Local High Risk Program

The State Auditor Is Removing Its High-Risk Designation From Four Cities and Retaining the Designation for Three Others

December 2024

REPORT 2024-801

CALIFORNIA STATE AUDITOR
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Grant Parks *State Auditor*

Mike Tilden *Chief Deputy*

December 19, 2024
Audit 2024-801

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

Dear Governor and Legislative Leaders:

This audit report updates the status of the cities of Blythe, El Cerrito, Lindsay, Lynwood, Montebello, San Gabriel, and West Covina as high-risk entities as part of our office's high-risk local government agency audit program. Our prior audits of these cities identified areas of high-risk related to the cities' financial conditions, financial stability, and oversight of city contracts, among other issues. For this statutory audit, we reviewed the extent to which each city has addressed recommendations from prior audits, assessed trends in the cities' financial conditions, and determined whether we should continue to designate any of these cities as high-risk local government agencies.

This report concludes that the cities of Blythe, El Cerrito, Lynwood, and San Gabriel have taken satisfactory corrective action and addressed key deficiencies identified in our prior reports. Therefore, we are removing their high-risk designation. In accordance with the laws relating to the local high-risk program, we may subsequently reevaluate the high-risk designations of the cities of Blythe, El Cerrito, Lynwood, and San Gabriel if situations change and these cities appear to be at risk of not being able to meet their financial obligations or provide efficient and effective services to the public, among other concerns.

Although the cities of Lindsay, Montebello, and West Covina have taken steps to improve their overall financial health, we are not removing the high-risk designation from those cities at this time. We will continue to monitor the cities and the actions they take to address the areas of high risk we have identified. When the cities' actions result in sufficient progress toward resolving or mitigating such risks, we will remove their high-risk designation.

Respectfully submitted,

GRANT PARKS
California State Auditor

Prior Relevant Reports Issued by the California State Auditor

Blythe

March 2021, *City of Blythe: Inadequate Planning and Other Ineffective Management Practices Hinder Its Ability to Provide Needed Services to Its Residents*, Report 2020-802

El Cerrito

March 2021, *City of El Cerrito: Excessive Spending and Insufficient Efforts to Address Its Perilous Financial Condition Jeopardize the City's Ongoing Fiscal Viability*, Report 2020-803

Lindsay

August 2021, *City of Lindsay: It Must Take Substantial Action to Address Its Financial Problems and Its Inadequate Management Practices*, Report 2020-804

Lynwood

December 2018, *City of Lynwood: Poor Management Has Contributed to Its Financial Instability and Led to Its Failure to Comply With State Law*, Report 2018-803

September 2021, *City of Lynwood: Despite Taking Some Action to Improve Its Management Practices, the City Continues to Risk Financial Instability and Violations of State Law*, Report 2021-808

Montebello

December 2018, *City of Montebello: Its Structural Deficit and Poor Operational Processes Threaten the City's Financial Stability and Delivery of Public Services*, Report 2018-802

October 2021, *City of Montebello: Although It Is Making Positive Changes, It Remains at High Risk Because of Recent Declines in Its Financial Condition*, Report 2021-807

San Gabriel

April 2021, *City of San Gabriel: Its Ongoing Deficit Is Inhibiting Its Financial Recovery*, Report 2020-805

West Covina

December 2020, *City of West Covina: Its Deteriorating Financial Situation Threatens Its Fiscal Stability and Its Ability to Provide City Services*, Report 2020-806

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Selected Abbreviations Used in This Report

ACFR	Annual Comprehensive Financial Report
ARPA	American Rescue Plan Act of 2021
GFOA	Government Finance Officers Association
OPEB	Other Post-Employment Benefits

Introduction

The California State Auditor's High-Risk Local Government Agency Audit Program

State law authorizes the California State Auditor (State Auditor) to establish a local high-risk program to assess, audit, and ultimately issue reports about local government agencies that we designate as high risk for potential waste, fraud, abuse, or mismanagement, or that we identify have major challenges associated with their economy, efficiency, or effectiveness. State law requires that all audits we conduct as part of this program initially be approved by the Joint Legislative Audit Committee. If we designate an agency as high risk, that agency must submit to us a corrective action plan that addresses the conditions that caused us to make the designation. In this report, we refer to those conditions as *high-risk areas*. An agency's corrective action plan is due no later than 60 days after the publication of an audit that concluded the agency was high risk, and agencies must then submit periodic updates on the status of that plan every six months thereafter.

We remove the high risk designation when an agency has taken satisfactory corrective action. To assess local agencies' progress in addressing their high-risk areas, we may conduct *assessments* of the agency's progress at six-month intervals that correspond with the corrective action plan updates that the local agencies provide. Also, state law requires that we issue an audit report on high-risk local government entities every three years, unless we have removed them from the high-risk program. For this audit, we reviewed the seven cities listed in the text box to determine the extent to which each city has addressed prior audit recommendations, assess trends in the city's financial condition, and determine whether we should continue to identify any of these cities as high-risk local government agencies.

Cities Included in This 2024 Local High-Risk Follow-Up

- Blythe (Riverside County)
- El Cerrito (Contra Costa County)
- Lindsay (Tulare County)
- Lynwood (Los Angeles County)
- Montebello (Los Angeles County)
- San Gabriel (Los Angeles County)
- West Covina (Los Angeles County)

Overall this audit concludes that the cities of Blythe, El Cerrito, Lynwood, and San Gabriel have taken satisfactory corrective action and addressed key deficiencies we identified in our prior reports. Therefore, we are removing their high-risk designation. In accordance with the laws relating to the local high-risk program, we may subsequently reevaluate whether Blythe, El Cerrito, Lynwood, or San Gabriel should be identified as high risk if situations change and these cities appear to be at risk of not being able to meet their financial obligations or provide efficient and effective services to the public, among other concerns. Although Lindsay, Montebello, and West Covina have taken steps to improve their overall financial health, we are not removing the high-risk designation from those cities at this time. Throughout this report, we have made additional recommendations to those cities whenever the circumstances of their risk areas meant that our previous recommended corrective actions were no longer relevant or sufficient. In cases when our existing recommendations from previous audits continue to be applicable to these cities' circumstances, we do not make any new recommendations.

General Areas of Importance to This Local High-Risk Audit

Although this audit addresses the specific risks pertaining to seven cities, several topic areas are applicable to more than one city. We present background information about each of these areas below.

American Rescue Plan Act of 2021

In response to the COVID-19 pandemic, the American Rescue Plan Act of 2021 (ARPA) appropriated federal funds to help provide state, local, and tribal governments with the resources needed to mitigate the fiscal effects. As Table 1 shows, each of the seven cities we reviewed as part of this audit received such funding, which we refer to as *ARPA funding*. Federal guidance on the regulations that govern ARPA funding prohibits recipients from using ARPA funding for debt service or to replenish financial reserves. However, the regulations permit recipients to claim a standard allowance of up to $10 million in ARPA funding as replacement for lost revenue. In effect, by claiming the lost revenue allowance, recipients could spend their ARPA funding on a wide range of activities and choose to save the revenue that they would have otherwise spent on those activities. To avoid reverting ARPA funding back to the federal government, recipients must spend the entirety of their ARPA funding by December 31, 2026.

Table 1
Total ARPA Funds Awarded to the Seven Cities We Audited

CITY	TOTAL ARPA FUNDS AWARDED
Blythe	$4,700,000
El Cerrito	6,100,000
Lindsay	3,200,000
Lynwood	24,400,000
Montebello	16,800,000
San Gabriel	9,500,000
West Covina	19,600,000

Source: U.S. Department of the Treasury and the California Department of Finance.

Proposition 218

Proposition 218—a constitutional amendment adopted by the voters in 1996 to limit the ability of local governments to impose taxes, assessments, charges, and fees based on property ownership—prohibits the use of revenue from fees and charges for any purpose other than that for which the fee or charge was imposed. It also establishes that revenue from the fees and charges may not exceed the costs of providing such services. Proposition 218 helps ensure that the proposed levy amount is proportionate to the cost of the related governmental activity and prohibits local governments from using fee revenue on unrelated expenses.

Guidance on Reserves for General Purpose Governments

According to the Government Finance Officers Association (GFOA), it is essential that governments maintain adequate levels of general fund balances to mitigate current and future risks such as revenue shortfalls and unanticipated expenditures. As a best practice, the GFOA recommends that governments, regardless of size, maintain an unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. We use the term *unrestricted* when discussing funding over which the government has discretion (i.e., no constraint) over how the funds can be spent. For the purpose of our report, we refer to unrestricted general fund balances as *general fund reserves*.

Other Post-Employment Benefits

City governments can provide compensation packages to employees who have completed their active service. The Governmental Accounting Standards Board defines Other Post-Employment Benefits (OPEB) as retirement health benefits provided separately from or through a pension plan, as well as other benefits such as life insurance or long-term care benefits as long as the city provided those benefits separately from a pension plan. OPEB benefits may include medical, dental, vision, hearing, and other health-related benefits paid subsequent to the termination of employment. According to the GFOA, OPEB and defined benefit pension plans can represent a significant challenge in terms of their funding and long-term stability. To ensure that these benefits are sustainable over the long term, the GFOA recommends governments evaluate key items specifically related to OPEB, including the structure of benefits offered.

Agencies' Proposed Corrective Action

Lindsay and West Covina acknowledged our current assessment of their progress in addressing their respective risk areas. Montebello generally concurred with our recommendations for addressing the risk areas that we determined were not fully addressed, but the city disputed some of our statements and conclusions about those areas. Although none of these cities submitted a corrective action plan as part of its response, we look forward to receiving the plans by February 2025.

The City of El Cerrito Has Taken Corrective Action to Address Its Risk Areas, and the State Auditor Is Removing Its High-Risk Designation

	RISK AREAS AS REPORTED IN MARCH 2021	STATE AUDITOR'S CURRENT ASSESSMENT OF EL CERRITO'S PROGRESS IN ADDRESSING THE RISK AREA*
	El Cerrito's Failure to Manage Its Spending Resulted in Depletion of Its General Fund	
1	Continual diminishing of financial reserves through overspending	Fully Addressed
2	Ineffective budget development and monitoring practices	Fully Addressed
	Without a More Coordinated Effort, El Cerrito's Financial Condition Will Continue to Deteriorate	
3	Lack of formal financial recovery plan	Fully Addressed
4	Insufficient reductions in ongoing costs	Partially Addressed
5	Missed opportunities to increase revenue	Fully Addressed

* In accordance with state law, we used our professional judgment to assess the city's progress in addressing each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

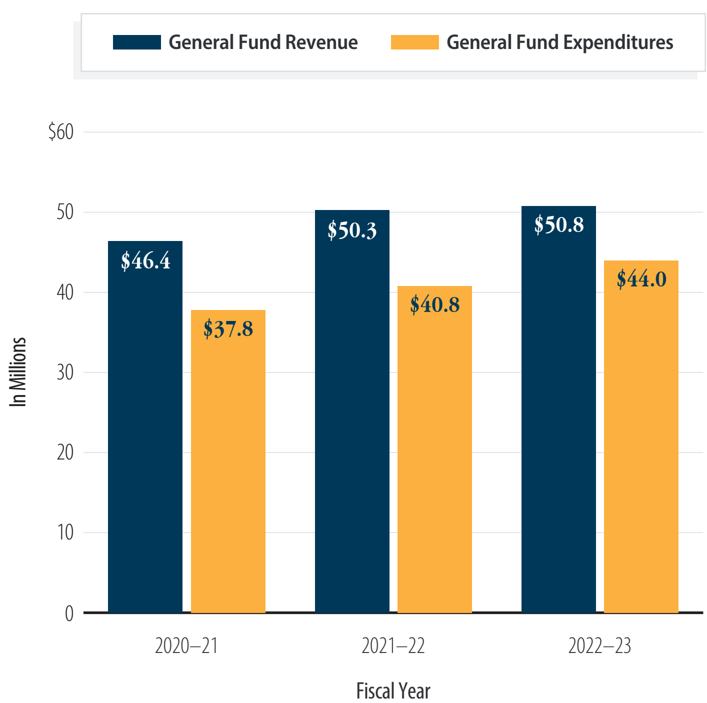
HIGH-RISK AREA #1
Continual Diminishing of Financial Reserves Through Overspending

Status: We conclude that El Cerrito's recent fiscal performance and increased general fund reserves demonstrate that it has fully addressed this risk area.

In our March 2021 audit, we reported El Cerrito was at high risk of being unable to meet its financial obligations. In the fiscal years preceding that audit, the city had consistently spent more than its general fund revenue and was relying on short-term loans to cover its financial obligations. However, in recent years, El Cerrito has made a concerted effort to control its finances and has stabilized the condition of its general fund. Further, in our March 2023 assessment, we reported that because of its improved financial position, the city discontinued its practice of short-term loan borrowing in fiscal year 2022–23. El Cerrito's adopted budgets for fiscal years 2023–24 through 2025–26 assume that the city will meet its debt obligations in those years without the use of short-term loans.

Figure 1 shows that from fiscal years 2020–21 through 2022–23, the city's general fund revenues exceeded its expenditures, which assisted the city in growing its general fund reserves to $23 million by the end of fiscal year 2022–23, which is an amount equal to about half of its general fund expenditures for that year. This amount surpasses the minimum of two months of unrestricted reserves the GFOA advises governments to maintain. According to the city's fourth quarter budget update for fiscal year 2023–24, El Cerrito expects its revenue to nearly cover its expenditures, with the shortfall being about $186,000. This amount represents less than 1 percent of the city's expected total expenditures for that fiscal year. According to its projections for future fiscal years, which extend as far as fiscal year 2028–29, the city expects that it may occasionally need to rely on its reserves starting in fiscal year 2026–27. However, the amount it expects to need in its reserves is proportionately small—less than 2 percent of the budgeted expenditures. Finally, the city also benefited in recent years from its receipt of about $6.1 million in ARPA funding. As of March 2024, the city reported having spent all of this funding and having used it for a variety of general government purposes, such as the provision of public safety services and on administrative facilities.

Figure 1
The City of El Cerrito's General Fund Expenditures Have Been Consistently Less Than Its Revenue in Recent Years



Source: El Cerrito's ACFRs.

Note: We calculated revenue by combining the revenue and transfers into the general fund in each fiscal year. We calculated expenditures by combining the expenditures and transfers out of the general fund in each fiscal year. The city did not have any material amounts of other financing sources or uses flowing in or out of its general fund in these three fiscal years.

The city has several strategies planned that could help it minimize reliance on its general fund reserves. For example, according to its biennial budget for fiscal years 2024–25 and 2025–26, the city intends to develop a citywide cost allocation plan and comprehensive fee study. Doing so will better ensure that the city is distributing costs across its funds in the most appropriate way, potentially lessening the burden on its general fund, and that it maximizes cost recovery from the service fees it charges. The city intends to follow those studies with a service delivery study to ensure that it delivers services in the best and most efficient ways. The city estimates that it will complete the cost allocation plan in December 2024 and the fee study in February 2025. The city's budget states its intent to complete the service delivery study sometime in fiscal year 2025–26. El Cerrito's city manager stated that the city will use the data collected from these studies to make informed and sustainable decisions during the next two fiscal years that will improve the city's ability to balance its future budgets and mitigate reliance on general fund reserves.

HIGH-RISK AREA #2
Ineffective Budget Development and Monitoring Practices

Status: In March 2022, we concluded that El Cerrito had fully addressed this risk area by improving its budget process and monitoring departmental spending.

In our March 2022 assessment, we reported that El Cerrito improved its budgeting processes to provide meaningful information for making fiscally sound decisions. The city improved its quarterly budget updates to the city council by providing revenue and expenditure amounts by department and comparing those amounts to both its budget and prior-year expenditures. This additional level of detail can assist city council members in identifying when a particular department may be overspending. The city has also improved the information presented in its adopted budgets. Its fiscal year 2021–22 budget included a five-year forecast with a comparison to the prior four-year period. Finally, its adopted fiscal years 2024–25 and 2025–26 biennial budget includes a forecast through fiscal year 2028–29 and a comparison of the prior two fiscal years.

HIGH-RISK AREA #3
Lack of Formal Financial Recovery Plan

Status: In September 2022, we concluded that El Cerrito had fully addressed this risk area by issuing its Fiscal Recovery and Sustainability Plan.

In our September 2022 assessment, we noted that El Cerrito issued its Fiscal Recovery and Sustainability Plan in August 2022 and concluded that the city addressed this risk area. The city organized the plan by the actions it planned to take, and it identified a lead staff member, a target date of completion, and an annual fiscal impact for nearly all of the actions. Further, the city divided the plan into actions the city council had approved in August 2020, such as the elimination of the assistant to the city manager position; actions the city identified that it could still take; and actions based on recommendations from our 2021 audit. The plan provides a number of objectives for the city to improve its financial condition and information that will allow the city council and the public to hold the city accountable.

HIGH-RISK AREA #4
Insufficient Reductions in Ongoing Costs

Status: We conclude that El Cerrito has partially addressed this risk area by making an effort to reduce personnel costs and completing a citywide salary study. Nonetheless, the city will need to be attentive to costs in the future because the recent salary study could generate pressure to increase personnel costs.

Through a variety of methods, El Cerrito has controlled its spending and has kept the growth of its expenditures below the growth of its revenue. Since fiscal year 2019–20, general fund revenue has grown 27 percent, and expenditures have grown only 10 percent. By freezing salaries, eliminating positions, and instituting controls for departmental spending, the city has limited ongoing costs. For example, the city did not implement cost-of-living increases for its management and confidential employees in fiscal years 2020–21 and 2021–22. In addition, in fiscal year 2021–22, the city eliminated seven positions in its police department, some of which had become vacant because of retirements and resignations. By fiscal year 2022–23, the city had decreased the police department's personnel costs by 3.4 percent from their fiscal year 2020–21 levels. However, the city reported that the actions it took to reduce the budget and staffing had a detrimental impact on the department, which the city asserts experienced high vacancies in 2022. According to its fiscal year 2022–23 budget, in fiscal year 2021–22 the city employed individuals in 28 of 37 authorized sworn positions. To address the police union's concerns, the city agreed to adjustments in salary ranges and pay differentials according to educational experience. As a result, although costs declined in fiscal years 2020–21 through 2022–23, the city budgeted to increase the police department's personnel costs by 18 percent in fiscal year 2023–24.

To sustain its financial health, the city will need to carefully approach any future compensation increases. In response to our 2021 audit, the city commissioned a salary study. In February 2024, the city received the results of that study, which identified that the city compensated some of its positions—including some public safety positions—at less than the market median when compared to similar positions at 18 other entities. The study found that, overall, the city's base salaries were approximately 8 percent less than the market median. Further, the city's total compensation, which includes salary and benefits, was about 2 percent less than the market median. Although the study did not explicitly recommend that the city raise compensation for its employees, it did provide suggested approaches the city could take to adjust its compensation. In March 2024, the city reported to our office that it plans to implement the study's recommendations over time, and as resources allow, through bargaining and other phased adjustments, and it expects that doing so will assist the city in recruiting, motivating, and retaining competent staff, including its public safety staff.

The city's fiscal years 2024–25 and 2025–26 biennial budget notes that the city was engaged in negotiations with several bargaining groups at the time it developed the budget. Therefore, the city may need to amend its budget if the negotiated compensation amounts exceed its budgeted costs. According to the adopted budget, the city plans to increase personnel costs by 6.4 percent in fiscal year 2024–25 and by 5 percent in fiscal year 2025–26. Overall, El Cerrito's personnel costs represented 73 percent of the city's budgeted general fund expenditures for fiscal year 2024–25. However, despite the upcoming challenge the city faces in determining how much to compensate its employees, the city has appeared to have maintained fiscal discipline in the past few years, which indicates that it is committed to overall fiscal health when deciding such matters. Finally, the city may also find that the cost allocation plan, fee study, and service delivery study that we mention earlier present it the opportunity to save additional amounts in its ongoing expenditures, which the city could then use to balance any increases in personnel expenditures.

HIGH-RISK AREA #5
Missed Opportunities to Increase Revenue

Status: In September 2023, we concluded that the city had fully addressed this risk area by completing a cost recovery analysis for its recreational services.

In our September 2023 assessment, we concluded that the city addressed this risk area. In particular, we noted that El Cerrito continued to subsidize its senior services with budgeted revenue for fiscal year 2023–24 covering 80 percent of the cost of those services—about $88,000 according to the city's budget documents. In its 2023 update to our office, the city reported that full cost recovery would not provide services at an acceptable cost that contributes to the quality of life of all people in El Cerrito. Because the city has made a policy decision to subsidize these costs and the amount of the subsidy is relatively small, we considered the risk area addressed.

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The City of Lynwood Has Made Significant Progress in Addressing Its Risk Areas, and the State Auditor Is Removing Its High-Risk Designation

RISK AREAS AS REPORTED IN DECEMBER 2018 AND SEPTEMBER 2021		STATE AUDITOR'S CURRENT ASSESSMENT OF LYNWOOD'S PROGRESS IN ADDRESSING THE RISK AREA*
Inadequate Financial Management Hinders Lynwood's Fiscal Stability		
1	Ongoing budget deficits and uncertain financial future	Fully Addressed
2	Inadequate budgeting practices	Fully Addressed
3	Questionable salary increases	Fully Addressed
Violations of State Law, Weak Oversight, and Policy Breaches Make Lynwood Susceptible to Fraud and Waste		
4	Violations of state law regarding the use of water and sewer funds	Fully Addressed
5	Poor contract administration	Fully Addressed
6	Inadequate controls over its financial operations	Fully Addressed
Ineffective Organizational Management Diminishes Lynwood's Ability to Provide Public Services		
7	Lack of strategic plan	Partially Addressed
8	Inability to effectively measure staffing needs	Pending
9	Significant turnover in key positions and no plan for identifying future leadership	Partially Addressed

* In accordance with state law, we used our professional judgment to assess the city's progress in addressing each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

Pending: The city has not taken substantial action to address the risk area and, at the time of this audit, the conditions that created high risk for the city continue to exist.

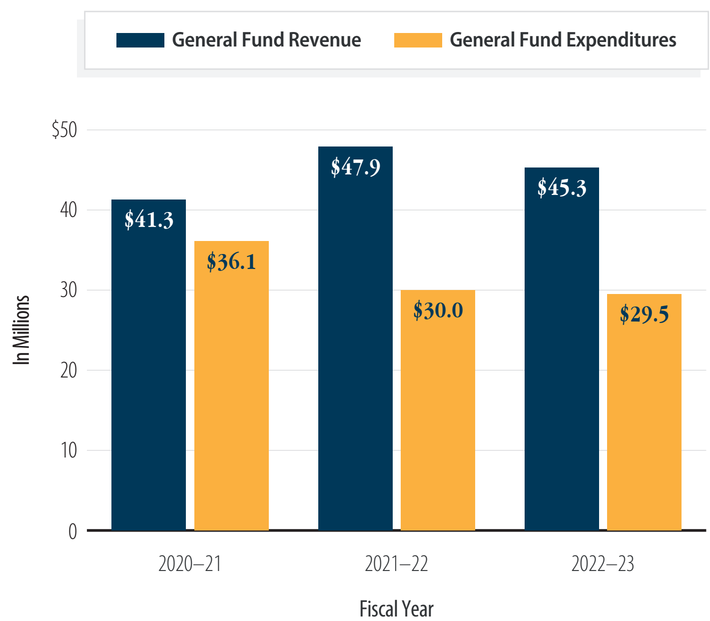
HIGH-RISK AREA #1
Ongoing Budget Deficits and Uncertain Financial Future

Status: We conclude that Lynwood's fiscal improvement and increased general fund balance demonstrate that it has fully addressed this risk area.

In our September 2021 follow-up audit, we determined that Lynwood did not always keep its general fund reserves at recommended levels, and we recommended that the city revise its reserve policy to align with GFOA best practices to facilitate ongoing financial stability and guard against short-term revenue shortfalls.

Since that audit, the city has increased its general fund reserves and has maintained its expenditures below revenues. Figure 2 shows that the city's revenue has increased over a three fiscal year period. By the end of fiscal year 2022–23, the city's general fund reserves had grown to $47.5 million—more than its revenue for that year and substantially surpassing the minimum of two months of unrestricted reserves the GFOA advises governments to maintain. A significant factor in the advances that the city made in its general fund reserves was the city's receipt of a total of $24.4 million in ARPA funding across fiscal years 2021–22 and 2022–23. The city was able to use this funding in place of its regular general fund revenue, thus allowing it to retain that regular revenue to be available for other needs.

Figure 2
The City of Lynwood Kept General Fund Expenditures Below Revenue for Three Straight Fiscal Years



Source: Lynwood's ACFRs.

Note: We calculated revenue by combining the revenue and transfers into the general fund in each fiscal year. This figure does not include other financing sources flowing into the general fund in the amount of $2 million in fiscal year 2021–22 that resulted from a one-time sale of assets. We calculated expenditures by combining the expenditures and transfers out of the general fund in each fiscal year.

In addition, in October 2024, Lynwood adopted a reserve policy that aligns with GFOA guidance. Because of the city's recent history of keeping spending below revenues and its improved general fund reserves, we determined that the city has mitigated this risk area.

HIGH-RISK AREA #2
Inadequate Budgeting Practices

Status: We conclude that Lynwood has fully addressed this risk area regarding its budgeting practices by adopting meaningful practices and formalizing those practices as required actions in its policies.

In our September 2021 follow-up audit, we raised concerns that Lynwood's budgeting process posed a risk to the city because it was incomplete and not done in a timely manner. As a result, we recommended that the city meet the specified timeframes in its budget calendar in future budget cycles. The city council's recent actions show that Lynwood is now adopting budgets on time. The city council approved the city's biennial budget for fiscal years 2023–24 and 2024–25 before the start of that period, which is the only full budget the city prepared since the conclusion of our last audit. The city council also approved the mid-cycle update to that budget before the start of fiscal year 2024–25.

We also determined in our September 2021 audit that the city should follow its existing policy and provide quarterly reports to its city council that compare budgeted to actual general fund revenue and expenditures. Further, we recommended that the city align its policy on quarterly reporting with GFOA best practices for budget monitoring. For example, the city's policy should require the city's staff to present an analysis of the reasons for budget deviations. For fiscal year 2023–24, the city provided the city council with quarterly reports, each of which presented the budgeted general fund revenue and expenditures to actual general fund revenue and expenditures and explained the variances between these amounts. The city adopted a policy in October 2024 that formalized the expectation that it continue its practice of providing quarterly reports to the city council.

Finally, our 2021 audit noted that the city had not adopted a policy to produce multi-year projections of its revenues and expenditures. Subsequently, the city included a multi-year projection of its general fund revenues and expenditures as part of its biennial budget for fiscal years 2023–24 and 2024–25. The city also formalized its practice of creating multi-year projections in its October 2024 policy update.

HIGH-RISK AREA #3
Questionable Salary Increases

Status: We conclude that Lynwood has fully addressed this risk area by assessing its compensation against other cities and presenting reasons for proposed increases to its city council.

In our September 2021 follow-up audit, we reported that Lynwood was not complying with its salary-setting policy. Specifically, in the three cases we reviewed, Lynwood did not maintain documentation showing it had compared its proposed salaries to those in benchmark cities. In two of these cases it did not present the justification for the proposed salaries to the city council.

During this audit, we found that the city was comparing salaries for certain city positions to those of other cities and that it presented justification for a set of proposed salaries to its city council. We reviewed the city's 2023 salary survey, which evaluated salaries for 13 city positions, comparing the salaries for those positions to the salaries for similar positions when they existed at 10 nearby cities. The city's director of human resources and risk management explained that the city conducted the salary survey during its negotiations with the bargaining unit that represented the employees in those positions. At the conclusion of negotiations, the city presented to the city council the proposed salaries for those positions and explained that the salaries resulted from the agreement the city had reached with the bargaining unit. Because Lynwood is documenting its salary-setting analysis and has shared its rationale for raising salaries with the city council, there exists better assurance that it is setting competitive and reasonable salaries in a transparent manner.

HIGH-RISK AREA #4
Violations of State Law Regarding the Use of Water and Sewer Funds

Status: We conclude that Lynwood has fully addressed this risk area through the elimination of lease payments from its utility authority and the use of a cost allocation plan that identifies water and sewer costs.

In our September 2021 follow-up audit, we identified risks associated with the city making inappropriate transfers to its general fund through a lease arrangement it established for its water and sewer infrastructure. Specifically, we noted that in fiscal year 2019–20 the city established a $1 million lease payment to its general fund from the utility funds, an amount for which the city could not provide justification. Consequently, we recommended that the city dissolve the Lynwood Utility Authority (utility authority), the entity with which it made the lease arrangement, and discontinue making any lease payments. In response, Lynwood declined to dissolve the utility authority and stated that the utility authority has issued revenue bonds. We agree that the city's concerns about dissolution are valid, insofar as the dissolution of the utility authority could potentially represent a breach of contract with the bond holders. Further, we noted that the city has planned to stop making the lease payments to the general fund. The city's fiscal year 2024–25 budget shows no plans to transfer the $1 million lease payment to the general fund. Accordingly, we consider this element of the area of risk resolved.

The city recently addressed a concern regarding reimbursement for overhead costs from its water and sewer funds to its general fund. In our September 2021 report, we noted that the city had not approved updated cost allocation plans that it could have used to support the amount it transferred from its water and sewer funds to its general fund for overhead charges. We concluded that the city was at risk for either over- or under-reimbursing the general fund. In April 2024, the city received the results of another cost allocation study, which identifies the city's overhead costs that the general fund may recover from the water and sewer funds. The city incorporated those adjusted overhead costs into its revised fiscal year 2024–25 budget. These adjustments resulted in an overall reduction in payments of approximately $80,000 from the water fund and an increase in payments of about $69,000 from the sewer fund.

HIGH-RISK AREA #5
Poor Contract Administration

Status: We conclude that Lynwood's steps to strengthen its contract administration demonstrate that it has fully addressed this risk area.

In our September 2021 follow-up audit, we found that Lynwood had not addressed a recommendation we had made in the 2018 audit that it amend its municipal code to require the city council to provide adequate written justification when bypassing competitive bidding through a supermajority vote and to define when such an action is appropriate. We also observed that the city had exempted contracts for garbage collection from competitive bidding, which we found jeopardized the city's ability to obtain the best value for its residents and community. In October 2022, the city council approved updates to the sections of its municipal code addressing procurement procedures. The municipal code no longer includes provisions for the city council to use a supermajority vote to exempt a purchase from competitive bidding requirements or exemption from competitive bidding for garbage collection contracts. Further, unless the purchase is a type preapproved in the city's municipal code for sole source procurement, the city's procurement policy requires it to use a competitive sourcing process whenever a product or service is available from more than one source and is valued at more than $5,000. In August 2023, the city provided training to its staff on its updated requirements for contracting and purchasing. The training addressed the municipal code sections the city amended in October 2022 and amendments to its contracting and purchasing policy.

HIGH-RISK AREA #6
Inadequate Controls Over Its Financial Operations

Status: In a previous audit, we concluded the city fully addressed external audit findings regarding control weaknesses in its financial operations.

In our September 2021 follow-up audit, we determined that the city had fully addressed this risk area and addressed an external auditor's findings regarding controls over its financial operations.

HIGH-RISK AREA #7
Lack of Strategic Plan

Status: We conclude that Lynwood has partially addressed its risk related to strategic planning.

Although the city engaged a consultant to help it to develop strategic priorities, that work did not include the development of specific strategies and outcomes to accompany the strategic priorities. Instead, the consultant's report indicated that the city's executive management team would meet later to identify those elements of a strategic plan. The city's director of human resources and risk management confirmed that the city has not developed a full strategic plan, and he indicated that the city would work beginning in 2025 to select a vendor to assist it in developing a strategic plan.

HIGH-RISK AREA #8
Inability to Effectively Measure Staffing Needs

Status: We conclude that Lynwood has not addressed its risk related to its inability to effectively measure staffing needs.

In our September 2021 follow-up audit, we found that the city could not effectively determine whether its staffing levels were sufficient and appropriate to efficiently address the city's priorities for the services that it provides. We identified that, according to the GFOA, strategic planning establishes logical connections between spending and an entity's goals and that the focus of strategic planning should be on aligning resources to bridge the gap between present conditions and the envisioned future. Therefore, strategic planning is a critical element to a city's ability to identify the appropriate staff levels it needs to achieve its goals. Accordingly, it will be important for the city to reassess its staffing after it develops a strategic plan. The city's director of human resources and risk management stated that the city will work to align its staffing to achieve its goals within the strategic plan the city plans to develop, but any changes in staffing levels or the allocation of staff will be subject to the city's budget constraints and availability of funding.

HIGH-RISK AREA #9
Significant Turnover in Key Positions and No Plan for Identifying Future Leadership

Status: We conclude that Lynwood has partially addressed its risk related to significant turnover in key positions and a lack of a plan for identifying future leaders.

In April 2022, in response to our previous audits of the city, the Lynwood city council adopted the city's succession plan, which has the purpose of identifying and developing internal staff with the potential to fill the city's key leadership positions. Among other actions, the plan calls for regular and recurring gap analyses to identify projected openings in positions that require certain skill sets, leadership and professional training opportunities, and job shadowing to provide opportunities for aspiring employees to develop an understanding of the positions into which they wish to advance.

Lynwood has begun implementing its plan. The city provided us with its September 2024 gap analysis identifying the city positions that face the greatest risk of employee retirements, and the director of human resources and risk management indicated that the city would amend its succession plan policy to include provisions for conducting the gap analysis annually. He also described his plan to coordinate with the city manager to develop a policy that would require department managers to document the processes they use to make key decisions to provide continuity among leadership, and he anticipated the city would complete that policy by the end of March 2025. In our September 2021 audit, we found that the city had implemented a leadership academy, and the human resources director described leadership training sessions from 2023 that the city was providing to designated staff members as part of that academy. However, he also confirmed that the city has not yet started its job shadowing program. As the city continues to plan for retirements from key positions, it should implement the remaining elements of its succession plan, such as the job shadowing program, as well as the policy changes described by the director of human resources and risk management.

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The City of San Gabriel Has Made Substantial Progress in Rebuilding Its Reserves and Addressing Other Risks, and the State Auditor Is Removing Its High-Risk Designation

RISK AREAS AS REPORTED IN APRIL 2021		STATE AUDITOR'S CURRENT ASSESSMENT OF SAN GABRIEL'S PROGRESS IN ADDRESSING THE RISK AREA*
San Gabriel's Poor Financial Management Has Eroded Its Financial Condition		
1	Declining financial health	Partially Addressed
2	Unfavorable loan agreements	Fully Addressed
3	Incomplete financial projections	Fully Addressed
San Gabriel Needs to Consider Additional Expenditure Reductions and Revenue Increases		
4	Rising employee retirement costs	Partially Addressed
5	Operational losses from the Mission Playhouse	Fully Addressed
6	Incomplete cost recovery	Fully Addressed
Gaps in San Gabriel's Management Controls Increase the Risk of Inefficiency and Waste		
7	Lack of competitive bidding	Fully Addressed
8	Inadequate contract management	Fully Addressed

* In accordance with state law, we used our professional judgment to assess the city's progress in addressing each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

HIGH-RISK AREA #1
Declining Financial Health

Status: We conclude that San Gabriel has partially addressed this risk area by building its general fund reserves and operating at a net surplus in its general fund each year.

In our April 2021 audit, we found that the city's general fund reserves decreased steadily from fiscal years 2014–15 through 2017–18 because of three primary reasons: a public works loan that restricted the availability of general fund cash due to a collateral requirement, insufficient oversight by the city council, and a lack of transparency by former city management. At the lowest point, the city's general fund reserves decreased to a deficit of $9.9 million in fiscal year 2017–18.

As a part of this audit, we found San Gabriel's general fund reserves have recovered largely because of increases in the city's tax revenue as well as one-time infusions of funding. At the end of fiscal year 2022–23, the city's general fund reserves were about $15.8 million—equaling three and a half months of its expenditures for that year. Assisting the city in reaching that level of reserves has been Measure SG, a new sales tax measure that went into effect in July 2020 and that has helped to increase tax revenue to the city from $22 million in fiscal year 2019–20 to $35 million in fiscal year 2022–23. The city also paid off the outstanding balance of its public works loan, which freed more than $5.8 million in funds to be available as unrestricted. Finally, the city used ARPA funds as lost revenue to pay for general government services. The city received a total of $9.5 million in ARPA funds during fiscal years 2020–21 and 2021–22, which allowed it to set aside some of its general fund revenue into reserves.

Although the city has in part relied on one-time events to rebuild its reserves, it also maintained a cumulative surplus of more than $15 million in its general fund over a three-year period of fiscal years 2020–21 through 2022–23. Figure 3 shows the city's general fund revenue and expenditures for those fiscal years, inclusive of the annual transfers that the city made into the general fund. San Gabriel has historically relied on a special property tax to help pay the retirement costs of city employees (retirement tax), which San Gabriel voters originally approved in 1948. The city maintains the revenue from that tax in its retirement fund. Because this tax supports the city's ongoing retirement costs, we considered it functionally equivalent to general fund operating revenue.

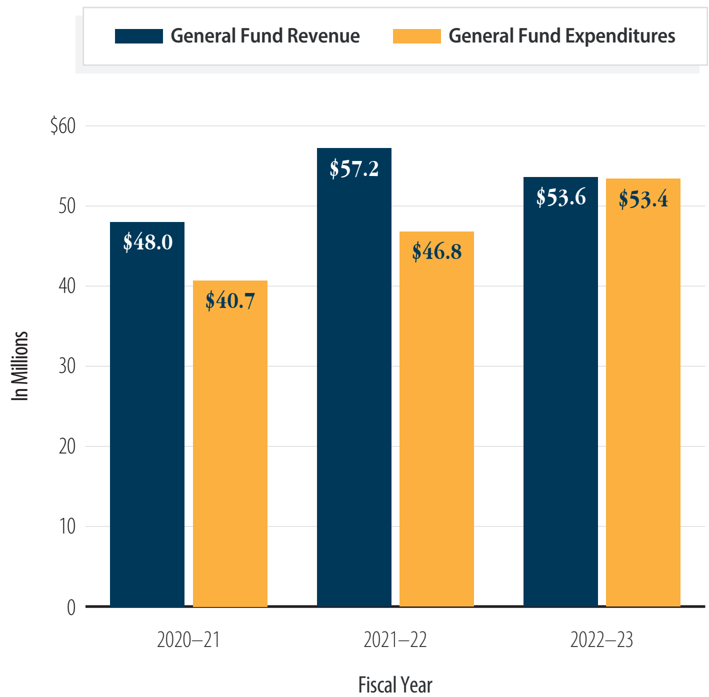
San Gabriel has made significant progress in addressing its general fund reserves, but it should continue to build its reserve. The city's reserve amount as of the end of fiscal year 2022–23 was equivalent to about three and a half months' worth of that year's general fund expenditures. Although this amount surpasses the GFOA guidance about minimum reserve levels, the GFOA also advises governments to set their reserve levels at amounts that are appropriate for their unique circumstances. Given that San Gabriel must still address challenges in meeting its OPEB obligations—which we describe more about later—the city would be in a better position if it increased the reserves that it sets aside for potential future financial challenges.

HIGH-RISK AREA #2
Unfavorable Loan Agreements

> *Status: We conclude that San Gabriel has fully addressed this risk area by paying the outstanding balance of its public works loan and not entering into additional loan agreements.*

As indicated above, the city took out a public works loan of $7.8 million in December 2014, which significantly restricted the city's ability to fund its city services using cash from the general fund because the loan agreement required that the city

Figure 3
The City of San Gabriel's Expenditures Have Been Below Its General Fund Revenue in Three Recent Fiscal Years



Source: San Gabriel's ACFRs.

Note: We calculated revenue by combining the revenue and other financing sources into the general fund in each fiscal year. We calculated expenditures by combining the expenditures and transfers out of the general fund in each fiscal year.

pledge an amount of funds equal to the borrowed amount as collateral. Our April 2021 audit report found that the city council and the city's management team at the time did not adequately evaluate the financial impact of the loan. We recommended that the city develop a plan to renegotiate or refinance the public works loan. In fiscal year 2022–23, San Gabriel paid off the loan's remaining balance of nearly $6 million, freeing up the general fund money that the bank used as collateral.

San Gabriel has also implemented our recommendation to create a policy that requires city staff to present options and considerations to its city council when entering into debt, including an analysis of alternative methods of financing and the impact on city finances. The city updated its debt management policy per our recommendation in January 2023. Further, other than two lease purchase agreements for the acquisition of public safety equipment totaling $1.4 million, the finance director asserts that the city has not taken on any new loans or debt since we issued our last audit. Before entering into these agreements, city management presented different financing options to the city council and described each option's potential impact on the city's finances. For example, in April 2022, city management presented to the city council options for purchasing or leasing two fire apparatuses for the fire department. The city council authorized staff to purchase one apparatus, but only if the terms would be the same as the terms offered for the two apparatuses. Providing these types of analyses allows the city council and city management to make informed decisions and strengthens the city council's oversight on city finances. San Gabriel has shown improvement in this area, sufficiently addressing the associated risk.

HIGH-RISK AREA #3
Incomplete Financial Projections

Status: We conclude that San Gabriel has fully addressed this risk area by producing financial projections that provide a reasonable basis for financial planning for major categories of revenue and expenses.

In our April 2021 audit, we found that the city did not consider key factors such as collateral for the public works loan, the impact of the pandemic, nor potential salary increases when developing its five-year financial projection. We noted that the GFOA considers it a budgeting best practice to analyze major revenue sources to identify forecasting assumptions and determine whether potential trends are likely to continue. To ensure that San Gabriel had relevant information for making decisions, we recommended the city update its financial projections to include in-depth analysis of key revenue sources and future costs.

To assess the accuracy of San Gabriel's more recent forecasts, we compared its financial projections for fiscal years 2022–23 and 2023–24 that the city made in its 2021–22 budget to the information about actual financial performance for those years found in the city's ACFR and budget documents. In general, the city developed conservative projections of its revenue. The largest revenue category for the city is its tax revenue, which was more than 80 percent of the city's annual revenue in fiscal year 2022–23. For both fiscal years we reviewed, the city's projection under estimated what its tax revenue would be by more than 10 percent. This underprojection meant that during its budgetary deliberations, the city expected to have less revenue than it would ultimately have at its disposal. We acknowledge that conservative projections of revenue are less problematic than overprojections, which could cause a city to unknowingly plan to spend beyond its capacity.

The city has generally been more accurate when projecting its expenditures. After adjusting for a one-time debt payment the city made in fiscal year 2022–23, the total expenditures the city made in fiscal years 2022–23 and 2023–24 were both within 10 percent of the forecasted amounts. Personnel costs are close to 75 percent of the city's general fund expenditures, and the city projected these costs within 5 percent in each of the two fiscal years we reviewed, which is a relatively close margin.

Although San Gabriel's forecasts have at times been different than its actual financial performance, we found that its projections for fiscal years 2022–23 and 2023–24 were generally close to the city's actual financial performance and therefore they were reasonable estimations for financial planning purposes. Accordingly, we consider this risk area fully addressed.

HIGH-RISK AREA #4
Rising Employee Retirement Costs

Status: We conclude that San Gabriel has partially addressed this risk area by contributing to its OPEB trust and reducing post-employment medical benefits for new employees.

In our April 2021 audit, we estimated that the retirement tax revenue would not be sufficient to cover pension costs from fiscal year 2020–21 through 2024–25. However, in fiscal years 2020–21 through 2022–23 (the most recently completed ACFR at the time of our audit) the city has covered all but less than 2 percent of its pension costs using the retirement tax revenue it collected in those years, along with the available amounts it has retained as a balance in the associated fund. In other words, the city has not needed to use general fund revenue in any substantive manner to pay for its pension costs.

Although the city may not always be able to pay for its pension obligations through its retirement tax alone, we are not as concerned about the city's overall ability to pay these pension obligations. The city's projections show that it will need to use general fund money to cover about $230,000 of its pension obligations in fiscal year 2025–26 and intermittently use general fund money in subsequent fiscal years as well. The city's finance director explained that the city's projections assume zero vacant positions to represent the upper threshold of the potential costs it could face. In the event that the retirement tax does not generate enough revenue to cover pension costs, he stated that the city will likely borrow from the general fund and repay the borrowed amount using retirement tax revenues generated in the following years. The city's projections show that in each year where the city expects to borrow from the general fund to pay for pension obligations, the retirement tax will generate enough revenue in the subsequent years to repay the general fund within two years.

In addition, our April 2021 audit report found that the city had been paying less than the amount needed to fully fund the costs of its OPEB benefits, increasing its total net obligation for OPEB. We noted that the city's unfunded OPEB liability nearly doubled in only two years, in part because the city had stopped prefunding these costs. As of the June 2023 reporting date, the city's net OPEB funding ratio was 13 percent, with more than $44 million in unfunded liability.

San Gabriel has taken some steps to address its OPEB liability. At the time of our April 2021 audit, San Gabriel did not require its employees to contribute to their OPEB costs, and we recommended that the city negotiate with its unions to require employees to contribute. According to the finance director, the city's primary focus has been on removing the lifetime medical benefit for future employees rather than negotiating with employees to contribute to the OPEB liability. The city negotiated with its unions to change post-employment medical benefits for employees hired after January 2023 to the Public Employees' Medical Hospital Care Act (PEMHCA) statutory minimum level of benefits. In order to calculate the savings resulting from eliminating the lifetime medical benefit and assigning new employees to the PEMHCA plan, the finance director stated that the city would need to contract the services of an actuarial firm. Although the magnitude of the benefit the city will eventually realize from this change is not clear, the step the city has taken will have positive effects on its overall retirement obligations at some time in the future.

In addition, the city contributed to its OPEB trust for the first time in five years. The city's OPEB trust provides a way for the city to prefund its OPEB obligation and reduce its overall OPEB liability. In June 2024, the city contributed $250,000 to the OPEB trust, bringing the trust's cumulative value to nearly $8.3 million. Also, the city has budgeted another $250,000 payment towards the trust in fiscal year 2024–25 and included contributions in this amount each year in its five-year forecast through fiscal year 2029–30. Although these are positive steps towards addressing the city's OPEB liabilities, the annual contribution amount is very small compared to the city's overall liability for OPEB. Even an annual contribution of double the amount the city is planning on making would increase the city's OPEB funding ratio by only 1 percent when using the outstanding liability of $44 million we describe above. Therefore, based on the actions it has taken and the sizeable OPEB liability the city still incurs, we consider the city to have partially addressed this risk area.

HIGH-RISK AREA #5
Operational Losses From the Mission Playhouse

Status: We conclude that San Gabriel has fully addressed this risk area by reducing the general fund subsidies it provides.

Our April 2021 audit report noted concerns regarding the Mission Playhouse's significant and consistent operating deficits that required the city to provide funding for it to remain solvent. The city subsidizes the operations of its Mission Playhouse—a community center that hosts various events, such as theater and music performances, and public meetings. According to the city's ACFRs, for fiscal years 2020–21 through 2022–23, the playhouse continued to operate at a deficit and relied on general fund transfers. The finance director confirmed that the city council is committed to providing the Mission Playhouse services to the public and that it views the theater as a vital arts and entertainment service for the community. The finance director highlighted that the city has more recently decreased the amounts it transfers from its general fund. In fiscal years 2020–21 through 2022–23, the city transferred slightly more than $1 million to the Mission Playhouse—an average of $350,000 each year. This average represents a significant reduction in transfers, namely half the amount we reported in our April 2021 audit, thus indicating that the city has made efforts to reduce its costs.

In addition, the city has made efforts to improve costs and operations at the Mission Playhouse. For example, the city eliminated the Mission Playhouse director position from its fiscal year 2021–22 budget and assigned oversight of the playhouse to the community services director. The playhouse's budgeted expenses decreased 22 percent that fiscal year. Further, the playhouse obtained a new ticketing system that the city asserts better serves its needs, results in lower ticket fees, and offers a more user-friendly interface for staff compared to its previous system.

In light of the significant decrease in the amount of the general fund subsidy, the efficiency gains, and the public benefit that the Mission Playhouse provides, we consider the city to have fully addressed this risk area.

HIGH-RISK AREA #6
Incomplete Cost Recovery

Status: We conclude that San Gabriel has fully addressed this risk area by updating its service fees annually.

In our April 2021 audit, we noted that the city had not evaluated whether the fees it charged for services aligned with the full cost of those services. In addition, we identified that the city had not adjusted a majority of its fees since 2016, and some had not changed since 2002. Consequently, the city had not ensured that it collected the commensurate amount of revenue that could have helped relieve the financial burden on the city's general fund. To ensure that the fees it charged for services align with their costs, we recommended that San Gabriel implement policies and procedures requiring it to reevaluate the cost of its fee-funded services at least every three years.

The city has increased its service fees and plans to increase those fees annually as adjusted to the Consumer Price Index (CPI) for the Los Angeles Metro area. The city's March 2021 fee study determined that the city's fiscal year 2020–21 fee revenue recovered only 42.5 percent of the city's service costs, causing the city to lose nearly $6.6 million in subsidies. In the two fiscal years following the study, San Gabriel's revenue from its charges for services averaged $4 million—an increase of 64 percent compared to the revenue the city generated in fiscal year 2020–21. In addition, from fiscal years 2021–22 through 2024–25, the city council passed annual resolutions that require the city to conduct comprehensive fee reviews at least once every five years to ensure that it is adequately recovering the cost of providing services. The finance director stated that the city intends to complete another fee study in fiscal year 2025–26. Because it has raised its fees to collect revenue more commensurate with its costs and plans to take similar action in the future, we consider this risk area addressed.

HIGH-RISK AREA #7
Lack of Competitive Bidding

Status: We conclude that San Gabriel has fully addressed this risk area by updating its contract bidding policy, and we no longer have concerns about its waste collection agreement.

In our April 2021 audit, we recommended that San Gabriel strengthen its purchasing policies to competitively bid services at least every three years or to document a justification for services that require a longer contract duration. In June 2023, the city updated its contract management administrative procedures, which are intended to strengthen the city's purchasing policies and help to ensure that the city is receiving the best value on all contracted goods and services. The updated procedures direct city staff to rebid contracts for most services every three to five years, a variation from the three-year interval we recommended. The finance director explained that with the exception of its waste collection contract, the city's contracts have durations of three years and allow for two one-year extensions. The finance director further explained that the city's reasoning for allowing contracts with terms as long as five years before being rebid, is that the process to procure services takes a significant amount of administrative time and effort—sometimes taking up to a year to complete—and that the market for services does not change significantly in a period of three years. Because San Gabriel's updated procedures direct staff to present service contracts to the city council at least every five years and to rebid contracts at this same frequency, we conclude that the city has ensured that it will regularly use the competitive bidding process.[1]

In addition, we conclude that the city's waste collection contract no longer presents an immediate risk to the city. In our prior report, we noted concern that San Gabriel had not verified whether its waste collection contract provided the best value to its residents and recommended the city renegotiate with its waste collection company to revise the terms of the agreement. However, in 2023 the city conducted a survey of the residential waste hauler rates of four nearby cities, which showed that San Gabriel's rates were the median rates among all of the cities. Further, according to the contract agreement with the waste collection vendor, any increases to waste collection rates that exceed the increase in the CPI would require the approval of the city council, which means that the city has a control in place to manage the rates its residents pay.

1 The policy makes an exception for the city's waste collection contract, which has a 25-year period and automatically extends another year on an annual basis.

HIGH-RISK AREA #8
Inadequate Contract Management

Status: We conclude that San Gabriel has fully addressed this risk area by developing a centralized system to track current contracts and implementing purchase order controls.

Our April 2021 audit found that San Gabriel did not have a centralized system for monitoring its contracts, which compromised its ability to prevent departments from overspending the amount of their contractual service budgets. We further noted that, because of its insufficient contract tracking system, the city could not track the total costs associated with each of its contracts over multiple years, and city management could not determine total citywide annual contract costs. In June 2023, the city implemented contract management administrative procedures that established a centralized contract depository and strengthened the city's purchasing controls. The procedures require departments to submit contracts approved by the city council to the city clerk, who is supposed to maintain and regularly update a centralized spreadsheet to track the contract vendor, responsible department, and the contract expiration date. We obtained a copy of this spreadsheet and verified that recently approved contracts were included on the spreadsheet. In addition, the city's contract management procedures include purchase order controls that require the finance department to verify that the contract is valid, properly authorized, and that funds are available in the current budget before payments under contracts are allowed. Because of the improvements described above, we conclude that the city has addressed this risk area.

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The City of Blythe Has Addressed Challenges Related to Its Long-Term Financial Stability, and the State Auditor Is Removing Its High-Risk Designation

RISK AREAS AS REPORTED IN MARCH 2021		STATE AUDITOR'S CURRENT ASSESSMENT OF BLYTHE'S PROGRESS IN ADDRESSING THE RISK AREA*
Blythe's Financial Stability Remains Uncertain Even With Recent Improvements		
1	Low financial reserves	Fully Addressed
2	Need for additional sources of revenue	Fully Addressed
3	Lack of a long-term plan	Pending
Blythe Must Address Deficits in Its Enterprise Funds as Well as Unmet Safety and Infrastructure Needs		
4	Enterprise fund deficits	Partially Addressed
5	Unpaid golf course loan	Fully Addressed
6	Need for public safety resources	Fully Addressed
7	Unaddressed vacant buildings	Fully Addressed
The City Needs More Effective Management Practices to Improve Its Financial Stability and Its Ability to Provide Services to Residents		
8	Utility rates and service fees insufficient to cover costs	Fully Addressed
9	Poor oversight of city contracts	Partially Addressed
10	Lack of a permanent city manager	Pending

* In accordance with state law, we used our professional judgment to assess the city's progress in each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

Pending: The city has not taken substantial action to address the risk area and, at the time of this audit, the conditions that created high risk for the city continue to exist.

HIGH-RISK AREA #1
Low Financial Reserves

Status: We conclude that Blythe's increased general fund reserve demonstrates that it has fully addressed this risk area.

In our March 2021 audit, we determined that Blythe's general fund reserve at the end of fiscal year 2019–20 was $804,000, which was only a little more than one month's worth of operating funds. At the end of fiscal year 2022–23, Blythe had a general fund reserve of $8.3 million, an increase of more than $7 million. This amount was equivalent to more than seven months of annual expenditures, which exceeded both the three months of expenditures that the city's reserve policy states the city will maintain and the GFOA best practice of at least two months.

HIGH-RISK AREA #2
Need for Additional Sources of Revenue

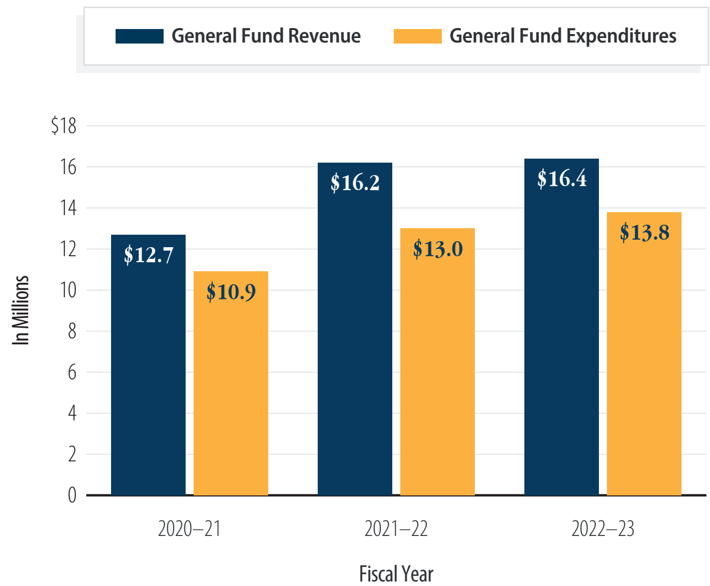
Status: We reported in March 2022 that Blythe had fully addressed this risk area. After that determination, the State decided to close Chuckawalla Valley State Prison. The economic impact of the closure will likely mean that Blythe would benefit from finding additional revenue, but the city has taken steps to address that need.

In 2022 Blythe contracted with a vendor to research economic development opportunities in the city and recruit retail businesses. In addition, in March 2022, we reported the city's assertion that it had engaged with stakeholders in a formal economic development effort. These actions led us to conclude that the city had fully addressed this risk area. Subsequent to that conclusion, in December 2022, the State announced its plan to close the Chuckawalla Valley State Prison, which is located in Blythe. Originally planned to close in March 2025, the prison officially closed in November 2024.

The city commissioned a June 2023 study of the economic and fiscal impact of the prison closure, which estimates that the full effect of the closure on the city's general fund revenue will be a reduction of $1.9 million, or about 12 percent, annually. The study also found that the prison supported 13 percent of the total jobs held by Blythe residents and 22 percent of the city's total wages. The study determined that the prison closure will raise the unemployment rate, considerably reduce average household incomes, and put pressure on local business, which will experience losses of both sales and profits. Figure 4 shows that the city's general fund revenue exceeded expenditures during fiscal years 2020–21 through 2022–23, indicating that the city can absorb some loss in revenue. Nonetheless, the actual effect of the prison closure remains unknown, and the city will need to be careful to avoid relying on other funding to sustain operations at their present levels.

A recent study by a consultant hired by Riverside County, where Blythe is located, could provide the city with a roadmap for economic development and thereby a path towards financial sustainability in the wake of the prison closure. In early 2024, this consultant presented an overview of the results of an economic development study of the Blythe region. The study included several action steps that could stimulate economic growth in the area, such as making infrastructure investments and encouraging and attracting private investment in the area. For example, the study suggested attracting tourism and capitalizing on Blythe's location along a regional highway system, the I-10 corridor, by investing in charging infrastructure for

Figure 4
The City of Blythe's General Fund Revenue Has Consistently Exceeded Its Expenditures



Source: Blythe's ACFRs.

Note: We calculated revenue by combining the revenue and transfers into the general fund in each fiscal year. We calculated expenditures by combining the expenditures and transfers out of the general fund in each fiscal year. The city did not have other financing sources or uses flowing in or out of its general fund in these three fiscal years.

electric vehicles. The study also recommended pursuing grant opportunities to help fund this type of infrastructure, and Blythe has already sought such grants. The city received a federal grant award of $19.6 million for the development of a publicly accessible, multi-class, electric vehicle charging facility. The interim city manager believes that renewable energy, along with tourism and distribution centers will be key in Blythe's recovery from the prison closure. According to the interim city manager, Riverside County will organize a work group of stakeholders at the start of 2025 to implement the economic development study's action items. She stated that the city hopes to have these investments made in the community over the next three to five years, assuming that funding is available.

Finally, the city will also benefit from the remaining ARPA funding it has yet to spend. The city received a cumulative total of $4.7 million in ARPA funding and, according to the city's reporting to the federal government, the city had about $3 million of that funding still left to spend on general government activities as of the end of March 2024. The funding will be available to the city until December 2026, when federal regulations require the city to return any obligated but unspent funds.

HIGH-RISK AREA #3
Lack of a Long-Term Plan

Status: We conclude that Blythe has not addressed this risk area because the city has not yet developed a long-term strategic plan.

In our March 2021 audit, we recommended that the city develop a five-year strategic plan to ensure that Blythe was adequately prepared to address long-term financial, budgetary, and operational challenges. As part of that audit, we observed that a strategic plan would provide a framework for Blythe city officials to consider the city's numerous competing priorities when allocating any additional revenue it received. Consequently, we reviewed whether the city had addressed this recommendation. The interim city manager explained that the city has not done so because it has devoted resources to other priorities, such as opposing the Chuckawalla Valley State Prison closure. Moving forward, she stated that city staff will ask the city council to approve funding for a strategic plan as part of Blythe's fiscal year 2025–26 budget. The interim city manager estimated adoption of a strategic plan by early 2026 if the city council approves the funding.

HIGH-RISK AREA #4
Enterprise Fund Deficits

Status: We conclude that Blythe has partially addressed this risk area because the city's enterprise funds no longer owe significant amounts to other city funds. Although the city's enterprise funds continue to have negative unrestricted net positions, the city's recent rate increases reduce the risk that the water fund will strain the city's general fund.

In our March 2021 audit, we reported that Blythe had subsidized its solid waste, golf course, and lighting district enterprise funds with other city funds. We reported that the city recorded these enterprise fund subsidies as *loans* that cumulatively amounted to more than $1.5 million. During this audit, we reviewed the city's fiscal year 2022–23 ACFR and found that the city's enterprise funds subsequently owe minimal amounts to other city funds, which resolves the condition that we found in our original audit. Specifically, the golf course and lighting district funds did not owe any amounts to other funds, and the solid waste enterprise fund owed only $101,000 to the general fund.

Although the city's enterprise funds no longer incur those significant obligations, the enterprise funds continue to be a risk area for the city. The independent auditor's reports for the ACFRs from fiscal years 2019–20 through 2022–23 have each noted significant doubt about the city's ability to continue as a going concern—which means the city is at risk of not being able to continue meeting its financial obligations. Each of these auditor opinions notes that the negative unrestricted net position of the city's enterprise funds is one of the reasons for the significant doubt. At the close of fiscal year 2022–23, the unrestricted net position of the water, solid waste, and golf course funds were all negative, as they have been for the last few fiscal years, as Table 2 shows. A fund's unrestricted net position represents the resources a government entity can use at its discretion to address a variety of costs, such as unexpected revenue shortfalls or infrastructure needs. Therefore, a fund with a negative unrestricted net position is less able to address those costs on its own and is at greater risk of needing assistance from other sources, such as a city's general fund.

Table 2
The Unrestricted Net Position of Three Enterprise Funds at Blythe Has Remained Negative Over Four Fiscal Years

	TOTAL UNRESTRICTED NET POSITION (ENDING BALANCE)		
FISCAL YEAR	WATER FUND	SOLID WASTE FUND	GOLF COURSE FUND
2019–20	$(1,728,000)	$(624,000)	$(2,300,000)
2020–21	(1,568,000)	(586,000)	(1,280,000)
2021–22	(1,883,000)	(602,000)	(26)
2022–23	(1,500,000)	(337,000)	(27)

Source: Blythe's ACFRs.

Although it is significant that the independent auditor reported substantial doubt about the city's ability to continue as a going concern, Blythe is on a path toward better financial health in its enterprise funds. The city's finance director believes that the city will be able to address in the near future the independent auditor's concerns about the enterprise funds. In February 2023 the city council approved water rate increases that began in March 2023 and are scheduled to continue through January 2027. For example, at the time the council approved the rate increase, a single-family home paid about $2.20 per 1,000 gallons of water, but that rate will increase to about $4 in January 2027. As Table 2 shows, the water fund had the largest unrestricted net position deficit among the city's enterprise funds as of the close of fiscal year 2022–23. The city's finance director expects that the independent auditor will continue to express doubt about the city's ability to continue as a going concern because of unresolved deficit balances for the city's fiscal year 2023–24 ACFR, which has yet to be issued. Nevertheless, the overall increases in rate revenue over the next few years will help offset a potentially worsening position.

HIGH-RISK AREA #5
Unpaid Golf Course Loan

Status: In May 2021, we concluded that Blythe had fully addressed this risk area by paying off its golf course loan.

In our March 2021 audit, we found that the city owed more than $1 million for a loan that its former redevelopment agency had made to the city's golf course fund. We recommended that the city adopt a payment schedule to pay down the loan. We reported in our May 2021 follow-up assessment that Blythe had paid the remaining balance of its golf course loan to the redevelopment agency's successor, which fully addressed this risk area.

HIGH-RISK AREA #6
Need for Public Safety Resources

Status: In September 2022, we concluded that Blythe had fully addressed this risk area by obtaining consulting services for its police department and by developing a plan to replace its fire vehicles.

In our March 2021 audit, we recommended that the city apply for consulting services from the Commission on Peace Officer Standards and Training (POST) to better assess its police department's efficiency and effectiveness. POST accepted the city's application for an organizational study in September 2021 and subsequently completed the study in November 2022. The interim city manager explained that the Blythe police department has implemented many changes in response to the POST study. For example, the city updated its public safety communication system, which now provides direct communication between the Riverside County system and the city to improve communications and coordination in case of multi-jurisdictional incidents. In addition, the city developed a schedule for replacing its three oldest fire vehicles by the end of 2025. In the nearly four years since our March 2021 audit, the city has purchased one fire engine, one rescue truck, and two pickup trucks. The fire engine and rescue truck replaced two of the three oldest vehicles.

HIGH-RISK AREA #7
Unaddressed Vacant Buildings

Status: In September 2022, we concluded that Blythe had fully addressed this risk area by removing abated properties.

In our September 2022 follow-up assessment, we concluded that the city had addressed this risk area, and we noted that addressing vacant buildings would be a long-term effort. In addition, we reported that the city had identified properties that might be eligible for receivership—a legal designation that would allow the city to take control of certain aspects of the properties and bring buildings on that property up to code instead of demolishing them.

During this audit, we found that the city continues its efforts to address the risks associated with its vacancy rate. In May 2023 and February 2024, the city completed the removal of abated properties damaged by fires. Regarding the properties the city had previously identified for receivership, the interim city manager indicated that the city must address ongoing legal issues before proceeding with any further steps.

HIGH-RISK AREA #8
Utility Rates and Service Fees Insufficient to Cover Costs

Status: In March 2022, we concluded that Blythe had fully addressed this risk area by establishing a policy to annually review and update its service user fees.

In our March 2022 follow-up assessment, we reported that the city had fully addressed this risk area. In January 2022, the city established a policy that allowed it to annually review and update its user fees and required Blythe to perform a rate study every five years. The city commissioned a consulting firm to perform a water and sewer rate study. The study analyzed the revenue sources and costs of the city's utility system and proposed rate adjustments for full cost recovery. In February 2023, following a public hearing, the Blythe city council approved the water and sewer rate increases that the study proposed.

HIGH-RISK AREA #9
Poor Oversight of City Contracts

Status: We conclude that the city has partially addressed this risk area by creating and using a contract tracking spreadsheet to better monitor its contracts. However, the city still has not implemented procedures for closing out its expired contracts, and it has not updated its financial management software.

In our March 2021 audit, we found that Blythe's financial system did not link contract-related payments to their corresponding contracts, hindering the city's ability to ensure that those payments are appropriate. The city relied on a manual process to issue contract payments, and that process did not always ensure prompt payment. We concluded that without a method to ensure that it can properly manage its contractual obligations, Blythe risked paying wasteful and avoidable late fees. Further, we found that the city did not have a way to determine which contracts were valid and active. We noted that without a reliable method of identifying and tracking contracts, the city risked making payments on expired contracts and missing opportunities to renegotiate contract terms or budget appropriately for multiyear expenditures. To ensure that it can properly manage its contracts, we recommended that Blythe develop a contract tracking system that would include the ability to identify contract amounts, durations, and any relevant special terms. We also recommended that the city develop procedures to close out expired contracts and clearly identify in its financial system the contract authority for a contract-related purchase. As we note in our March 2021 audit, effective contract management practices at the end of a contract include reallocating unused funds and documenting information regarding the contractor's performance to ensure that the city does not enter into another contract with an entity that performed poorly and that the city does not make payments on an expired contract.

In our September 2022 assessment of the city's progress, we reported that the city had partially addressed this risk area. Our assessment reported that the city developed a contract tracking spreadsheet that identified the total contract amounts, contract dates and durations, and relevant special contract terms. The contract tracking spreadsheet procedures specify that the director of finance or a designee shall review and update the spreadsheet at least monthly. However, our assessment also found that the city had not implemented procedures to close out its expired contracts. We reported the city's assertion that its current financial system did not have the ability to monitor contracts in the way we recommended. Subsequently, in January 2023, the interim city manager stated that the city planned to ensure that when it purchased new financial management software that the software would include a contract management module.

During this audit, we confirmed that the city continues to use the contract tracking spreadsheet to log the contract amounts, dates and durations, and special terms. Relevant to our other recommendation, the interim city manager reaffirmed that the city plans to procure a new financial management system once its existing system is no longer supported, which she expects will occur after 2026. She also confirmed that the city still has not developed procedures for closing out expired contracts. Therefore, the city should continue with its plan to procure a software solution that would allow it to monitor contracts and also develop procedures that would better guard it against the potential negative effects of not properly closing out a contract.

HIGH-RISK AREA #10
Lack of a Permanent City Manager

Status: We conclude that Blythe has not addressed this risk area because the city has not yet hired a permanent city manager.

In our March 2021 audit, we recommended that the city begin the process for hiring a permanent city manager. At the time, the interim city manager had been in the role since July 2017 after the previous city manager resigned. Further, we found that in addition to performing the duties of the city manager, she was responsible for the role of the city clerk and for several other important positions within the city. We concluded that hiring a permanent city manager would not only remove some of the work burden from the current interim city manager, but doing so would also allow Blythe to more effectively plan its next steps for improving its financial stability and its ability to continue providing service to residents in the long term.

Blythe has yet to hire a permanent city manager, instead relying on the same interim city manager to fulfill the position that she had been responsible for during our 2021 audit. In addition, she still maintains her elected position as the city clerk. The interim city manager stated that the city council may revisit the subject of hiring a permanent city manager after the November 2024 election. However, she also noted that the city does not have a formal timeline for when the hiring process will begin.

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The City of Lindsay's Negative Reserve Level and Deficits in Key Enterprise Funds Are Factors Resulting in Its Continued Designation as a High-Risk Entity

	RISK AREAS AS REPORTED IN AUGUST 2021	STATE AUDITOR'S CURRENT ASSESSMENT OF LINDSAY'S PROGRESS IN ADDRESSING THE RISK AREA*
Lindsay's Actions Raise Doubt About the Financial Stability of Its General Fund		
1	Inadequate revenue led to illegal transfers to the general fund	Pending
2	Potentially improper contributions to the city's streets maintenance efforts	Partially Addressed
3	Insufficient planning for federal assistance funds	Fully Addressed
Lindsay Must Increase Its Efforts to Address Deficits in Its Enterprise Funds		
4	Inadequate enterprise fund balances	Partially Addressed
5	Service fees did not cover costs	Partially Addressed
Lindsay Must Improve Its Management Practices to Effectively Plan for Its Financial and Operational Needs		
6	No long-range financial planning	Partially Addressed
7	No formal strategies to address its rising employee retirement costs	Pending
8	Lack of planning for public safety training and equipment needs	Fully Addressed

* In accordance with state law, we used our professional judgment to assess the city's progress in each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

Pending: The city has not taken substantial action to address the risk area and, at the time of this audit, the conditions that created high risk for the city continue to exist.

HIGH-RISK AREA #1
Inadequate Revenue Led to Illegal Transfers to the General Fund

Status: We conclude that Lindsay has not addressed this risk area. Although the city has implemented a plan to eventually repay transfers to its general fund, the city has depleted its general fund, leaving Lindsay poorly situated to handle unexpected economic conditions.

In our August 2021 audit, we found that the city forgave $6.3 million in loans made by several funds, including its water and sewer funds, to its general fund—an action that violated state law and exposed the city to litigation. Specifically, we observed that state law, as amended by Proposition 218, restricts cities from using revenue derived from property related fees and charges to pay for general government operations, and the city's forgiveness effectively converted those restricted funds into general funds, violating state law. We recommended that the city develop and implement a plan to repay fully these funds.

During this audit, we found that Lindsay's city council reinstated the loans, and approved an interest free repayment plan in February 2022. The plan calls for annual payments of up to $136,000. Further, the plan describes that the city will first reimburse $1.8 million to the water fund and $2.1 million to the sewer fund, which the city anticipates will take until fiscal years 2049–50 and 2054–55 respectively. The city then plans to reimburse the other affected funds including the street improvement fund. The city began its repayments in fiscal year 2022–23, and it anticipates completing full repayment to all funds in fiscal year 2090–91, a period that does not violate state law.

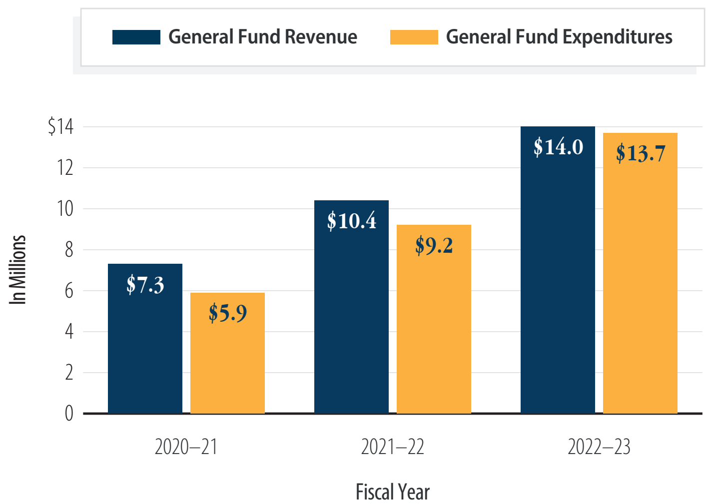
As Figure 5 shows, the city spent less than its general fund revenue in fiscal years 2020–21 through 2022–23. Although the city's revenue is sufficient to cover expenditures, its negative general fund reserves of $1.4 million as of the end of fiscal year 2022–23 will hinder its ability to react to current and future financial risks. Fiscal year 2022–23 was the second fiscal year in a row in which the city ended the year with negative general fund reserves. The GFOA recommends that government entities maintain at a minimum two months of unrestricted reserves to mitigate current and future risks, such as revenue shortfalls and unanticipated expenditures. Consequently, the city will have to identify additional sources of revenue or reduce its expenditures to ensure its financial stability. To help identify potential revenue sources, the city's financial plan, which we describe in more detail below, has strategies Lindsay should continue to pursue to derive more revenue through economic development and to ensure that its enterprise funds do not require general fund subsidies.

HIGH-RISK AREA #2
Potentially Improper Contributions to the City's Streets Maintenance Efforts

Status: We conclude that Lindsay has partially addressed this risk area by conducting a cost study identifying the impact of water and sewer damage to roadway conditions.

In our August 2021 audit, we noted that the city charges its utilities for the cost of street repair and maintenance that result from damage by those utilities. For example, the utility's water lines run underneath city streets and may cause damage through leaks or projects to replace or repair the water lines. However, we found that the city did not know the true annual cost of the damage its water, sewer, and refuse utilities caused to its roadways. Therefore, we concluded that the city violated Proposition 218 when it transferred nearly $900,000 annually from those utilities' funds to the city's general fund to pay for that roadway damage because it could not demonstrate how it knew that was the appropriate amount to transfer. The city

Figure 5
The City of Lindsay's General Fund Revenues Were Higher Than Its Expenditures in Three Recent Fiscal Years



Source: Lindsay's ACFRs.

Note: We calculated revenue by combining the revenue and other financing sources into the general fund each fiscal year with the exception of $900,000 in one-time proceeds from the disposal of capital assets in fiscal year 2022–23. We calculated expenditures by combining the expenditures and transfers out of the general fund in each fiscal year.

received the results of a cost study in June 2022 that determined the cost of roadway damage that the city could attribute to the utilities to be a collective $688,000 annually. The consultant's report noted that the estimated cost of the damage was conservative, because it included only certain types of damage caused by the utilities.

Lindsay's director of finance stated that the city has not updated the amount it transfers from the utility funds since it received the cost study in 2022. The director started in her position with the city in 2024 and did not know why the city had not yet adjusted the transfer amounts. The director of finance anticipates that the city will revise the transfer amounts in January 2025. She further asserted that the city would review the transfer amounts every five years. Until it adjusts the amount it transfers for street repairs, the city continues to expose itself to liability under Proposition 218.

Recommendation to Address This Risk Area:

The city should update the amount that it transfers to the general fund to reflect the amount supported by its cost study.

HIGH-RISK AREA #3
Insufficient Planning for Federal Assistance Funds

Status: We conclude that Lindsay has fully addressed this risk area by developing a plan for spending its federal funds.

In our August 2021 audit, we raised concerns that Lindsay had not yet specifically planned how it would spend ARPA funding, and we recommended that the city develop a plan for effectively using those funds. As we describe in the Introduction, the city received $3.2 million in ARPA funds. In April 2022, Lindsay's city council approved a spending plan for the ARPA funds. That plan largely reserved the city's ARPA funds for future projects that the city would determine at a later date. However, in the April 2022 spending plan, the city indicated that it planned to spend funding on downtown beautification, economic development, and two fire department personnel. According to federal regulations, these are allowable uses of ARPA funds. As of March 2024, the city reported having spent $1.3 million of its ARPA award.

HIGH-RISK AREA #4
Inadequate Enterprise Fund Balances

Status: We conclude that Lindsay has partially addressed this risk area by developing a plan to build and maintain its fund balances, but risks remain for its water fund.

In our August 2021 audit, we noted that Lindsay's annual deficits and loan forgiveness had led to concerning deficit balances in two of the city's enterprise funds—the water and sewer funds. We recommended that the city develop and implement a plan to build and maintain these balances.

In June 2022, the city adopted a fiscal sustainability and financial improvement plan for the water and sewer funds that included provisions for outlining infrastructure replacement schedules, projecting cash flows and fiscal forecasts, and establishing contingency reserve policies for the water and sewer funds. Further, because the city reinstated the loans we describe under High-Risk Area #1, the unrestricted net position of the water fund is no longer negative. Nonetheless, the net position of the water fund depends significantly on the repayment of approximately $1.8 million as of the end of fiscal year 2022–23, which the city does not expect to fully repay until fiscal year 2049–50.

A more direct measurement of the financial health of the city's enterprise funds is whether they can sustain themselves or require subsidies. As Table 3 shows, the city's water fund has incurred operating deficits in fiscal years 2020–21 through 2022–23, and the sewer fund has been self-sustaining. The city approved water rate increases in October 2024, and those increases will go into effect over the next four to five years, with the first of the increases to take effect in January 2025. Establishing appropriate rates will assist the city in effectively operating its water utility.

Table 3
The City of Lindsay's Water Fund Operates at a Loss, but Its Sewer Fund Is Self Sustaining

	WATER FUND		SEWER FUND	
FISCAL YEAR	NET OPERATING INCOME (LOSS)	GENERAL FUND TRANSFERS IN	NET OPERATING INCOME	GENERAL FUND TRANSFERS IN
2020–21	$(233,000)	—	$353,000	—
2021–22	(252,000)	$99,000	382,000	—
2022–23	(569,000)	897,000	262,000	—

Source: Lindsay's ACFRs.
Note: All amounts are rounded to the nearest thousand dollars.

HIGH-RISK AREA #5
Service Fees Did Not Cover Costs

Status: We conclude that Lindsay has partially addressed this risk area. It developed a fee study and improved its accounting system, but it must address other weaknesses in its cash receipt processing.

In our August 2021 audit, we raised concerns that because it did not periodically review and update its fees and rates, Lindsay had not ensured that it collected sufficient revenue to cover the costs of services it provided. Further, we noted that limitations in its accounting system made the city unable to identify the precise amount of revenue it collects from some of its fees and rates. Although the city addressed the issues we identified in our prior report, we identified other issues during this audit that raise concerns.

In December 2022, the city council adopted a new citywide fee schedule to set city fees at the same level as the full cost the city incurred to support the various activities for which it charged user fees, such as issuing plumbing or electrical permits. The city council also approved an amendment to the fee schedule in July 2024. City staff proposed that amendment to increase certain fees they had either listed incorrectly or had left out of the schedule of fee increases the city approved in December 2022. We also confirmed that the city's accounting system has the capacity to track the revenue it collects from the fees it charges and that the city has established revenue accounts in that system for many of its fees.

However, as part of this audit, we identified other factors related to the city's fees and rates that demonstrate that this area remains a risk to Lindsay. The city's external auditor identified internal control weaknesses in its fiscal year 2022–23 audit. Specifically, for one city department's fees, a single individual handled deposits of fee revenue and did so without preparing proper supporting documentation. Deposits that do not include supporting documentation leave a city at risk of misappropriation of funds. Further, city staff did not reconcile cash receipts from two departments to the city's general ledger, which leaves Lindsay susceptible to the potential for misappropriation of fee revenue. Without proper controls over its cash receipt processes, the city cannot ensure that it is correctly collecting and recording its actual fee revenues, and it increases its risk that it does not handle collected cash properly. The city's director of finance stated that the city plans to centralize the fee collection process to better control fee collection and to better assure the city that its staff appropriately handle all fee revenue.

Recommendation to Address This Risk Area:

The city should adopt appropriate controls to address the internal control weaknesses regarding fee revenue its external auditor noted.

HIGH-RISK AREA #6
No Long-Range Financial Planning

Status: We conclude that Lindsay has partially addressed this risk area. It has developed a financial improvement plan, but it has not kept up with the financial forecasting requirements of that plan.

In our August 2021 audit, we raised concerns that, although Lindsay had taken some steps to improve its financial position in the short term, the city had no clear plan for its long-term financial decision-making. We noted that the GFOA recommended that all governments regularly engage in long-term financial planning as part of their overall strategic planning efforts, and that long-term financial planning should include key elements, such as revenue and expenditure forecasts, strategies for achieving and maintaining financial stability, and a process for periodically reviewing and updating that plan. In this audit, we determined that Lindsay has partially addressed this risk area. In February 2022, the city council approved a Fiscal Sustainability and Financial Administration Improvement Plan (financial improvement plan). The financial improvement plan established that the city would create annual five-year long-range fiscal forecasts, identify challenges to the city's continued financial health, and take steps to reduce expenditures or increase revenues when the city is projecting a deficit. The financial improvement plan also included an initial five-year forecast of the condition of the city's general fund.

Because the financial improvement plan calls for the city to perform the five-year long-range fiscal forecast annually, we expected at the time of our audit that the city would have already conducted two additional forecasts beyond the initial version included in the February 2022 financial improvement plan. However, the director of finance confirmed that the city has not performed any updates to its long-range financial forecast. She said that the city intends to include updated forecasts in future city budgets. As we describe earlier, at the end of fiscal year 2022–23, Lindsay had negative general fund reserves. The city would likely benefit from following through with its long-range financial forecasting so that it can better anticipate its revenue and expenditures and take steps as necessary to improve its poor financial condition.

HIGH-RISK AREA #7
No Formal Strategies to Address Its Rising Employee Retirement Costs

Status: We conclude that Lindsay has not addressed this risk area. The city still needs to develop and implement strategies to reduce its retiree health benefit costs.

In our August 2021 audit, we raised concerns that Lindsay had not prefunded its OPEB liabilities as the GFOA recommends. Lindsay's OPEB benefits include continuing medical, dental, and vision coverage to its qualified retired employees. Further, we stated that the lack of prefunding had caused the city's OPEB liabilities to increase by 36 percent from fiscal years 2017–18 through 2019–20. In addition, we noted that the city's pension costs could place a financial burden on the city unless it took substantial action.

The city's financial improvement plan includes a commitment to fully fund the costs of the city's retirement plans and hold annual discussions of the city's progress in funding its pension program. Related to OPEB, Lindsay's ACFRs show an overall decline in its OPEB liability, from nearly $2 million at the end of fiscal year 2021–22 to $1.4 million at the end of fiscal year 2022–23. However, a significant factor in this decline were changes in the assumptions the city made to estimate the OPEB liability, rather than any change in the city's approach to funding OPEB. Similar to the condition at the time of our original audit, the city had not prefunded its OPEB in fiscal year 2022–23.

The director of finance explained that the city would develop a plan by June 2025 to help reduce its OPEB liabilities. She noted that she would work with the city manager to look into the city's options to reduce its OPEB costs. Among the options the city would consider will be establishing an OPEB trust to prefund its OPEB liabilities and negotiating with the unions in preparation for the next bargaining agreement to consider requiring current employees to begin contributing to the future costs of their retirement health care benefits, among other strategies. As we described in our August 2021 audit report, if the city does not require its employees to begin contributing to their OPEB, Lindsay will likely have to make higher contributions from its general fund, displacing other spending priorities.

HIGH-RISK AREA #8
Lack of Planning for Public Safety Training and Equipment Needs

Status: We conclude that Lindsay has fully addressed this risk area. It has evaluated the effectiveness of its combined police and fire department, ensured that its firefighters have appropriate training, and adopted a fleet management and replacement policy covering its police and fire vehicles.

In our August 2021 audit, we raised concerns that Lindsay did not appear to be committed to the public safety approach it used at the time—a combined fire and police department—and that it needed to evaluate whether that approach was still an appropriate model for providing services to its community. We further identified concerns related to the city's public safety training, noting that although Lindsay generally hired trained police officers and then provided them with training in firefighting, the city had not ensured that two officers had received firefighting training. Finally, we noted that the age of Lindsay's police and fire vehicles could affect the safety of Lindsay's residents should those vehicles break down while responding to an emergency.

Lindsay evaluated the effectiveness of using combined police and fire functions, and in February 2022 presented a reorganization proposal to the city council. In March 2022, the city began its reorganization to create a single public safety department operated with separate functions for both police and fire. The city calculated the fiscal impact of the personnel elements of this change to be between $88,000 and $112,000 in additional costs annually. To support these additional costs, the city expected to use ARPA funds to pay for the first year's costs and use general fund monies to pay for costs in the second and following years. The city indicated that it would seek grant funding as it became available. The city further requires annual mandatory training for its firefighters, and it has established checklists to show that its firefighters and volunteers have met their annual training requirements. The city also established tracking documents that it can use to track whether its staff have demonstrated the knowledge, skills, and abilities related to their assigned duties. Accordingly, we find that the city addressed our recommendation regarding its public safety approach and training.

In addition, the city adopted a fleet management and replacement policy in November 2021, which establishes, among other things, guidelines for replacing all city vehicles. The city included factors for consideration such as the vehicle's age and mileage, its reliability and useful life, and the cost of maintenance and repairs. We note that Lindsay is currently monitoring the status of its public safety vehicles. For example, in its September 2024 annual fleet management and replacement evaluation, the city identified eight vehicles in its fleet that qualify for priority replacement and another two that qualify for replacement as the city's budget allows. The director of finance stated that the city no longer needs two of the vehicles identified as priority replacements and plans to replace two others during fiscal year 2024–25. She explained further that the city's chief of public safety had identified which two vehicles from the eight listed as priority replacements are in the greatest need of immediate replacement. The director of finance said that, beginning in fiscal year 2025–26, the city plans to replace three additional vehicles and begin budgeting to replace other vehicles as needed in the future.

The City of Montebello Has Not Kept Its Costs Below Its Revenue and Thus Remains a High-Risk Entity

RISK AREAS AS REPORTED IN OCTOBER 2021		STATE AUDITOR'S CURRENT ASSESSMENT OF MONTEBELLO'S PROGRESS IN ADDRESSING THE RISK AREA*
Despite Progress in Some Areas, Montebello's Financial Stability Remains Uncertain		
1	Declining financial situation	Pending
Montebello Continues to Make Questionable Decisions Related to Its Hotels		
2	Did not provide analysis of hotel performance	Fully Addressed
3	Did not include an important financial decision on the council agenda	Fully Addressed
4	Did not adopt a policy to timely pay hotel management fees	Fully Addressed
Montebello Has Not Fully Resolved Problems With Its Procurement Process		
5	Did not follow competitive bidding process	Partially Addressed
6	Did not follow petty cash and credit card policies	Fully Addressed
7	Made gifts of public funds	Partially Addressed

* In accordance with state law, we used our professional judgment to assess the city's progress in each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

Pending: The city has not taken substantial action to address the risk area and, at the time of this audit, the conditions that created high risk for the city continue to exist.

HIGH-RISK AREA #1
Declining Financial Situation

Status: We conclude that Montebello has not yet addressed this risk area because the city has continued deficit spending in its general fund.

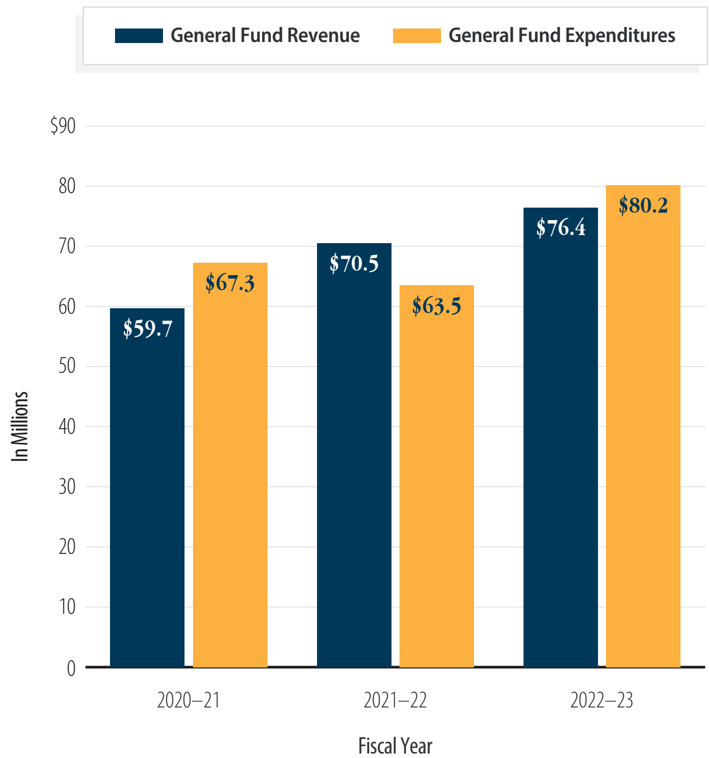
In our December 2018 audit, we found that the city struggled to generate sufficient recurring revenue to meet its expenditures. Our October 2021 follow-up audit found that the city's finances improved slightly following our 2018 audit, but they declined dramatically in fiscal year 2019–20, in part because of the economic repercussions of the COVID-19 pandemic. We reported that Montebello's lower revenue and higher expenditures depleted its general fund reserves, thereby limiting its ability to respond to further revenue declines or expenditure growth while still maintaining services.

In the years since our follow-up audit, the city has built its general fund reserves through one-time infusions of funding. According to the city's fiscal year 2022–23 ACFR, Montebello had amassed a general fund reserve of $25.3 million by the end of that fiscal year, an amount that could cover nearly four months of that year's expenditures. The city's general fund reserves grew significantly between fiscal years 2021–22 and 2022–23—increasing by nearly $15 million. The increase in the city's general fund reserves primarily resulted from selling its water system to the San Gabriel Valley Water Company for $16.2 million in February 2023, as we recommended it consider in our original audit. However, this condition is similar to the findings from our December 2018 audit of Montebello, which concluded that the city relied on one-time revenue to preserve and grow its general fund reserves. Although the city has made progress in building its general fund reserves, it will not be in a sustainable financial position unless it is able to avoid consistent deficits in its general fund.

Montebello has generally been unable to maintain general fund expenditures below the amount of its revenues. As Figure 6 shows, for fiscal years 2020–21 through 2022–23, there were two years in which the city's expenditures and transfers out of its general fund exceeded general fund revenue and transfers into the fund. The surpluses and deficits during this period ranged from a $7 million surplus in fiscal year 2021–22 to a $7.6 million deficit in fiscal year 2020–21, and the cumulative deficit in the general fund was $4.4 million. The director of finance shared with us that some of the expenditures in the city's general fund during this period were expenditures of bond revenue from bonds that the city's former redevelopment agency had issued. According to the director of finance, the city made the decision to record revenue from these bonds in the general fund before his tenure as director of finance. He believed that these expenditures—cumulatively $2.5 million during that period—were not reflective of the city's true ongoing costs in the general fund because they were one-time expenditures for restricted purposes. We reviewed the information the director of finance provided about these expenditures and found that, even after excluding those expenditures, the city still experienced deficits during two of the three fiscal years we reviewed and incurred an overall cumulative deficit. In other words, although accounting for these expenditures reduces the magnitude of the city's deficits, our overall concern remains that the city has not kept general fund expenditures below its revenues.

Further, according to the projections in the city's fiscal year 2024–25 budget, Montebello anticipates that beginning in fiscal year 2025–26, it will enter a three-year period of budget deficits of more than $1 million annually in its general fund. The director of finance stated that the city will use these projections to adjust current fiscal year expenditures, pursue opportunities to expand the city's sales tax base, and review the organization as a whole in order to identify opportunities for cost savings or revenue enhancements. However, he also shared his belief that the city would eventually realize more revenue than these forecasts assumed. Specifically, he highlighted that the budget states that the city's forecast does not include significant changes to sales tax revenue, which the city expects will occur in fiscal year 2024–25. The director of finance stated that the city did not include or did not fully realize large revenue-generating operations in the forecasted revenue because of the timing of

Figure 6
The City of Montebello's General Fund Expenditures Have Generally Been Higher Than Its Revenue in Two of Three Recent Fiscal Years



Source: Montebello's ACFRs.

Note: We calculated revenue by combining the revenue and transfers into the general fund in each fiscal year. This figure does not include other financing sources flowing into the general fund in the amount of $5.8 million in fiscal year 2020–21, $44,000 in 2021–22, and $1.3 million in 2022–23 that were related to the issuance of debt and the sale of assets. In addition, for fiscal year 2022–23, we excluded the $16.3 million transfer into the general fund because this was a one-time transfer that resulted from the city closing the water fund after the sale of the city's water system. We calculated expenditures by combining the expenditures and transfers out of the general fund in each fiscal year.

when the city developed the forecast. He explained that, in part, the forecast includes a conservative estimate of sales tax revenue, noting that the city did not have enough data from a recently opened entertainment venue at the time to more accurately project the growth of its sales tax revenue in future years. Nonetheless, Montebello has consistently overspent its general fund revenue and must show sustained progress in controlling costs to fully address this risk area.

Recommendation to Address This Risk Area:

To ensure that the city is able to sustain its general fund without relying on one-time events, Montebello should adopt a financial plan with specific strategies to reduce its expenditures and build and maintain its revenue.

HIGH-RISK AREA #2
Did Not Provide Analysis of Hotel Performance

Status: We conclude that Montebello has fully addressed this risk area by providing detailed financial updates about hotel operations to the city council.

In our October 2021 audit, we describe that Montebello owns two hotels—the Hilton Garden Inn and the Home2Suites Hotel—both of which are operated by a third-party we refer to as the *hotel operator*. Our 2021 follow-up audit found that since our December 2018 audit, city staff presented a financial analysis of only one of these two hotels to the city council, and it did so just once in nearly three years. Without detailed financial information—which could include the hotels' total revenue, expenses, and the amount due to pay for related debt—the city council has only limited ability to make informed financial decisions to protect the city's interests. We determined that the city council is at risk of not detecting underperformance, errors, or misstatements in the hotels' finances and that it cannot protect Montebello's interests when it considers matters related to its contracts for hotel operations. In our May 2022 follow-up assessment, we noted that staff were still presenting incomplete and inconsistent financial information to the city council.

Montebello has now provided more consistent and complete financial presentations to the city council. For example, in its first quarter budget report during fiscal year 2022–23, city staff presented that quarter's revenue and expenses for both hotels and compared them with the actual revenue and expenses from the first quarter of each of the previous three fiscal years. We saw similar levels of detail in subsequent updates to the city council. These details provide transparency for hotel operations and allow the city council to more readily identify underperformance. Because the city has regularly provided detailed reports on hotel operations to the city council, Montebello has fully addressed this risk area.

HIGH-RISK AREA #3
Did Not Include an Important Financial Decision on the Council Agenda

Status: In May 2022, we concluded that Montebello had fully addressed this risk area by implementing our recommendation to include all matters of fiscal policy on its public city council meeting agendas.

Our October 2021 follow-up audit found that the city council approved a loan of up to $3.4 million from its general fund for hotel renovations without properly including the issue on a council agenda. We recommended that the city council ensure that it includes all matters of fiscal policy on its council meeting agenda as state law requires. In May 2022, we reported that the city implemented our recommendation, and city council meeting agendas we reviewed during this audit show that the city has included matters of fiscal policy on council agendas.

HIGH-RISK AREA #4
Did Not Adopt a Policy to Timely Pay Hotel Management Fees

Status: We conclude that Montebello has fully addressed this risk area because it has adopted a policy to pay its hotel fees on time and has recently paid those fees on time.

In our December 2018 audit, we found that because Montebello did not pay its hotel management fees, the city had accrued $2 million in interest costs by the end of fiscal year 2016–17. In our October 2021 follow-up audit, we determined that the city was working to pay off its remaining management fee obligations, but Montebello had not developed policies to ensure prompt payment.

Following our October 2021 audit, the city created a policy related to timely payment of its hotel management fees. Further, trial balance reports from the city's financial system as of June 2024 show that the city had no accrued unpaid interest for either hotel. According to a spreadsheet the city uses to track the payments it owes, only one payment remained outstanding as of June 2024 in the amount of $384,000. According to the director of finance, the city will pay this amount when the hotel's revenue account has sufficient funding. In recent years, the city has paid the fees for this hotel several months late without accruing interest. Further, the city has improved the timeliness of its payments since our original audit and follow-up audit in 2021. Therefore, we consider this risk area fully addressed.

HIGH-RISK AREA #5
Did Not Follow Competitive Bidding Process

Status: We conclude that Montebello has partially addressed this risk area by updating its municipal code to require city council approval for exceptions to the competitive bidding process, but the city can do more to improve its safeguards for procurement.

In our December 2018 audit, we found that Montebello had not sought competitive bids for certain contracts and that a former city manager had approved a contract that exceeded her approval authority. Further, our October 2021 follow-up audit found that the city was not following requirements for contracting for services and would have benefited from increased city council oversight of its procurement activity. For example, we determined that Montebello violated its municipal code by not soliciting formal bids for a large professional services contract related to its golf course. To ensure that it obtains the best value when procuring services, we recommended that Montebello create a policy requiring staff to document when a valid exception—as described in the city's municipal code—exists to the procurement process and report the rationale for using the exception to the city council in a public meeting.

In January 2023, the city updated its municipal code, which addressed this risk by requiring city staff submit to the city council for approval a written justification for any exception to the procurement process. We reviewed examples of these notifications in two city council meeting minutes and found that the city staff had presented their rationale for using an exception when the city contracted for services outside of the standard process. In both instances, the city council authorized the exceptions.

However, Montebello has not adopted a policy addressing contracts without a maximum value. In both our 2018 and 2021 audits, we noted that Montebello needed a policy that addressed agreements without maximum values. We noted instances in both audits in which the city had entered into agreements with no maximum value, which provide fewer safeguards against overspending than contracts that include not-to-exceed values. In 2021 we recommended that the city establish a policy that requires contracts to include a maximum value when feasible and the city council to review and approve any agreement that binds the city financially and that does not include a maximum value. In March 2024, the city informed us that it had not implemented this recommendation, and the city's director of finance confirmed during this audit that the city has still not adopted such a policy. He indicated that his preference would be for the city to amend its municipal code to address this issue.

Finally, because of our findings in 2018 related to the city not consistently using competitive bidding processes to ensure that it received the best value for services, we recommended that the city provide annual training on procurement requirements for all staff involved in the procurement process. In 2021 we found that the city had not provided the procurement training as we recommended.

Since our October 2021 follow-up audit, the city has conducted procurement training and has taken steps to improve its training program. In February 2023, the city developed a policy for procurement training but, according to the city's director of finance, the city manager never approved the policy. The city's director of finance explained that the city manager at the time was on leave and the assistant city manager assumed his duties. The director of finance stated that because of this transition at the city manager level, the acting city manager never officially approved the policy. Montebello's current city manager approved the policy in October 2024. The policy describes the minimum topics covered in the training, such as the municipal code language and policies and procedures governing purchasing and procurement. The policy specifies the job classifications required to attend at least one training annually, and it requires the city to conduct three training events per year.

Before the recent approval of this training policy, the city had provided procurement training to its staff, but it could not present evidence showing that it ensured that all employees involved in procurement attended the training events. As it implements the new policy, it will be important for Montebello to track compliance with the policy. The city tracks attendance at training events by scanning and saving the paper sign-in sheets, but it does not enter the attendance information into any electronic tracking system or searchable document. Although the sign-in sheets provide records of who attended the training events, they do not allow the city to easily determine whether the necessary employees attended at least one training during a 12-month period, challenging the city's ability to monitor compliance with the new policy's requirements. The director of finance indicated that he is open to implementing an electronic tracking system to make it easier to determine who did or did not attend training events.

Recommendation to Address This Risk Area:

To help ensure that city staff are properly trained in competitive bidding processes and other procurement activity, the city should monitor adherence to the new procurement training policy.

HIGH-RISK AREA #6
Did Not Follow Petty Cash and Credit Card Policies

Status: In May 2022, we concluded that Montebello had fully addressed this risk area by generally eliminating the use of petty cash, issuing credit cards to individual employees instead of departments, and strengthening its purchasing controls.

In our May 2022 assessment, we reported that the city had fully addressed this risk area by implementing all of our recommendations regarding its use of credit cards and petty cash. Our December 2018 audit found that Montebello's poor control over its petty cash and its lack of credit card policies increased the risk of fraud and abuse. Although the city implemented petty cash and credit card policies after that audit, our 2021 follow-up audit determined that Montebello's staff members had not consistently followed them. In our May 2022 assessment, we noted that the city stated that it had eliminated all petty cash drawers with the exception of a single drawer overseen by its finance department. In addition, the city eliminated departmental credit cards and instead issues credit cards to individual employees. Montebello set individual transaction limits for each cardholder. The city also established a credit card policy that prohibits splitting a purchase into multiple transactions to circumvent the transaction limits and requires city manager approval for transactions that exceed the approved transaction limits. The result of implementing our recommendations is that the city has strengthened its purchasing controls and reduced the risk of abuse and fraud.

HIGH-RISK AREA #7
Made Gifts of Public Funds

Status: We conclude that Montebello has partially addressed this risk area by updating its municipal code to prohibit gifts of public funds, but the city has not ensured that its employees receive ethics training that addresses the prohibitions on gifts of public funds.

Our October 2021 follow-up audit found that Montebello's senior management circumvented the city's credit card policies when it used multiple transactions to purchase gift cards and mugs to show its appreciation of its employees during the holiday season—purchases that we considered to have constituted gifts of public funds. To help prevent such occurrences in the future, we recommended that the city revise its municipal code to prohibit the purchases of employee gifts with public funds. In February 2022, the city revised its municipal code accordingly. We also recommended that the city obtain for the city council and all employees with purchasing authority periodic legal and ethics training regarding the appropriate use of public funds and the prohibition on such funds to make gifts. The city manager stated that the city has not yet required legal and ethics training, but he intends to hire an independent entity to conduct the training. Further, he noted that he will implement a formal requirement that all staff complete their ethics training every two years and a process to monitor their completion.

The City of West Covina Remains a High-Risk Entity Because Its Approach to Addressing Its Reserve Level Increases Its Risk for Future Financial Instability

RISK AREAS AS REPORTED IN DECEMBER 2020		STATE AUDITOR'S CURRENT ASSESSMENT OF WEST COVINA'S PROGRESS IN ADDRESSING THE RISK AREA*
West Covina's Ineffective Fiscal Management Threatens Its Ability to Meet Its Financial Obligations and to Provide City Services		
1	Continual diminishing of reserves	Partially Addressed
2	Questionable use of city resources	Partially Addressed
3	Financial decisions based on insufficient analyses	Fully Addressed
4	Lack of formal financial recovery plan	Fully Addressed
West Covina's Weak Enforcement of Its Procurement Policy Increases the Risk of Waste and Fraud		
5	Inadequate management of purchase cards	Fully Addressed
6	Lack of oversight to ensure that contracts provide best value	Partially Addressed

* In accordance with state law, we used our professional judgment to assess the city's progress in each of the risk areas in the table. We determined whether the steps the city took and the overall conditions relevant to each risk area meant that the city fully or partially addressed the risk areas, or whether substantial action relevant to the risk area was still pending. We explain the statuses identified in this table in more detail below.

Fully addressed: The city has taken sufficient action to address the risk area when we consider its effort in combination with the related conditions at the time of this audit.

Partially addressed: The city has taken positive action to address the risk area, but its effort is incomplete when we consider it in combination with the related conditions at the time of this audit.

HIGH-RISK AREA #1
Continual Diminishing of Reserves

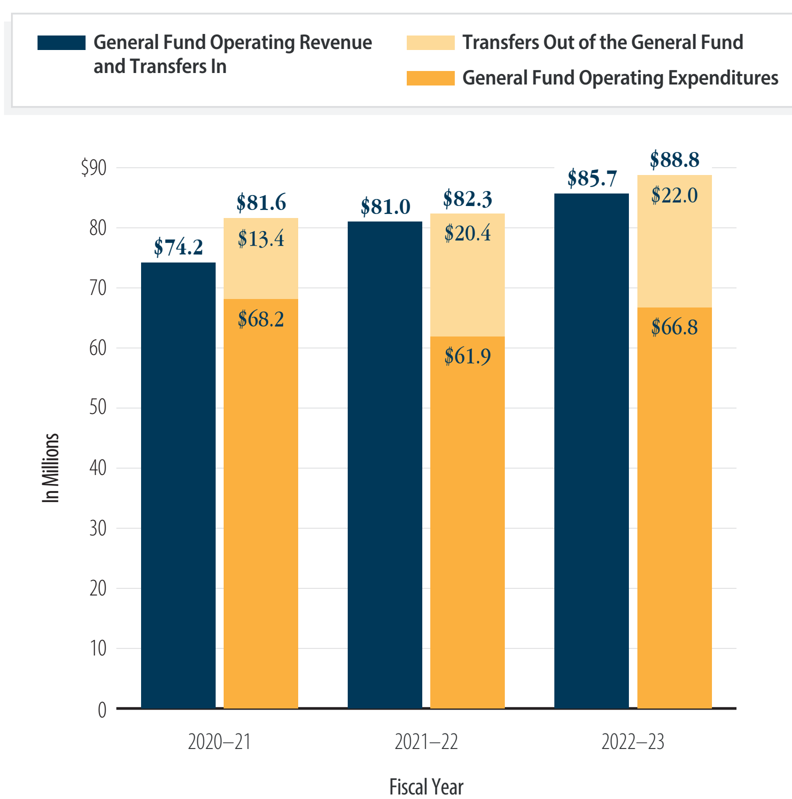
Status: We conclude that West Covina has partially addressed this risk area. Although the city's general fund revenue is higher than its operational expenditures, the city has chosen to maintain the minimum recommended reserve level, which introduces higher risk it will not be able to address future financial needs.

In our December 2020 audit, we reported that West Covina had diminished its general fund reserve by operating with a *structural deficit*, a condition in which operating expenditures exceeded revenue. We reported that the city's general fund reserves had declined, leaving the city vulnerable to unexpected expenditures or reductions in anticipated revenue, which jeopardized the city's ability to meet its financial obligations without reducing services.

Since our original audit in December 2020, West Covina has grown its general fund reserves from $12.6 million in fiscal year 2019–20 to $17.7 million as of the end of fiscal year 2022–23, which equals roughly two and a half months of general fund expenditures. The GFOA recommends that government entities maintain unrestricted fund balances in their general funds of no less than two months of reserves. West Covina's general fund reserves were above that minimum standard at the end of fiscal year 2022–23.

In addition, the city no longer operates with a structural deficit. Instead, the city's general fund revenue exceeds its operating expenditures. Figure 7 shows the city's revenue, which includes the transfers the city made into its general fund, as well as operating expenditures and transfers the city made out of the general fund from fiscal years 2020–21 through 2022–23. Because the amount the city transfers out of its general fund causes the funding flowing out of the general fund to exceed the funding flowing in, we inquired further with the city about how it was managing its resources.

Figure 7
The City of West Covina Has Maintained Its Operating Expenditures Below Its Operating Revenue



Source: West Covina's ACFRs.

Note: We calculated revenue by combining the revenue and transfers into the general fund in each fiscal year but did not include $185.6 million in transfers into the general fund related to the city's pension bonds in fiscal year 2020–21. The city did not have other financing sources or uses flowing in or out of its general fund in these three fiscal years.

The city explained that it is managing the general fund according to its reserve policy, which states that the city will maintain a reserve of no less than 17 percent of its annual operating expenditures, equating to a two-month threshold. In fiscal years 2020–21 through 2022–23, because the city's general fund reserves were above the two-month threshold, the city made certain transfers out of its general fund. During those years, the city calculated the level of general fund reserves its policy required it to maintain and transferred most of the remaining difference in general fund revenue to other city funds. These other funds include a fund related to the city's OPEB costs and another fund accounting for capital projects. These transfers were discretionary as the city's policy on reserves allows the city council to override them. Although the city also made other transfers that were not discretionary, its general fund reserves would have grown by the end of fiscal year 2022–23 if the city had not made the discretionary transfers.

The city's approach to managing its general fund reserves is riskier than if it focused on building a higher reserve amount. Although the city's reserve policy aligns with the GFOA's fund balance guidelines, the GFOA also identifies that a government's particular situation may require a reserve balance significantly in excess of this recommended minimum level. West Covina's pension related debt may represent such a situation. The city's net pension liability and pension-related debt equaled nearly 200 percent of government-wide revenue for fiscal year 2022–23. When a city's pension obligations and debt reach levels that equal such high percentages of its overall revenue, the city is at high risk for obligations and debt payments supplanting other priorities or goals that the city needs to or wants to accomplish. The city's pension debt represents a significant risk to the stability of the city's general fund, which should prompt West Covina to consider establishing a general fund reserve target at a level above its current policy to better mitigate this risk.

Recommendation to Address This Risk Area:

West Covina should establish a general fund reserve level higher than its current 17 percent goal that is sufficient to mitigate current and future risks, including its pension-related debt.

HIGH-RISK AREA #2
Questionable Use of City Resources

Status: We conclude that West Covina has partially addressed this risk area. The city has not renegotiated its labor agreements with its employee unions as we recommended, but it has updated its fee schedule.

In our December 2020 audit, we raised concerns about city leadership's decisions regarding the use of city resources because we concluded that those decisions had significantly reduced the city's financial reserves. Specifically, we focused on the decisions the city had made to fund its employees' health benefits at rates well above the average for state and local governments. West Covina paid 95 percent of its employees' healthcare premiums, compared to the 86 percent and 75 percent rates, on average, that state and local governments in the region paid for employee-only and family plans respectively. As of fiscal year 2022–23, the city's contribution rates to employee health benefits remained at 95 percent, demonstrating that the city is still incurring unusually high costs for healthcare. The finance director stated that the city has not yet renegotiated its agreements with its employee unions to alter how much it contributes to health benefits. The finance director also stated that West Covina is in the process of renegotiating those agreements and that the city hopes to complete its negotiations before the end of December 2024.

In December 2020, we also expressed concern about the fact that the city had not raised service fees to levels that would fully cover the city's costs to provide services such as building permits and inspections. West Covina has now addressed that concern. The city's August 2023 cost of service study calculated the full cost of city services and identified new fees for services the city had been providing without charging a fee. In December 2023, the city adopted an updated fee schedule with the amount the city planned to charge for specific services.

HIGH-RISK AREA #3
Financial Decisions Based on Insufficient Analyses

Status: We conclude that West Covina has fully addressed this risk area. The city has improved its processes for providing financial information to its city council and has developed long-range financial forecasts.

In our December 2020 audit, we noted that West Covina did not always provide complete information to the city council when it requested approval for budgetary or organizational changes. For example, we noted an instance in which the city council approved salary increases for firefighters based on the city fire chief's assertion that the increases would save money in the long term, but the fire chief did not present a documented analysis to support this assertion. We also raised concerns that West Covina lacked a process for developing financial projections of its planned expenditures and anticipated revenue for the following years.

West Covina has taken steps to ensure that it considers the financial impact of its decisions. The city has developed a financial evaluation template that provides a guide for evaluating both the short and long-term impacts of major revenue and expenditure decisions, and it has incorporated the template into its city council proposals for agenda actions. Further, West Covina has begun to regularly produce long-range financial forecasts. For each of its last three budgets, the city has produced a corresponding long-range financial forecast. The forecasts include projected general fund revenues and expenditures, and they identify assumptions the city used for projecting growth in its revenues and expenditures.

HIGH-RISK AREA #4
Lack of Formal Financial Recovery Plan

Status: In January 2022, we determined that West Covina had fully addressed this risk area by developing and implementing a financial recovery plan.

In our December 2020 audit, we concluded that West Covina had not developed a comprehensive financial recovery plan to improve its long-term financial health. In January 2022, we determined that West Covina had fully addressed this risk area. West Covina developed a financial recovery plan that included corrective action objectives, steps to achieve those objectives, expected completion dates for those steps, the lead and support staff responsible for accomplishing each of the steps, and the status of its progress toward accomplishing its objectives. The city's finance director has submitted updates of this plan to the city's audit committee—the members of which are a combination of city representatives and members of the general public—ensuring that the city is able to track its progress and be held accountable to its objectives by the public.

HIGH-RISK AREA #5
Inadequate Management of Purchase Cards

Status: We conclude that West Covina has fully addressed this risk area by strengthening its purchase card policy.

In our December 2020 audit, we found that West Covina had inadequately managed components of its purchase card policy. In particular, we determined that the city did not have sufficient documentation showing that managers had authorized temporary increases to the amount that individuals were allowed to charge in a single purchase card transaction. We raised concerns that the lack of documentation could be indicative of systemic issues that, if left unaddressed, could result in increased risk of excessive expenditures or potential fraud.

The city's July 2022 purchasing manual includes provisions covering employees' use of purchase cards, including the process for requesting single-transaction limit increases. We reviewed examples of completed single-transaction limit increase requests, which document the individual's current transaction limit and the temporary transaction increase amount. The examples document the duration for the temporary increase and the reason for the request. Because of its recent implementation of policies and practices, the city has addressed this risk area.

HIGH-RISK AREA #6
Lack of Oversight to Ensure That Contracts Provide Best Value

Status: We conclude that West Covina has partially addressed this risk area. The city has addressed some but not all of our concerns regarding its contracting practices.

In our December 2020 audit, we found that West Covina had violated its competitive bidding requirements by contracting with a consulting firm because of a recommendation from the human resources director rather than comparing bids. We also raised concerns about repeated amendments the city had made to a waste collection contract. That contract provided to the city annual recurring payments of $300,000 from the waste collection company. It also included terms that we determined may not be in the best interest of the city or its residents, such as the contract's built-in extensions that annually reset the period of the agreement to 25 years. To address this risk area, we recommended that the city adopt policies clarifying when contract amendments are appropriate, adopt a policy requiring the city to document its rationale for contract periods longer than five years, and negotiate with the waste collection vendor for more favorable terms.

In response to our recommendations, the city has established policies clarifying the appropriate use of contract amendments. In particular, West Covina's June 2022 update to its ordinances identifies circumstances under which the city manager may amend purchase orders or contracts. However, according to its finance director, West Covina has not amended its contracting policies to include a requirement that city management document reasons for entering into any contract or extension with a duration in excess of five years. The finance director stated that, by July 2025, the city will develop such a policy. Finally, the finance director stated that West Covina has not taken steps to address issues we identified related to the questionable terms in the waste collection contract. She indicated that the city's commercial and residential rates under the contract were in line with rates from surrounding cities, as the city noted in a February 2022 staff report to the city council, and that it was in the city's best interest to keep the terms of the contract in order to maintain the annual recurring payments that the city receives from its waste collection provider. City staff presented a similar analysis to the city council again in May 2023 as part of ongoing negotiations with its waste collection vendor about a contract amendment. In light of its regular comparison to the waste collection rates paid by surrounding cities, we are no longer concerned about this element of this risk area.

We conducted this audit in accordance with generally accepted government auditing standards and under the authority vested in the California State Auditor by Government Code section 8543 et seq. 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 the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

GRANT PARKS
California State Auditor

December 19, 2024

Staff: Bob Harris, Audit Principal
Ralph M. Flynn, Senior Auditor
Richard Power, MBA, MPP
Savanna Rowe

Legal Counsel: Richard B. Weisberg

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Appendix

Scope and Methodology

Government Code section 8546.10(e) requires that the California State Auditor issue a report on high-risk local government entities every three years, unless we have removed them from the high-risk program. For this audit, we reviewed the cities of Blythe, El Cerrito, Lindsay, Lynwood, Montebello, San Gabriel, and West Covina. Our prior audits of these cities identified areas of high risk related to the cities' financial condition, financial stability, and oversight of city contracts, among other issues. The table lists the resulting audit objective and related procedures that address these high-risk areas. Unless otherwise stated in the table or elsewhere in the report, statements and conclusions about items selected for review should not be projected to the population.

Audit Objective and the Methods Used to Address It

	AUDIT OBJECTIVE	METHOD
1	Evaluate the cities of Blythe, El Cerrito, Lindsay, Lynwood, Montebello, San Gabriel, and West Covina to determine the extent to which each city has addressed prior audit recommendations, assess trends in the city's financial condition, and determine whether we should continue to designate any of these cities as high-risk local government agencies.	• Evaluated each city's progress toward addressing the risk areas we identified in our prior audits and the recommendations associated with those risk areas. The analysis of the cities' efforts to address these risk areas and recommendations included a review of the specific documentation relevant to each risk area and recommendation. These steps included a review of city policies and procedures, tracking spreadsheets, budgets and financial information, contracts and contract management practices, among other information and documents as we describe in more specific detail throughout this report. • Interviewed city officials and staff to inquire about specific actions taken to address the risk areas and recommendations. To the extent possible, substantiated assertions by analyzing the documentation and information referenced above. • Reviewed the cities' audited financial statements to determine and assess trends in their financial conditions, including their general fund balances, revenues and expenditures, and, when relevant, other major fund balances. At the time of our audit, the most recently available audited financial statements for each city were for fiscal year 2022–23. • Determined whether the cities had taken satisfactory corrective action in addressing their areas of high risk and concluded whether we should remove their high-risk designation. We drew our conclusions about each city's high-risk status from our assessment of the unique circumstances at each city and the relative importance of the high-risk areas that we identified during previous audits. We did not make our determinations based on a formula or standard number of high-risk areas that the cities needed to have demonstrated progress in addressing.

Source: Audit workpapers.

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THE CITY OF EL CERRITO
CITY MANAGER'S OFFICE

November 22, 2024

Grant Parks
California State Auditor
621 Capitol Mall, STE 1200
Sacramento, CA 95814

Dear State Auditor Parks:

The City of El Cerrito has reviewed the Draft Audit Report for Audit 2024-801, which is a follow-up to the original Audit Report 2020-803 issued to the City in March 2021. The City is pleased that the California State Auditor's office is removing the City of El Cerrito from the Local High Risk Program.

As your report stated, the City has made significant progress in addressing the identified risk areas, and we are committed to ensuring that the City continues to maintain fiscal discipline to sustain our financial health, particularly in the area of ongoing costs. We are resolved to continue to right-size the budget and consider additional strategies to ensure our long-term sustainability, including conducting a cost allocation and fee study and a service delivery study as indicated in the Audit Report. Engaging these studies will allow the City to objectively look at operational protocols and streamline processes while ensuring that services are equitable and costs are effectively recovered, and confirm that these risk areas remain addressed.

The City is extremely proud of our accomplishments that have addressed the identified risk areas and beyond. The remarkable turnaround in the City's financial position, completion of all the recommendations in the report, and removal from the Local High Risk Program in just three years is the result of a great deal of hard work on the part of the City Council, City staff, and community. We want to thank the State Auditor team and appreciate the opportunity that the audit and the Local High Risk Program presented the City to enhance and improve our policies and procedures and address our structural financial issues, which has ensured the City's fiscal sustainability and provides a bright future for El Cerrito.

Please feel free to contact me should you have any questions.

Respectfully,

Karen E. Pinkos

Karen E. Pinkos, ICMA-CM
City Manager
City of El Cerrito

cc: El Cerrito City Council

Lindsay All-America City

City of Lindsay

Opportunity Zone

P.O. Box 369 - Lindsay, California 93247 - 251 Honolulu Street

November 25, 2024

Grant Parks, State Auditor
State of California Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Subject: 2024-801- City of Lindsay Audit Report Findings Response

HIGH-RISK AREA #1

- City staff agree with this finding and are actively working to reduce expenditure by eliminating non-essential spending, while ensuring essential services are maintained. They are prioritizing needs, implementing a purchase order system for better oversight, and ensuring all purchases are vetted and approved prior to being made.

HIGH-RISK AREA #2

- City staff agree with this finding and secured City Council approval for the feasibility study conducted in 2022, further adopting the rate increases recommended within that study taking effect January 1, 2025. The city will no longer transfer funds exceeding the allowable rate specified in the 2022 study. Instead, the city will apply the rates outlined in the study, plus the cost-of-living adjustment (COLA) for each subsequent year and will continue monitoring these transactions to ensure compliance with Prop 218. The city is also committed to conducting regular cost reviews and completing a study every 5 years. Transfers for the current year have already been halted, and a "true up" will occur at year-end to ensure no over-transfers of funds.

HIGH-RISK AREA #3

- City staff agree that this issue has been resolved and will continue to develop plans for all funding sources as necessary.

HIGH-RISK AREA #4

- City staff agree with this finding and are confident that our water and sewer funds will be self-sustaining once they are implemented on January 1, 2025, as the rates have not increased in over 20 years. We anticipate a positive net result after the first year of implementation.

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Additionally, the city is actively working on the wellness enterprise account by reducing costs while seeking to increase revenues and membership.

HIGH-RISE AREA #5

- City staff acknowledge this finding and are actively working to enhance financial systems that can track and generate real-time data reports, enabling more informed decision making. Internal controls have been lacking for quite some time, but the new administration is addressing all aspects of this area. The city is in the process of centralizing accounts payable and receivable functions to improve financial oversight. Additionally, a purchase order system is being implemented, which will require approval before purchases are made and will limit credit card usage.

HIGH-RISK AREA #6

- City staff agree with this finding and will implement an MYP budget during interim reporting, year-end reporting, and budget adoption. The MYP will include forecasts for the current year and the next two years, along with projections for two additional years based on the status quo of the second subsequent year.

HIGH-RISK AREA #7

- The city agrees that this needs to be reviewed and will explore options to prefund the ongoing retirement costs.

HIGH-RISK AREA #8

- City staff confirm that this issue has been resolved and will continue the implementation of our plans to secure funding for a vehicle replacement program.

Sincerely,

Lacy Meneses
Director of Finance

City Manager's Office
Raul Alvarez City Manager

MONTEBELLO

November 25, 2024

Auditor of the State of California
ATTN: Grant Parks, California State Auditor*
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Dear Mr. Parks:

The City of Montebello appreciates the opportunity to work with your office to showcase the significant positive progress the City has made since your office published its first audit in 2018. The City takes the recommendations from the State Auditor seriously and has worked to implement them in order to respond fully to the 2018 and 2021 audit reports. Moreover, Report 2024-801 highlights this progress by noting seven high-risk areas have been fully or partially addressed. This progress is a testament to the City's commitment to improve internal controls and its overall financial status. 1

The City is pleased with the progress it has made since 2021 to resolve State Auditor recommendations. The City has fully addressed four areas of concern and has made significant progress in partially addressing two additional areas. We fully anticipate fully addressing these two areas by the conclusion of Fiscal Year 2024-25, if not sooner.

The City is committed to the path of improvement and recognizes there is concurrence with your office on recommendations contained in Report 2024-801. However, the City does dispute certain statements and representations of facts contained in this report. The following pages present our response to Report 2024-801.

"Despite Progress in Some Areas, Montebello's Financial Stability Remains Uncertain"
High Risk Area #1 – Declining Financial Situation

The City of Montebello has made tremendous, positive strides in addressing various State Audit areas of concern from the 2018 and 2021 audits – especially its financial situation. It takes effort to transform an organization the size and complexity of Montebello. Addressing the City's financial situation is a complex task that requires commitment across the entire organization to address.

This commitment began with implementing a formal budget development and adoption process, as well as introducing quarterly budget reviews. Moreover, a five-year budget development strategic plan was developed in an effort to address areas of financial

* California State Auditor's comments begin on page 77.

concern. It is important to note that over the past five years, management has had to address significant equipment, staffing and infrastructure needs that suffered from years of neglect: lack of sufficient staff across all departments, the need to adjust salaries and benefits to provide competitive wages to retain and attract the best and brightest, deferred maintenance of facilities, deteriorating equipment, outdated and unsafe vehicles, the list goes on.

If Montebello is to prosper and achieve financial stability, it is first necessary to invest in the organization. These investments in human and infrastructure capital come at a cost – but they are necessary investments in the organization. These investments have improved infrastructure by repairing streets and other City assets. The investments in human capital have allowed Montebello to add key personnel in public safety, economic development, code enforcement, street maintenance, community services, etc. These areas in turn provide the City with resources to beautify the City, attract new businesses, provide community services to residents, and to implement the essential programs needed and desired by both residents and businesses.

In reviewing Montebello's financial standing it is imperative to understand the necessity of expending resources in order to provide the City with the ability to achieve financial stability. It is also important to remember the City dealt with the social and economic impacts of the global pandemic. Montebello made a conscious choice to not reduce services or staffing during the pandemic – choosing instead to maintain service levels even if that meant utilizing reserves while revenue declined.

Management remains focused on its bottom line and achieving a lasting balance between ongoing revenues and expenditures is a fundamental goal. To that end, it is important to note some of the many positive improvements to General Fund revenue in the past four years which will ultimately resolve this high-risk area.

The passage of Measure H in March 2020 – a ¾ cent transaction and use tax – has provided $37.144 million in General Fund revenue between Fiscal Years 2020-21 and 2023-24, with a projected $10.250 million for FY 2024-25. As discussed above, this additional General Fund revenue has been used to make necessary investments in equipment, staffing, infrastructure, programs, and services.

2 Furthermore, the development of Metro Heights – a 1,200-unit residential development – has begun to provide additional property tax to the General Fund. Fiscal Year 2023-24

saw the first notable impacts to General Fund revenue from this housing development. The current fiscal year includes increased property tax revenue, fueled by Metro Heights as well as various other developments throughout the City. Metro Heights will generate additional economic benefits beyond increased General Fund revenue, as retail operators seek out Montebello as a desirable place to do business as new housing is added and new residents call Montebello home.

The recent approval of a General Plan update and Housing Element will further Montebello's ability to drive new development throughout the City in coming years. New housing and retail development will improve the City's sales and property tax bases, improving General Fund revenue performance for generations to come.

This context is important in order to better understand and appreciate the continuing efforts management is undertaking to ensure current and future financial stability. Measure H and new real estate development throughout the City have provided much needed resources for the City to continue improving its services. Granted, as noted in Report 2024-801, FY 2019-20 saw a use of General Fund reserves as expenditures out-paced revenues. But this "pandemic year" was an anomaly, and the City prides itself on having maintained services during this difficult time. With a precipitous drop in sales tax revenue in FY 2019-20, expenditures did exceed revenues – but City services were not negatively impacted.

Fiscal Year 2019-20 requires an "asterisk" when comparing ongoing revenue vs. ongoing expenditures. General Fund revenue dropped 12.0% from FY 2018-19 to FY 2019-20. The deleterious and lasting impacts of the pandemic on the City's General Fund revenue should not be overlooked.

Despite the negative impacts the pandemic had on the local economy, General Fund reserves increased to $28.468 million as of June 30, 2023. The point of reserves is to have funding for a "rainy day." The City did not have City Council adopted reserve policies until June 2020. It was not until FY 2022-23 that the City could begin implementing these policies – due to having total General Fund reserves of $28.468 million. The City (as of June 30, 2023) has commitments for "economic uncertainties" and "unfunded liabilities" as well as an assignment for "capital improvement."

The State Auditor should be applauding Montebello for having GASB 54 compliant reserve policies and implementing them as of June 30, 2023. Instead, Report 2024-801 3 appears to penalize the City for how its General Fund reserves grew.

3 The 2018 State Auditor report recommended the sale of the City's water system. Following through on this recommendation, the sale was completed in February 2023. The City realized $16.2 million in one-time General Fund revenue. It seems unfair that Report 2024-801 acknowledges the water system sale as a State Auditor recommendation, but then dismisses its positive impact on General Fund reserves.

4 Furthermore, Report 2024-801 does not provide necessary analysis of the many one-time expenditures that have occurred in the past three fiscal years. These one-time expenditures are above and beyond the necessary investments in infrastructure and human capital noted above. Unfortunately, the City has had to pay out several large dollar legal settlements – which are paid by utilizing General Fund resources. There was no way to anticipate these settlement payments nor forecast their final impact on the General Fund. Had Report 2024-801 taken the time to better explore General Fund expenditures over the last three fiscal years, a more accurate picture of ongoing expenditures would have been presented by removing multi-million-dollar settlement agreement payments. These types of settlement payments are not uncommon to many municipalities, but with the direction and proper attention to these issues by the City's new management team, these circumstances should be reduced, if not eliminate such impacts and payments in the future.

2 The report also discusses the three-year financial forecast provided in the FY 2024-25 adopted budget book. While that initial financial forecast does project deficits in FY 2025-26 and beyond, it does not include anticipated revenue from current and pending retail operations. The report does state this fact, and the summary of feedback provided by staff is accurate. However, it is important to reflect on the recent changes discussed in the opening paragraphs above: a new source of sales tax that will exceed $10 million annually in FY 2024-25 coupled with additional property tax from Metro Heights and other new retail operations in the City.

The financial forecast model presented in the FY 2024-25 budget will be updated when new information is available from two new significant sales tax producing operations contributing revenue in FY 2024-25. Furthermore, that financial forecast model will be used to guide future budget discussions with management and City Council. The goal will be to utilize the forecast model as part of annual budget development, and to adjust expenditures as necessary to match on-going revenue forecasts.

Recommendation

Management feels strongly that this high-risk area would have been at least "partially addressed" had this report included additional analysis on one-time General Fund expenditures, as well as more fully recognized the impact the pandemic had on revenue. A more in-depth analysis by the State Auditor would have produced a more accurate assessment of the City's overall financial status. Furthermore, the City's General Fund reserves, at their highest amount in over ten years – regardless of how that was achieved – is a remarkable and positive achievement deserving of acknowledgment in this report. 5

Regardless, Management does agree that the recommendation made in Report 2024-801 to address this risk area is reasonable: "*To ensure that the city is able to sustain its general fund without relying on one-time events, Montebello should adopt a financial plan with specific strategies to reduces its expenses and build and maintain its revenue.*"

Management is committed to right-sizing the organization. Utilizing and fully implementing the already developed financial forecast model tool will allow the City to satisfy this recommendation. Management is confident that the combination of improved General Fund revenue and use of the financial forecast model in budget development will help the City achieve lasting financial stability.

High-Risk Area #5 – Did Not Follow Competitive Bidding Process

This high-risk area is listed as "partially addressed" in Report 2024-801. The State Auditor notes that the City's municipal code was updated in January 2023 to address when exceptions to the procurement process exist. Moreover, the report cites examples of how these exceptions are presented to the City Council in agenda reports. Staff have endeavored to be transparent in all areas of procurement and noting when exceptions to the standard procurement process are recommended is just one of myriad improvements made to the purchasing process over the past four years.

Report 2024-801 notes that a specific policy should be adopted that addresses agreements without maximum values. While agreements with no maximum values are rare, there are instances when approval of such an agreement is necessary. For example, there are some services where a vendor is paid based on a percentage of revenue collected (e.g., building plan check services). Staff will work to draft and implement a policy which addresses agreements without a maximum (i.e., "not-to-exceed") value and how they are presented for approval.

This high-risk area also addressed the need for purchasing training for City staff. The City has made tremendous, positive strides in providing training to staff involved in the purchasing process. Both the frequency and quality of this training have improved since 2021. Finance Department staff take the lead on preparing and presenting purchasing training to all department staff involved in any aspect of procurement. Not only are general trainings held, but Finance staff have conducted department specific trainings where needed and/or requested.

We feel the current method of tracking attendance at training is sufficient – requiring attendees to sign-in and then saving copies of the attendance sheets on an internal drive. However, the City is open to improving attendance tracking and will implement an electronic database to ensure all staff required (per policy) to attend training actually do attend training, as Report 2024-801 recommends.

High-Risk Area #7 – Made Gifts of Public Funds

6 The City has maintained its disagreement with the specific incident upon which this finding from 2021 was based. While the City disagrees that the provision of gift cards and coffee mugs – in-lieu of a citywide holiday party – was a "gift of public funds," it does agree that regular ethics training is a positive recommendation that should be implemented.

It must be noted that this particular recommendation would have been implemented had the State Auditor been more forthcoming with the exact type of training required. The original recommendation included in the 2021 report recommended legal and ethics
7 training *"from an entity that is independent from and not affiliated with the city or the city council, such as from the Attorney General's Office or the District Attorney's office…"* Staff worked with State Auditor staff throughout 2022 and 2023 to identify a training that would satisfy this specific recommendation. However, the City was not provided direction or recommendations for training that either of these two recommended entities could – or would -- provide.

7 Report 2024-801 removes the reference to the Attorney General and District Attorney as recommended agencies from which to obtain the ethics training. Discussions with State Auditor staff during the current (2024) audit process allowed the City to pursue ethics training from a prominent employment law firm that is well-regarded in the State of California. As of the publication of Report 2024-801, Staff is working to finalize an agreement with this law firm to begin providing regular ethics training to appointed and

elected officials. Staff are confident that this recommendation will be fully addressed within six months. Aside from the previous recommendation for City staff, it should be noted that AB 1234 ethics training has been completed by all elected officials and City Directors.

Conclusion
The City remains committed improving all facets of its operations. Furthermore, we are proud of the significant progress made across all "high-risk" areas noted in the 2018 and 2021 reports. Montebello's elected and appointed officials look forward to continuing these improvements and will provide the necessary updates as required by the State Auditor – as included in a forthcoming corrective action plan.

Once again, the City of Montebello thanks the Office of the State Auditor for your careful review and consideration to the comments provided in this letter. The undersigned are proud of the great strides achieved by the City since the last review, and we look forward to the continued cooperation and collaboration with your Office.

Sincerely,

Raul Alvarez
City Manager
City of Montebello

Michael Solorza
Director of Finance
City of Montebello

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Comments

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

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

Montebello misstates the number of risk areas that we determined it has fully or partially addressed. As page 47 shows, we determined that the city fully addressed four high-risk areas, partially addressed two other high-risk areas, and the city's progress in addressing another risk area is pending. ①

The city's response cites various factors, such as increases in sales tax and property tax revenue, occurring during a period that audited financial statements were not available at the time we conducted our audit. We look forward to reviewing information from these financial statements, when available, that Montebello can use to demonstrate its progress in addressing its risk areas. ②

The city's response refers to criteria that is not relevant to our audit's findings. Our analysis of the city's reserve was primarily accomplished by considering two factors: the relative size of the reserve and the means by which the city built its reserve. Governmental Accounting Standards Board Statement Number 54 does not establish criteria for assessing either of these factors. Further, the city incorrectly states that our report appears to penalize the city for the way it grew its reserves. On page 48, we report our concern that the city primarily relied on one-time revenue to grow its general fund reserves. That condition is similar to the condition we found during our 2018 audit. Relying on one-time revenue to build or maintain a general fund reserve is an unsustainable approach. As we state on page 48, the city will not be in a sustainable financial position unless it is able to avoid consistent deficits in its general fund. Moreover, we disagree with Montebello's characterization of how we describe the sale of its water system. On page 48, we recognize the positive impact that the sale had on the city's general fund reserves by reporting that the city's reserve grew by nearly $15 million between fiscal years 2021–22 and 2022–23, an increase we attribute to the sale of the water system and describe as *significant*. ③

During our audit, Montebello brought these expenditures to our attention, as well as other expenditures the city stated were one-time in nature, and we determined that it would be inappropriate to exclude them from our analysis. All of these costs pertained to city operations and should be accounted for as general fund expenditures that impacted the city's financial position. The city's description of its experience with these types of expenditures underscores why it is important for Montebello to maintain a sustainably healthy level of general fund reserves to mitigate current and future financial risks. ④

5 We stand by our assessment of Montebello's progress in addressing High-Risk Area #1. The comments we made above, specifically comments 3 and 4, explain our position on the city's objections to our review of its general fund reserves and general fund expenditures. Furthermore, we acknowledge on page 47 that our 2021 audit of the city reported that the pandemic affected revenues and expenditures of the city's general fund in the fiscal years addressed by that audit. Therefore, our assessment of the city's progress in addressing its financial condition is accurate.

6 We stand by the conclusion we reported in October 2021. As that audit report states, we believe that purchases the city made to provide gift cards and mugs to its employees constituted a gift of public funds. Although the city disputed our conclusion and stated that these purchases were not violations of the law, no evidence the city presented convinced us that we were incorrect in our conclusion.

7 Montebello inaccurately characterizes our office's involvement and role in its effort to implement a recommendation from the 2021 audit. First, the city implies that our office was not forthcoming with information about the type of training we recommended the city obtain. To the contrary, our recommendation specifically contained this information. That recommendation states that "*To ensure the city does not make gifts of public funds, the city should … obtain for the City Council and all employees authorized to make expenditures with city funds bi-annual legal and ethics training from an entity that is independent from and not affiliated with the city or the city council, such as from the Attorney General's Office or the District Attorney's Office, regarding the appropriate use of public funds and the prohibition on using public funds to make private gifts.*"

Secondly, Montebello implies that after the 2021 audit, we did not provide it with direction about specific legal and ethics training that the Attorney General's Office or District Attorney's Office could offer to the city. To be clear, our recommendation never precluded the city from obtaining training from another source that it deemed to be independent. Moreover, we believe it would be inappropriate for our office to choose a specific training course for the city. The audit standards we are required by state law to follow specify the need to avoid management participation threats, such as the preparation of an audited entity's corrective action plan. Consequently, we believe it is not our role to make decisions about the selection of training for city staff.

Finally, Montebello mischaracterizes that it was eventually able to move forward with implementing this recommendation only after we amended the phrasing of the recommendation. Although page 54 presents a summarized version of the recommendation that we made in our 2021 report, the recommendation remained unchanged. The city was always at liberty to procure ethics training from any independent source it felt was appropriate.

November 25, 2024

Grant Parks
California State Auditor
621 Capitol Mall, Ste. 1200
Sacramento, CA 95814

Subject: 2024-801—Confidential Draft Audit Report for Review

Dear Mr. Parks:

I have reviewed the draft report regarding the City's status in the Local High-Risk Program and acknowledge that the City remains a high-risk entity due to the State Auditor's assessment that the City's approach to addressing its reserve level increases its risk for future financial instability. Further, I understand that the City must submit a corrective action plan to your office no later than 60 days after the publication of the associated audit report.

If you have any questions, please contact Finance Director Stephanie Sikkema at ssikkema@westcovina.org or (626) 939-8463.

Sincerely,

Paulina Morales
City Manager

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