



## *City of Lynwood*

Despite Taking Some Action to Improve Its Management Practices, the City Continues to Risk Financial Instability and Violations of State Law

*September 2021*

**REPORT 2021-808**





**CALIFORNIA STATE AUDITOR**

621 Capitol Mall, Suite 1200 | Sacramento | CA | 95814



**916.445.0255** | TTY 916.445.0033



For complaints of state employee misconduct,  
contact us through the **Whistleblower Hotline:**

**1.800.952.5665**

*Don't want to miss any of our reports? Subscribe to our email list at*

[auditor.ca.gov](https://auditor.ca.gov)





September 23, 2021  
**2021-808**

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

Dear Governor and Legislative Leaders:

As required by Government Code section 8546.10, subdivision (e), my office conducted a follow-up audit of the city of Lynwood (Lynwood), which we initially determined in 2018 to be at high risk under our local government high-risk program. During that initial audit, we identified numerous risk areas pertaining to Lynwood's inadequate financial management, its susceptibility to fraud and waste, and its ineffective organizational management. In this follow-up report, we conclude that Lynwood remains high risk.

Although Lynwood has taken some action to address the risk areas we identified in our 2018 audit, the city's financial stability continues to be at risk because its general fund expenditures are projected to outpace its revenue during the next two fiscal years while its financial reserves have fallen below recommended minimum balances. Despite such uncertainty about its long-term fiscal outlook, the city has not implemented monitoring procedures, such as preparing multiyear revenue and expenditure projections or providing interim budget reports to the city council at regular intervals.

Moreover, the city remains at risk of violating state law because it has been subsidizing its general fund with restricted revenue from water and sewer fees. In addition, Lynwood has neither developed a strategic plan nor undertaken other efforts that would allow the city to provide meaningful guidance to its departments on aligning resources with citywide goals and priorities. To address these concerns, we present several recommendations, which include following best practices to develop and monitor its budget, maintaining sufficient financial reserves, discontinuing its inappropriate use of water and sewer revenue, and engaging in strategic planning.

Respectfully submitted,

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

ELAINE M. HOWLE, CPA  
California State Auditor

**LOCAL HIGH RISK**

Blank page inserted for reproduction purposes only.

# HIGH RISK ISSUES—*Follow-Up Audit*

City of Lynwood, Los Angeles County

Risk Designation: **High Risk**

RISK AREA REPORTED BY THE STATE AUDITOR IN 2018	STATE AUDITOR'S ASSESSMENT OF LYNWOOD'S PROGRESS IN ADDRESSING THE RISK AREA	PAGE
<b><i>Inadequate Financial Management Hinders Lynwood's Fiscal Stability</i></b>		
<i>Ongoing budget deficits and uncertain financial future</i>	Partially addressed	3
<i>Inadequate budgeting practices</i>	Partially addressed	7
<i>Questionable salary increases</i>	Partially addressed	7
<b><i>Violations of State Law, Weak Oversight, and Policy Breaches Make Lynwood Susceptible to Fraud and Waste</i></b>		
<i>Violations of state law in the use of water and sewer funds</i>	Partially addressed	11
<i>Poor contract administration</i>	Partially addressed	16
<i>Inadequate controls over its financial operations</i>	Fully addressed	17
<b><i>Ineffective Organizational Management Diminishes Lynwood's Ability to Provide Public Services</i></b>		
<i>Lack of strategic plan</i>	Pending	19
<i>Inability to effectively measure staffing needs</i>	Pending	19
<i>Significant turnover in key positions and no plan for identifying future leadership</i>	Partially addressed	20
<b><i>Appendices</i></b>		
<i>Appendix A—Scope and Methodology</i>	23	
<i>Appendix B—The State Auditor's Local High-Risk Program</i>	25	
<b><i>Agency Response</i></b>		
<i>City of Lynwood</i>	27	

Blank page inserted for reproduction purposes only.

## Risks the City of Lynwood Faces

---

The city of Lynwood (Lynwood) continues to face several significant risks pertaining to its financial and operational management. In December 2018, the California State Auditor (State Auditor) published an audit of Lynwood (2018 audit) under the high-risk local government agency audit program. This program authorizes the State Auditor to identify local government agencies that are at high risk for potential waste, fraud, abuse, or mismanagement or that face major challenges associated with their economy, efficiency, or effectiveness. The 2018 audit identified Lynwood as high risk because of its inadequate financial and organizational management, weak oversight of financial operations, and violations of state law.

State regulations specify that an entity designated as high risk is to submit to the State Auditor a corrective action plan within 60 days after the audit report is published and formal updates every six months describing its progress in addressing the risk areas. Lynwood provided its corrective action plan in February 2019 but did not provide formal updates. In response to our subsequent inquiries, the city informed us in October 2019 of its progress addressing a few risk areas, but it has not provided any additional information since that time. State law also requires the State Auditor to issue audit reports with recommendations at least once every three years until we determine that the high-risk local government entity has sufficiently addressed the identified areas of risk. This report summarizes the results of our audit work.

In the 2018 audit, we identified nine risk areas categorized under three core themes: inadequate financial management, susceptibility to fraud and waste, and ineffective organizational management. Lynwood has since fully addressed one risk area, has partially addressed six risk areas, and has identified actions it plans to take for the remaining two risk areas. For example, the 2018 audit identified that Lynwood had numerous unresolved findings reported by its external financial auditor. Lynwood has since addressed all of these findings. Further, in response to the 2018 audit, the city implemented policies addressing several budgeting best practices and adopted a succession plan to identify and develop staff within the city who have the potential to assume key leadership positions in the future.

However, Lynwood must continue to focus on addressing the remaining risk areas. In particular, the city remains at risk of violating state law because it continues to use its water and sewer funds to make questionable lease payments to itself for the water and sewer infrastructure and to use those funds to subsidize the city's administrative overhead costs. Lynwood also has neither fully implemented nor adhered to other budgeting best practices, such as developing multiyear revenue and expenditure projections. Moreover, the city has not developed a strategic plan or undertaken other efforts that would allow it to provide meaningful guidance to its departments on aligning city resources with broader city goals and priorities for the future.

**LOCAL HIGH RISK**

To help Lynwood continue to address the risks we identified in 2018, we developed recommendations for the city to implement, including the following:

- Adopt and follow best practices for developing its budget and maintaining sufficient financial reserves.
- Ensure compliance with state law by determining the correct amount of the overhead costs incurred by the city that can be paid for with water and sewer funds.
- Formalize its goals for the future and align its planning, budget preparation, and staffing needs assessments with those goals.

***Agency's Proposed Corrective Action***

Lynwood provided its initial response to our audit report stating that it will prepare a corrective action plan to address the risks we identified. We will await delivery of the plan by November 2021 to understand and evaluate the specific actions the city intends to undertake.

# Lynwood's Financial Management Remains Inadequate

---

## Lynwood's Financial Reserves Remain Low, and the City Does Not Have Sufficient Transparency Over Its Financial Reporting

Although Lynwood's financial situation appears to have improved in certain years since our 2018 audit, we continue to be concerned about the city's reserve levels and the timing and sufficiency of the financial information it provides to the city council. In our 2018 audit, we identified that Lynwood's general fund expenditures had exceeded its general fund revenue during fiscal years 2013–14 through 2016–17, resulting in its general fund balance declining substantially during those years. During our 2018 audit, Lynwood projected that revenue would exceed expenditures in fiscal year 2018–19 by only \$100,000, meaning that the city would have had only a narrow margin of available funding for addressing unexpected costs before having to further deplete its general fund reserves. We recommended that Lynwood identify specific approaches for monitoring and managing its general fund's financial condition.

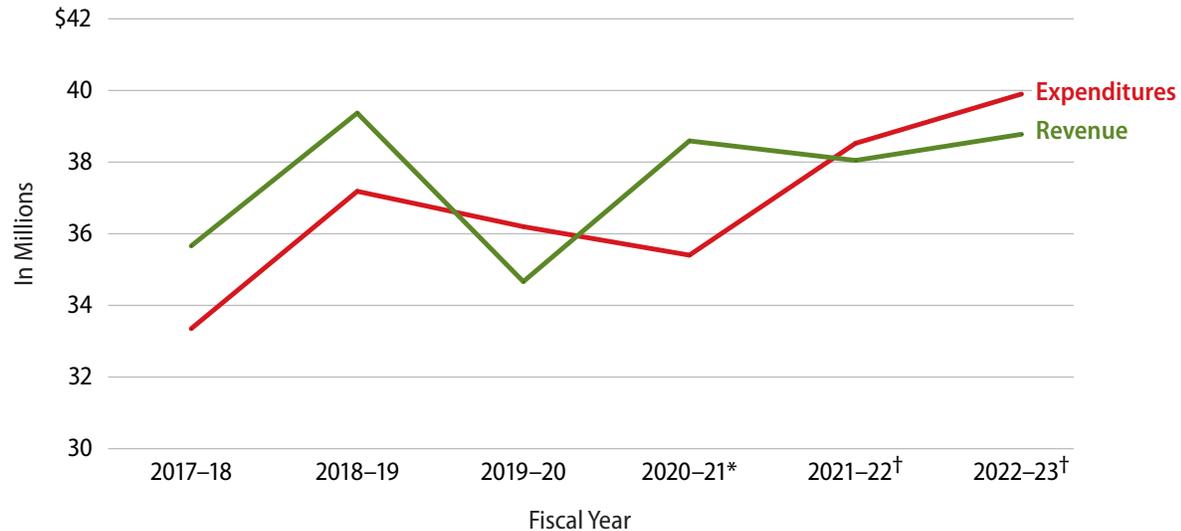
Since the 2018 audit, the gap between Lynwood's general fund revenue and expenditures has fluctuated significantly, as Figure 1 shows. The city's general fund revenue exceeded its expenditures in fiscal years 2017–18 and 2018–19 by \$2.3 million and \$2.2 million, respectively. In contrast, general fund expenditures exceeded revenue by approximately \$1.5 million in fiscal year 2019–20. As we reported in our August 2021 update of our local government high-risk dashboard, we updated our designation of Lynwood's revenue trends from low risk in fiscal year 2018–19 to moderate risk in fiscal year 2019–20.

Although Lynwood's initial budget for fiscal year 2019–20 projected a revenue shortfall of only \$419,000, its actual deficit was substantially larger because of the impact of the COVID-19 pandemic (pandemic) and because the city chose not to pursue a one-time, or nonrecurring, source of revenue that it had initially included in its budget. The city's finance director explained that the one-time revenue, budgeted at \$3 million, was for the anticipated sale of a cellular tower that the former city manager negotiated. However, the finance director stated that after reviewing information related to the potential sale, he determined that the city would not realize as much revenue as originally anticipated and concluded that the proposed sale would not benefit the city.

When updating its fiscal year 2020–21 budget in March 2021, Lynwood projected that general fund revenue would exceed expenditures by \$2.2 million. In June 2021, Lynwood adjusted that projection upward, estimating that revenue for fiscal year 2020–21 would exceed expenditures by approximately \$3.2 million. The city anticipates a downturn in fiscal years 2021–22 and 2022–23, however. Its proposed biennial budget for these years, which the city council adopted, projects that expenditures will exceed revenue by approximately \$500,000 in fiscal year 2021–22 and \$1.1 million in fiscal year 2022–23. If these projections hold true, Lynwood will need to use its general fund reserves to cover some of its costs. Although the federal government has allocated to Lynwood \$24.4 million in federal stimulus funds from the American Rescue Plan Act of 2021 (ARPA), the city has not yet budgeted how it will spend these funds. Federal law requires that these funds be used

**LOCAL HIGH RISK****Figure 1**

Although Lynwood's General Fund Revenue and Expenditures Have Fluctuated in Recent Years, the City Expects Expenditures to Exceed Revenue During Fiscal Years 2021–22 and 2022–23



Source: Lynwood's audited financial statements, year-end estimates for fiscal year 2020–21, and the adopted budget for fiscal years 2021–22 and 2022–23.

\* Amounts represent fiscal year 2020–21 unaudited revenue and expenditures reported to the city council in late June 2021.

† Amounts represent fiscal years 2021–22 and 2022–23 budgeted revenue and expenditures adopted by the city council in July 2021.

to address the impacts of the pandemic or to make certain necessary investments in infrastructure. In July 2021, the city council approved a proposal by city management to contract with a consulting firm for guidance on spending the funds in a manner that complies with the law and ensures the best value to the city. The Government Finance Officers Association (GFOA), which publishes best practices for financial operations of governments, notes that because ARPA funds are nonrecurring, governments should use them primarily for nonrecurring expenditures and avoid spending them in a manner that will require an ongoing financial commitment, such as creating new programs.

To ensure its ability to provide public services while withstanding short-term revenue shortfalls, Lynwood established a policy to maintain a minimum balance in its general fund reserves. The GFOA recommends that cities maintain a reserve balance

equivalent to a minimum of two months of either revenue or expenditures, which is equivalent to 17 percent of annual revenue or expenditures. In our 2018 audit, we identified that Lynwood's reserve policy did not align with GFOA best practices because it required the city to maintain a general fund reserve balance of only 10 percent of the general fund budget, which the finance director defined as annual budgeted expenditures. We recommended that Lynwood address the disparity between its adopted minimum reserve and the minimum recommended by the GFOA by revising its policy to align with best practices.

In 2019 Lynwood adopted a new reserve policy that changed the minimum reserve balance to be based on 10 percent of budgeted *revenue*. However, this modification still does not align with the 17 percent balance recommended by the GFOA. For example, the city's reserves were \$5.5 million at the end of fiscal

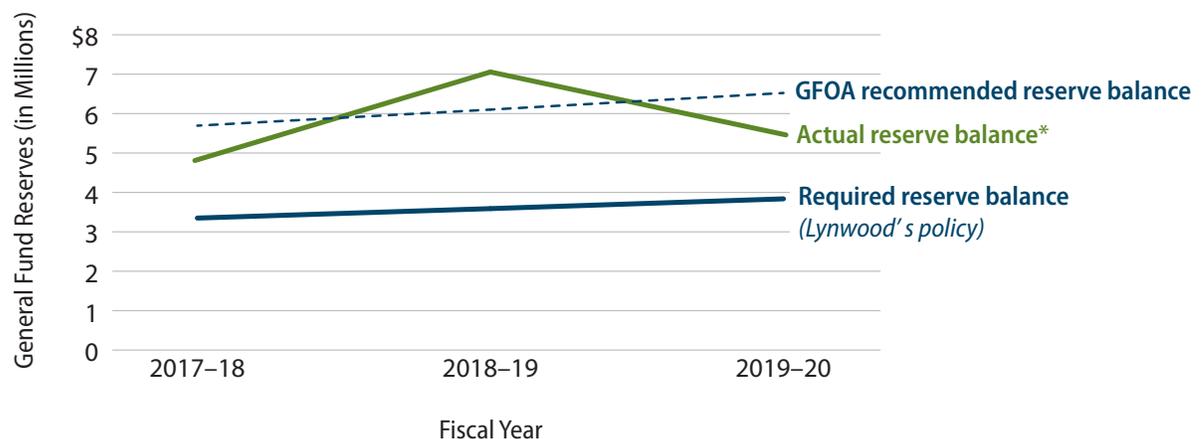
year 2019–20, which represented 14.4 percent of its annual budgeted revenue—an amount above the 10 percent threshold. Nevertheless, as Figure 2 shows, this amount is substantially lower than the minimum balance of \$6.5 million that the GFOA recommends based on a threshold of 17 percent of annual revenue. Moreover, the decline in the city’s reserves from fiscal years 2018–19 to 2019–20 resulted in our local government high-risk dashboard reporting a change in our designation of Lynwood’s general fund reserves from moderate risk in fiscal year 2018–19 to high risk in fiscal year 2019–20.

Lynwood’s finance director agreed that the percentage used for the city’s minimum reserve balance should be increased. He explained that the city has not increased the percentage because it has not been able to maintain a sufficient reserve balance to comply with a higher threshold. The city manager stated that he plans to present a new reserve policy to the city council that would require the city to maintain a 10 percent reserve but strive to achieve a reserve of 20 percent. Without sufficient reserves, Lynwood risks being unable to cover revenue

shortfalls—which it projects that it will experience during the next two fiscal years—or unanticipated expenditures.

In our 2018 audit, we also identified that Lynwood was late in starting its budget preparation process for fiscal years 2017–18 and 2018–19. Because of the shortened time frame, the finance department did not perform a thorough review of budgeted expenditures. Our audit concluded that, as a consequence of the late start, the finance department had overestimated the beginning general fund balance in the city’s fiscal year 2017–18 budget and had potentially overestimated the beginning general fund balance in the fiscal year 2018–19 budget. As we described in our 2018 audit, these inaccurate estimates distort the city’s overall financial position and can mislead stakeholders. However, the city started the budget preparation process on time for the two budget development cycles that Lynwood has undertaken since our 2018 audit. Moreover, the city’s estimate of its beginning general fund balance in its fiscal year 2019–20 budget aligned with the actual amount reported in its audited financial statements.

**Figure 2**  
 Lynwood Did Not Achieve Reserve Levels Recommended by the GFOA in Fiscal Years 2017–18 and 2019–20



Source: Lynwood’s audited financial statements and budgets and GFOA best practices.

\* Consistent with the methodology used in our local government high-risk dashboard, we calculated reserves for the general fund as the committed and unassigned portions of the city’s fund balance as reported in the city’s audited financial statements.

**LOCAL HIGH RISK**

More recently, even though Lynwood began its budget preparation process promptly for its biennial fiscal year 2021–22 and 2022–23 budget cycle, it did not complete that budget on time. Although its budget calendar stipulated that the city should finish preparing that budget in mid-June 2021 and the city council should approve it by early July 2021, city management did not present a budget to the city council for approval until later in July. The city manager stated that this delay resulted from the timing of the start of his tenure with the city in late March 2021 and his desire to understand the city’s budget and financial needs. Without ensuring completeness and timeliness in its budgeting process, Lynwood risks providing insufficient information to decision makers and delaying communication about the city’s planned actions and spending.

In addition, based on our 2018 audit and our recommendation that it align its budgeting process with best practices, Lynwood established a policy in 2019 to provide quarterly reports to the city council on its revenue and expenditures. Its policy aligns with the GFOA’s recommendation that cities institute procedures to periodically review their budgets throughout the year and adjust them as needed to ensure that they are balanced. However, Lynwood has not produced the reports required by its policy. Specifically, Lynwood did not provide the city council with quarterly reports in the first and second quarters of either fiscal year 2019–20 or 2020–21. The only interim reports that Lynwood produced during these years were budget updates that it presented to the city council in April 2020 and March 2021. The finance director stated that he intends to prepare quarterly reports starting in fiscal year 2021–22 and had not done so previously because his attention had been focused on responding to issues pertaining to the pandemic.

---

**“Lynwood did not provide its city council with quarterly revenue and expenditure reports.”**

Moreover, the interim budget report for fiscal year 2019–20 contained inadequate information. Although that report presented budget expenditure adjustments and a projected general fund ending balance, it was missing other significant information necessary to assess and understand the city’s financial performance. In particular, the report did not compare budget projections and actual results to date for general fund revenue and expenditures that would assist the public and the city council in evaluating whether the city was adhering to its adopted budget. GFOA best practices specify that budget-monitoring processes should contain a comparison of budgeted amounts to actual amounts and an analysis describing why deviations occurred.

In contrast to the interim budget report for fiscal year 2019–20, the fiscal year 2020–21 interim budget report included a budget-to-actual comparison of revenue and expenditures and explanations for significant differences. For example, the fiscal year 2020–21 report identified lower actual revenue pertaining to charges for city services compared to the amount budgeted and identified the cause as being less revenue received than expected from certain city fees. Nevertheless, the city’s policy addressing quarterly reports does not specify the type of information or analyses that should be included in these reports. The policy simply states that reports on revenue and expenditures will be prepared for and reviewed quarterly by the city

council. Consequently, city management has discretion over the detail provided in these reports, thereby creating some risk of insufficiently communicating to the city council about the city's financial performance.

### **Lynwood Has Implemented Some Budgeting Best Practices but Still Lacks Some Key Practices**

In our 2018 audit, we determined that Lynwood did not follow best practices for budgeting that the GFOA recommends. The GFOA has identified budgeting as one of the most important activities undertaken by governments and has called attention to it as an operational area in which many governments are in need of guidance. We assessed Lynwood against 11 recommended best practices for budgeting and found that the city either did not follow or only partially followed 10 of those practices. For example, Lynwood did not prepare multiyear revenue and expenditure projections and did not have a policy limiting the use of one-time revenue to pay for ongoing expenditures.

Lynwood has since fully implemented five of the 10 practices, as Table 1 shows. For example, Lynwood implemented the fee-setting policy best practice when it adopted a policy in 2019 that requires the city to annually review city fees and adjust them as needed so that they support the costs of providing the related services. Examples include fees for commercial recycling services, animal licenses, and rental of city facilities. The GFOA also recommends reviewing and updating fees periodically to ensure the adequacy of cost recovery and to address any increases in the costs of providing services. We determined that Lynwood has reviewed and updated its fee schedule each year since our 2018 audit.

“Lynwood has not implemented a best practice for identifying unpredictable revenue.”

However, as Table 1 also shows, Lynwood has not yet implemented a best practice for identifying unpredictable revenue and has only partially implemented four other practices. In particular, Lynwood has only partially implemented the best practices of preparing multiyear revenue and expenditure projections. Although the city changed its budget development process from preparing annual budgets to issuing biennial budgets starting with the two-year cycle of fiscal years 2019–20 and 2020–21, it has not developed any longer-term projections. The finance director stated that he is planning to develop five-year revenue and expenditure projections by December 2021 to assist in the city's development of a long-term capital improvement plan and to identify sources of funding for specific projects. We believe that developing such projections for five or more years would also be beneficial to the city because they would provide critical information to decision makers about whether projected expenditure levels can be sustained beyond the current budget cycle.

### **Lynwood Has Not Complied With Its New Salary-Setting Policy**

In our 2018 audit, we determined that Lynwood increased salaries for 40 position classifications from September 2017 through August 2018 that affected approximately three-quarters of its total staff. The city increased the base salaries for the position classifications we reviewed by amounts

**LOCAL HIGH RISK**

**Table 1**  
**Lynwood Now Follows or Partially Follows Many Budgeting Best Practices**

BUDGETING BEST PRACTICE THAT THE GFOA RECOMMENDS	EXTENT TO WHICH LYNWOOD FOLLOWS THE BEST PRACTICE
<b>Reserve policy:</b> Develop policies to guide the creation, maintenance, and use of resources—such as a reserve—for financial stabilization purposes.	<b>Fully followed:</b> Lynwood implemented a reserve policy that addresses this best practice. However, the policy stipulates that the city maintain a minimum reserve balance that does not align with the recommended minimum balance specified in a different GFOA best practice, as we discuss on page 4.
<b>Fee-setting policy:</b> Adopt policies that identify the manner in which fees and charges are set and the extent to which they cover the cost of the service provided.	<b>Fully followed</b>
<b>Capital asset inventory:</b> Identify and conduct an assessment of its capital assets, including the condition of the assets and factors that could affect the need for or ability to maintain the assets in the future, and develop a process for inventorying capital assets.	<b>Fully followed</b>
<b>One-time revenue policy:</b> Adopt a policy limiting the use of one-time revenue for ongoing expenditures.	<b>Fully followed</b>
<b>Revenue diversity policy:</b> Adopt a policy that encourages a diversity of revenue sources.	<b>Fully followed</b>
<b>Budget review procedures:</b> Institute procedures to review the budget periodically, such as quarterly, and decide on actions to bring the budget into balance.	<b>Partially followed:</b> Although Lynwood has adopted a policy requiring quarterly reviews, it has not complied with its policy.
<b>Balanced operating budget policy:</b> Develop a policy that defines a balanced operating budget, encourages commitment to a balanced budget under normal circumstances, and provides for disclosure when a deviation from a balanced operating budget is planned or when it occurs.	<b>Partially followed:</b> Although Lynwood has a policy that defines a balanced operating budget, it does not have a policy requiring the city to disclose when it deviates from a balanced operating budget.
<b>Multiyear revenue projections:</b> Prepare multiyear projections of revenue and other resources.	<b>Partially followed:</b> Lynwood has implemented a biennial budget cycle but does not develop revenue projections beyond the two years.
<b>Multiyear expenditure projections:</b> Prepare multiyear projections of expenditures for each fund and for existing and proposed new programs.	<b>Partially followed:</b> Lynwood has implemented a biennial budget cycle but does not develop expenditure projections beyond the two years.
<b>Identification of unpredictable revenue:</b> Identify major revenue sources considered unpredictable and define how this revenue may be used.	<b>Not followed:</b> Lynwood does not identify whether any of its revenue sources are unpredictable.

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

ranging from 2 percent to 72 percent, with the increases averaging 27 percent overall. However, we found many problems with Lynwood's approach to increasing these salaries. Through the efforts of its staff and a consultant, Lynwood reviewed salaries from a selection of other cities as a comparison

for proposing salary increases for its own positions. The city presented the results of its review as a salary survey that identified the cities reviewed, the titles of those cities' comparable positions, and the salaries for those positions. The salary survey also included the average salary and median salary

for each position as the basis for justifying adjustments to staff salaries at Lynwood. However, we questioned the appropriateness of including certain cities in the salary survey because they had significantly larger populations, expenditures, and geographic areas compared to Lynwood. We also noted that Lynwood included other entities in its salary survey, such as counties and school districts, that have staff positions with responsibilities that may not be comparable to the duties performed by employees at cities such as Lynwood.

Moreover, we identified problems with the limited amount of information city staff provided to the city council related to the proposed salary increases. The staff reports to the city council requesting approval for salary increases did not include the results of the salary survey for 10 of the 40 position classifications we reviewed. Instead, those staff reports simply stated the salary amounts recommended by city staff without disclosing the salary survey results. The city council subsequently approved base salaries for the 10 classifications ranging from \$131 to \$846 per month more than the amounts in the salary survey. When we inquired about these differences, the city was unable to explain why the recommendations were higher than the amounts presented in the survey. We recommended that Lynwood develop a policy describing how it will prepare salary surveys and provide justification to the city council in instances when it proposes to increase salaries above the amounts recommended by the salary survey.

In response to our recommendation, Lynwood implemented a salary-setting policy in June 2019 that, if adhered to, would address our concerns about justifying proposed salary adjustments. The policy specifically requires that salary surveys be conducted using 10 benchmarked cities agreed to by the city's employee unions. The policy also requires that the human resources department

document the decisions regarding the proposed salary amounts and provide the analysis and justification to the city council as part of its staff report.

However, we determined that Lynwood is not complying with its new policy. Since the city implemented its policy, it has conducted three salary surveys. We found that for two of these surveys, city staff did not present an analysis of the survey and a justification for the proposed salary amount in their report to the city council. Further, city staff could not provide documentation from all three salary surveys to demonstrate that they complied with the requirement to survey 10 benchmarked cities agreed to by the employee unions. For example, the supporting documentation Lynwood provided for a salary survey of the human resources and risk specialist position listed only three entities, one of which is a school district. Lynwood was also unable to provide sufficient explanations or other evidence to demonstrate that it complied with its salary survey policy because those surveys were conducted and overseen by individuals who are no longer employed by the city, and the city's current personnel were unable to locate supporting information for the surveys. The city manager acknowledged the importance of retaining documentation of salary surveys and also plans to work with the city's new human resources director to update other components of the salary-setting policy to ensure that it meets the city's needs.

#### **Recommendations to Address These Risks**

- *To facilitate ongoing financial stability and guard against short-term revenue shortfalls, Lynwood should revise its reserve policy by December 2021 to align with GFOA best practices.*

**LOCAL HIGH RISK**

- *To ensure that it provides timely budget information to stakeholders, Lynwood should follow the time frames for tasks in its budget calendar in future budget cycles.*
- *To provide timely and meaningful information to the city council for its budget monitoring, Lynwood should follow its policy of providing quarterly reports to its city council that compare budgeted to actual general fund revenue and expenditures. Lynwood should also strengthen its policy to require that its quarterly reports contain information that aligns with GFOA best practices for budget monitoring, such as analyses of the reasons for any budget deviations.*
- *To determine whether projected expenditures can be sustained beyond the current budget cycle, Lynwood should develop and follow a policy by December 2021 to prepare multiyear projections of revenue and expenditures and present them to the city council each year. The city's projections should encompass at least five years of financial activity. The city should also complete its implementation of other budgeting best practices.*
- *To substantiate proposed salary increases in the future, Lynwood should follow its salary-setting policy and retain documentation supporting its adherence to the policy.*

# Despite Improvements in Its Oversight and Practices, Lynwood Remains at Risk of Violating State Law

---

## Lynwood Has Not Taken Sufficient Action to Mitigate Its Continued Risk of Violating State Law Related to Its Use of Water and Sewer Funds

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 those fees and charges for any purpose other than that for which the fee or charge was imposed. Lynwood risks violating this provision of state law because of the transfers of property-based fee revenue it makes to its general fund through a lease arrangement it established for its water and sewer infrastructure. Moreover, although state law allows Lynwood to use its water and sewer funds to reimburse the general fund for city overhead costs related to its water and sewer infrastructure, the city may be paying more than is allowable and thus may be using water and sewer revenue for purposes other than those for which it was collected.

### *Lease Agreement*

In our 2018 report, we determined that Lynwood had established a lease arrangement for its water and sewer infrastructure, which includes structures, pipes, and machinery used to generate, transmit, distribute, and sell water as well as to treat, purify, and dispose of sewage. The lease agreement gives the city the ability to subsidize its general fund with revenue from the water and sewer funds by making lease payments to itself for its water and sewer infrastructure.

Figure 3 summarizes the structure of the lease between the city and the Lynwood Utility Authority (utility authority). The utility authority consists solely of the city of Lynwood.

One of the primary concerns in our 2018 report about the lease structure was that the lease agreement stipulated that the utility authority would make lease payments to the city for the water and sewer infrastructure but did not establish a dollar value or timing of payments. Even though we did not identify any lease payments at the time, the city manager during our 2018 audit informed us that the city could justify any transfers between the water and sewer funds and the general fund as lease payments. This perspective is concerning because it assumes that Lynwood can unconditionally transfer water and sewer revenue—which is collected and intended for the specific purpose of supporting water and sewer services—to the general fund, where the city could use the revenue with far fewer restrictions. Using property-related fee revenue, such as revenue collected from water and sewer use charges, to pay for costs not associated with providing those services is a violation of Proposition 218.

Following our 2018 audit, Lynwood sought assistance from a consulting firm to establish the value of its water and sewer infrastructure, which it then used to define the total rental amount in the lease agreement for that infrastructure. Although the lease agreement, which ends in 2058, stipulates that the total amount of the individual lease payments should equal the lease's total rental amount, neither amount

**LOCAL HIGH RISK**

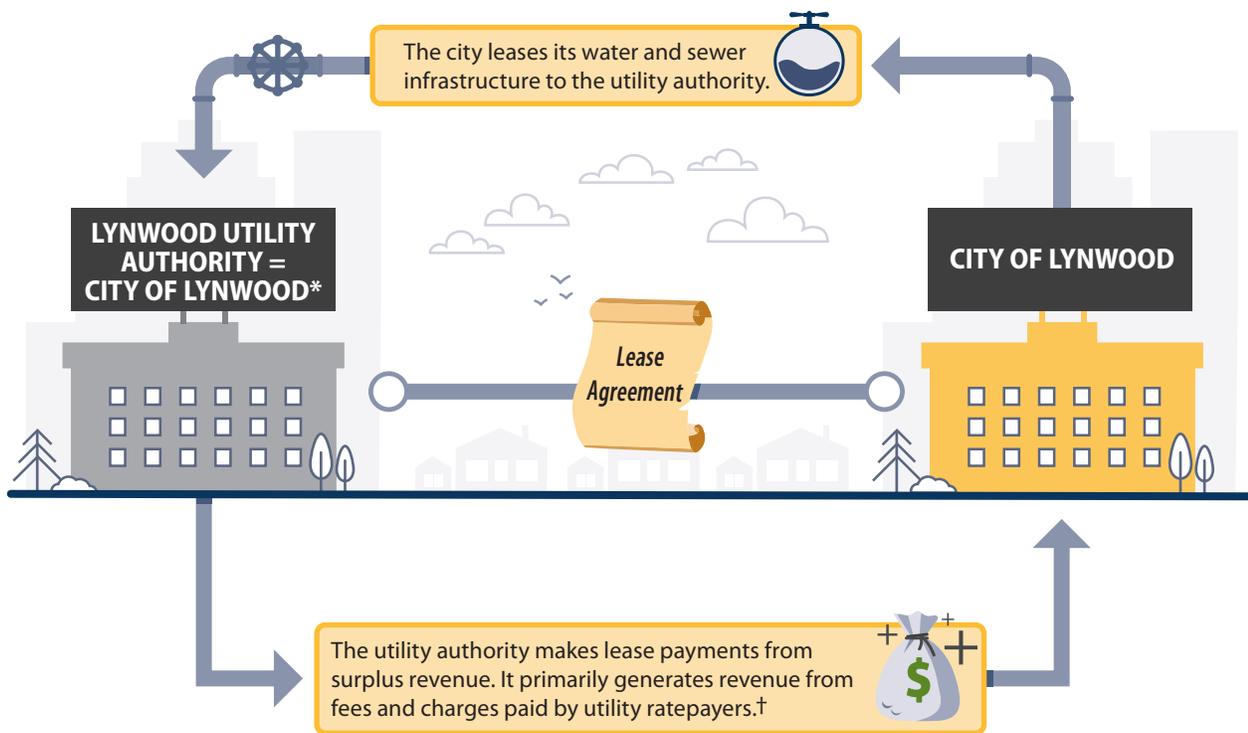
was quantified in the lease agreement. In December 2019, the city established the total rental amount of the lease as \$84.8 million, based on the consultant's valuation report. In addition, Lynwood established a lease payment for fiscal year 2019–20 of \$1 million payable to its general fund from its water and sewer funds—\$750,000 from the water fund and \$250,000 from the sewer fund. The lease agreement also specifies that lease payments should be made from surplus revenue, defined in the agreement as any revenue during a fiscal year beyond the funds needed to pay for contracts, debt service required on any obligations, and amounts set aside for capital replacements and improvements.

However, the lease agreement does not otherwise specify how to determine the amount of the individual lease payments.

Proposition 218 also specifies that revenue derived from the provision of water and sewer services to properties within a jurisdiction may not exceed the cost of providing the services to those properties. As nearly all of Lynwood's water and sewer revenue is derived from fees and charges, there does not appear to be a legal basis for accumulating surplus revenue or using the revenue to make lease payments for a purpose unrelated to providing water and sewer services. Accordingly, we recommended

**Figure 3**

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



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

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

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

in our 2018 audit that the city dissolve the utility authority. Lynwood stated in its 2019 corrective action plan that it did not intend to do so; however, the city did not describe the need for or purpose of the utility authority. Moreover, the city's current management does not plan to dissolve the utility authority and believes that the lease payments are legally allowed because the utility authority pays the city for the use of the water and sewer infrastructure. Nevertheless, because the utility authority consists solely of the city of Lynwood and the source of the funds derives primarily from property-related fees, we continue to question the validity and necessity of the utility authority's existence and the relationship of the lease payment to the provision of water and sewer services.

Further, although Lynwood established and formalized the total rental amount and the lease payment, it did not provide adequate justification for the payment amount. In the staff report to the utility authority requesting to establish the lease payment, the city cited amounts reported in its fiscal year 2017–18 audited financial statements indicating that total revenue exceeded total expenditures for its water and sewer funds by \$2.5 million for that year. However, the finance director was unable to explain how the \$1 million lease payment for fiscal year 2019–20 was calculated and stated that the former city manager was responsible for determining this amount. The finance director was also unable to locate any information about how the former city manager calculated the amount of the lease payment. Lynwood made another lease payment of \$1 million in April 2021 and intends to include similar payments in its budgets for fiscal years 2021–22 and 2022–23. Because it has not sufficiently justified the amount of the lease payment and the reason why such a payment is necessary, we think Lynwood's transfers of water and sewer revenue to its general fund violate Proposition 218.

### **Overhead Costs**

Lynwood further risks violating Proposition 218 by over-reimbursing the general fund from its water and sewer funds for administrative overhead. Because Lynwood provides water and sewer services to its residents and businesses and charges fees to cover the costs of providing those services, the city uses its water and sewer funds to account for this revenue. As previously described, state law prohibits the use of revenue derived from a property-related fee or charge for any purpose other than that for which the fee or charge was imposed.

---

**“The city risks violating Proposition 218 by transferring too much from its water and sewer funds for overhead costs.”**

State law further requires that revenue derived from a fee or charge on behalf of properties in the jurisdiction receiving service not exceed the costs required to provide the service. The costs for providing water and sewer services can include equipment, repairs to infrastructure, and salaries for employees who work on the water and sewer system, among other expenditures. Additional costs can include overhead costs, such as administrative support costs pertaining to human resources and information technology. This overhead is provided by city personnel and departments paid through the general fund, so the water and sewer funds should reimburse the general fund for these costs, which is allowed under Proposition 218. These reimbursements are separate from the amounts transferred to the general fund under the lease agreement between the utility authority and the city.

**LOCAL HIGH RISK**

In our 2018 audit, we identified that Lynwood may have over-reimbursed its general fund for overhead costs from its water and sewer funds. At that time, Lynwood appeared to have continued to use a cost allocation plan developed in 2006 to identify the amount of overhead costs to transfer from the water and sewer funds to the general fund. We recommended that Lynwood update its cost allocation plan—a document used to support the appropriate amounts of recoverable overhead costs—more frequently and use it to determine the amounts to be recovered from the water and sewer funds. Using an outdated cost allocation plan could lead the city to over- or under-reimburse the general fund for overhead costs, given that costs can change significantly over time.

Lynwood contracted with a consulting firm to prepare a cost allocation plan, which it received during our 2018 audit, and the finance director stated that he would begin using that plan to determine overhead cost amounts beginning in fiscal year 2019–20. The consulting firm’s cost allocation plan concluded that the annual amount the general fund could recover from the water and sewer funds for overhead costs was about \$240,000 lower than the \$1.1 million Lynwood had transferred in fiscal year 2016–17 and planned to transfer in fiscal years 2017–18 and 2018–19.

In 2019 Lynwood contracted with the same firm to prepare another cost allocation plan, despite not approving the plan from 2018 or using that plan to reduce the overhead costs it transferred from its water and sewer funds in fiscal year 2018–19. The finance director indicated that the city did not approve the 2018 draft plan because the then-city manager wanted a more in-depth analysis of the water and sewer overhead costs, and so the city contracted with another consulting firm to conduct a valuation of the water and sewer infrastructure, as we discuss earlier in relation to the lease agreement. However, it is unclear how this valuation would have

affected the determination of overhead costs and prompted the city to delay its approval of the 2018 draft plan. Moreover, the city did not approve or use its 2019 draft cost allocation plan either. Although the finance director stated that Lynwood did not approve the 2019 draft plan because it had been focusing on addressing financial and operational issues related to the pandemic, the city received the plan in September 2019, well before the start of the pandemic.

#### Amount of Overhead Costs Recoverable From Lynwood's Water and Sewer Funds

- 2018 draft cost allocation plan: **\$875,660**
- 2019 draft cost allocation plan: **\$659,618**

Source: Lynwood's 2018 and 2019 draft cost allocation plans prepared by an external consulting firm.

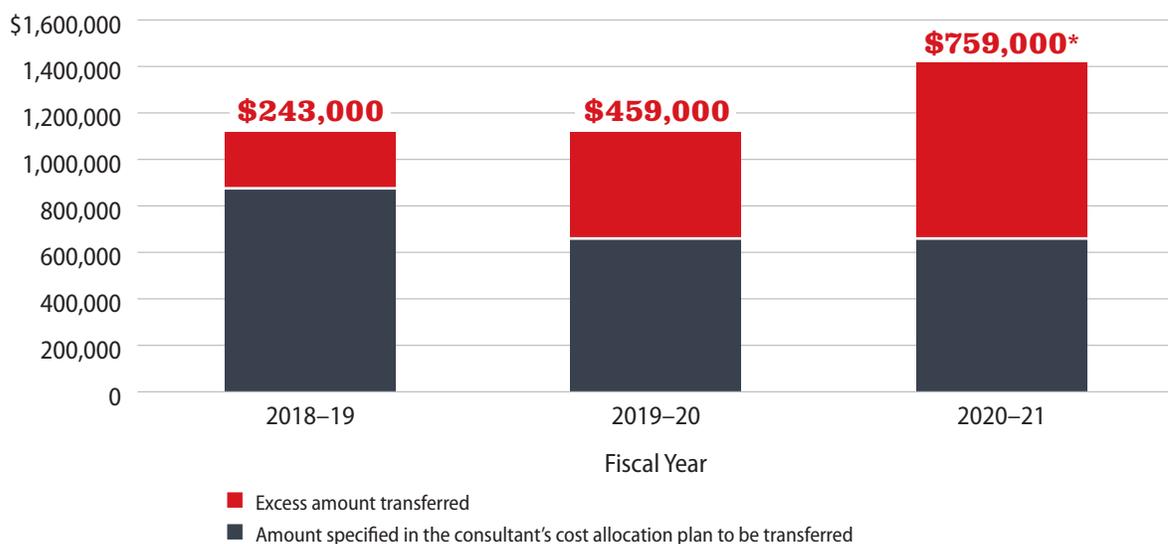
Lynwood’s failure to approve its 2019 draft cost allocation plan is significant because, as the text box shows, the 2019 draft plan reported an even smaller amount of recoverable overhead costs than the amount reported in the 2018 draft plan. Because of the absence of an approved cost allocation plan, the city’s finance director initially stated that the city intended to carry forward the amount allocated for overhead costs in its fiscal year 2020–21 budget to its budget for fiscal years 2021–22 and 2022–23. The city therefore risks continuing to transfer too much from its water and sewer funds for overhead costs, thus subsidizing its general fund in violation of state law, similar to the condition we identified in our 2018 audit. Not using a cost allocation plan to determine the appropriate amount of overhead costs also violates Lynwood’s policy requiring that the cost allocation plan be used to determine overhead costs.

As Figure 4 shows, since fiscal year 2018–19 Lynwood has transferred to its general fund significantly more water and sewer revenue than the two draft cost allocation plans would have allowed. Specifically, the city transferred \$243,000 and \$459,000 in excess of the overhead costs reported in its draft cost allocation plans in fiscal years 2018–19 and 2019–20, respectively. Moreover, the city budgeted for a transfer of \$759,000 more than allowed by its cost allocation plan in fiscal year 2020–21. Although Proposition 218 permits the use of water and sewer revenue to fund the costs of overhead services, transferring additional amounts beyond the actual costs of those services is a violation of state law.

the city still needs to review the accuracy of its 2019 cost allocation plan before approving it. He indicated that he now intends to complete this review by the end of 2021 so that the city can use the plan to calculate the overhead costs for the water and sewer funds and update the fiscal year 2022–23 budget. Nevertheless, as we discuss previously, we are concerned about the city’s apparent lack of attention toward approving the plan, given its policy requiring that its cost allocation plan be updated every three years and the fact that its 2019 draft plan was prepared several months before the start of the pandemic. We would have expected the city to prepare and approve a cost allocation plan at the beginning of each three-year period and then use it to allocate costs for that entire period. Because it has not approved the 2019 plan as of July 2021, Lynwood has allowed the majority of the three-year period to elapse without using updated overhead cost

In addition, Lynwood cannot demonstrate that the amount of recoverable overhead costs in its draft cost allocation plans is appropriate. The finance director stated that

**Figure 4**  
**Lynwood Continues to Transfer More Revenue From Its Water and Sewer Funds Than Its Consultant’s Cost Allocation Plans Allow**



Source: Lynwood’s draft cost allocation plans, audited financial statements for fiscal years 2018–19 and 2019–20, and budget for fiscal year 2020–21.

\* Amount included in Lynwood’s fiscal year 2020–21 budget to be transferred from its water and sewer funds to its general fund.

**LOCAL HIGH RISK**

information. The city should review, revise if needed, and approve its cost allocation plan and use it to determine the appropriate overhead costs as soon as possible. Until it does so, Lynwood continues to risk using its water and sewer funds inappropriately to subsidize its general fund and is exposed to potential litigation as a result.

### Lynwood Is Using a Competitive Bidding Exception Less Frequently Than in the Past

We identified in our 2018 audit that Lynwood's municipal code allows the city to bypass the competitive bidding process for contracts through a supermajority vote of four of the five city council members. The text box shows that the city council may use this exception if it determines that an acquisition can be made more economically and efficiently through a procedure other than competitive bidding. We found that within a two-year period from June 2016 through June 2018, the city council used this exemption at least 49 times, including for goods and services that were generally not specialized, such as contracts for office furniture and for temporary staffing in the finance department. Doing so precluded the city from being able to identify other opportunities to obtain such goods and services at a better price and value through competitive bidding. We recommended that Lynwood 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.

Although Lynwood has not amended its municipal code to address our recommendation, it now appears to be more judicious in its use of the supermajority vote to bypass competitive bidding. We reviewed a selection of 10 months of city council votes during the period from June 2019 through February 2021 and identified only three instances in which the city council used the

supermajority vote exception—a much lower rate than we found in our 2018 audit. We further identified that the city adequately justified the use of the exception in each of the three instances by explaining in writing why the procurement process used in place of competitive bidding would be more economically effective or efficient.

#### Competitive Bidding Exceptions

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

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

Source: Lynwood's municipal code.

The text box also indicates an exception to competitive bidding when the city is seeking a contract for garbage collection. It is unclear why the municipal code allows for such an exception, given that Lynwood engaged in competitive bidding when it contracted with its current garbage collection vendor in 2013. Allowing the city to bypass competitive bidding for a contract of this nature jeopardizes the city's ability to obtain the best value for its residents and community.

Moreover, Lynwood has not addressed two other weaknesses related to its contracting practices. In our 2018 audit, we identified that the city amended a contract that significantly

changed the vendor's scope of services without engaging in competitive bidding and that the city had assigned duties to a contractor that were not described within its contracted scope of services. We recommended that Lynwood address these issues by further amending its municipal code to require competitive bidding when a proposed contract amendment would significantly alter a contract's scope of work, including defining what constitutes a significant alteration of scope. We also recommended that the city assign to contractors only those duties that are expressly described in the contracted scope of services.

As of July 2021, Lynwood had not amended its municipal code regarding contract amendments that significantly alter the scope of the contract. However, the city manager indicated that he would work with the city attorney to amend the municipal code to address this concern by the end of 2021. In its 2019 corrective action plan, Lynwood stated that it would conduct a contract processing training class for all managers, project coordinators, and administrative personnel to ensure that employees understand their responsibilities related to managing contracts and contract changes. However, the finance director said that the city has not conducted a contract training course. The city manager said that he would work with the new human resources director to identify appropriate contract training courses.

### **Lynwood Has Addressed Outstanding Findings From Its External Auditor**

We identified in our 2018 audit that Lynwood did not have a plan for addressing outstanding findings reported by the external auditor of its financial statements. During that audit, we reviewed Lynwood's financial audit findings for fiscal year 2015–16 and found that the external auditor reported 12 findings. By September 2018, Lynwood had implemented steps to address only seven of the findings, leaving five unaddressed. Many of those

findings focused on the need for stronger management and oversight by the city's finance department. For instance, one of the outstanding findings noted that significant turnover in the finance department had resulted in inadequate review, analysis, and reconciliation of financial statements to the accounting records. The external auditor identified many potential problems that we concluded could lead to inaccurate financial reporting, fraud, and waste if Lynwood did not correct the deficiencies described in the findings.

After reviewing the four subsequent audit reports from fiscal years 2016–17 through 2019–20, we determined that the external auditor concluded that Lynwood had sufficiently addressed the concerns raised in the five remaining audit findings from the fiscal year 2015–16 audit. The external auditor also reported six additional findings in its fiscal year 2016–17 report that it later concluded, during subsequent audits, that the city had sufficiently resolved. Moreover, Lynwood's most recent financial audit report from fiscal year 2019–20 had only one finding, which identified that the city did not file certain federal financial reports on time. Accordingly, we conclude that Lynwood has fully addressed this risk area.

### **Recommendations to Address These Risks**

- *To comply with state law and ensure that revenue from property-based fees and charges is not used inappropriately, Lynwood should dissolve the utility authority by June 2022 and discontinue making any lease payments.*
- *To ensure that its general fund is recovering the appropriate overhead costs, Lynwood should review, revise if necessary, and approve its 2019 draft cost allocation plan by December 2021 or sooner and use it to determine the*

**LOCAL HIGH RISK**

*amount of overhead costs its general fund can recover from its water and sewer funds.*

- *To ensure that it seeks opportunities to procure goods and services at the best value, Lynwood should amend its municipal code by December 2021 to require the following:*
  - » *Justification when the city council uses its supermajority vote competitive bidding exception.*
  - » *Competitive bidding when seeking a garbage collection contract.*
  - » *Competitive bidding when the city determines that the services it seeks are outside of any existing contract's scope of services.*
- *To ensure that city staff understand their contracting responsibilities, Lynwood should conduct a training class by December 2021. In addition, the city should ensure that its staff assign only those tasks to contractors that are expressly described within their contracted scope of services.*

# Lynwood's Organizational Management Continues to Be Ineffective

---

## Lynwood Still Lacks a Strategic Plan That Identifies Goals and Defines How Progress Toward Those Goals Will Be Measured

In our 2018 audit report, we identified that Lynwood lacked a comprehensive and cohesive framework, such as a strategic plan, for guiding its departments. The GFOA recommends that all governmental entities use some form of strategic planning to provide guidance for budgeting and future service delivery. The GFOA believes strategic planning establishes logical connections between spending and an entity's goals. According to the GFOA, the focus of strategic planning should be on aligning resources to bridge the gap between present conditions and the envisioned future.

Although we identified in our 2018 audit that Lynwood included some elements of a strategic plan in its annual budget document—such as goals, objectives, and past achievements for each department—we concluded that the budget did not fulfill the purpose of a strategic plan. Specifically, the budget lacked a description of how the city planned to achieve its goals and also did not include performance measures that could clearly show whether those goals had been met. Moreover, beginning with its fiscal year 2018–19 budget, Lynwood no longer includes department goals and achievements in its budget document. The finance director believes that the city manager responsible for developing that budget likely decided to remove the department goals and achievements to reduce the size of the budget document.

In its 2019 corrective action plan and its responses to our subsequent inquiries, Lynwood stated that it was developing a strategic plan. Lynwood further informed us that it would finalize the strategic plan in early 2020. However, the city had not completed this plan as of June 2021. The current city manager, who assumed his position in March 2021, informed us that he believes strategic plans have limited value. Based on his experience, he observed that other cities do not use their strategic plans effectively. Nevertheless, he intends to address this risk area by contracting with an external facilitator to conduct a goal-setting workshop with the city council by the end of 2021 to document the city's overarching goals.

## Lynwood Cannot Effectively Measure Its Staffing Needs Without Engaging in Strategic Planning Efforts

In our 2018 audit report, we identified that some of Lynwood's departments were unable to effectively evaluate their staffing needs and were at risk of inadequately or inefficiently providing services. We also identified that Lynwood had been attempting to provide increased services with fewer staff: its budgeted staffing level in fiscal year 2018–19 was 8 percent lower than its staffing level in fiscal year 2009–10, which represented the highest staffing level during fiscal years 2009–10 through 2018–19.

In its 2019 corrective action plan, Lynwood indicated that it would develop performance measures upon the completion of the strategic plan that it intended to create. The city would then consider those measures

**LOCAL HIGH RISK**

when conducting a staffing analysis to determine appropriate staffing levels. However, as we discuss previously, Lynwood has not yet developed a strategic plan or completed other strategic planning efforts. To address this risk area, the city manager stated that he intends to use the goals that the city council will develop to guide budgeting decisions and determine future staffing needs. Nevertheless, until it develops goals and priorities as well as taking subsequent action to align resources with those goals, Lynwood cannot effectively determine whether its staffing levels are sufficient and appropriate to efficiently address the city's priorities for the services that it provides.

**Lynwood Will Need to Align Future Strategic Planning Efforts With Its Succession Planning**

We identified in our 2018 audit that Lynwood had experienced frequent turnover in its key leadership positions, causing its departments to lose institutional knowledge about how past leaders made decisions. For example, the human resources director at the time of the 2018 audit was unable to explain why the city had increased salaries for numerous positions, because those decisions occurred before she was employed with the city and she was unable to find any documentation memorializing the rationale. To address these issues, we recommended that Lynwood complete the succession plan it was in the process of developing and create a policy to require that its managers formally document the processes they use to make key decisions.

Although Lynwood adopted its succession plan in late 2018, it still needs to align that plan with its future strategic planning efforts. The city's succession plan is intended to identify and develop staff within the city who have the potential to fill key leadership positions. A key element in the succession plan is for Lynwood to develop a leadership

academy for high-potential employees to receive enhanced development experiences for future leadership opportunities.

We verified that Lynwood implemented its leadership academy and that 17 city employees completed the academy's courses in the summer of 2020. If Lynwood continues to follow its succession plan, it will adequately address our concerns related to succession planning. However, city staff did not know whether the city has completed two other key elements of the succession plan, one of which is to conduct a gap analysis to project openings in positions. To maximize the succession plan's full potential, Lynwood will need to align the plan with its future strategic planning efforts so that efforts to develop staff are consistent with the city's goals and priorities. The city manager indicated that the citywide goals he intends to develop with the city council will be used to guide future succession planning efforts.

Since the 2018 audit, Lynwood has experienced some additional turnover in management that has contributed to its inability to explain the actions its staff have taken. Specifically, as we discuss previously, Lynwood does not have sufficient supporting documentation to

---

**“Lynwood has experienced some additional turnover in management that has contributed to its inability to explain the actions its staff have taken.”**

show compliance with its salary-setting policy. Because the salary surveys we reviewed were overseen by individuals no longer employed by the city, current staff are unable to explain the causes of the issues we identified. In addition, the finance director was unable to locate documentation to support the calculation of the lease payment amount for the city's water and sewer infrastructure. He could not provide any additional insight because the city manager who made that determination is no longer employed by Lynwood. To provide continuity in leadership and maintain institutional knowledge, the current city manager stated that he plans to develop a policy by the end of 2021 to require cross-training among management positions and better documentation of processes that managers use. Further, the city manager said that he expects to assign the development of the new policy to the human resources director.

#### **Recommendations to Address These Risks**

*To improve the efficiency of its organizational management, Lynwood should do the following:*

- *Formalize its goals for the city by February 2022.*
- *Align its succession planning, budget preparation, and staffing needs assessments with its newly developed goals by May 2022.*
- *Develop and implement a policy by December 2021 to maintain institutional knowledge, retain documentation of key management decisions, and ensure continuity in city leadership.*

---

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

Respectfully submitted,



ELAINE M. HOWLE, CPA  
California State Auditor

September 23, 2021

**LOCAL HIGH RISK**

Blank page inserted for reproduction purposes only.

# Appendix A

## Scope and Methodology

In May 2018, the Joint Legislative Audit Committee (Audit Committee) approved a proposal by the State Auditor to perform an audit of Lynwood under the local high-risk program. We published the results of our 2018 audit in a report titled *City of Lynwood: Poor Management Has*

*Contributed to Its Financial Instability and Led to Its Failure to Comply With State Law*, Report 2018-803. In this follow-up audit required by state law, we assessed the progress Lynwood has made in addressing the nine risk areas we identified in the 2018 audit. The following table shows the nine risk areas and the methods used to follow up on Lynwood’s progress.

## Risk Areas and the Methods Used to Evaluate Lynwood's Progress in Addressing Them

RISK AREA	METHOD
<p>1 Lynwood is at risk of not meeting its future financial obligations.</p>	<ul style="list-style-type: none"> <li>• Evaluated Lynwood’s audited financial statements, budgets, and budget updates to determine its financial condition, including its general fund balances, revenue, and expenditures.</li> <li>• Assessed the timeliness of the city’s budget process since the publication of our 2018 audit and the accuracy of the city’s budgeted general fund balance for fiscal year 2019–20.</li> <li>• Reviewed the city’s reserve levels and reserve policy compared to best practices.</li> </ul>
<p>2 Lynwood did not adhere to many best practices when preparing its budget.</p>	<ul style="list-style-type: none"> <li>• Assessed Lynwood’s budgets and budget policies against the GFOA best practices the city had not fully adhered to during the 2018 audit.</li> <li>• Evaluated whether Lynwood complied with key budget policies that it adopted in 2019.</li> </ul>
<p>3 Lynwood risked future deficits by significantly increasing the number of employees and their salaries when it could not afford to do so.</p>	<ul style="list-style-type: none"> <li>• Evaluated the city’s salary survey policy that it adopted in June 2019 to determine whether the policy addressed the concerns identified in the 2018 audit.</li> <li>• Assessed the three salary surveys completed after June 2019 to determine whether the city complied with key elements of its salary survey policy.</li> <li>• Determined that Lynwood decreased its budgeted positions and number of staff since our 2018 audit. In late 2020, the city council approved the elimination of 17 positions, resulting in the removal of six vacant positions from the budget and layoffs for 11 employees because of financial pressures related to the pandemic.</li> <li>• Interviewed city staff regarding documentation the city maintains to demonstrate compliance with its salary survey policy.</li> </ul>
<p>4 Lynwood violated state law through its inappropriate use of water and sewer funds.</p>	<ul style="list-style-type: none"> <li>• Reviewed Lynwood’s cost allocation plans and transfers to its general fund from its water and sewer funds.</li> <li>• Assessed the changes that Lynwood made to its utility authority lease based on its recent infrastructure valuation and evaluated its justification for lease payments.</li> <li>• Interviewed city staff to identify how the city determined the amounts for overhead cost payments from the water and sewer funds and the utility authority’s lease payments.</li> <li>• Evaluated a judgmental selection of three capital projects. We found that the city’s reports to the city council adequately supported the proposed use of water, sewer, or utility bond funds for these projects.</li> </ul>

continued on next page . . .

## LOCAL HIGH RISK

RISK AREA	METHOD
<p>5 Lynwood's use of competitive bidding exceptions within its municipal code and insufficient contract management increase its risk of wasting public funds.</p>	<ul style="list-style-type: none"> <li>• Reviewed 10 months of city council resolutions during the period from June 2019 through February 2021 to assess the frequency of and justification for Lynwood's use of its supermajority vote exception to competitive bidding.</li> <li>• Evaluated Lynwood's municipal code sections related to procurement to identify whether it amended them to address the recommendations in our 2018 audit.</li> <li>• Interviewed city staff regarding Lynwood's efforts to conduct contract training classes and the city's plans to amend its municipal code.</li> </ul>
<p>6 Lynwood has several recurring control weaknesses in its financial operations that make it susceptible to fraud and waste.</p>	<p>Reviewed Lynwood's external audit reports from fiscal years 2016–17 through 2019–20 to determine whether the city addressed the outstanding audit findings from its fiscal year 2015–16 external audit and subsequent audits.</p>
<p>7 Lynwood's leadership has not created a strategic plan that would direct its departments' goals and objectives towards a unified vision.</p>	<ul style="list-style-type: none"> <li>• Reviewed city council agendas and interviewed city staff to determine whether Lynwood had developed a strategic plan since the 2018 audit.</li> <li>• Interviewed the city manager to identify his plan for conducting strategic planning efforts.</li> </ul>
<p>8 Some of Lynwood's departments claim to be understaffed but do not effectively measure their staffing needs.</p>	<ul style="list-style-type: none"> <li>• Identified changes to Lynwood's staffing levels since the 2018 audit.</li> <li>• Interviewed the city manager to obtain his perspective on his plan to use strategic planning efforts to determine future staffing needs.</li> </ul>
<p>9 Lynwood has not adequately performed succession planning to retain its institutional knowledge when turnover occurs in key leadership positions.</p>	<ul style="list-style-type: none"> <li>• Evaluated Lynwood's succession plan and determined whether the city had implemented key elements.</li> <li>• Interviewed city staff regarding implementation of the succession plan and the city's expectations to address management turnover and the loss of institutional knowledge.</li> </ul>

Source: Audit workpapers.

## Appendix B

---

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

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

As we describe in our 2018 report, following an initial assessment and analysis we sought and obtained approval from the Audit Committee to conduct an audit of Lynwood in May 2018. In December 2018, we published the results of our audit, which concluded that Lynwood was a high-risk city because of its inadequate financial and organizational management, weak oversight, and violations of state law.

If a local agency is designated as high risk as a result of the audit, it must submit a corrective action plan. If it is unable to provide its corrective action plan in time for inclusion in the audit report, it must provide the plan no later than 60 days after the report's publication. It must then provide written updates every six months after the audit report is issued regarding its progress in implementing the corrective action plan. This corrective action plan must outline the specific actions the local agency will perform to address the conditions causing us to designate it as high risk and the proposed timing for undertaking those actions. We will remove the high-risk designation when we conclude that the agency has taken satisfactory corrective action. In addition, state law requires that if the State Auditor determines that a local government agency is high risk, then the State Auditor shall issue an audit report at least once every three years with recommendations for improvement in the local government agency.

**LOCAL HIGH RISK**

Blank page inserted for reproduction purposes only.



OFFICE OF THE  
**CITY MANAGER**  
**ERNIE HERNANDEZ**

*City of*  
**LYNWOOD**

Incorporated 1921

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



September 2, 2021

Elaine Howle  
California State Auditor  
621 Capitol Mall, STE 1200  
Sacramento, CA 95814

Dear Ms. Howle:

The City of Lynwood received the draft report from the State Auditor titled "City of Lynwood – "Despite Taking Some Action to Improve Its Management Practices, the City Continues to Risk Financial Instability and Violations of State Law".

I have reviewed the report and will share with the City's leadership team. Once our team has concluded our review, we will prepare a corrective action plan to address the risks identified within the draft audit document and bring it before the City Council.

Additionally, the City plans on integrating the recommendation that was identified in the audit to adopt and follow best practices for developing its budget and maintain sufficient financial reserves.

Sincerely,

A handwritten signature in black ink, appearing to read "Ernie Hernandez", with a long horizontal stroke extending to the right.

Ernie Hernandez  
City Manager