Corrective Action Plan for The City of Lindsay

Re: California State Auditor Report 2024-801, December 2024

The city's most recent State Audit has determined that the city will maintain a designation as a High-Risk entity. California Code of Regulations, title 2, section 61140, requires the city to provide a corrective action plan within 60 days of the conclusion of the audit which is February 17, 2025. The city will also be required to submit updates every six months due to maintaining High-Risk entity status. The first update will be due June 19, 2025.

HIGH-RISK AREA #1

Inadequate Revenue Led to Illegal Transfers to the General Fund

> Status: We conclude that Lindsay has not addressed this risk area. Although the city has implemented a plan to eventually repay transfers to its general fund, the city has depleted its general fund, leaving Lindsay poorly situated to handle unexpected economic conditions.
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> In our August 2021 audit, we found that the city forgave $6.3 million in loans made by several funds, including its water and sewer funds, to its general fund—an action that violated state law and exposed the city to litigation. Specifically, we observed that state law, as amended by Proposition 218, restricts cities from using revenue derived from property related fees 39 CALIFORNIA STATE AUDITOR Report 2024-801 | December 2024 LOCAL HIGH RISK and charges to pay for general government operations, and the city's forgiveness effectively converted those restricted funds into general funds, violating state law. We recommended that the city develop and implement a plan to repay fully these funds.
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> During this audit, we found that Lindsay's city council reinstated the loans and approved an interest free repayment plan in February 2022. The plan calls for annual payments of up to $136,000. Further, the plan describes that the city will first reimburse $1.8 million to the water fund and $2.1 million to the sewer fund, which the city anticipates will take until fiscal years 2049–50 and 2054–55 respectively. The city then plans to reimburse the other affected funds including the street improvement fund. The city began its repayments in fiscal year 2022–23, and it anticipates completing full repayment to all funds in fiscal year 2090–91, a period that does not violate state law.
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> *Corrective Action:*
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> > *The city is working to reduce the overall general fund expenditures by reducing on going salary costs back to pre-Covid staffing levels through attrition. Currently city management staff have identified 22 positions that will not be back filled and instead eliminated from the budget. In addition to reducing salary and benefit cost the city is exploring zero based budgeting to eliminate the deficit fund balance in*

the year two (2026) to begin building a reserve of at least a 3-month average of expenditures.

The city management is responsible for ensuring this is met.

Timeline: address deficit spending in year one (2025), establish reserve in year two (2026) and have a sufficient reserve by year three (2027).

HIGH-RISK AREA #2

Potentially Improper Contributions to the City's Streets Maintenance Efforts

Status: We conclude that Lindsay has partially addressed this risk area by conducting a cost study identifying the impact of water and sewer damage to roadway conditions.

In our August 2021 audit, we noted that the city charges its utilities for the cost of street repair and maintenance that result from damage by those utilities. For example, the utility's water lines run underneath city streets and may cause damage through leaks or projects to replace or repair the water lines. However, we found that the city did not know the true annual cost of the damage its water, sewer, and refuse utilities caused to its roadways. Therefore, we concluded that the city violated Proposition 218 when it transferred nearly $900,000 annually from those utilities' funds to the city's general fund to pay for that roadway damage because it could not demonstrate how it knew that was the appropriate amount to transfer. The city received the results of a cost study in June 2022 that determined the cost of roadway damage that the city could attribute to the utilities to be a collective $688,000 annually. The consultant's report noted that the estimated cost of the damage was conservative, because it included only certain types of damage caused by the utilities.

Lindsay's director of finance stated that the city has not updated the amount it transfers from the utility funds since it received the cost study in 2022. The director started in her position with the city in 2024 and did not know why the city had not yet adjusted the transfer amounts. The director of finance anticipates that the city will revise the transfer amounts in January 2025. She further asserted that the city would review the transfer amounts every five years. Until it adjusts the amount it transfers for street repairs, the city continues to expose itself to liability under Proposition 218.

Corrective Action:

The city has adjusted the transfers to be made for current year. The rates have been adjusted to include the CCI of the past two years that have passed since the study was completed in 2022. The water fund is to transfer $105,741; the sewer funds is to transfer $83,361 and the refuse fund is to transfer $633,765.

The city finance department is responsible for ensuring this is met.

Timeline: completed

HIGH-RISK AREA #3

Insufficient Planning for Federal Assistance Funds

Status: We conclude that Lindsay has fully addressed this risk area by developing a plan for spending its federal funds.

Corrective Action:

None to be taken.

HIGH-RISK AREA #4

Inadequate Enterprise Fund Balances

Status: We conclude that Lindsay has partially addressed this risk area by developing a plan to build and maintain its fund balances, but risks remain for its water fund.

In our August 2021 audit, we noted that Lindsay's annual deficits and loan forgiveness had led to concerning deficit balances in two of the city's enterprise funds—the water and sewer funds. We recommended that the city develop and implement a plan to build and maintain these balances.

In June 2022, the city adopted a fiscal sustainability and financial improvement plan for the water and sewer funds that included provisions for outlining infrastructure replacement schedules, projecting cash flows and fiscal forecasts, and establishing contingency reserve policies for the water and sewer funds. Further, because the city reinstated the loans we describe under High-Risk Area #1, the unrestricted net position of the water fund is no longer negative. Nonetheless, the net position of the water fund depends significantly on the repayment of approximately $1.8 million as of the end of fiscal year 2022–23, which the city does not expect to fully repay until fiscal year 2049–50.

A more direct measurement of the financial health of the city's enterprise funds is whether they can sustain themselves or require subsidies. As Table 3 shows, the city's water fund has incurred operating deficits in fiscal years 2020–21 through 2022–23, and the sewer fund has been self-sustaining. The city approved water rate increases in October 2024, and those increases will go into effect over the next four to five years, with the first of the increases to take effect in January 2025. Establishing appropriate rates will assist the city in effectively operating its water utility.

Corrective Action:

The city has gone through the prop 218 process to increase the water and sewer rates. The new water and sewer rates went into effect as of January 2025. The new rates are projected to make the water and wastewater accounts whole at the conclusion of year one allowing a reserve to build. It is projected that the reserve meets $1 million in 5 years to address uncertain events such as a well going down or unforeseen costs with the water and wastewater infrastructure. As stated in High-Risk #1 The city is also working to reduce the overall general fund expenditures.

The city management is responsible for ensuring this is met.

Timeline: in progress and expected to be completed by June 30, 2025

HIGH-RISK AREA #5

Service Fees Did Not Cover Costs

Status: We conclude that Lindsay has partially addressed this risk area. It developed a fee study and improved its accounting system, but it must address other weaknesses in its cash receipt processing.

In our August 2021 audit, we raised concerns that because it did not periodically review and update its fees and rates, Lindsay had not ensured that it collected sufficient revenue to cover the costs of services it provided. Further, we noted that limitations in its accounting system made the city unable to identify the precise amount of revenue it collects from some of its fees and rates. Although the city addressed the issues we identified in our prior report, we identified other issues during this audit that raise concerns.

In December 2022, the city council adopted a new citywide fee schedule to set city fees at the same level as the full cost the city incurred to support the various activities for which it charged user fees, such as issuing plumbing or electrical permits. The city council also approved an amendment to the fee schedule in July 2024. City staff proposed that amendment to increase certain fees they had either listed incorrectly or had left out of the schedule of fee increases the city approved in December 2022. We also confirmed that the city's accounting system has the capacity to track the revenue it collects from the fees it charges and that the city has established revenue accounts in that system for many of its fees.

However, as part of this audit, we identified other factors related to the city's fees and rates that demonstrate that this area remains a risk to Lindsay. The city's external auditor identified internal control weaknesses in its fiscal year 2022–23 audit. Specifically, for one city department's fees, a single individual handled deposits of fee revenue and did so without preparing proper supporting documentation. Deposits that do not include supporting documentation leave a city at risk of misappropriation of funds. Further, city staff did not reconcile cash receipts from two departments to the city's general ledger, which leaves Lindsay susceptible to the potential for misappropriation of fee revenue. Without proper controls over its cash receipt processes, the city cannot ensure that it is correctly collecting and recording its actual fee revenues, and it increases its risk that it does not handle collected cash properly. The city's director of finance stated that the city plans to centralize the fee collection process to better control fee collection and to better assure the city that its staff appropriately handle all fee revenue.

Corrective Action:

> *The city plans to adopt strong internal controls which would include centralizing all processes with fiscal oversight. Internal controls shall include every transaction having proper documentation to support each transaction, proper cash handling procedures followed, appropriate personnel access, fees schedule structures to cover costs of departmental expenditures, proper expenditure oversight and purchasing controls to maintain cost integrity, and segregation of duties to reduce the risk of fraud, misappropriation of funds and misuse of funds.*
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> *The city will create standard operating procedures outlining procedures to be followed as well as what positions are responsible also addressing segregation of duties.*
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> *The city management is responsible for ensuring this is met.*
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> *Timeline: address internal controls immediately to be able to show improvement by June 30, 2025*

HIGH-RISK AREA #6

No Long-Range Financial Planning

Status: We conclude that Lindsay has partially addressed this risk area. It has developed a financial improvement plan, but it has not kept up with the financial forecasting requirements of that plan.

In our August 2021 audit, we raised concerns that, although Lindsay had taken some steps to improve its financial position in the short term, the city had no clear plan for its long-term financial decision-making. We noted that the GFOA recommended that all governments regularly engage in long-term financial planning as part of their overall strategic planning efforts, and that long-term financial planning should include key elements, such as revenue and expenditure forecasts, strategies for achieving and maintaining financial stability, and a process for periodically reviewing and updating that plan. In this audit, we determined that Lindsay has partially addressed this risk area. In February 2022, the city council approved a Fiscal Sustainability and Financial Administration Improvement Plan (financial improvement plan). The financial improvement plan established that the city would create annual five-year long-range fiscal forecasts, identify challenges to the city's continued financial health, and take steps to reduce expenditures or increase revenues when the city is projecting a deficit. The financial improvement plan also included an initial five-year forecast of the condition of the city's general fund.

Because the financial improvement plan calls for the city to perform the five-year long-range fiscal forecast annually, we expected at the time of our audit that the city would have already conducted two additional forecasts beyond the initial version included in the February 2022 financial improvement plan. However, the director of finance confirmed that the city has not performed any updates to its long-range financial forecast. She said that the city intends to include updated forecasts in future city budgets. As we describe earlier, at the end of fiscal year 2022–23, Lindsay had negative general fund reserves. The city would likely benefit from following through with its long-range financial forecasting so that it can better anticipate its revenue and expenditures and take steps as necessary to improve its poor financial condition.

Corrective Action:

> *The director of finance has created reports for city council and management that are meaningful to make educated decisions. Previously council was not provided budget updates or reports that had revenues and expenditures in one place, which caused council to approve a negative $1.7 million budget in prior year. The director of finance is now educating council on budget and how to read each report presented to provide a better understanding of the city finances. As stated in High-Risk #1 the city is working to resolve the negative fund balance to establish a reserve by reducing salary and benefit costs and exploring zero based budgeting to eliminate the deficit fund balance in the first year (2025) to begin building a reserve of at least a 3-month average of expenditures in year two (2026).*
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> *The city management is responsible for ensuring this is met.*
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> *Timeline: address deficit in year one (2025), establish reserve at end of year one in year two (2026) and have a sufficient reserve by year three (2027), once first year deficit is addressed a 5-year projection will be presented at least bi annually in addition to each budget adoption.*

HIGH-RISK AREA #7

No Formal Strategies to Address Its Rising Employee Retirement Costs

Status: We conclude that Lindsay has not addressed this risk area. The city still needs to develop and implement strategies to reduce its retiree health benefit costs.

In our August 2021 audit, we raised concerns that Lindsay had not prefunded its OPEB liabilities as the GFOA recommends. Lindsay's OPEB benefits include continuing medical, dental, and vision coverage to its qualified retired employees. Further, we stated that the lack of prefunding had caused the city's OPEB liabilities to increase by 36 percent from fiscal years 2017–18 through 2019–20. In addition, we noted that the city's pension costs could place a financial burden on the city unless it took substantial action.

The city's financial improvement plan includes a commitment to fully fund the costs of the city's retirement plans and hold annual discussions of the city's progress in funding its pension program. Related to OPEB, Lindsay's ACFRs show an overall decline in its OPEB liability, from nearly $2 million at the end of fiscal year 2021–22 to $1.4 million at the end of fiscal year 2022–23. However, a significant factor in this decline were changes in the assumptions the city made to estimate the OPEB liability, rather than any change in the city's approach to funding OPEB. Similar to the condition at the time of our original audit, the city had not prefunded its OPEB in fiscal year 2022–23.

The director of finance explained that the city would develop a plan by June 2025 to help reduce its OPEB liabilities. She noted that she would work with the city manager to look into the city's options to reduce its OPEB costs. Among the options the city would consider will be establishing an OPEB trust to prefund its OPEB liabilities and negotiating with the unions in preparation for the next bargaining agreement to consider requiring current employees to begin contributing to the future costs of their retirement health care benefits, among other strategies. As we described in our August 2021 audit report, if the city does not require its employees to begin contributing to their OPEB, Lindsay will likely have to make higher contributions from its general fund, displacing other spending priorities.

Corrective Action:

> *The city manager and negotiation team will address personnel costs through negotiations with the established unions. The state auditor will be kept informed during this process.*
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> *The City Manager and negotiation team is responsible for ensuring this is met.*
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> *Timeline: prepare a plan in year one (2025) and establish funding within year two (2026).*

HIGH-RISK AREA #8

Lack of Planning for Public Safety Training and Equipment Needs

Status: We conclude that Lindsay has fully addressed this risk area. It has evaluated the effectiveness of its combined police and fire department, ensured that its firefighters have appropriate training, and adopted a fleet management and replacement policy covering its police and fire vehicles.

Corrective Action:

None to be taken.