December 20, 2019

Letter Report 2019-807

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

Dear Governor and Legislative Leaders:

This letter report provides a statutorily required update on our assessment of the status of the city of Maywood (Maywood) as a high-risk entity under the California State Auditor (State Auditor) high-risk local government agency audit program. In October 2016, we issued Report 2015-803, which detailed the results of our audit of Maywood and concluded that issues related to its weak governance, poor financial and contract management, and inadequate internal controls rendered the city at high risk. When the State Auditor designates a local entity as high risk, state regulations require it to prepare a corrective action plan and submit to us written updates and supporting information regarding its progress in addressing the areas of risk identified in our audit report within six months of the date the report is published and every six months thereafter. State law also requires us to issue a report at least once every three years for each city identified as high risk with recommendations for improvement until we determine that the local entity has addressed the identified areas of risk and is no longer considered as a high-risk entity under our program.

In the three years since we issued the October 2016 audit report, Maywood provided its initial corrective action plan in January 2017 and three subsequent updates, one each in April 2017, March 2019, and October 2019. During this period, the city has experienced significant changes in its leadership. The interim city administrator who served the city at the time we conducted the audit ended his employment in April 2018 when the city informed him that the city council had decided not to extend his contract. Between April 2018 and May 2019, the city was led by a new interim city administrator, who was subsequently replaced by a permanent city manager who was awarded a two-year contract. Two months later, in July 2019, the city’s finance director, who had been with the city since September 2016, departed. Further, the composition of the city council changed since the release of our report in 2016 with only two of the five members remaining on the council three years later.

Maywood’s October 2019 updated corrective action plan reflects the city’s most recent efforts to address our recommendations. We reviewed the plan and found the city has made progress toward resolving some of the concerns raised in our report. However, the city still has not finalized or obtained approval of the city council for many of the policies that were under development when the city submitted its initial update in April 2017. Additionally, although the city paid one of its overdue obligations, a large portion of the city’s outstanding debt, which is another problem we highlighted in our 2016 report, continues to remain unaddressed. We discuss Maywood’s progress and the issues it still needs to address to eliminate its high-risk designation in the remainder of this report.
Identified Area of Risk: Maywood’s Weak Governance Inhibits Recovery From Its Precarious Financial and Operational Condition

Our October 2016 report highlighted multiple ways in which the city council failed to adequately oversee the city’s financial and administrative functions. This included poor handling of a former city manager’s contract, which placed restrictions on the city’s ability to dismiss that city manager and made her dismissal very costly to the city. In fact, after our audit ended, the city paid her a $300,000 settlement, mostly to cover the $270,000 in severance the city agreed to in her contract. This former city manager allowed many of the city’s financial and operational problems to remain uncorrected during her five-year tenure with the city before the city council dismissed her.

Our report also raised concerns about the city’s poor hiring practices, including an absence of a competitive and structured process to ensure that it hires the strongest candidate for each open position. In its most recent recruitment of a city manager in May 2019, Maywood appears to have followed a better selection process. According to the city council staff report Maywood provided in its October 2019 updated corrective action plan, the city appears to have used a competitive recruitment process that included advertising the position in multiple publications, reviewing 15 submitted resumes, and interviewing multiple candidates. Documents show that the city ultimately selected an individual with a relevant educational background and prior experience working in two local cities. In addition, the current city manager’s contract includes an annual performance evaluation requirement, a reasonable termination clause, and only a modest severance package.

We also found that the city better handled the timing of the city manager’s contract, which stands in contrast with our 2016 report findings regarding high-ranking officials the city allowed to work without written contracts. In this case, the city obtained the approval of the city council and entered into a contract with the city manager several days before her scheduled start date. These and other improvements regarding the city’s hiring processes, including the city’s adoption of a comprehensive hiring policy, led us to upgrade the status of the area of risk related to the city council’s lack of transparency to fully implemented. We show our updated assessments for each identified area of risk in the summary table at the end of this report.

Several of our original recommendations focused on ensuring that council members have sufficient knowledge of the city’s municipal code, open meeting requirements, and other subjects related to areas of their responsibilities. Although the city shared with us records of the council’s open meeting and contracting training, it did not provide sufficient evidence demonstrating whether and how the council members became familiar with the provisions of the municipal code or obtained training on financial management, budgeting, or human resources. It is imperative that each member of the city council receives sufficient training in these key areas and that the city follows a formalized training plan to ensure that all council members, both incumbent and newly elected, receive training relevant to their responsibilities.
Identified Area of Risk: Ineffective Financial Management Hinders Maywood’s Economic Recovery

In our October 2016 report, we discussed how Maywood’s recurring deficits and outstanding debt put its ability to provide services to its residents at risk. In the past three years, Maywood has experienced substantial growth in its general fund revenue, allowing it to pay off $3.1 million in overdue pension obligations. Compared to fiscal year 2015–16, during which Maywood reported $7.4 million in general fund revenue, the city reported $11 million in general fund revenue in fiscal year 2017–18, the latest period for which audited financial information is available, which is a 49 percent increase. Furthermore, in its latest budget for fiscal years 2019–20 through 2020–21, the city also projects that it will sustain a higher level of revenues in the following three years with general fund revenue estimated to range from $10.5 million to $10.8 million. Our review of the city’s financial records revealed two significant factors that contributed to this growth: additional revenue derived from a special property tax and new sales tax revenue collected from cannabis businesses operating within city limits.

In August 2016, the city council, acting under an exception to Proposition 13, voted to more than double an existing special property tax restricted for the payment of its pension liability. In 1978 California voters approved Proposition 13, which capped property tax at 1 percent of property value. The proposition exempted from this limitation special assessments to pay indebtedness approved by voters prior to July 1, 1978. In 1974 Maywood voters approved such a property tax for the purpose of raising sufficient revenue to fund the city’s pension contributions. The rate of this additional property tax has varied through the years. In 2016 Maywood’s city council increased the rate from 4 cents per $100 of assessed property value to 10 cents per $100 of assessed property value. According to the latest city budget, this tax is projected to generate $950,000 in fiscal year 2019–20, allowing the city to fund a significant portion of its $1.3 million annual pension payment, with the remainder coming from general fund revenue. However, as the city enters the next decade, it may need to continually increase the portion of the pension payment paid out of general fund revenue because the annual required contribution for pensions is expected to increase to $1.8 million by fiscal year 2025–26.

The November 2016 passage of Proposition 64, a statewide initiative legalizing the nonmedical use of cannabis, led to another significant increase in the city’s general fund revenue. Following the passage of this proposition, the city has taken a number of steps to allow cannabis businesses to operate within the city. In 2018 the city council approved an amendment of the Maywood Municipal Code with detailed regulations for governing commercial cannabis activity in the city. Later that same year, Maywood voters approved a measure allowing the city to establish a special tax on cannabis activity not to exceed 10 percent of gross receipts. In early 2019, the city council approved a special tax of 10 percent for dispensaries and 6 percent on all other commercial cannabis activity. Our review of Maywood’s most recent budget projections shows a steadily increasing stream of sales tax revenue from cannabis businesses. In fiscal year 2019–20 alone, the city anticipates collecting $1.2 million in cannabis sales tax and related licensing revenue, amounting to 12 percent of total general fund revenue budgeted for that year.

While the new revenue from cannabis businesses may positively affect the city’s financial standing, the stability of this revenue stream remains in question. In August 2019, the city council approved a new ordinance prohibiting any new licenses for cannabis businesses in Maywood while allowing the existing businesses to apply for their annual renewals.
According to the city manager, the city council acted in response to concerns raised by city residents about the unusually large number of cannabis businesses operating within city limits. Additionally, the city manager said that she anticipates the revenue to level off or decrease in the future. She explained that this expectation comes from her understanding of the volatility of this new area of commerce and potentially increasing competition from cannabis businesses in nearby cities.

Despite increasing revenues, the city remains in debt to the successor agency to its former redevelopment agency for an inappropriate transfer of $2.6 million and to the California Joint Powers Insurance Authority (Authority) for nearly $10 million in overdue payments. Specifically, the State Controller’s Office determined that Maywood must repay $2.6 million that a former redevelopment agency transferred to the city in June 2011 and January 2012 because the transfers were unallowable under state law. The $10 million debt to the Authority stems from civil lawsuits against the city’s police department, which was dissolved in 2010. These debt amounts remain virtually unchanged since the release of our report in October 2016. Although the city budgeted to make regular annual payments of $144,000 to the Authority, it has yet to negotiate a payment plan that will eliminate this liability in a reasonable amount of time. If the city continues to make payments at the current rate, it will take 68 years to pay off this liability. As we previously recommended, the city should take more active steps to address its overdue debt.

The city has also failed to make significant progress in improving its budgeting and financial planning. The city’s latest budget for fiscal years 2019–20 through 2020–21 exhibits many of the same weaknesses we found in the four biennial budgets we reviewed as part of our 2016 audit. For example, the latest budget does not clearly articulate the city’s long-term financial policies, nor does it include sufficient information on existing debt obligations, which continue to pose risk to the financial stability of the city. Although the city began providing council members with monthly reports that compare budgeted to actual revenue, it has not created such reports for expenditures. Further, the city only provided us with a draft of a multi-year financial forecast as part of its latest corrective action plan update, and that draft lacks a timetable for paying off its substantial outstanding debts. According to the interim finance director, the city intends to finalize its financial forecast during the development of its next budget document for fiscal years 2020–21 through 2021–22. Until Maywood fully addresses our recommendations regarding its financial management, it will likely continue to struggle in restoring its financial health.

**Identified Area of Risk: Weak Internal Controls and Noncompliance With Its Municipal Code Compromise Maywood's Provision of Basic Services to Residents**

Three years after the release of our October 2016 report, the city continues to operate without many critical internal controls. In its April 2017 corrective action plan update, the city presented separate draft policies regarding internal controls, accounting practices, budgeting, and hiring. According to the interim finance director, only one of these policies was subsequently finalized and approved by the city council. In its latest update, the city committed to developing only a timeline for completing accounting policies and procedures manuals describing accounting, purchasing, and leasing functions by March 2020. It is unclear how much longer the city will continue operating without these policies. In the meantime, the city will still be exposed to the risks we identified in our report.
One example of the city’s need to prioritize implementing such policies and procedures is its repeatedly late publication of audited financial statements, which is symptomatic of weak internal controls in the accounting and reporting functions. Specifically, the city’s audited financial statements for fiscal year 2017–18 were released in September 2019, nearly 15 months after the end of the fiscal year. In contrast, the Government Finance Officers Association, an organization that promotes best practices in government finance, recommends six months after the fiscal year end as a goal for timely financial reporting. In its report on internal controls, the city’s external auditor (auditor) pointed to the lack of regular analysis and reconciliations of multiple financial accounts as a contributing factor to the delay in the publication of the financial statements. The auditor noted that the city continued adjusting its accounting records as late as 12 months after the end of the fiscal year. The auditor further stated that it had to propose multiple material adjustments to bring the financial statements into compliance with generally accepted accounting principles. This finding is essentially identical to the one this auditor issued for fiscal year 2015–16 and in each of the four years prior. Considering the recurring nature of this finding, the lack of account reconciliations appears to be a systemic issue that the city has repeatedly failed to address. The auditor’s findings highlight the importance of timely implementation of strong policies that will ensure accurate accounting and reporting of the city’s financial condition, information that is critical for the city’s decision makers and other stakeholders. In view of that, we expect the city to promptly revisit its draft policies, make appropriate revisions, obtain approval of the city council, and implement them accordingly.

Maywood has taken steps to address the areas of risk we identified in our report, but—as we show in the following table—it has not made sufficient progress for us to remove its high-risk designation. We upgraded our assessment of the city’s status regarding contract administration since our last assessment in April 2017 because Maywood has made progress in addressing our recommendations in this area of risk. For example, to illustrate its improvements in contract management, it provided evidence of contracting training that it presented to council members and showed that it has taken steps to begin tracking its contracts. However, the city continues to bear significant financial obligations without a plan to pay for them. In addition, a lack of comprehensive financial planning tools and timely audited financial statements still deprive key decision makers of the information needed to make educated decisions about the city’s financial future. We have assessed the city’s efforts to address one area of risk as fully addressed and each of the remaining areas of risk as partially addressed, which means that the city took action to address some but not all aspects of our recommendations regarding those areas of risk. Accordingly, we look forward to receiving Maywood’s next corrective action plan and working further with the city as it continues to address the areas of risk that our October 2016 report identified.
## Table

State Auditor Assessment of Maywood's Progress in Addressing Areas of Risk

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Source: Analysis of financial and other documents provided by Maywood.

Respectfully submitted,

**Elaine M. Howle**

ELAINE M. HOWLE, CPA  
California State Auditor

For questions regarding the contents of this report, please contact Margarita Fernandez, Chief of Public Affairs, at 916.445.0255.