

CITY OF CUDAHY

Review Report

ADMINISTRATIVE AND INTERNAL ACCOUNTING CONTROLS

July 1, 2010, through June 30, 2012



JOHN CHIANG
California State Controller

April 2014



JOHN CHIANG
California State Controller

April 15, 2014

Honorable Chris Garcia
Mayor of the City of Cudahy
5220 Santa Ana Street
Cudahy, CA 90201

Dear Mayor Garcia:

Enclosed is the report of the State Controller's Office (SCO) review of the City of Cudahy's (City) administrative and internal accounting controls. The review was conducted to assess the adequacy of the City's controls to safeguard public assets and to ensure proper use of public funds.

Our review found significant weaknesses with the City's accounting and administrative controls system. We found that the potential for waste, fraud, and abuse of public resources is extremely high due to numerous deficiencies noted in the Findings and Recommendations section of our report.

As a part of the review, we assessed various aspects of the City's internal control components and elements based on guidelines established by the General Accounting Office. Of the 79 control elements evaluated pertaining to internal control components, we found only six, or 8%, in which controls were considered to be adequate.

The results of our review and evaluation of the elements of internal control are included in this report as an Appendix. Our assessments of the elements were based on the conditions that existed during our review period of fiscal year (FY) 2010-11 and FY 2011-12. To the extent feasible, we made inquiries to assess whether the control deficiencies have been addressed since the conclusion of FY 2011-12.

It should be noted that the City generally agreed with the findings noted in the report and is in the process of developing corrective actions and implementing our recommendations. Therefore, the City should be commended for taking these matters seriously and being proactive in resolving the noted deficiencies.

As always, my staff and I are available to address your questions. You may contact Steven Mar, Chief, Local Government Audits Bureau, by telephone at (916) 324-7226 or by email at smar@sco.ca.gov.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/kw

cc: Henry Garcia, Interim City Manager
City of Cudahy
Steven Dobrenen, Finance Director
City of Cudahy
Angela Bustamante, Deputy City Clerk
City of Cudahy
Cristian Markovich, Vice Mayor
City of Cudahy
Diane Oliva, Council Member
City of Cudahy
Baru Sanchez, Council Member
City of Cudahy
Jack Guerrero, Council Member
City of Cudahy

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Review Report

Introduction

The State Controller's Office (SCO) reviewed the City of Cudahy's (City) system of administrative and internal accounting controls for the period of July 1, 2010, through June 30, 2012 (fiscal year [FY] 2010-11 and FY 2011-12). As necessary, we expanded our testing to include prior and current transactions to follow-up on issues identified through interviews of City officials and through our review of the work of the independent auditors and other audit reports.

On September 3, 2013, the SCO responded to the letters from Mayor Jack Guerrero dated November 2, 2012, May 23, 2013, and June 16, 2013, in which the Mayor requested the SCO to conduct a forensic audit of the City's internal financial controls.

In those letters, Mayor Guerrero cites concerns that support the need for such an audit, including:

- Corruption charges filed against previous City Council members.
- Possible illegal raises authorized by the previous City Manager who was terminated in March 2011. Additional key City employees were either terminated or resigned during 2011 and 2012.
- The 2010-11 independent financial audit was not issued until November 27, 2012, nearly one year after such an audit should have been completed. In addition, the audit firm declined to express an opinion.
- The 2011-12 independent financial audit was performed by a different audit firm that issued its final report on January 3, 2013. While this report is timely, the audit firm noted a number of qualifications based on the lack of necessary information which did not allow the audit firm to calculate extraordinary gain or loss in various funds.
- The last formal evaluation of the City's internal control was performed as a part of a single audit required for 2009-10. However, the firm conducting the 2011-12 independent financial audit issued a SAS 115 letter to the City which identified several material deficiencies in internal controls.

The SCO also reviewed the independent financial audits for the last three years and noted the following information, which raises questions about the City's financial status:

- General Fund expenditures have exceeded revenues in each year as follows:

FY 2009-10	\$332,500
FY 2010-11	\$582,500
FY 2011-12	\$823,000

The SCO also reviewed the City's compliance with financial reporting requirements and found that the City generally has submitted such reports timely. However, based on the factors supporting the Mayor's request for a forensic audit of internal controls, the additional information from the independent financial audits and the internal control letter from the independent audit firm, the SCO concluded that there is reason to believe that the City's ability to provide reliable and accurate information relating to required financial reports submitted by the City is questionable. Therefore, under Government Code section 12464(a), the SCO Division of Audits conducted an investigation to validate the financial transaction reports submitted by the City during FY 2009-10, FY 2010-11 and FY 2011-12. Under Government Code section 12464 (b), the costs of this review, including preparing a report of the results and transmitting copies to the City Council, will be borne by the City.

This report presents the results of findings and conclusions reached in our review of the City's administrative and internal accounting controls system.

Background

The City of Cudahy is located in southeastern Los Angeles County, California. The City covers a total area of 1.23 square miles and is bordered by the cities of Bell on the north, Bell Gardens on the east, South Gate on the south and southwest, and Huntington Park on the west. Cudahy is the second smallest City in Los Angeles County but with one of the highest population densities of any incorporated City in the United States. It is part of the Gateway Cities region. Cudahy is populated predominantly by Latino immigrants and has a population of 23,805 as of the 2010 U.S. Census

Objective, Scope, and Methodology

The objective of this review was to evaluate the City's system of administrative and internal accounting controls to ensure:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with applicable laws and regulations; and
- Adequate safeguard of public resources.

To accomplish our objective, we performed the following procedures:

- Evaluated the City's formal written internal policies and procedures;
- Conducted interviews with City employees and observed the City's business operations for the purpose of evaluating City-wide administrative and internal accounting controls;
- Reviewed the City's documentation and supporting financial records;
- On a limited basis, performed tests of transactions to ensure adherence with prescribed policies and procedures and to validate and test the effectiveness of controls; and

- Assessed various aspects of the City's internal control components and elements in accordance with guidelines established by the General Accounting Office.

Conclusion

We found the City of Cudahy's administrative and internal accounting control deficiencies to be serious and pervasive. As a result, the potential for fraud, waste, and abuse is very high.

As part of our review, we made an assessment of various aspects of the City's internal control components and elements based on guidelines established by the General Accounting Office's Internal Control Management and Evaluation tool.

Of the 79 control elements evaluated pertaining to internal control components, we found only six, or 8%, of elements in which controls were considered to be adequate. The results of our review and evaluation of elements of internal control are included in this report as an Appendix.

In the Control Environment components "Integrity and Ethical Values," and "Commitment to Competence," we found none of the eight control elements to be adequate. We found the City's administrative and internal accounting control deficiencies to be serious and pervasive during our review period. Under such a weak control environment, the potential for waste, fraud, and abuse is extremely high.

The City should develop a comprehensive remedial plan to address these deficiencies. The plan should identify the tasks to be performed, and milestones and timelines for completion. Additionally, the City Council should require periodic public updates on the progress in implementing the remedial plan.

Views of Responsible Official

We issued a draft report on February 6, 2014. Steven Dobrenen, Finance Director, on behalf of Interim City Manager Henry Garcia, responded by email dated March 5, 2014. The city did not dispute the findings and is in the process of implementing our recommendations.

Restricted Use

This report is solely for the information and use of the City of Cudahy and the SCO; it is not intended to be and should not be used by anyone other than these parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

April 15, 2014

Findings and Recommendations

Noncompliance with Government Code section 12464

Pursuant to Government Code section 12464, our review determined the following reporting issues:

Financial Transactions Report (FTR) for Fiscal Year 2011-12

- Unexplained prior period adjustments to Governmental Funds – The City reported prior period adjustments totaling \$321,583 as an increase to the fund balance. However, the City's Comprehensive Annual Financial Report (CAFR) disclosed 10 prior period adjustments totaling \$124,521 as a net decrease to the fund balance; a difference of \$446,104 between the FTR and the CAFR. No explanations for prior period adjustments were noted in the FTR.
- Overstated Traffic Congestion Relief Fund (TCRF) Revenues – The City reported \$67,001 in TCRF revenues. However, no TCRF revenues were allocated to the City during this fiscal year.
- Unrecorded Fixed Assets – The City did not report \$125,943 of fixed assets purchased, which understates the Fixed Assets Group of Accounts. See Finding 6 for details.

Financial Transactions Report (FTR) for Fiscal Year 2010-11

- Understated Highway Users Tax Apportionments (HUTA) – The HUTA apportionments were understated by \$254,940. The total apportionments allocated were \$647,317, and the City reported \$392,377.
- Grant refund not reported – The City returned \$240,114 to the State Department of Parks and Recreation for ineligible expenditures. However, this transaction was not reported. See Finding 5 for details.

Recommendation:

The above findings should be taken into consideration when preparing future Financial Transaction Reports. Amounts reported should be reconciled to the City's CAFR. Also, the City should ensure that internal control findings and recommendations noted in this report are reviewed and evaluated for impact on future reporting.

City's Response

The City agrees with the finding and recommendation and would like to add that the Financial Transactions Report (FTR) is prepared prior to the audited Financial Statement. Due to the timing differences, transactions requiring adjustments made after the submittal of the FTR are reflected in the audited Financial Statements but will not be reconciled to the FTR until the following year. Accordingly, any prior period adjustment to the opening fund balance in the FTR's current fiscal year 2013-14 will include items which reconcile to the ending

fund balance of the preceding fiscal year's audited Financial Statements.

SCO's Comments

The City agrees with the SCO's recommendation and will make the necessary prior period adjustments to the opening fund balance in the fiscal year 2014-15 FTR.

Results of Analysis of City's Administrative and Internal Accounting Controls

Our review of the City's Administrative and Internal Accounting Controls focused on fiscal year (FY) 2010-11 and FY 2011-12. However, we expanded our tests of selected transactions into prior and future periods as necessary to follow-up on related issues.

As a part of our internal control review, we assessed various aspects of the City's internal controls components and elements based on guidelines established by the General Accounting Office's Internal Control Management and Evaluation tool. Of the 79 control elements evaluated pertaining to internal control components, we found only six (8%) that were considered adequate. (See Appendix for the results of our evaluation of internal control elements.)

In the Control Environment components "Integrity and Ethical Values," and "Commitment to Competence," we found none of the eight control elements to be adequate. We found the City's administrative and internal accounting control deficiencies to be serious and pervasive during our review period. Under such a weak control environment, the potential for waste, fraud, and abuse is extremely high.

Using the results of our internal control matrix, we performed reviews of selected transactions to document examples of weak and non-existent controls. The specific findings described below all resulted, at least in part, from these deficiencies.

Recommendation

While there are specific recommendations to address the findings described below, from a broader perspective, we recommend that the City develop a comprehensive remedial plan to address the deficiencies noted in the Appendix. The plan should identify the tasks to be performed, and milestones and timelines for completion. In addition, we recommend that the Cudahy City Council require periodic public updates on the progress in implementing the remedial plan.

City's Response

In accordance with AB 1248, Assemblyman Ken Cooley's (D-Rancho Cordova) transparency bill, the City of Cudahy will work with the State Controller's office indirectly through the California League of Cities in providing input to the State Controller on or before January 1, 2015, to develop internal control guidelines applicable to a local agency. An

important element that the City will work to communicate is that a one-size fits all approach will not work. The economies of scale difference between a City with a budget of \$10 million and \$500 million is so significant that the timeframe to implement recommendations should be adjusted and State funding should be provided to the five smallest cities in each county to defray the cost of establishing a compliance program that lines up with the State’s guidelines. The City looks forward to indirectly work with the State Controller’s office for the goal articulated in the words of State Controller John Chiang “... to develop stronger fiscal management practices aimed at protecting communities against self-dealing, misuse of taxpayer monies and other abuses of public trust”. Upon the appointment of a City Treasurer and/or hiring of a City Auditor a remedial plan will be developed to address the matters raised in the Administrative and Internal Accounting Controls review report.

SCO’s Comments

The City agrees with SCO and is in the process of taking appropriate corrective action to remedy the noted deficiencies.

**FINDING 1—
Questionable leave and
other pay for some City
officials**

Our review noted that the gross pay of several City officials showed material increases from year to year for FY 2004-05 through FY 2011-12. The gross pay paid to these City officials included regular salary, Leave Pay, and Other Pay.

We have identified the total payments that City officials received during the FY 2004-05 through FY 2011-12 from the Earnings History Report as follows:

Positions/ Fiscal Year	Total Regular Pay	Monthly Salary	Monthly % Change	Leave Pay	Leave Hours	Other Pay	Gross Pay	Yearly % Change	Notes
City Clerk									
2005	67,608	5,634		—	—	(252)	67,356		
2006	77,346	6,446	14%	—	—	39	77,385	14.89%	
2007	88,950	7,412	15%	38,210	—	—	127,160	6.32%	
2008	100,906	8,409	13%	5,925	120	13,734	120,565	-5.19%	
2009	106,018	8,835	5%	10,303	40	7,922	124,244	3.05%	
2010	106,294	8,858	0%	13,243	259	7,825	127,363	2.51%	
2011	91,321	7,610		29,628	295	15,250	136,199	6.94%	1
2012	—	—		—	—	—	—		
	<u>638,443</u>			<u>97,309</u>	<u>714</u>	<u>44,518</u>	<u>780,273</u>		
HR Director									
2005	37,644	3,137		2,901	145	900	41,445		
2006	42,659	3,555	13%	6,086	280	1,291	50,036	20.73%	
2007	50,036	4,170	17%	5,374	230	2,268	57,678	15.27%	
2008	64,347	5,362	29%	5,644	183	7,629	77,619	34.57%	
2009	79,451	6,621	23%	6,827	188	8,239	94,517	21.77%	
2010	90,083	7,507	13%	11,823	273	5,700	107,606	13.85%	
2011	91,988	7,666	2%	10,871	251	5,700	108,559	0.89%	
2012	43,465	3,622	-53%	13,246	—	238	56,948	-47.54%	1
	<u>499,673</u>			<u>62,772</u>	<u>1,550</u>	<u>31,965</u>	<u>594,408</u>		

Positions/ Fiscal Year	Total Regular Pay	Monthly Salary	Monthly % Change	Leave Pay	Leave Hours	Other Pay	Gross Pay	Yearly % Change	Notes
Director of Community Services									
2005	45,435	3,786		8,903	347	1,238	55,577		
2006	79,826	6,652	76%	5,717	149	1,059	86,602	55.82%	
2007	83,387	6,949	4%	8,875	224	900	93,162	7.57%	
2008	94,562	7,880	13%	10,471	236	2,740	107,773	15.68%	
2009	108,231	9,019	14%	13,306	196	3,352	124,889	15.88%	
2010	112,283	9,357	4%	16,070	298	900	129,253	3.49%	
2011	116,601	9,717	4%	24,707	458	900	142,208	10.02%	
2012	<u>111,311</u>	9,276	-5%	<u>99,867</u>	<u>1,850</u>	<u>3,059</u>	<u>214,237</u>	50.65%	1
	<u>751,635</u>			<u>187,916</u>	<u>3,758</u>	<u>14,148</u>	<u>953,701</u>		
City Manager									
2005	114,001	9,500		15,424	168	1,091	130,515		
2006	123,976	10,331	9%	17,025	284	4,632	187,384	43.57%	
2007	134,838	11,237	9%	26,949	407	4,640	166,428	-11.18%	
2008	155,753	12,979	16%	36,703	504	28,616	221,072	32.83%	
2009	173,558	14,463	11%	43,931	512	8,412	225,900	2.18%	
2010	186,347	15,529	7%	47,572	531	21,867	255,787	13.23%	
2011	<u>160,814</u>	13,401	-14%	<u>—</u>	<u>—</u>	<u>32,689</u>	<u>193,503</u>	-24.35%	1
	<u>1,049,287</u>			<u>187,604</u>	<u>2,406</u>	<u>143,697</u>	<u>1,380,589</u>		

Note 1 – Salary stated is not for the entire fiscal year

It is not clear how the amounts for salary increases, Leave Pay, and Other Pay are authorized and approved. For instance, it appears that these actions may be approved by the City Manager or the City Council. In addition, Leave Pay and Other Pay may each be used to compensate for unused sick leave, vacation, or compensation time. As a result, it is difficult to determine whether such payments are properly calculated and approved.

We identified the following questionable salary payments for the four positions listed above:

- The City Clerk received \$38,210 of Leave Pay during FY 2006-07. The Earnings History Report did not show any hours used.
- The HR Director received material salary increases totaling 111% from \$42,659 in FY 2005-06 to \$90,083 in FY 2009-10. There were no documents in the employee’s personal record to support these salary increases.
- The Community Services Director received Leave Pay based on a total of 3,758 hours for FY 2004-05 through FY 2011-12. This indicates that he accumulated approximately 470 hours each year. It appears unreasonable for an employee to be earning that much leave time each year.

- The City Manager received \$187,604 and \$143,697 in Leave Pay and Other Pay, respectively, over a seven-year period in addition to his regular salary without documentation to support these charges.

Recommendation

The City Council should review the calculations and approve appointed positions' salaries, Leave Pay, and Other Pay, including payout of unused sick leave and vacation time. The City Manager, or his or her designee, should be responsible for calculating and approving payouts for non-appointed management group members.

The City should review the Leave Pay and Other Pay to officials to determine if the City overpaid, and seek refunds where necessary.

City's Response

In Resolution 07-25 the salaries for appointed officials have been memorialized and in the case of the City Manager, the contract is negotiated directly between the parties. Going forward the City Council will document approval of any salary increases given to appointed officials. Additionally, support for Leave Pay and Other Pay to be made appointed officials will be presented to the appropriate sub-committee of the City Council to document their approval that the calculation was supported and in accordance with any contracts and/or memorandum of understandings that exist at the time. With respect to Leave Pay and Other Pay to management individuals, the approval of the City Manager or their designee will be affixed to the supporting documentation. In December 2013, there was one management member who was eligible for and "cashed out" Leave Pay. The calculation for that individual's Leave Pay and the non-management individual leave pay was reviewed by a responsible individual prior to the payment being processed. It is the City's intention that upon appointment of a City Treasurer or hiring of a City Auditor the individual will review the items noted above and seek refunds where necessary.

SCO's Comments

The City did not dispute this finding. The City has started to implement our recommendations and is taking steps to improve oversight of its financial and operational activities pertaining to salary increases and Leave Pay and Other Pay. Although the City is moving forward, it must review the salary increases and leave payments cited in the finding to ensure that these payments were appropriate.

The finding remains as stated.

**FINDING 2 —
City officials failed to
comply with and violated
City’s municipal code
over contracts**

During our review of the City’s contracting process from January 1, 2005, through June 30, 2012, we noted that the City officials as well as the City Council did not comply with and therefore violated the City’s municipal code. This code requires a written contract for purchases of supplies and services greater than \$10,000. City officials made numerous questionable decisions by not following the contract process, including obtaining City Council approval when required.

In addition, when contracts were actually submitted to City Council, the meeting minutes revealed a lack of analysis, discussion, or deliberation by the City Council. As a result of these significant deficiencies, non-compliance, and violations of City’s municipal code, we expanded our review to all City Council minutes made available for our review. (See Finding 9.)

We also noted that payments for goods and services were readily approved by City officials and City Council without detailed review or analysis of the reasonableness of these costs. We identified numerous contracts and transactions that raised questions regarding reasonableness and proper use of public funds. Examples are:

Payments to contractors without negotiated contract agreements:

- **ITL, Inc.**

For the period of January 1, 2005 through June 30, 2012, ITL, Inc. billed \$424,276 to the City for fuel used by City vehicles. However, the City could not provide contract documents relating to these purchases.

- **Special Projects/Community Outreach Consulting Services**

During the period of June 1, 2010, through July 30, 2011, the City was billed for consulting services amounting to \$52,849. The City confirmed that there was no written contract agreement relating to these services. Billing documents indicated that the services provided were for various activities such as preparing for project meetings, attending various meetings, calling businesses for fundraising, attending town hall and community dinners, etc. The City could not provide a reasonable justification for how these activities relate to City operations and how the City benefitted from these services.

- **Steelworkers Oldtimers Foundation**

The Steelworkers Oldtimers Foundation (Oldtimers) had a contract with the City for providing Dial-A-ride, Fixed Route, and Charter Transportation services that expired on June 30, 2011. However, Oldtimers continued to bill the City on an expired contract for services provided during the period of July 1, 2011 through May 31, 2012. The total amount billed during this period was \$259,201.

We also noted that the Oldtimers billed the City in excess of the contract amount resulting in unallowable payments. For two fiscal years ended June 30, 2006, the contract amount was \$210,000 per

fiscal year. However, the City was billed for and made payments of \$227,900 and \$233,657, respectively. Accordingly, the City exceeded the contract authority by \$17,900 for FY 2004-05 and \$23,657 for FY 2005-06.

- **Code Enforcement Prosecuting Services**

The City was unable to provide copies of contracts and contract amendments for the period of January 1, 2005, through June 30, 2012 for services performed by the Code Enforcement Prosecuting Service. Though the City was able to provide City Council minutes that noted the approvals or motions to award or extend the contract, we could not confirm if any contract and/or amendments were ever properly executed. As a result, the City made unauthorized payments of \$409,798 for these services.

The situation is further complicated because City Council minutes use different names for the Code Enforcement Prosecution Services between the City and the Law Offices of Edgar Coronado, (i.e., Code Enforcement Prosecuting Services, Prosecuting Attorney Services, contractor, Code Enforcement – Prosecution Services between the City of Cudahy and the Law Offices of Edgar Coronado, Community Development Block Grant Contract between the City of Cudahy and the contractor). It appears that the City Council was approving contracts and amendments for the same service, however without the actual contract we could not determine if this was actually the case.

Our review of the billing documents also noted that this contractor was paid \$8,323 for services provided to council on May 20, 2011, and \$13,025 on March 31, 2012, and April 23, 2012, for reviewing the Shuttle Services agreement during FY 2011-12. These services appear to be outside the scope of the work as approved by the City Council.

Payments to contractors in excess of the amount approved by the City Council or the contract amount:

- **Code Enforcement Prosecuting Services**

We noted that the City made payments to the Law Offices of Edgar Coronado that exceeded the amount approved by the City Council. Our review of City Council minutes reflected a \$22,000 maximum approved amount for FY 2010-11 and FY 2011-12. However, the City was billed and paid \$42,967 (FY 2010-11) and \$42,877 (FY 2011-12) which exceeded the amounts approved by the City Council by \$20,967 and \$20,877, respectively.

- **D & J Engineering Services**

For the period of July 1, 2004, through July 1, 2012, the City paid D & J Engineering Services a total of \$2,533,416 for various engineering services.

These services were for general plan update, land survey and appraisal services, code enforcement services to the Community Development Block Grant (CDBG) Program, preparation of plans and specifications, and other various engineering, design, and inspection services. From our review of the document provided by the City, the billed engineering services are as follows:

Code Enforcement	\$ 61,641
Building, Planning and Engineering Services	1,716,050
Street Light Assessment	131,254
Clara Street Park Extension	40,935
General Planning Services	63,801
Environmental Site Assessment	124,486
Basketball Court Renovation	85,095
City Hall Renovation Project	46,437
ARRA Federal Projects	90,318
Public Works Inspection	82,481
Land Survey and Appraisal Services	62,215
Other Project Services	<u>28,703</u>
Total	<u>\$ 2,533,416</u>

As part of our review, we requested from the City all existing contract agreements and amendments to support the allowability of these services. The City provided us the following contracts only:

• Consultant for General Plan Update, dated 12/22/03	\$79,500
• Design and Construction for Clara Street Park, dated 6/26/03	\$200,000
• Consultant to CDBG Code Enforcement Program, dated 12/03/03	<u>\$50,000</u>
Total	<u>\$329,500</u>

In addition, we considered information noted during our review of the City Council minutes wherein the City Council approved several requests to execute additional contracts with D & J Engineering Services. We determined from the minutes that an additional \$493,000 for the following consulting services could be allowable if proper contracts were executed between the City and D & J Engineering Services:

<u>Date</u>	<u>Purpose</u>	<u>Amount</u>
10/03/2006	Engineering services for implementation of the Atlantic bus pad project	\$ 60,000
10/03/2006	Engineering services for implementation of the Olive Street overlay project No. 230-7033-6725	80,000
10/03/2006	Engineering services for implementation of the speed hump installation project No. 230-7037-6745, Live Oak and Elizabeth Street	32,000
10/17/2006	Engineering services for City-wide curb ramp improvement project No. 255-7029-6725	35,000
10/17/2006	Engineering services for traffic signal improvement project No. 251-7010-6725 (Wilcox Avenue and Live Oak Street)	60,000
01/08/2008	Engineering and inspection services for AC overlay at Live Oak and Elizabeth project No. 251-7022-6725	11,000
03/17/2009	Engineering services for Elizabeth Street asphalt overlay, Atlantic to Wilcox project No. 240-7047-6725	20,000
04/07/2009	Engineering design services for Live Oak street rehabilitation project	65,000
07/07/2009	Engineering and inspection services for Clara Street bridge street light installation project No. 240-7048-6725	10,000
08/11/2009	Prepared plans, specifications, and estimates for concrete pavement project at the intersection of Florence and Atlantic	100,000
11/03/2009	Engineering and inspection services for Clara Street traffic signal upgrade improvement project No. 251-7091-6725	8,000
11/03/2009	Engineering and inspection for Atlantic Avenue traffic signal upgrade	12,000
	Total	<u>\$ 493,000</u>

Therefore, only \$822,500 (\$329,500 contract and \$493,000 in City Council approvals) was actually approved by the City Council. As a result, the City overpaid D & J Engineering Services by \$1,710,916 (\$2,533,416 less \$822,500).

Recommendation

The City Council should direct City officials to comply with the City's municipal code pertaining to contracting. In addition, the City should ensure that:

- Contracts are properly executed and approved, including the use of competitive bidding and City Council approval when required;
- Payments do not exceed contract amounts; and
- Payments are for contracted services.

City's Response

The City agrees with the spirit of the finding in that contracts were not provided for all the amounts that were paid. The Cudahy Municipal Code has recently been modified to require all new contracts above \$5,000 to be presented to the City Council to approve or require additional bids to be received. The City agrees with the use of competitive bidding and City Council approval when required. The City will implement changes to ensure that payments made do not exceed the contracted (with amended) amounts, and are for the services contracted. Since the City has recently filed their annual 1099 with the IRS they will use the reports generated for that purpose to determine if there are any outside entities for which negotiated contracts do not exist and will take the appropriate action to ensure that the City complies with the Cudahy Municipal Code.

SCO's Comments

The City agrees with the spirit of the finding. The City has modified the Municipal Code requiring City Council approval of all new contracts in excess of \$5,000. The City has also started to implement our recommendations to ensure that payments are for contracted services and that the City pays only up to the contract amount. The City is taking steps to improve oversight of its financial and operational activities. Although the City is moving forward, it must review the contracts cited in the finding and ensure that these services were appropriately provided.

The finding remains as stated.

**FINDING 3 -
Questionable payments
for lobbying services**

The City entered into a contract dated March 17, 2000, with the Legislative Advocacy Group (LAG) consulting firm, providing lobbying services for the City. However, the City was not able to provide our auditors with a copy of the original contract for review.

An amendment to the above contract (Amendment No. 1) was entered on August 5, 2003 increasing the monthly retainer fee to \$2,000.

The description of services per the amendment is:

“LAG shall represent the interest of the CITY before the various governmental agencies . . .”

“All correspondence, legislative updates, documents related to this agreement, and any other documentation prepared by LAG shall be provided to the City Council with a copy to staff. . .”

Exhibit “A”, Scope of Services states:

LAG shall provide lobbying and advocacy support services before the California Legislature and related governmental services regarding all issues impacting local municipal governments including, but not limited to redevelopment and housing policy, gaming policy, labor and employment issues, municipal finance, land use issues, funding for parks and recreational facilities, and transportation and infrastructure issues and any other projects or

issues directed by the City Council.

The City has been paying a \$2,000 monthly retainer fee to LAG's contract totaling \$192,000 from July 1, 2004 through June 30, 2012. It is unclear as to what specific services, if any, LAG provided to the City.

Therefore, all payments to LAG are questionable because each of the invoices we reviewed stated "For professional services rendered." We also reviewed City Council minutes and could not find any documentation relating to any of LAG's services or any issues directed to LAG by the City Council. Additionally, the City Council nor City management ever reviewed or evaluated this contract as to the necessity and benefits to the City.

Recommendation:

The City should review and evaluate all contract terms, especially the description and scope of services to be provided. The invoices should include a full description of services and should be reviewed and approved prior to payment.

City's Response

The amounts paid are currently from amounts budgeted in the City Council department. On March 4, 2014 the City Council began discussions to put a moratorium on all non-essential professional services, until such time that the City Council approves a balanced budget which affirmatively re-incorporates these services.

SCO's Comments

The City did not dispute this finding. The City is in the process of implementing the SCO's recommendation.

The finding remains as stated.

**FINDING 4 —
The City failed to exercise
adequate control over
expenses charged to City-
issued credit cards**

During our review period, the City did not have a policy governing City-issued credit cards. From July 1, 2007, through June 30, 2012, City employees charged a total of \$144,901 in expenses on City-issued credit cards. Out of the total expenses incurred during this time period we found that \$64,152, or 44%, to be questionable.

Our review found that many of the charges, particularly those incurred by the former City Managers, the Director of Community Services, the Director of Community Development, the Code Enforcement Director, the Human Resources Director and other City employees, are questionable.

Current City officials or employees could not provide an explanation or rationale for charges that included meals, hotel stays, personal cellphones and accessories purchases, late charges, and miscellaneous expenditures as follows:

Meals

The City did not have an established policy relating to meals and incidental expenses related to out-of-pocket reimbursements. Expenditures for meals totaled \$20,535, or 14%, of total City-issued credit card expenditures. These charges were for various restaurants. Some of these charges were for the City Manager's meetings with City Council Member(s), dinners, staff meetings, and business lunches. However, not all of these charges had an explanation or reason for the charges. For example:

- The former Code Enforcement Director charged meal expenses of \$260 on September 05, 2008; \$133 on September 12, 2008, and \$286 on September 13, 2008.
- The former City Manager charged meal expenses of \$174 on January 2, 2012, and \$317 on January 4, 2012.

The above charges supposedly were for periodic meetings with the City Council. These types of charges were incurred monthly between 2008 and 2012. However, the City could not provide us with a valid reason or documentation to support these charges. The fact that City officials and upper management routinely incur charges without adequate supporting documentation, justification, and/or description shows a lack of fiscal control, accountability, and integrity.

Also, while the City has no specific limit on meals, the amounts incurred seem excessive.

Hotel Charges

During our review period, the City did not have a policy governing City hotel charges. Expenditures for hotel stays totaled \$7,519, or 5%. We also noted that, in many instances, the purpose for some of the expenses were not clear and properly documented. For example:

- On June 3, 2009, the former Code Enforcement Director charged \$859 for a stay at the Marriott Renaissance Resort in Indian Wells, CA.
- On February 2, 2012, a City Council member charged \$560 for a two-night weekend stay at the Marriott Marquis in San Diego, CA.
- On January 13, 2012, the former City Manager charged the City-issued credit card \$275 for a one-night stay at the Hyatt Regency in Sacramento, CA.
- During June 2008, the City Manager and the Community Development Director charged the City-issued credit cards \$649 and \$744 for a weekend stay at the Marriott Renaissance Hotel.

As noted in other examples cited above, there was a lack of a description, justification, or any type of documentation as to the purpose and necessity of these trips.

In addition, while the City had no limit on hotel charges, the amounts incurred seem excessive. For example, the lodging expense allowance for State employees only ranges from \$90-\$150 depending on the location.

In each of above instances, as well as other instances concerning lodging expenses, there was no discernible indication that the former City Manager, Community Development Director, Community Services Director or other City employees ever inquired or considered staying at hotels that offered government rates. Some of the hotels identified above offer government rates even on weekends if it is a legitimate business trip.

Cellphones and Accessories

Expenditures for personal cell phones and accessories totaled 11% or \$15,324. We found that City-issued credit cards used to purchase cellphones/accessories did not have any support or description for the purpose. For example:

- On September 17, 2007, the Human Resources Director spent \$1,382 for unlocked cellphones.
- On October 3, 2007, the Community Development Director spent \$1,147, on unlocked cellphones.
- On July 30, 2008, and September 3, 2008, the Human Resources Director spent \$1,159 and \$1,148 for cellphones and accessories.
- On September 5, 2008, the City Manager spent \$2,020 for unlocked cellphones.

Miscellaneous Expenditures

Expenditures for miscellaneous expenditures totaled \$16,501, or 11%, and were not supported with receipts and/or detail. For example:

- On December 16, 2011, the City Manager paid \$493 to a Halloween Club. The City did not provide any support that these costs were business-related.
- On June 17, 2010, the Human Resource Director's City-issued credit card was paid-off \$922 for amounts accumulated on the card during various months. However, the City did not provide receipts for these charges.
- On June 5, 2009, the Community Development Director charged \$2,554 of various expenditures to the City-issued credit card. The City did not provide any receipts to support that these costs were business related.
- On June 2, 2008, the City paid the \$3,010 balance accumulated over time on the City Manager's City-issued credit card, again without providing any receipts to support the necessity of these charges.

Late Payment Charges

Late payment fees and over-the-limit charges totaled \$4,273, or 3%, including:

- In FY 2007-08, the Human Resources Director and Code Enforcement Director accumulated \$718 and \$495 in late monthly payment fees or over-the-limit charges on the City-issued credit card.
- In FY 2009, the Community Development Director and Code Enforcement Director accumulated \$380 and \$406 in late monthly payment fees or over-the-limit charges on the City-issued credit card.
- In FY 2012, the City Manager accumulated \$382 in late monthly payment fees or over-the-limit charges on the City-issued credit card.

Recommendation

The City should implement appropriate control measures to ensure proper review and approval of all charges relating to meals, lodging, and incidental expenses including City-issued credit card charges. This should include:

- A comprehensive travel policy which establishes clear guidance for travel, including the purpose of the trip and documentation requirements, and sets limits on lodging rates, meals, and other travel expenses;
- A policy governing circumstances for which business meals are authorized, including documentation requirements, and limits on the maximum amount allowable for business meals; and
- An expedited payment process to avoid late charges.

We also recommend that the City review the questionable charges noted above and determine whether the City officials and employees should be required to refund the City for all or part of them. The City should also consider performing a review of travel and meal expenses for the period of our review to determine whether additional refunds should be sought.

City's Response

The City agrees with the finding. Since the period under review the City reduced the credit cards that were being held by City employees. The City will implement procedures to ensure that a business expense is documented for the purchase of meals and travel related items. The City currently has a travel policy that could be updated to address the concerns raised by the findings noted. On the most recent proposed travel to a conference in California it has been documented that an inquiry was made for rooms available at the government rate. In recent travel completed by members of the City Council to participate in the California League of California City conference, members of the City Council who attended waived their right to receive per diem. It is the City's intention that upon appointment of a City Treasurer or hiring of a City Auditor a review of the items noted in the finding be performed and where applicable refunds will be sought. As time permits, those individuals will be directed to review the expenses during the periods referenced to

determine if additional refunds should be sought.

SCO’s Comments

The City agrees with the finding. The City is in the process of implementing the SCO’s recommendation.

The finding remains as stated.

**FINDING 5 —
Mismanagement of
state grant funds**

On May 5, 2011, the City refunded \$240,114 to the California Department of Parks and Recreation (Department) for disallowed amounts and unexpended balances plus interest from grant funds advanced to the City for the Clara Park Sports Complex.

Our review of available documents confirmed that in 2004 the City received a \$2.5 million grant award from the Department’s Office of Grants and Local Services for the acquisition and development of the Clara Park Sports Complex. In February 2005, the City received an advance of \$250,000 for the project.

The City contracted with Verde Vistas, LLC to provide consulting services to acquire property, manage grant services, and for project management. However, the consultant failed to properly manage and oversee this project. While some responsibility for this can be attributed to the consultant, it was the City’s responsibility to supervise the consultant closely to avoid the problems that occurred.

On October 6, 2008, the City submitted to the Department a Project Costs Summary identifying \$173,500 in costs incurred. On February 4, 2009, the City submitted a revised Project Costs Summary for \$159,750. The Department conducted an interim grant review of the Project Costs Summary submitted by the City and determined the following:

Description	Amount Claimed	Amount Allowed	Amount Disallowed
Appraisal fees	\$ 9,500	\$ —	\$ 9,500
Acquisition/grant services/ consulting fees	147,500	35,000	112,500
Landscape design	2,750	2,750	—
Subtotals	159,750	37,750	122,000
Unexpended funds deposited in a bank account	<u>90,250</u>	<u>—</u>	<u>90,250</u>
Totals	<u>\$ 250,000</u>	<u>\$ 37,750</u>	<u>\$ 212,250</u>

As shown above, the Department disallowed:

- \$112,500 for consulting services in excess of the contract amount;
- \$9,500 for appraisal fees for which the City could not provide a completed appraisal report; and
- \$90,250 represents unexpended funds deposited in an interest bearing bank account could not be accounted for by the City.

The City was requested to refund the Department a total amount of \$240,114 (the disallowed claim of \$212,250 plus \$27,864 in interest). In addition to the loss of advanced funds, the project was delayed past the grant expiration date and requires legislative action. While some responsibility for this can be attributed to the consultant, it was the City's responsibility to supervise the consultant closely to avoid the problems that occurred.

Recommendation:

The City should establish and implement grant management policies and procedures to ensure that the City properly manages and accounts for grants awarded to the City whether they are administered by City staff or by consultants.

City's Response

The City agrees with the recommendation. The Los Angeles Community Development Commission (LACDC) has requested this same document and the City has committed to provide this as part of the Manual. The timeline has been provided to LACDC.

SCO's Comments

The City agrees with the finding and is in the process of implementing the SCO's recommendation.

The finding remains as stated.

**FINDING 6 —
The City’s fixed assets
were not properly and
accurately accounted for**

The City failed to include \$125,943 out of \$59,605,670 in fixed assets in its financial records for FY 2011-12. The City did not comply with Generally Accepted Accounting Principles by not properly and accurately accounting for its fixed assets.

The City provided a copy of an electronic file containing six worksheets of transactions relating to fixed assets, including a List of Fixed Assets as of June 30, 2012. However, we noted some assets purchased during FY 2011-12 were not included in the List of Fixed Assets, as follows:

<u>Date Purchased</u>	<u>Check Number</u>	<u>Description</u>	<u>Amount</u>
08/26/2011	33488	Vehicle for municipal officer	\$ 4,800
10/20/2011	33721	Two treadmills, LUGO fitness	8,381
10/31/2011	33748	2001 and 2006 Ford Crown Victoria (US Auction)	6,666
01/12/2012	34100	Multi-hip machine	6,956
01/26/2012	34129	2002 Crown Victoria	2,500
08/17/2011	33453	Hardware and software	32,668
04/05/2012	34100	Inner/outer thigh machines	5,209
04/23/2012	34488	Machines for fitness center	5,209
04/23/2012	34462	City Hall network server	8,475
04/30/2012	34525	Two new machines, LUGO fitness	5,209
05/21/2012	34601	Windows 7 iPad 3 (16GB)	5,642
05/31/2012	34647	Ford Fusion vehicles (lease)	5,903
05/31/2012	34664	TOSHIBA laptops, emergency operations center	6,061
06/07/2012	34684	2012 Ford Fusion Hybrid (including monthly payments)	22,264
		Total	<u>\$ 125,943</u>

All fixed assets purchased by the City should be properly recorded and accounted for in its listing of fixed assets, and included in its annual financial reports reported on by its independent auditor and in its annual financial transactions report submitted to the SCO.

An accurate and complete listing of fixed assets is important to the City governance and management because it provides information for:

- Safeguarding fixed assets, because assets that are properly recorded can be easily located and maintained;
- Financial and managerial reporting, for determining capitalized cost and depreciation;
- Insurance coverage, for recording replacement and insurance values;
- Facilities and administration rate proposals, for recording use, location, funding source, and depreciation; and
- Compliance with annual audit and financial transaction reporting requirements.

Recommendation:

We recommend that the City ensure consistent City-wide procedures for fixed asset accounting, management, control, and accountability including:

- Proper financial accounting and reporting in accordance with Generally Accepted Accounting Principles (GAAP), the

- Governmental Accounting Standards Board (GASB), and other applicable government accounting standards;
- A complete and accurate listing of fixed assets of significant value;
 - A description of the responsibilities of stewardship involved in safeguarding such an important and valuable public investment; and
 - Maintenance of fixed asset records for the life of each asset which should be retained in accordance with the City's retention program.

City's Response

The City acknowledges that out of \$59 million in Capital assets \$125,943 or .21% was not shown as City property in the audited fiscal year 11/12 financial statements. While the City strives to have timely financial information, the State recognizes and allows the FTR to be submitted unaudited. Accordingly, the FTR may not always agree include fixed assets which are recorded after the submission of the FTR. The City intends to fine tune the controls over recording machinery and equipment to ensure that all movable items purchased over the capitalization policy are recorded.

SCO's Comments

The City agrees with the finding and is in the process of implementing the SCO's recommendation.

The finding remains as stated.

FINDING 7 — The City's Accounting Policy and Procedures Manual has not been updated

A well-designed and properly maintained system of accounting policies and procedures enhances both accountability and consistency. The resulting documentation can also serve as a useful training tool for staff. The documentation of accounting policies and procedures should be evaluated and updated periodically, according to a predetermined schedule. Changes in policies and procedures that occur between these periodic reviews should be updated and documented promptly. Documentation provides guidance for implementing controls and serves as a basis for training new personnel in implementing them, and provides evidence that the controls are operating effectively.

Undocumented and outdated policies and related internal controls result in unclear roles and responsibilities and lead to improper handling of transactions. An essential element of internal control is monitoring, which includes verification by management that policies and procedures are updated to adequately address new challenges identified by ongoing risk assessments.

The City updated its Accounting Policy and Procedures Manual (Manual) in September 2003. There have not been any updates through June 30, 2012, to reflect current processes and procedures over payroll and accounts receivables and payables.

The City does not have a process in place to routinely review and update its Manual. Therefore, documentation for completeness, accuracy, and consistency with existing processes is lacking.

In addition, most employees are not aware of the existence of the Manual and had no written procedures for their particular assignments. Therefore, most staff members do not have a comprehensive understanding of the City's accounting system.

Specific deficiencies related to the City's Manual are:

- Computerized payroll system changes have not been reflected in the Manual.
- The accounts receivables and payables processes are not included in the Manual.
- Travel policy and procedures are not included in the Manual; accordingly, guidance and cost limitations relating to travel expenses were not properly established. See Finding 4.
- Budget and planning are not included in the Manual; accordingly, budget estimates and expenditures are not monitored throughout the appropriation cycle. See Finding 10.
- A computerized accounting system section is not included in the manual.

It should be noted that the City's current management team is taking an active role by working with the department staff to review, develop, and update its Manual to minimize internal control weaknesses.

Recommendation

The City should review and update its Manual to ensure consistency with current processes and organizational structure, and perform periodic and ongoing reviews to ensure proper documentation, accuracy, and completeness in its financial transactions and records.

The updated Manual should be readily available to all responsible employees. It should clearly state the authority and responsibility of all employees, especially the authority to authorize transactions and the responsibility for the safekeeping of assets and records.

The Manual should also indicate which employees are to perform which procedures. Procedures should be described as they are actually intended to be performed. Also, the documentation of accounting policies and procedures should explain the design and purpose of procedures related to controls to increase employee understanding of and support for controls.

City's Response

As acknowledged by the State, the City is in process of updating the Manual and is committed to a timeline that is being monitored by the Los Angeles Community Development Commission (LACDC). Once the City has updated the Manual in accordance with the scope committed to the LACDC, the City will set a timeline to address other items noted by the State Controller's Office. Prior to addressing in a formal policy items noted by the State, the City will informally implement items to ensure that employees know and understand what duties they are expected to perform.

SCO's Comments

The City agrees with the finding and is in the process of updating its Administrative Policy Manual. The City will also continue to implement and update its policies on a regular basis and ensure that City staff are fully aware and understand the duties required of them.

The finding remains as stated.

**FINDING 8 —
Bank reconciliations not
performed, reviewed,
and approved**

Cash can be the most vulnerable asset of an entity. Timely bank reconciliation provides the necessary control mechanism to help protect this valuable resource by uncovering irregularities such as unauthorized bank withdrawals. Timely monthly preparation of bank reconciliations also assists in the regular monitoring of the City's cash flows.

Bank reconciliation is an important monthly task for the City's accounting department because:

- It compares the City's general ledger against its bank statement to check for any irregularities or overcharges,
- It provides City management a good financial oversight from month to month; and
- It provides information regarding misclassified and/or missing funds.

It is also essential that the duties of issuing payments and reconciliation are separated, and that bank reconciliation statements be reviewed and approved by upper management, performed at least once a month, and reviewed by an external auditor at least once a year.

In our review of the City's bank reconciliation process and procedures for the period of July 1, 2010, through July 31, 2012, we could not ascertain that bank reconciliations were performed monthly. The City's bank reconciliation consisted only of a print-out summary of adjusted cash balances for FY 2011-12.

Recommendation:

The City should establish and implement procedures to properly document monthly bank reconciliation process and ensure that bank reconciliations are completed, reviewed, and approved timely.

City's Response

The City agrees with the finding that during the period under review, bank reconciliations were not performed monthly. Currently, the City performs the bank reconciliation within 30 days of the end of each month.

SCO's Comments

The City agrees with the finding and has implemented the SCO's recommendation.

The finding remains as stated.

**FINDING 9 —
Insufficient records of
City Council meeting
minutes and resolutions**

State law establishes the duties of a general law City Clerk in Government Code section 40801, et seq. A summary of some of the City Clerk's duties include the following:

- Keep an accurate record of the proceedings of the legislative body.
- Maintain records readily reflecting the financial condition of the City. Keep a book marked "ordinances" and record in it all City ordinances with his or her certificate annexed to each, stating:
 - a. It is a true and correct copy of a City ordinance.
 - b. The ordinance number.
 - c. It has been published or posted pursuant to law.

The City's Municipal Code section 2.20.010 (1) states "The City clerk shall perform such duties as are set forth in the Government Code and in this code and as the City Council from time to time shall direct or authorize." The Office of the City Clerk is responsible for legislative proceedings, elections, records management, and public records including agenda and minutes. City Council minutes and resolutions are a record of official City activities and authorization for various City expenditures.

We found that not all of the minutes and resolutions were properly maintained and recorded by the City. During the period of January 1, 2005, through December 31, 2012, the City Council held 140 meetings and approved 297 resolutions, however, the City was unable to locate sufficient records of what transpired at all of these meetings. We noted the following:

- City Council meeting minutes for the period of January 1, 2005, through June 30, 2008 were incomplete and lacked the required signatures. The City Council meeting minutes were transcribed from audio into a draft copy which was not finalized, therefore, the City did not have an official final copy;

- The City was unable to locate any information for 24 City Council meetings;
- Audio recorded tapes for meetings held during the period of July 1, 2008, through December 31, 2008, could not be found and there were no written minutes for these City Council meetings; and,
- The City was unable to locate documentation for 53 resolutions adopted at City Council meetings.

Recommendation

We recommend that the City Clerk establish policies and procedures to ensure that City Council activities are properly recorded, retained, and available to the public as required by state law.

City's Response

The City acknowledges the recommendation and is currently developing a list of policies and procedures that will be implemented in the City Clerk's Office. It is estimated that by June 2014 all minutes, resolutions, and ordinances will be completed and recorded in the City Books.

SCO's Comments

The City agrees with the finding and is in the process of implementing the SCO's recommendation.

The finding remains as stated.

FINDING 10 — Delayed submission and adoption of annual budgets and amendments

Late submission to and approval of the budget by the City Council will limit the legislative scrutiny of fiscal and budgetary policies, which undermines transparency and accountability in resource allocation and utilization. Late approval of the budget also prevents the City from initiating procurement processes at the start of the financial year based on the approved budget.

During our review we found:

- For FY 2010-11 and FY 2011-12, the proposed annual budgets were not presented to the City Council for approval until August 5, 2010, and August 18, 2011, respectively. Consequently, these budget proposals were not approved by the City Council until September 2, 2010, for FY 2010-11 and November 1, 2011, for FY 2011-12. Both are well after the start of the fiscal year.
- A budgetary amendment for an increase in additional expenditures for the FY 2010-11 budget was not approved until September 6, 2011, nearly three months after the end of the fiscal year.
- There was no budget amendment approved for FY 2011-12, even though general fund expenditures for this fiscal year exceeded the appropriation by \$1,310,907.

Adoption of a timely budget and amendments allows local officials and others to use budget numbers as a reference against which to compare expenditures and revenues throughout the year. As such, the budget provides an ongoing financial management tool to ensure that the City spends within its means and balances expenditures against revenues.

Without the assurance that budget amendments are recorded timely to the financial accounting system, expenditures may exceed budgeted amounts without City Council and management's knowledge. It may also result in misstatement of the accounting records and financial reports. From a control standpoint, this is a significant deficiency in the City's administrative and internal accounting control system.

Recommendation:

The City should develop a policy and procedures to ensure that proposed budgets and amendments are submitted to the City Council with adequate time to discuss the City's proposal, make changes where appropriate, and approve the annual budget before the start of the new fiscal year and amendments prior to the end of the fiscal year.

City's Response

The City agrees with the finding and adopted Resolution 13-53 which requires the City to approve a structurally balanced budget no later than 60 days after the beginning of the fiscal year. The City will set a timeline to formalize their budget process and add that to the Manual.

SCO's Comments

The City agrees with the finding and is in the process of implementing the SCO's recommendation.

The finding remains as stated.

**Observation—
Continued decline in
general fund balance**

Based on our review of the FY 2009-10, FY 2010-11, and FY 2011-12, year-end general fund balance, we noted a decline of approximately \$2.5 million, or 26%. The City's ending fund balance amounts were as follows:

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Ending Balance</u>	<u>Ending Balance Increase (Decrease)</u>
2009-10	\$ 9,300,964	\$ 8,968,448	\$ (332,516)
2010-11	8,968,448	7,567,550	(1,400,898)
2011-12	7,567,550	6,838,969	(728,581)

Conclusion

The above table indicates that for FY 2009-10, FY 2010-11, and FY 2011-12, the City did not receive sufficient revenues to fund the level of services provided. The City should monitor the changes to its fund balance to ensure that revenues received are equal to or more than expenditures incurred. This will ensure that the City will be able to continue to provide current services and to avert fiscal emergencies.

City's Response

The City acknowledges that expenditures exceeded revenues for the three fiscal years ended June 30, 2012. As noted in the City's response to the Los Angeles Grand Jury report, the City will use available resources when there are anticipated revenue short falls. The City Council has been reformed and with the exception of two members have all served less than 6 months. Accordingly, the City Council in March 2014 will be meeting to establish a strategic plan for the City. At that time the City Council will decide what programs to offer its residence and what revenue sources will be needed to sustain the level of service desired.

SCO's Comments

The City agrees with the observation and is in the process of implementing the SCO's recommendation.

The finding remains as stated.

Appendix— City of Cudahy Evaluation of Elements of Internal Control

Management Oversight and Control (Control Environment)			
A1. Integrity and Ethical Values			On July 2012, based on information available to the general public, certain officials of the City of Cudahy's management and governing body entered into plea agreements stipulating to criminal acts including bribery, kickbacks, and misuse of public funds.
a.	Are code of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards to ethical and moral behavior established and communicated to all City management and employees?	X	City staff interviewed were not aware of the City's code of conduct and other policies regarding integrity and ethical values.
b.	Is the reasonable management attitude of "Tone at the Top" established and communicated to City management and staff?	X	See A1.
c.	Is everyday interaction with vendors, clients, auditors and other parties based on honesty and fairness?	X	See A1 and Finding 7.
d.	Is appropriate remedial action taken in response to non-compliance?	X	Based upon our inquiry with City staff, they are not aware of any remedial action taken in response to employee non-compliance with the established policy.
e.	Is management appropriately addressing intervention or overriding established controls?	X	See A1.
A2. Commitment to Competence			
a.	Is management identifying and defining the tasks required to accomplish particular jobs and fill - various positions?	X	Excessive turn-over of City management is affecting decisions and the evaluation of critical City jobs. Temporary employees and consultants are performing critical functions to continue City operations. See Finding 7.
b.	Does the City conduct appropriate analysis of the knowledge, skills, and abilities needed to perform job assignments?	X	For the period of July 1, 2010, through June 30, 2012, there was no evaluation and analysis performed to evaluate the knowledge and skills of City employees in their performance of assigned tasks.

Management Oversight and Control (Control Environment)				
	c. Is the City providing training and counseling in order to help employees maintain and improve their job competence?		X	Training in general safety and practices have not been provided to employees since October 31, 2005. In addition, based upon our inquiry there was no training provided to City employees to improve job performance.
A3.	Audit Committee			
	a. Does the City have an audit committee that is appropriate for the size and nature of the entity?		X	The City has no audit committee.
	b. Are members of the audit committee independent from the City management?		X	See A3-a.
	c. Do audit committee members have sufficient knowledge, experience, and time to serve effectively?		X	See A3-a.
	d. Does the audit committee meet regularly to set policies and objectives, review the City's performance, and take appropriate actions; and are minutes of such meetings prepared and signed on timely basis?		X	See A3-a.
	e. Do the members of the audit committee regularly receive the information they need to monitor management's objectives and strategies?		X	See A3-a.
	f. Does the audit committee review the scope and activities of the internal and external auditors?		X	See A3-a.
	g. Does the audit committee meet privately with the Chief Financial Officer/and or accounting officers, internal auditors, and external auditors to discuss the reasonableness of the financial reporting process, the system of internal control, significant comments or recommendations, and management performance?		X	See A3-a.
	h. Does the audit committee take actions as a result of its audit findings?		X	See A3-a.

A4. Management Philosophy and Operating Style			
a. Is management conservative in accepting risks, and does management move carefully, and proceed only after careful evaluation?		X	The Joint Power Insurance Agency (JPIA) performed two risk management and evaluation reviews (October 31, 2005 and February 16, 2010) in which the "Loss Control Action Plan" was identified. As of June 30, 2012, the City had not initiated any action to address the noted issues. As a result, the City was placed in a "Performance Improvement Plan" (PIP) status. Members of the JPIA that do not complete the PIP will be denied membership and will not benefit from the lower operating costs (i.e., insurance costs) afforded to JPIA members.
b. Are procedures or activities in place to regularly educate and communicate to management and employees the importance of internal controls and to raise the level of understanding control?		X	Prior to June 30, 2012, except for the built-in control in the computerized accounting system (Fund Balance) there were no procedures or activities in place to educate management and employees of the importance of internal controls. Most of the City staff was not aware of the existence of the Accounting and Administrative Policy Manual. See Finding 7.
c. Is personnel turnover in key functions at an acceptable level?		X	Turnover at key City management positions was excessive. For example, from July 1, 2010 through December 11, 2013, (last day of fieldwork) there were five different Interim City Managers and three different City Finance Directors who assumed these key City positions.
d. Does management have a positive and supportive attitude towards internal control and audit functions?		X	The City did not provide a management representation letter to the independent auditor relating to the financial audit for FY 2010-11. Also see A4-a.
e. Are valuable assets and information safeguarded from unauthorized access or use?		X	There were several City Council minutes and resolutions missing. In addition, several computer equipment and vehicles were not included in the City's "List of Fixed Assets." See Findings 9 and 6.
f. Are there frequent interactions of senior management and operation management?	X		
g. Is management attitude appropriate towards financial, budgetary and other operational reporting?		X	Annual budgets for FY 2010-11 and FY 2011-12 were adopted after the beginning of the fiscal year. There was no approved budget amendment for FY 2011-12. The City failed to provide a management representation letter for the financial audit for FY 2010-11. See Finding 10.
A5. Organizational Structure			
a. Is the City's organizational structure appropriate for its size and the nature of its operation?		X	Part-time employees are performing critical functions. The City Treasurer position must be evaluated. This position is mandated by the Cudahy Municipal Code; however, it has been vacant since 2005.

	b. Are key areas of authority and responsibility defined and communicated throughout the organization?		X	The Accounting Policy and Procedures Manual is outdated and most of the employees were not even aware its existence. These employees do not have a copy of specific procedures applicable to their assigned tasks. See Finding 7.
	c. Have appropriate and clear reporting relationships been established?	X		
	d. Does management periodically evaluate the organization's structure and make changes as necessary in fluctuating conditions?		X	There were no evaluations made of the City's organizational structure. There were several changes made to fill vacated key positions but were not based on an evaluation or analysis to meet the City's goals and objectives.
	e. Does the City employ an appropriate number of employees, particularly in managerial positions?		X	At the beginning of our review period, approximately 60 employees were employed by the City, of which only 12 are on permanent full-time status. The City relies on consultants to perform some of the critical accounting functions.
A6.	Assignment of authority and responsibility			
	a. Is the City appropriately assigning authority and delegating responsibility to the proper personnel to deal with organizational goals and objectives?		X	As of June 30, 2012, there were 64 employees employed by the City, of which 14 were permanent full-time and 50 were permanent part-time. In addition, some operation-critical functions were performed by consultants.
	b. Does each employee know how his or her work interrelates to others in the way in which authority and responsibility are assigned, and how duties are related concerning internal control?		X	Based upon our interview of several City staff, they are not aware how the work and duties interrelate with internal controls.
	c. Is delegation of authority appropriate in relation to the assignment of responsibility?		X	See A6-a.
A7.	Human Resources policies and practices			
	a. Are policies and procedures established for hiring, training, and promoting employees and management?		X	Prior to June 30, 2012, per our inquiry with City staff, there were no policy and procedures established for hiring and promoting employees. The City Manager promotes and assigns staff to management positions. Additionally, there was no training provided to City staff during the period of July 1, 2010, through June 30, 2012.
	b. Are background checks conducted on candidates for employment?		X	There were no policy and procedures requiring candidates to have background checks when applying for City employment. See Finding 7.
	c. Are employees provided the proper amount of supervision?		X	Most of the City staff we interviewed learned their specific assignment through on-the-job training. Employees in the accounting department were not properly supervised.

Risk Assessment				
B1.	Establishment of Entity-wide Objectives			
	a. Are there entity-wide objectives that were established by management?	X		
	b. Are City-wide objectives clearly communicated to all employees, and does management obtain feedback signifying that communication has been effective?		X	City-wide objectives were not communicated to some of the employees and feedback from employees was not obtained and evaluated by management.
	c. Is there a relationship and consistency between the department's operational strategies and the City-wide objectives?	X		
	d. Is there an integrated management strategy and risk assessment plan that considers the City-wide objectives and the relevant sources of risk from internal management factors and external sources, and that establishes a control structure to address those risks?		X	See A4-a.
B2.	Risk Identification			See A4-a.
	a. Is management appropriately and comprehensively identifying risk using various methodologies?		X	See A4-a.
	b. Are there mechanisms in place to anticipate, identify, and react to routine events or acts that affect achievement of objectives?		X	See A4-a.
	c. Do adequate mechanisms exist to identify risks to the City arising from external factors?		X	See A4-a.
	d. Is management assessing other factors that may contribute to or increase the risk to which the City is exposed?		X	See A4-a.
	e. Is management identifying risks City-wide and for each significant activity level of the City?		X	See A4-a.
B3.	Risk Analysis			
	a. After risks to the City have been identified, does management undertake a thorough and complete analysis of the possible effect?		X	See A4-a.

	b. Has management developed an approach for risk management and control based on how much risk can be prudently accepted?		X	See A4-a.
Control Activities				
C1. Policies and Procedures (General Applications)				
	a. Do appropriate procedures, techniques, and mechanisms exist with respect to each City's activities?		X	The Accounting Policy and Procedures Manual has not been updated since September 2003.
	b. Are the control activities identified as necessary in place and being applied?		X	Most of the City staff we interviewed was not aware of the existence of an Accounting Policy and Procedures Manual.
	c. Are control activities regularly evaluated to ensure that they are still appropriate and working as intended?		X	For the period of July 2010 through June 30, 2012, there was no evidence that evaluations were performed.
C2. Common Categories of Control Activities				
	a. Are top level reviews made of actual performance relative to budgets, forecasts, and prior periods?		X	City management is relying on the audited financial statements to identify variances between budgeted and actuals.
	b. Do managers review performance reports?		X	There were no performance reports completed for City staff and, therefore, were not reviewed.
	c. For information processing, are varieties of controls in place for performing check accuracy, completeness, and authorization of transactions?	X		
	d. Are controlled items periodically counted and compared to amounts shown on control records?		X	There was no count or comparison of controlled items.
	e. For performance indicators, does management compare different sets of data and investigate differences?		X	There were no reviews performed by City management.
	f. Are duties properly segregated among different people to reduce the risk or error or inappropriate actions?		X	See A4-a.
	g. Are administrative and operation policies in writing, current, and do they set clear procedures for compliance?		X	The Accounting Policy and Procedures Manual is outdated.

Information and Communication				
D1. Information				
a.	Are mechanisms in place to obtain relevant information on legislative or regulatory developments and program, budget, or economic changes?		X	The City contracted with Legislative Advocacy Services (LAG) to provide lobbying services including legislative tracking, analysis of legislation or regulations, and advocacy support. LAG is to provide quarterly oral reports to the City Council regarding these services; however, based upon our review of the City Council minutes there was no quarterly oral report provided to the City Council. See Finding 3.
b.	Is information provided to the right people in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively?		X	Not all operation-critical functions were communicated to the City staff. The excessive turnover of City management personnel and the problem with the City Council affected the flow of information within the City.
c.	Is development or revision of information systems based on the strategic plan linked to the entity's overall strategy, and is it responsive to achieving City-wide objectives?		X	Based upon our inquiry with the City staff, there were minimal changes to the automated accounting system, but these were updates and not changes related to the City's overall strategy.
d.	Does management support the development of necessary information systems and show its support by committing appropriate resources.		X	There is an insufficient number of permanent full-time employees that were assigned to perform operation critical functions.
D2. Communications				
a.	Does management ensure that effective internal communications occur?		X	There is lack of communication between management and staff resulting from excessive turnover at key positions (see A4-c) and problems noted in A1 relative to some of the City Council members.
b.	Does management ensure that effective external communication occurs regarding issues with serious impact on programs, projects and other activities?		X	See D2-a.
c.	Does the City employ various forms and means of communicating important information with employee and others?		X	See D2-a.
d.	Does the City manage, develop, and revise its information systems in an effort to continually improve usefulness and reliability?		X	There was no efforts noted for the period ending June 30, 2012.

Monitoring			
E1. On-going monitoring			
a.	Does management have a strategy to ensure that ongoing monitoring is effective and will trigger separate evaluations?	X	For the period of July, 1, 2010, through June 30, 2012, monitoring information relating to accounting and administrative controls was not obtained; accordingly, there were no outputs to be evaluated, no monitoring discussions among City management, no summation of monitoring data, and no general monitoring information developed.
b.	Do City personnel, in the process of performing their regular duties, obtain information about whether internal control is functioning properly?	X	Among the City staff we interviewed, most of them were not aware about the City's internal controls.
c.	Are communications from external parties corroborated with internally generated data and able to indicate problems with internal control?	X	Based on our inquiry, there were no internally generated data available.
d.	Is there appropriate organizational structure and supervision to help provide oversight of internal control functions?	X	There was no supervision to provide oversight of internal control functions except for built-in controls in the computerized accounting system.
e.	Are data recorded by information and financial systems periodically compared with physical assets and discrepancies?	X	We noted that several fixed assets were purchased during FY 2011-12 that were not included in the City's lists of fixed assets. See Finding 6.
f.	Are the City Auditor's Office and other auditors regularly providing recommendations for improvements in internal control, and is management taking appropriate follow-up action?	X	Recommendations were noted in independent as well as other audit/review reports; however, these recommendations were not always implemented. See B2.
g.	Are meetings with employees used to provide management with feedback on whether internal control is effective?	X	Per our inquiry with City staff, there were no meetings between management and City staff relating to the City's internal control policies and procedures.
h.	Are employees' regularly asked to state explicitly whether they comply with the City's code of conduct?	X	Some of the City staff we interviewed do not appear to be well-informed regarding the City's code of conduct.
E2. Separate evaluation			
a.	Are the scope and frequency of separate internal control evaluations appropriate for the City?	X	There was no separate evaluation of internal control performed on the City except for the consideration of internal control over financial reporting for FY 2009-10.
b.	Are the methodologies for evaluating the City's internal control logical and appropriate?	X	See E3-a.

	c. If the evaluations are conducted by the City Auditor’s Office, does the office have sufficient resources, ability, and independence?		X	See A3-a.
	d. Are deficiencies found during separate evaluations promptly resolved?		X	The Comprehensive Audited Financial Reports for fiscal year 2010-11, issued by the external auditor, noted that the Management Representation Letter was not provided in connection with this audit. As of December 12, 2013, the end of our fieldwork, this has not yet been resolved.
E3. Reporting deficiencies				
	a. Are there means of obtaining reports of deficiencies from both internal and external sources?	X		
	b. Is there ongoing monitoring of internal controls?		X	The City does not have on-going monitoring for internal controls. The City addresses internal control issues when presented in a report, but not all the time. For example, the Risk Management Evaluation Report, dated August 12, 2010, identified 44 operational deficiencies that included internal controls. As of June 30, 2012, none of these issues was evaluated or corrected as recommended.
	c. Are deficiencies reported to the person directly responsible and to a person at least one level higher?		X	Noted deficiencies in reports were directly communicated to the City manager. Neither the documents we reviewed nor our interview of several City staff denotes that deficiencies were ever reported to the person directly responsible for the deficiency.
	d. Are the identified transactions or events investigated to determine causes and correct problems?		X	There was no procedure in place to perform or investigate noted causes of problems. Likewise, problems noted were never corrected.

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