that Lynwood has not implemented five of the 12 recommendations its external auditor reported as part of the city's fiscal year 2015–16 financial audit. Although Lynwood's response lists numerous policies and procedures pertaining to financial management, the city does not identify how any of them address the outstanding audit recommendations. Moreover, as of November 8, 2018, the city has not indicated that its external auditor has issued its findings for fiscal year 2016–17, which would include an update on the status of the fiscal year 2015–16 findings that we list in Appendix B. We look forward to hearing from Lynwood in its corrective action plan about how it plans to address those recommendations.

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Although Lynwood asserts that it has already addressed the external auditor's finding pertaining to delayed bank reconciliations, that finding, as described in Appendix B on page 34, also states that the city does not have a method for ensuring that timely and complete year-end closing procedures are in operation. Because Lynwood has not created year-end closing procedures, which it confirms in this response, we conclude that it has not implemented the external auditor's recommendation. Also, as noted in our previous comment, the city has not indicated that its external auditor has issued its findings for fiscal year 2016–17, which would include an update on the status of this finding.

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- ②③ Lynwood misrepresented our conclusion on its strategic planning efforts. We state on page 25 that Lynwood lacks a comprehensive and cohesive framework, such as a strategic plan, for guiding its departments. Lynwood describes in its response various actions that appear to be activities related to strategic planning. However, it also acknowledges that it has not created a formal strategic plan. Formalizing such a plan will direct its departments' delivery of services in the most effective manner. Consequently, we stand by our conclusion and look forward to hearing from Lynwood in its corrective action plan how it plans to formalize its strategic planning efforts.
- ②④ Lynwood did not have a formal succession plan in place during the period in which we conducted our audit. However, we acknowledged on page 29 that the city completed a draft plan in October 2018 that it intended to submit to its city council for approval in early November 2018. We look forward to hearing from Lynwood in its corrective action plan about how it plans to align the succession plan with the strategic plan that we recommended the city create.