January 17, 2018

TO: MEMBERS OF THE CALIFORNIA STATE LEGISLATIVE JOINT AUDIT COMMITTEE

FROM: ANDREW G. PASMANT, ACTING CITY MANAGER

SUBJECT: KEY POINTS FOR DENIAL OF STATE AUDITOR'S REQUEST TO CONDUCT A FULL AUDIT OF THE CITY OF MONTEBELLO

BACKGROUND

The California State Auditor's Office ("Auditor") has conducted a preliminary assessment of the City of Montebello ("Montebello") and circumstances surrounding recent activities both from a financial perspective and from a newspaper reporting standpoint. Representatives from the Auditor's office have informed Montebello's officials that the Auditor's office will be recommending a full audit to be approved by the Joint Audit Committee.

This summary will outline key elements and points to consider seeking the Committee's vote to DENY the request from the Auditor.

AUDITOR'S REASONS FOR SEEKING FULL AUDIT

The Auditor claims the reasons for the request for a full audit are as follows:

- Budget expenses which exceed revenues
- Montebello's growing pension burden
- Adherence to 2011 State Controller's audit findings
- Concerns over internal controls and impacts of Montebello's directive to freeze positions
- Profitability of Montebello's enterprise funds
- Bad press received from local news papers

MONTEBELLO'S RESPONSE AND ACTION TO ADDRESS CONCERNS

Budget expenses which exceed revenues:

- Montebello hired new Acting City Manager with over 30 years of experience in overseeing City operations and balancing budgets.
- Montebello is evaluating current business and development opportunities to maximize revenues.

- Major housing project was approved which will infuse $5 million in up-front revenues for upcoming budget season and long-term property tax and other revenues from future stability.
- Montebello is evaluating other one-time revenue sources to balance budget.
- Montebello has general fund reserves of $9.3 million as of June 30, 2016.

Montebello's growing pension burden:

- Montebello is not alone in the growing pension burden crisis.
- Unlike other cities in California, Montebello has a property tax override to offset public safety pension costs.

Adherence to 2011 State Controller's audit findings:

- Montebello has suffered from turnover in key management positions.
- Directive given to new Acting City Manager to find and retain experienced municipal executives to strengthen internal activities and operations.
- Montebello has followed bidding requirements in awarding City Engineer contract.
- Montebello has implemented Controller's recommendations regarding timely budget compliance.
- Many findings of the Controller are related to former Redevelopment Agency activities. These findings are now moot due to the State eliminating Redevelopment and having oversight placed in the hands of Successor Agency, Oversight Board and Department of Justice.

Concerns over internal controls and impacts of Montebello's directive to freeze positions:

- Acting City Manager has set the priority to review and update standard operating procedures and administrative policies for Finance Department which will positively impact city operations.
- Recruitment of qualified finance professional is currently underway to achieve review of fiscal and administrative controls.
- Directive to freeze positions is not absolute. The City Council has retained authority to authorize the hiring of positions on an as-needed basis and as substantiated by the Acting City Manager.
- Favorable budget impacts realized by hiring freeze.

Profitability of Montebello's enterprise funds

- Montebello attempted to sell water system to relieve the burden of operational shortfalls and long-term capital improvements. Montebello's voters rejected this solution to the water system dilemma.
- Montebello City Council approved water rate increase to generate needed revenues. Increase of 15% approved on February 2017 and additional increase of 15% implemented July 2017. Additionally, volumetric rates and meter charges were increased by 50% effective August 1, 2013 and by 25% effective July 1, 2014.

- City Council retained professional engineering firm to review and evaluate water system needs for implementation. Findings will be presented to the City Council in the near future.
- Independent financial analysis shows that the Hotel project profitability has increased which will result in projected revenues between $1.25 million to $2.58 million which will be infused into general fund.
- The Hotel operation shows a positive financial result of $668,000 after transfers out which include debt service as reported in City's 2016 CAFR (Comprehensive Annual Financial Report).
- Acting City Manager is reviewing golf course operation to evaluate operational issues and possible increase of green fee schedule.
- Operation of Montebello's jail results is cost savings in police officers time away from patrol and other public safety activities by not having to transport arrestees to County jail facilities.
- Montebello Transit operation is not running in a deficit when depreciation expense is removed from operational costs. This "book" cost is not a true cost and should not be evaluated as a cash flow impact.

Bad press received from local newspapers:

- Press reports have a negative perspective, because that's what "sells papers."
- Montebello has been burdened with the same style of reporting from local paper for years. The reporter has a negative view towards city officials.
- In order to reduce budget costs, Montebello has not filled or retained Public Information Officer or public relations firm to promote city.

WHY THE COMMITTEE SHOULD REJECT AUDITOR'S REQUEST FOR FULL AUDIT

The purpose of an audit is to provide an independent opinion to the shareholders on the truth and fairness of the organizations financial status. Montebello understands the value of statutory audits. Montebello also understands the purpose of the State Audit, which is to identify waste, fraud, mismanagement and other challenges facing the agency.

Montebello's concern to the Auditor's request is that it has been subjected to numerous audits; both annually required (independent budget review, CAFR, City's auditor reports) and imposed upon the City as presented in the State Controller's Audit of 2011, the audit report by HUD and other Federal agencies.

Through this process Montebello acknowledges:

- Montebello has and will continue to have issues for the foreseeable future
- Another Audit will only restate what Montebello knows is a problem. This will continue to exacerbate a negative city image, feed political agendas and further contribute to City's problems. Auditor's preliminary assessment and request adds nothing new and is an unnecessary expense (waste) of taxpayers' funds.

- How many times can you say the same thing? Montebello understands it has problems it needs to correct. The City has been moving forward with many of the corrections from 2011.
- Montebello has attempted to seek voter approval for the sale of the water system and an increase in the sale tax of the City. Unfortunately, the voters have rejected both measures which would have assisted the City through its financial crisis.
- Audits by their nature provide direction not necessarily realistic solutions. They fail to recognize by their nature the variables (i.e. human factors, community support) and the factors that inhibit their implementation.
- The REAL issue and challenge is how to effectively implement sustainable solutions. This is what new Acting City Manager is working on.

WHAT IS MONTEBELLO DOING?

- Montebello's City Council and management have not ignored audit recommendations, but voter action has left limited options. Montebello will focus on what we can do.
- Montebello knows it needs to update operating policies, but when there are multiple issues to address simultaneously and limited resources, the City must pick the priorities. Montebello seeks your understanding.
- Our goal is to focus on financial condition and internal controls and new manager is making this a priority.
- Montebello is currently conducting user fee updates, business license audits, and other enterprise fund evaluations. The City is conducting limited recruitment for public safety positions and will be filling critical management positions. The City Council has authorized the Acting City Manager to obtain interim finance director assistance.
- Montebello needs to pay competitive salaries, but also needs to operate within its means. New organizational models and approaches to managing and operating a city need to be considered and evaluated.
- MONTEBELLO DOES NOT NEED ANOTHER AUDIT EXERCISE TO TELL US WHAT WE KNOW.

RECOMMENDATION REQUEST

The City of Montebello respectfully requests that instead of a full audit as sought by the Auditor, that the Committee recommends ongoing monitoring of city progress using (i) the 2011 Controller audit recommendations, (ii) the Auditor's 2017 preliminary audit assessment and (iii) the City's own annual internal audits as the basis for defining a course of action over the months and years ahead. It is recommended that Montebello be placed on 6 month reviews for next two years.