



CITY OF MONTEBELLO CORRECTIVE ACTION PLAN

January 2019

AUDIT ISSUE:**Enterprise funds and long term obligations pose a significant financial risk to the City.****Identified Risk Factor(s):**

Municipal Golf Course's increasing debt to the City's general fund

- The City's general fund has contributed more than \$6 million to the golf course fund to cover operating losses since fiscal year 2010-11.

Auditor Recommendation:

To repay the golf fund's debt and reduce the City's structural deficit, Montebello should immediately make a decision on implementing the golf consultant's recommendations. By December 2019, the City should also evaluate the effectiveness of its current plans and consider alternate uses for the golf course property.

City's Response:

The City agrees to consider the recommendation.

The City has already taken steps to reduce the operating deficit through the construction and use of reclaimed water.

The City Golf Course Commission has completed their review and staff will present the recommendations of the consultant along with the Golf Commission to City Council shortly.

The City's ability to consider alternate uses is limited and restricted by covenants and other legal and political obligations. The City has evaluated alternate uses in the past which has resulted in strong community opposition. Simply stated, the residents of Montebello and those from surrounding communities that use this facility truly enjoy the recreational benefit of the Golf Course.

Action Plan:

The City will present the consultant's recommendations to City Council and evaluate other alternatives to enhance Golf Course revenues.

The Public Works Director will be responsible for implementation.

Timing:

By January 2019, the City will present the final report of the golf consultant, which was reviewed by the City's Golf Commission, to the City Council.

By December 2019, the City will continue to evaluate the Golf Course operations and discuss alternate uses.

Identified Risk Factor(s)

Unless Montebello sells its water system or secures alternative financing, necessary improvements could burden the City's general fund in the future.

- In a 2017 water system inspection, a consultant identified nearly \$1.6 million in urgent repairs.
- Apart from the urgent repairs needed, the City has not addressed nearly \$50 million in longstanding capital improvements needed for the City's water system.

Auditor Recommendation:

To address the long-term needs of its water system, Montebello should, by March 2019, reevaluate selling its water system in light of recent legislation or retain a consultant to assist the City in applying for state loans and identifying other options for funding capital improvements.

City's Response:

In an effort to address this ongoing issue, the City Council placed an initiative for the sale of the water system in 2016 in the form of a ballot measure. When presented to the community, seeking approval for the sale the City's water system, it was narrowly rejected by the voters.

Recent legislation now allows the sale of the water system without voter approval. City staff will revisit this issue with the new City Council and review alternative solutions to address the risks identified by the State Auditors.

The City is addressing the immediate capital needs through a rate study and intends to report to City Council in the next 90 days.

In addition to exploring State loans, the City will also pursue State and Federal grant opportunities for capital improvements and other available options.

Action Plan:

The City will revisit the possible sale or lease of the Water System.

The City will develop a five-year capital improvement and financing plan.

The City will also pursue State and Federal grant opportunities.

The Public Works Director will be responsible for implementation.

Timing:

By March 2019, the City will revisit the sale or lease of the Water System. Depending on direction given by City Council, the City will initiate actions to address the water system. By June 2019, the City will develop a five-year capital improvement and financing plan.

Identified Risk Factor(s):

Retirement costs could burden the City's finances in future years.

- Because of past unfunded retiree pension and ongoing health benefit obligations, City leadership faces higher annual retirement expenses.
- The City's unfunded pension liability has increased to nearly \$136 million, while its unfunded retiree health benefit obligation reached nearly \$11 million in June 2017.

Auditor Recommendation:

To address higher retirement costs and obligations for retiree health benefits, Montebello should, by June 2019, identify and retain a consultant to help it identify ways to reduce the financial risks that such obligations pose.

To address increasing retirement payments, the City should consider ceasing payments of the employee portion of retirement costs for employees hired before July 2013. It should renegotiate this payment the next time it renews contracts with its employees.

City's Response:

It is important to note that CALPERS' actions have a direct implication on the City's finances which are not in the control of the City of Montebello and other public agencies. For example, CALPERS has adjusted its discount rate on 5 separate occasions since 2003, causing the unfunded liability to jump from \$89 million to \$136 million dollars.

The City pays the amortized unfunded liability as fully amortized as required by CALPERS. These payments are sufficient to cover all of the City's unfunded pension obligations as scheduled, by 2048.

The City will evaluate the impacts of ceasing payments of the employer's portions of retirement costs. The City needs to evaluate this recommendation as a part of the Auditor's recommendation to review the competitiveness of our salaries.

Action Plan:

The City will hire a consultant to identify ways to mitigate the financial risks that such liabilities and obligations pose.

The Finance Administrator will be responsible for implementation.

Timing: By June 2019.

AUDIT ISSUE:**Montebello's hotels pose an ongoing risk to the City's general fund.****Identified Risk Factor(s):**

Hotel bonds could impair the City's general fund.

- The general fund is at risk of covering significant amount of hotel bond payments should the City's hotels fail to generate sufficient revenue.
- If hotel revenues fall short of expenses for multiple fiscal years, in order to avoid default, the City's general fund would be responsible for up to \$1.1 million for the first hotel and \$3.6 million for the second hotel annually in hotel bond payments.

Auditor Recommendation:

To ensure that Montebello does not expose its general fund to additional financial risk, the City should refrain from taking on additional debt in the form of certificates of participation and lease revenue bonds until the City's financial situation improves.

City's Response:

The City has no plan to incur additional debt through Certificate of Participation or Lease Revenue Bonds.

The investment risk factors and remedies are fully disclosed in the bond official statements. The risks are not extraordinary, but typical for investments of this nature and not unique to the City of Montebello. There is no indication that the hotel revenues will fall short of its expenses.

Per our discussion with the State Auditors' office, the recommendations apply to more speculative investments as opposed to other debt to finance infrastructure improvements.

Action Plan:

The City will retain a consultant to evaluate operational efficiency and provide guidance on managing the assets.

The City will meet with the Hotel Operator on a regular basis to monitor performance and to address hotel operational efficiency.

The Finance Administrator and the City Manager will be responsible for implementation.

Timing: By June 2019.

Identified Risk Factor(s):

Mismanagement of hotel revenues has cost Montebello at least \$1.6 million.

- The City failed to pay for the first hotel's management fees, even when revenue was available, and accrued \$2 million in interest costs by the end of fiscal year 2016-17.

Auditor Recommendation:

To ensure the City does not accumulate additional interest expenses, the City should pay off the remaining accrued interest for late management fees by the end of 2019, as planned. To avoid paying interest on future hotel management fees and to ensure all hotel obligations are paid on time, the City should immediately develop a formal process that requires the City to pay all outstanding bills related to the hotel if hotel revenues are available.

City Response:

In 2015, the City made payments from the Hotel Revenue Fund to the hotel management company. In making these payments, the City did not utilize any General Fund or Reserve Fund balances. All payments came from revenues generated by the hotel operations.

As the State Auditors are aware, the City is reviewing the calculation of accrued interest as presented by a previous consultant who no longer works for the City. The City's internal analysis and an independent review of the previous consultant's report reveal the accrued interest may be significantly less.

Action Plan:

The City will finish its evaluation of interest calculation and develop a formal policy to keep payments current going forward.

The Finance Administrator will be responsible for implementation.

Timing:

January 2019

Identified Risk Factor(s):

The City has not ensured it receives best value from its agreements with the Hotel Operator.

- The City's agreements with the Hotel Operator favor the operator's financial interests while the City assumes the significant financial risk.
- Without having followed a competitive bid process for a Hotel Operator, the City cannot be sure that this was the best deal to maximize the potential revenue from the hotel that it might receive to its General Fund.

Auditor Recommendation:

To ensure that the City safeguards its interests in various agreements, and to ensure the Hotel Operator meets the requirements in those agreements, related to hotel and event center operations, beginning in January 2019, the City should begin to routinely review information submitted to the City by the Hotel Operator. At least annually, City staff should report to the City Council and the public on the efficiency and effectiveness of hotel operations.

City Response:

Before the City developed the first hotel in 2001, the site was blighted and under-utilized. The City economic vision took undeveloped property and created a resort environment with two hotels to augment the Golf course and convention-center style operations. While these decisions carried certain risks, they also provided potential for long-term social and economic rewards for the community. In addition, the City receives ancillary benefits from the synergy created by hotel customers and their influx of dollars to surrounding businesses. These projects also created jobs and other economic stimulus for local residents and businesses.

We agree with the recommendation to report to the City Council and the public on the efficiency and effectiveness of the hotel operations.

The City intends to analyze and compare the hotel's budgets with the financial assumptions within the bond documents.

Action Plan:

Complete a financial analysis (January 2019).

The City will retain a consultant to evaluate operational efficiency and provide guidance on managing the assets (June 2019).

The Finance Administrator and the City Manager will be responsible for implementation.

Timing:

By January 2019 & by June 2019.

AUDIT ISSUE:

Poor contracting practices and unresolved staffing needs hinder the City's ability to provide services to its residents.

Identified Risk Factor(s):

Monitoring of the City Manager's contracting activities.

- The City Manager, who is currently on leave, approved work above the authorization limit.

Auditor Recommendation:

To monitor the contracting activities of its City Manager, the City Council should do the following:

- Ensure by March 2019 that the municipal code reflects the council's desired limit on the City Manager's contracting authority.
- By March 2019, establish a quarterly limit on the City Manager's contracting authority, pursuant to the Council's resolution, or modify the resolution to eliminate the provision.

To ensure the City Council reviews and approves contracts that exceed the City Manager's authority, the City should establish a policy by March 2019 that any agreement to pay for services by unit – such as hourly – should contain a maximum value and receive appropriate approvals based on that value.

To reduce confusion among City staff and facilitate efficient procurement, City staff should bring its proposals for streamlining and updating the City's procurement policies to the City Council for review by March 2019.

City's Response:

The City agrees with the recommendation.

Most City contracts already provide for maximum limits to the contract. We will review those few exceptions and recommend controls moving forward.

Action Plan:

The City will begin the process of amending municipal code to reflect the City Council's desired limit on the City Manager's contracting authority.

The City will establish or eliminate a quarterly limit on the City Manager's contracting authority, pursuant to the City Council's resolution.

The City will establish a formal policy to ensure all contracts specify a maximum contract limit or provide for alternate controls.

City staff will present proposals for streamlining and updating the City's procurement policies to the City Council for review.

The Finance Administrator and the City Manager will be responsible for implementation.

Timing:

Initiate by March 2019.

Identified Risk Factor(s):

Competitive bidding processes were not always followed and the City has not adequately ensured that it receives the best value for services.

- Montebello entered into 10 of the 16 agreements reviewed without competition.
- Although it is best practice, the City's municipal code does not require competitive bidding for services.

Auditor Recommendation:

To ensure Montebello obtains the best value from the services it receives, the following should occur:

- City staff should immediately begin to follow all recommendations in the City's municipal code related to procuring goods and services. Should the City have a valid reason for deviating from these recommendations for a specific procurement, it should document such rationale in its procurement files.
- The City Council should amend its municipal code by March 2019 to require competitive bidding for most procurements and to outline procedures for, and identify circumstances in which, the City may procure professional and special services from a single source.
- The City should develop a policy by June 2019 that describes how it will comply with state law regarding future architectural and engineering contracts, including how it will ensure that it awards such contracts pursuant to a fair and competitive process.
- By March 2019 – and annually thereafter – the City should train all staff involved in procurement regarding City procurement requirements as well as State law pertaining to certain public procurements.
- Establish a policy by March 2019 that requires the City Council to review and approve any agreement that binds the City financially in a way that cannot have a maximum value attached – such as the franchise agreement for the second hotel.

City Response:

The City was already making improvements to its procurement practices and recognizes that further improvements are needed. The City agrees with the recommendations.

Action Plan:

1. City staff will follow the City's municipal code related to procuring goods and services and justify and document any deviations.
2. City staff will present to the City Council proposals for streamlining and updating the City's policies and municipal code, including procurement of professional and special services from a single source, compliance with state law regarding architectural and engineering contracts, and ensure the City Council reviews and approves any agreement that binds the City financially and does not have a maximum value attached.
3. The City will increase training of staff especially in the area of procurement and regulations.

The Finance Administrator will be responsible for implementation.

Timing:

Initiate by January 2019.

Identified Risk Factor(s):

The City has not addressed some of the deficiencies identified by the State Controller.

- When the status of 21 recommendations the State Controller made to improve Montebello's control over its activities were reviewed, City officials could only provide information demonstrating that it addressed 12.

Auditor Recommendations:

To reduce the risk of fraud, waste, and abuse, Montebello should, by December 2019, address all of the State Controller's recommendations regarding its accounting practices, policies, and procedures. Beginning in March 2019, the City Manager or a designated staff member should report quarterly to the City Council on the progress of addressing the State Controller's recommendations. The report should identify timelines for addressing each recommendation, outline the specific steps taken to respond to the recommendation, and name staff responsible for any new processes or controls put in place.

City Response:

The City had corrected its practices but did not document a formal policy and procedure for 4 of the remaining 9 State Controller recommendations. Those 4 items were the timely year end closing of the financial statements, the timely adoption of the City's budget, restricted computer access for human resources and payroll activities, and proper reporting of compensation as required by the IRS.

Action Plan:

The City will address the remaining 5 items from the 2011 State Controller's report, and formally document the other 4 items.

Staff will report quarterly to the City Council on the progress of completing these items.

The Finance Administrator and City Manager will responsible for implementation.

Timing:

By December 2019.

Identified Risk Factor(s):

Poor control over petty cash and lack of credit card policies and procedures could lead to fraud.

- In review of the City's latest petty cash transactions, multiple instances were found in which City staff circumvented the \$100 limit by splitting purchases into multiple receipts.
- Lack of documented policies and procedures has enabled staff to use City credit cards without following proper purchasing protocols.
- Upon review of 20 of the City's credit card transactions greater than \$500 from fiscal year 2017-18, it was found that the City did not follow its purchasing procedures for any of the 20 payments.

Auditor Recommendations:

To protect against fraud and abuse, by March 2019, Montebello should establish an official petty cash policy which includes reimbursement limits and prohibits splitting purchases to circumvent the City's established reimbursement limits.

By March 2019, Montebello should establish an official credit card policy that aligns with best practices from the Government Financial Officers Association.

City Response:

The petty cash and credit card transactions addressed by the State Auditors were for legitimate City purchases.

The City agrees with the recommendations to formalize the policies.

Action Plan:

The City will establish a formal petty cash policy and credit card policy.

The Finance Administrator will be responsible for implementation.

Timing:

By March 2019.

Identified Risk Factor(s):

Lack of consistent leadership and competitive salaries have reduced the effectiveness of the City's departments.

- The turnover in key positions has reduced organizational stability, affected the ability of City employees to understand past practices and protocols, and created a lack of institutional knowledge.
- Until the City can resolve the circumstances regarding the City Manager, the City will not have a permanent City Manager providing ongoing leadership.

Auditor Recommendations:

To help ensure Montebello operates effectively, the City Council should, by March 2019, develop and follow through with plans to hire individuals in key positions.

To ensure consistent executive leadership, the City Council should resolve the status of its City manager on leave and, if necessary, begin recruiting a new, permanent City Manager.

To ensure that Montebello can recruit and retain qualified candidates, and to ensure that its salaries are competitive for its current staff, the City should, by December 2019, complete a salary survey and adjust salaries as necessary.

To determine the correct level and mix of positions in the City, by June 2019 city staff should present a proposal to the City Council for studying Montebello's staffing levels.

City Response:

The City of Montebello has continued to respond to the many ongoing fiscal challenges for well over a decade. The City has responded to these challenges by cutting expenses and utilizing one-time revenues. The audit also identifies other short-term revenue solutions.

In order to properly respond to the above recommendations, the City needs to identify a sustainable revenue stream to meet its ongoing obligations, support additional staff and raise salaries to a competitive level.

Action Plan:

The City Council will work toward resolving the status of the City Manager on leave.

By March 2019, the City Manager will address the hiring of individuals in key positions.

By December 2019, The City will complete a salary survey and consider salary adjustments and funding.

By June 2019, the City will initiate a study of the staffing level and mix of positions by department and present results to City Council.

The City Manager and Human Resources Department will be responsible for implementation.

Timing:

March through December 2019