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## **COUNTY LIBRARY**

### **CASH CONTROLS AUDIT REPORT**

#### **BACKGROUND**

The Board of Supervisors, by resolution, establishes cash funds for county departments to facilitate their operations. The Board has delegated the County Auditor/Controller-Recorder (ACR) the authority to establish cash funds up to \$2,500. Several different types of cash funds are used throughout the county, including petty cash funds to buy small items, change funds to make customer change, and cash shortage funds to reimburse cash shortages that occur during daily operations. The ACR has documented some general cash controls in the Internal Controls and Cash Manual (ICCM) for departments with cash funds. Among these is for departments to designate a fund custodian to be in charge of the fund. The fund custodian must be able to account for the fund in the form of cash, vouchers and receipts. Each department head or authorized designee is responsible to develop and implement the necessary guidelines and procedures to control, safeguard and handle cash.

Periodically, ACR Internal Audits Section performs audits of departmental cash funds. Upon demand of the ACR or the Board of Supervisors, the fund custodian is to give an accounting of the fund. In compliance with Article V, Section 6, of the San Bernardino County Charter, the Board of Supervisor's Policy statement on Internal Operational Auditing, and the Internal Controls and Cash Manual (ICCM), the Auditor/Controller-Recorder (ACR) completed a cash control audit of the County Library on May 13, 2008. On November 16, 2009, a Library Cash Controls Follow-Up Audit report was completed.

The original Library Audit was conducted for the period July 1, 2006 through December 31, 2006 and included surprise cash counts, tests of deposit records, inquiries of staff, observation of library cash handling procedures and other audit procedures considered necessary. Five branches-Apple Valley, Big Bear, Chino Hills, Hesperia, and

Needles-were audited along with a petty cash audit of the Library Administration. That report was submitted to the County Librarian, the County Administrative Officer, the Board of Supervisors, and the Grand Jury.

During the ACR audit of the Library's cash control, it was found that the Library was netting its overages with its shortages, thereby understating both. This is contrary to the ICCM and also violates California Government Code (GC) 50050, which states:

*Except as otherwise provided by law, money, excluding restitution to victims, that is not the property of a local agency that remains unclaimed in its treasury or in the official custody of its officers for three years is the property of the local agency (only) after notice if not claimed or if no verified complaint is filed and served.*

Even small or non-differentiated items must be kept in a separate fund for a period of one year. As is stated in GC 50055:

*Any other provision of this article notwithstanding, any individual items of less than fifteen (\$15), or any amount if the depositor's name is unknown, which remain unclaimed in the treasury or in the official custody of an officer of a local agency for the period of one year or upon an order of the court may be transferred to the general fund by the legislative body without the necessity of publication of a notice in a newspaper.*

By reducing the Library's overages by its shortages, the overages cannot be claimed by the patrons that overpaid, which is required by GC 50050 and 50055.

The ACR recommended that the County Library department should immediately stop the practice of netting their shortages with their overages. The ACR pointed out that the correct method of accounting for overages is to deposit all overages in the countywide overage fund (Fund AOV-Dept OVR). The correct procedure for shortages is to report

them to the Internal Audits Section of the office of the ACR when the department's cash fund reaches the dollar amount described in the ICCM. The ACR summarized the shortages and overages for the month of April, 2009: total overages were \$1,633 and total shortages were \$1,284. If the trend were to continue through the year, the annual totals would be \$19,596 of overages and \$15,409 of shortages.

The practice of netting shortages against overages does not show the actual amount of cash losses which occur within the County Library Department. As required by government code 29390 and 29390.1 departments are required to report all shortages to the ACR and request relief of liability from the Board of Supervisors annually. The ACR researched back to 1990 and found that the County Library has not requested a relief of liability for cash losses other than thefts in the past 19 years. By continuing to refuse to follow the recommendations of the ACR audit report the cash losses could become a personal loss of the department head since the department has not been relieved of the liability. The ACR will decline the authority granted by the Board of Supervisors to relieve any of the County Library's cash losses.

The County Library did not concur with the ACR recommendations. Their response stated that the Library's automated circulation system is its only method of accounting for cash received, but it is not a cash register system. It is a library materials circulation system, with a basic capability of accounting for cash receipts. It does not allow for online correction of entry errors, which if detected during the transaction, are recorded manually for management review and reconciliation. The totals reported by the system cannot be altered, so there will inevitably be differences between that reported amount and actual deposits; however the differences in the amounts is not significant by any standards. The Library's management reviews focus on detecting potential theft, and not on ensuring exact matches of reported receipts and cash received. Entry errors that are not detected during the transaction remain recorded and reflect on the daily money reports as overages or shortages, even when the appropriate amounts of cash have been tendered and received. Because the functionality of the system is not specifically cash

handling, these differences are as likely to be keying errors as actual cash-handling errors.

Two Government Code sections, 50050 and 50055 are cited to support the mandated deposit of overages into a separate account. Government Code 50050 refers to "money. ..that is not the property of a local agency that remains unclaimed in its treasury or in the official custody of its officers for three years," is then to be advertised in local newspapers per Section 50051 with the total amount and notice that if unclaimed the property will become the property of the local agency. There are noticeable exceptions for individual items of less than \$15, but there is no way to discern whether any overage is the result of a single transaction over \$15. This code reference is clearly inappropriate to the amounts being considered "overages" by the Library. Patrons paying fees or paying for books at sales are given receipts for the amounts they've tendered, and no one has ever returned at a later date to claim they paid too much and requested a reimbursement. And as noted above, keying errors will not produce future claimants to this "unclaimed property." Section 50055 refers to the "depositor" clearly indicating the intent of this section is other than applicable to library fines and fees.

Similarly, the amounts labeled as "shortages," again are as likely to be attributed to keying errors as actual mishandling of money. Reporting these as "shortages" is not appropriate because there is no way to determine whether they are actual shortages or keying errors that cannot be adjusted in the circulation system. Reporting and recording these amounts for "reimbursement" from Library accounts at a later date creates extra staff time/costs and also a significant expense to the Library with no clear benefit.

The Government Code sections cited and the provisions in the Cash Manual would appear to apply to different situations than that of Library operations, and to be appropriately applied would require a type of library circulation system that doesn't exist, as the ACR office has previously determined. No other County library system, to the knowledge of the Chief Librarian, in the State is compelled to follow such recommended guidelines. Furthermore the amounts of money involved, as compared to the Library's

total operations revenue, are not significant. The Library cannot determine the amount of overage or shortage per transaction and the cumulative daily amount of a shortage or overage is often less than \$1.00 per day per branch location and the average shortage per pay station is \$ .02 per day and the average overage is \$ .03 per station per day. The amount of staff time involved in cumulating overages and shortages to specific thresholds and forwarding cumulated overages and requesting cumulative reimbursements would be significant and would serve no practical purpose. No staff member can recall any request from a customer for reimbursement of an overage (unclaimed property) in the several million transactions that have occurred during the past five years.

Recent budget reductions have left the library's staffing significantly diminished. However, the library would consider the auditor's recommendation, when staffing allows or when technology changes diminish staff involvement.

## **METHODOLOGY**

The Grand Jury conducted an analysis of the original Audit of Library Cash Controls dated May 13, 2008 and the Library Cash Controls Follow-Up Audit dated November 16, 2009. Further, it reviewed and analyzed the Interoffice Memo from the Office of the Auditor/Controller-Recorder, to the County Librarian, dated February 25, 2008. The Grand Jury reviewed the audit for compliance with the County Charter, the Board of Supervisors' Policy Statement on Internal Operational Auditing and the Internal Controls and Cash Manual (ICCM). The Grand Jury review shows that the audit was accomplished according to professional standards. On Thursday April 8, 2010, an interview with the County Librarian was conducted by members of the Grand Jury. On May 4, 2010, a telephone conference call interview was conducted by Grand Jury members with the Auditor/Controller-Recorder.

## **FINDINGS**

1. Language used throughout the ICCM is more “advisory” than “directory” with no presence of giving command resulting in varied response from management to the findings of the auditors. The 2008-2009 Grand Jury had recommended that the language in the ICCM Manual be revised. Ambiguous language results in differing interpretations and therefore differing responses. The ACR had agreed with the recommendation with the changes scheduled to be included in the next revision of the Manual in June 2010. An introductory paragraph would also be included stressing that the Manual is not a guide, but a requirement that must be followed.
2. The six month follow-up audit called for in the November 2009 audit may be extended for a few months to give the Library time to work on changes being implemented at the recommendation of the County Administrative Office (CAO).
3. Audit recommendations need to be responded to in the appropriate manner with suitable oversight. This corresponds to a 2008-2009 Grand Jury recommendation that the Board of Supervisors and CAO “establish oversight of internal operational audits along with the ACR to ensure enforcement and support department management in compliance with written procedures and policy.”
4. The Library anticipates a reduction in actual cash handling over the next several years thus reducing its risk due to the implementation of the PayPal system. This system allows for payment of library fines and fees from either one’s home PC or at a library computer.

**RECOMMENDATIONS**

- 10-29            The ACR comply with the response to the 2008-2009 Grand Jury recommendations and revise the language in the ICCM. Replacing the words **should** and **must** with the word **will** results in a document that is more commanding than instructional and provides clearer direction to management and staff. (Finding 1)
  
- 10-30            The ACR follow up with its commitment to an introductory paragraph explaining that the ICCM is **not a guide, but a requirement that must be followed** with non-compliance resulting in reports to the Board of Supervisors, County Administrative Office and the Grand Jury as is the current practice. (Finding 1)
  
- 10-31            The Board of Supervisors and the County Administrative Office enforce the implementation of ACR audit recommendations by overseeing and following-up on compliance. (Finding 3)

| <b><u>RESPONDING AGENCY</u></b> | <b><u>RECOMMENDATIONS</u></b> | <b><u>DATE</u></b> |
|---------------------------------|-------------------------------|--------------------|
| Auditor/Controller-Recorder     | 10-29 through 20-30           | 9-30-2010          |
| Board of Supervisors            | 10-31                         | 9-30-2010          |
| County Administrative Office    | 10-31                         | 9-30-2010          |

# AD HOC COMMITTEES



## **AD HOC COMMITTEES**

### **MEMBERS**

#### **Barstow Cemetery**

**Brad Kuiper, Chair**

**Rosie Hinojos**

**Bill Rorick**

#### **City of Adelanto**

**Duane Mellinger, Chair**

**Julie C. Crites**

**Shawn-Marie Green**

**Donna Howard**

**Ever Marie James**

**Lydann Lord**

**Jesus C. Morga**

**Melinda O'Connor**

**Michael R. Pichler**

**Albert vande Steeg**

## **AD HOC COMMITTEES**

The Grand Jury presently has four standing committees:

1. Law & Justice
2. Admin/Financial
3. Human Services/Economic Development
4. Public Support & Services

Each of these committees is responsible for handling assignments within the cities and County, including special districts and redevelopment agencies.

For whatever reason, when it is felt that a standing committee is unable to absorb an issue into its scope, an ad hoc committee is formed to examine that specific problem or issue.

The 2009-2010 Grand Jury formed six ad hoc committees. Two of these committees are providing the following information for this Final Report.

## **BARSTOW CEMETERY DISTRICT DBA MOUNTAIN VIEW MEMORIAL PARK**

### **SUMMARY**

The Barstow Cemetery District is one of the very few Independent Special District Cemeteries in the County. The Cemetery was created in 1937. The County took it over in 1947 as a Special District. The Barstow Cemetery District is a very small operation. They have a Superintendent who manages the Cemetery, a part time office assistant, and three groundskeepers. The governing board is made up of five members. They do not have a bookkeeper and the County's Auditor Controller/Recorder's (ACR) office pays all of their bills. Since they are an Independent Special District, the County's Special District Department has no oversight of this Cemetery and plays no ongoing role. The Local Agency Formation Commission (LAFCO) for the County has the only oversight on Independent Districts. They provide a "Sphere of Influence" review every 4 1/2 years and can recommend that an Independent Special District be dissolved. In the fall of 2008, the Barstow Cemetery District's Sphere of Influence review gave them a score of '0' and recommended their dissolution. As of this date, this action has not taken place.

Government Code Section 56076 defines a sphere of influence as "a plan for the probable physical boundaries and service area of a local agency as determined by the commission." In simple terms, a sphere of influence is a planning boundary within which a city or district is expected to grow into over time. The purpose of a sphere of influence is to encourage the "logical and orderly development and coordination of local government agencies so as to advantageously provide for the present and future needs of the county and its communities."

The LAFCO “Sphere of Influence” review listed the following issues:

1. The District is non-responsive to LAFCO’s multiple Public Records Act requests for Data to complete the mandatory Municipal Service Review/Sphere of Influence update as well as written requests from the ACR for submission of monthly financial statements, annual budgets and annual Audits, as required by Health & Safety Code 9007 (Public Cemetery Law) and Government Code 26909. As of November 18, 2008, the ACR indicated that they had just received the Audit for FY 2004-05.
2. Large sums have been transferred from the endowment fund to the operating fund. Pursuant to Public Cemetery District Law, only interest and gains may be utilized from the Endowment Fund. Since the District only submitted audits for FY 2003-04 and FY 2004-05, LAFCO was unable to determine with certainty that principal was transferred.
3. Unusually high benefit payments for only two employees. LAFCO reported that the benefit payments during FY 2006-07 were approximately 85% of salaries.
4. Unusually high payments for retail water and fuel for motor vehicles charged to the District.

## **METHODOLOGY**

Grand Jury members conducted interviews with the following during the course of this investigation:

1. Barstow Cemetery District personnel on Thursday, December 3, 2009.
2. LAFCO Executive Officer on Monday, March 29, 2010.

3. Barstow Cemetery District personnel and Board Members on Thursday, April 8, 2010.
4. Director of Special Districts on Tuesday, April 20, 2010.

In addition to these interviews, Grand Jury members also reviewed various publications regarding the workings and responsibilities of LAFCO, Special Districts and California Association of Special Districts to become familiar with how they affect the workings of a Special Cemetery District. They also reviewed the most recent Audit of the Barstow Cemetery, the ACR's Financial Accounting System (FAS) report, the LAFCO meeting minutes discussing the Cemetery's Sphere of Influence report and Government Code Section 56425-56434.

## **FINDINGS**

The Grand Jury's investigation into this issue found the following.

1. The Cemetery management claims they have never been informed of the requirements regarding submitting monthly financials and annual budgets.
2. The Cemetery does submit annual Audits, but their Audits are generally received 2 years after the period of time for which they are done.
3. Since the ACR pays all of their bills, the Cemetery is of the opinion that the ACR maintains their books. The ACR sends them a monthly report (approximately 54 pages) titled "Report Distribution System" and referred to by the County as a FAS report. The Barstow Cemetery people are of the opinion that this is a financial statement.

4. The Barstow Cemetery Superintendent states that they know nothing about transfers from their Endowment Funds. They claim the ACR does that.
5. Regarding the high cost for employee benefits, there are actually five employees, not two as LAFCO indicated. Also, because of their low salaries, the Cemetery Board authorized a good health insurance plan for the employees. And with only five employees, the cost for benefits is very high, both for health insurance and worker's compensation. They are not covered in the County system where they could receive much lower premiums if they were allowed to participate.
6. The high cost of water is due to the fact that they had three wells but they have all gone dry. When they looked into re-digging a well, they were told there was no water under their property and they had no choice but to use retail water.
7. With agreement of the Barstow Cemetery District and the County, the County Special Districts Department could transfer the Cemetery to a County Controlled Special District.

## **RECOMMENDATIONS**

- 10-32 LAFCO, Special Districts and the ACR's office need to set up a meeting with the Cemetery Supervisor and the Board of Directors and provide them with understandable guidelines and rules they are to follow. (Finding 1)
- 10-33 Special Districts needs to look into taking over the Cemetery and determining what changes would have to be made in order for the Cemetery to afford this change over. (Finding 7)

- 10-34 The Barstow Cemetery needs to contact LAFCO, the ACR and Special Districts and ask for help. (Findings 1, 2, 3)
- 10-35 The Barstow Cemetery needs to arrange for someone to become their bookkeeper and keep monthly financial statements and do an annual budget. (Findings 1, 2, 3)
- 10-36 The Barstow Cemetery needs to consider finding a new auditing firm. There is no reason it should take two-plus years to do an audit on this small of an operation. (Finding 2)
- 10-37 The Barstow Cemetery needs to start budgeting so they can operate the cemetery without losing money. (Findings 2, 3, 4)
- 10-38 The Barstow Cemetery needs to again look into the possibility of drilling its own well for water. (Finding 6)
- 10-39 The Barstow Cemetery needs to contact the California Association of Special Districts and consider joining so they can obtain health insurance and workers compensation at a considerable savings. (Finding 5)

| <b>RESPONDING AGENCY</b>    | <b>RECOMMENDATIONS</b> | <b>DATE</b> |
|-----------------------------|------------------------|-------------|
| LAFCO                       | 10-32                  | 09-30-2010  |
| Special Districts           | 10-32 through 10-33    | 09-30-2010  |
| Auditor Controller/Recorder | 10-32                  | 09-30-2010  |
| Barstow Cemetery            | 10-34 through 10-39    | 09-30-2010  |

## **CITY OF ADELANTO**

### **BACKGROUND**

Information was supplied to the 2009-2010 Grand Jury that the financial status of the City of Adelanto was in very poor to severe condition. The main complaint stated that the annual audit of the budget had not been conducted for several years which concerned several governmental agencies and departments within the County of San Bernardino.

### **JURISDICTION**

The Grand Jury has jurisdiction over the Cities within the County of San Bernardino pursuant to Penal Code Section 925a.

### **INVESTIGATION**

After preliminary information was obtained and the financial condition of the City was found to be as reported, the Grand Jury agreed that a special committee should be formed to continue the investigation. An Ad Hoc Adelanto Committee was formed and the preliminary investigation of the financial status and general operation of the City was started.

### **FINDINGS**

1. Since the City of Adelanto was incorporated, until recently, they have not had a professional Administrator to guide and direct the operations of the City.
2. The City Treasurer was a part time (two days a week) position, until recently, when a full time Treasurer was employed.

3. The present City Council has recently hired a qualified, professional administrator with 30 years experience, to guide and direct the City operations.
4. As additional information regarding the finances of the City was obtained, it became very apparent that these problems covered a multitude of different functions and levels within the operation of the City and had been manifested over a long period of time.
5. Pursuant to State Penal Code Section 926, the Grand Jury may employ an expert if in its judgment they find that the employment of an expert is necessary. After the bidding process, the Grand Jury retained the services of Harvey Rose and Associates.
6. The financial and budget analysis report completed by Harvey Rose and Associates is incorporated herein as Attachment 1.

### **RECOMMENDATIONS**

- 10-40 Direct the City Manager and staff to complete the comprehensive annual financial audit reports for the fiscal years ending in June of 2008 and 2009 no later than July 31, 2010.
- 10-41 Direct the City Manager and staff to produce the completed annual financial audit report of the year ending June 30, 2010 by September 30, 2010. This is contingent on the schedule of the independent auditor that the City contracts with.
- 10-42 Request that the City Manager develop and present a comprehensive financial projection and plan for resolving the City's structural deficit in the next five years, by using the audited numbers and expenditure trends shown in the ending budget of June 30, 2010 as the base. This should be

completed and committed to by the staff and Council by the end of the year.

10-43 Immediately start discussions with the San Bernardino County Sheriff's Department and the San Bernardino County Fire Department in a concerted effort to reduce the cost of services provided to the City by both departments. This may involve the very difficult task of reducing selective services provided by the departments for a period of time until the financial situation begins to improve. This could include but is certainly not limited to the reduction in the hours that patrol deputies are on duty or the hours that fire stations are manned. There are other services that both departments provide that could be limited depending on the work load or specific requirements of the City.

10-44 It is strongly recommended that a series of public workshops be held to discuss the financial condition of the City and to explore all possible solutions to the deficit that faces the City. We understand that the problems are many, very complex, and some very hard decisions will have to be made. The more input and assistance that can be obtained from the citizens would be of tremendous help to the Council and Staff. One possibility would be requesting the citizens to approve a fire district to assist in funding this function. Although we understand this is a very unlikely possibility due to the present economic situation and the recent failure to obtain the necessary support in local adjacent communities. This is another reason that we recommend the Adelanto taxpayers be made aware of the problems that are facing the city and the possible alternatives if the situation is not dealt with in a timely fashion.

10-45 It is recommended that the City negotiate with the County to modify the terms of the Redevelopment Agency (RDA) settlement agreement to

permit a long term debt relief, which could possibly include the exchange of property which is owned by the RDA.

| <b><u>RESPONDING AGENCY</u></b> | <b><u>RECOMMENDATIONS</u></b> | <b><u>DATE</u></b> |
|---------------------------------|-------------------------------|--------------------|
| City of Adelanto                | 10-40 through 10-45           | 09-30-2010         |

**Financial and Budget Analysis  
of the  
City of Adelanto**

Submitted to the  
**2009-10 San Bernardino County  
Grand Jury**

by

**Harvey M. Rose Associates, LLC**

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April 8, 2010

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April 8, 2010

Kent Fogleman, Foreman  
Members of the 2009-10 San Bernardino County Grand Jury  
351 North Arrowhead Avenue, Room 200  
San Bernardino, CA 92415-0243

Dear Mr. Fogleman and members of the 2009-10 San Bernardino County Grand Jury:

Harvey M. Rose Associates, LLC is pleased to submit this report on the *Financial and Budget Analysis of the City of Adelanto*. This report was prepared in accordance with the scope of work described in our contract with the Grand Jury dated January 8, 2010. The intent of the analysis was to examine the City of Adelanto's overall financial condition and ascertain whether the City has sufficient resources to fund the cost of its operations and service the debt incurred by the City and its Redevelopment Agency (RDA).

The report concludes that the City is facing significant financial challenges that have been exacerbated by the current recession and rising costs of public safety services provided by the County of San Bernardino. At the end of FY 2009-10, the City will have a General Fund budget deficit of approximately \$4.2 million on base expenditures of approximately \$13.7 million, representing approximately 30 percent of its annual costs.

During the recession, the City has relied upon accelerated payments of debt owed by the Adelanto Public Utility Agency (APUA) to the General Fund to close this deficit. However, this source of funding will decline by \$3.2 million beginning in FY 2010-11, due to decisions surrounding a recent APUA bond issue. The City now intends to supplement its operating budget with the proceeds from the sale of the Adelanto Community Corrections Facility in June 2010. However, this one-time source of funds will be depleted within six years.

Similarly, the Adelanto Redevelopment Agency (RDA) is unable to service its debt with the amount of property tax increment that it receives. As a result, it has been borrowing funds from the County of San Bernardino under the terms of a 1996 settlement agreement to meet its debt obligations. Since FY 2006-07, the amount of this debt has grown by \$4.9 million, or 39.8 percent, increasing the City's total debt by approximately 5.0 percent. Unless the City is able to negotiate revisions to the settlement agreement, this debt will continue to grow into the foreseeable future.

Kent Fogleman, Foreman  
Members of the 2009-10 San Bernardino County Grand Jury  
April 8, 2010  
Page 2

The sale of the Adelanto Community Correctional Facility and other short-term solutions to the City's financial difficulties will provide only temporary deficit relief. Accordingly, the City is pursuing a number of long-term strategies to strengthen its tax base and draw development to the community. However, to accomplish these long-term strategies, City officials will need to clearly communicate the severity of its financial difficulties to its citizens and investors, while simultaneously increasing public confidence in the reasonableness of solutions that it pursues.

The report includes several recommendations that, if implemented, would aid the City in these efforts. A response to these recommendations from the City Manager has been attached for the Grand Jury's consideration.

Thank you for this opportunity to serve the 2009-10 San Bernardino County Grand Jury. Please don't hesitate to call with any questions that the members may have.

Sincerely,

Stephen Foti  
Principal/Partner

# Introduction

The 2009-10 San Bernardino County Grand Jury requested that Harvey M. Rose Associates, LLC conduct a financial and budget analysis of the City of Adelanto to evaluate the financial condition of the City and to ascertain whether the City will have sufficient resources to fund its operations and service debt obligations incurred by the City and its Redevelopment Agency (RDA) in the foreseeable future.

The Grand Jury's concerns were influenced by the conclusions reached in a 2009 San Bernardino County Local Agency Formation Commission (LAFCO) *Community Service Review* of the City of Adelanto. That review concluded:

- As of September 3, 2009, the City had not yet produced audited financial statements for fiscal years 2005-06, 2006-07, 2007-08 or 2008-09.
- As of June 30, 2005, the City had substantial long-term debt obligations related to its capital projects, redevelopment and enterprise fund activities. In addition, the General Fund had advanced approximately \$2.1 million to the RDA that was not expected to be repaid within one-year.
- As of June 30, 2005, fund balance deficits existed in the General Fund, Sanitation Special Revenue Fund, Maverick Stadium Special Revenue Fund and RDA Project Area 3 Capital Projects Fund. Although the City stated that these deficits would be eliminated with future revenue growth, it is likely that recovery has been impacted by the economic downturn.
- Approximately two-thirds of the City's territory lies within redevelopment areas. As a result, the City does not have access to property tax revenues that otherwise could have been used for general operations, had development occurred outside of the redevelopment areas.
- Due to the lack of audited financial statements and uncertainty regarding the validity of fund balance estimates included in the adopted budgets, the overall financial condition of the City could not be determined.
- A dramatic decline in assessed valuation, evidenced by County Assessor records and supported by high foreclosure rates and a drop in construction activity, indicate that the City may have significant difficulty funding service levels and servicing its debt in future years.

In summary, LAFCO concluded that:

“the City has and continues to experience financial challenges. This is evidenced by the challenges in reducing debt, the deferral of payments of certain debt, excess of expenditures over appropriations in more than one fund, which includes the General Fund, and the lack of funding to adequately provide non-enterprise services. In addition, the use of reserves generated during the building boom of the past couple of years to balance the current budget, in staff view, signals a continuing financial challenge for the City of Adelanto. LAFCO staff expresses concern that with the downturn in the economy, the reduction in assessed valuation due to the high foreclosure rate in Adelanto, and the sharp decline in construction activity, the use of reserves may not be able to close future budget gaps due to their depletion in prior years.”

Our review generally supports the conclusions reached by LAFCO in its 2009 review. Most of the conditions cited in LAFCO's *Community Service Review* continue to exist and an evaluation of budget and financial records, as well as information received from City officials during interviews, suggest that the City will be depending on various strategies that include the sale of its most valuable assets, negotiations with the County of San Bernardino for debt relief and service reductions to the community. Although many of the solutions being sought by the City are likely to provide temporary financial stability, the continuing recession, an imbalance between available revenues and the cost of services that results in a severe structural deficit, as well as other economic factors impacting the future of the community, make the long term financial viability of the City uncertain.

The remainder of this report discusses these areas of concern in more detail and provides the basis for our conclusions regarding the City's overall financial condition and viability.

## **Acknowledgements**

We would like to thank the Adelanto City Manager and Finance Director for their cooperation and assistance throughout this review. It is clear that they are facing difficult challenges as they move forward and have creatively pursued solutions that they believe will provide additional time to resolve the problems that lie at the core of their financial difficulties.

# 1. General Fund Financial Condition

- **The Adelanto General Fund has a structural deficit that has been exacerbated by the severity of the current recession. In the last three fiscal years, operating revenues have declined by 27.5 percent. In addition, the City has relied very heavily on accelerated wastewater and water utility purchase payments from the Adelanto Public Utility Authority (APUA) to finance the cost of basic General Fund services, amounting to approximately \$5.4 million in FY 2009-10. It is likely that the City will continue to use income from the sale of assets to fund its operations in the foreseeable future.**

The City of Adelanto provides a full range of services to the community that includes police, fire, planning, building, street maintenance and other municipal services. These services are funded from a variety of sources that include:

- Tax Revenue – consisting of motor vehicle in lieu tax<sup>1</sup>, sales tax, franchise tax and property tax. In FY 2009-10, the City projects that the General Fund will collect nearly \$4.0 million from these sources.
- Non-Tax Revenue – consisting of fees and charges to persons receiving services from the City and to other City funds, licenses and permits, fines and forfeitures, investment income and other miscellaneous revenues. In FY 2009-10, the City projects that the General Fund will collect nearly \$4.5 million from these sources.
- Interfund Revenue – consisting of fund transfers received by the General Fund from other City funds for a variety of purposes, including loan repayments being made by the other funds. In FY 2009-10, the City projects that the General Fund will collect approximately \$5.4 million from these sources.

In total, the City projects that the General Fund will receive approximately \$13.9 million from all sources in FY 2009-10 to fund approximately \$13.7 million in operating costs.<sup>2</sup>

## Operating and Non-Operating Revenues

The revenues collected by the General Fund can generally be grouped into two categories: (1) Operating Revenues, and (2) Non-Operating Revenues. Operating Revenues include both tax and non-tax revenue, and can generally be considered reoccurring resources that the City is entitled to receive by law or collects as a result of its activities. Non-Operating Revenues do not result from the City's activities, and are typically either one-time in nature or have a defined end-date. In Adelanto, the Interfund Revenue that the General Fund receives can be considered Non-Operating Revenue, since it principally consists of income from the sale of assets.

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<sup>1</sup> These tax revenues are provided to the City as an intergovernmental transfer from the State.

<sup>2</sup> February 24, 2010, Resolution: Approval of Resolution Adopting Mid-Year Budget Adjustments for FY 2009-10, Exhibit A

In FY 2009-10, the City projects that approximately 61.2 percent of total General Fund resources will be derived from Operating Revenue and 38.8 percent will be derived from Non-Operating Revenue. The distribution of these resources by major account category are displayed in the table, below, for FY 2006-07 through FY 2009-10.<sup>3</sup>

**Table 1**  
**Schedule of Adelanto General Fund Revenues**  
**FY 2006-07 through FY 2009-10**

| Revenue Source                     | FY 2007<br>Actual | FY 2008<br>Actual | FY 2009<br>Estimate | FY 2010<br>Estimate | 4-Year<br>Change   | Percent<br>Change | Percent<br>Of Total |
|------------------------------------|-------------------|-------------------|---------------------|---------------------|--------------------|-------------------|---------------------|
| MVIL In Lieu                       | 2,383,060         | 3,000,557         | 3,025,000           | 2,287,000           | (96,060)           | -4.0%             | 16.5%               |
| Sales Tax                          | 1,718,761         | 1,451,544         | 1,375,000           | 850,000             | (868,761)          | -50.5%            | 6.1%                |
| Franchise Tax                      | 247,006           | 325,429           | 286,500             | 390,000             | 142,994            | 57.9%             | 2.8%                |
| Property Tax                       | 324,638           | 352,230           | 453,500             | 330,000             | 5,362              | 1.7%              | 2.4%                |
| Property Transfer                  | 278,898           | 81,467            | 106,500             | 100,000             | (178,898)          | -64.1%            | 0.7%                |
| Other Taxes                        | 25,675            | 26,055            | 30,000              | 30,000              | 4,325              | 16.8%             | 0.2%                |
| <b>Subtotal Taxes</b>              | <b>4,978,038</b>  | <b>5,237,282</b>  | <b>5,276,500</b>    | <b>3,987,000</b>    | <b>(991,038)</b>   | <b>-19.9%</b>     | <b>28.8%</b>        |
| Service Fees                       | 718,135           | 1,980,130         | 1,317,248           | 1,317,248           | 599,113            | 83.4%             | 9.5%                |
| Administrative Fees                | 528,641           | -                 | 426,752             | 526,752             | (1,889)            | -0.4%             | 3.8%                |
| Interest Income                    | 1,565,050         | 1,477,453         | 1,500,000           | 1,234,310           | (330,740)          | -21.1%            | 8.9%                |
| Licenses & Permits                 | 2,251,864         | 445,487           | 302,000             | 339,500             | (1,912,364)        | -84.9%            | 2.5%                |
| Charges for Services               | 1,350,872         | 628,693           | 244,100             | 258,500             | (1,092,372)        | -80.9%            | 1.9%                |
| Fines & Forfeitures                | 144,067           | 132,184           | 146,450             | 172,000             | 27,933             | 19.4%             | 1.2%                |
| Other Revenue                      | 142,100           | 403,416           | 167,600             | 634,800             | 492,700            | 346.7%            | 4.6%                |
| <b>Subtotal Non-Tax</b>            | <b>6,700,729</b>  | <b>5,067,363</b>  | <b>4,104,150</b>    | <b>4,483,110</b>    | <b>(2,217,619)</b> | <b>-33.1%</b>     | <b>32.4%</b>        |
| <b>Total Operating Revenue</b>     | <b>11,678,767</b> | <b>10,304,645</b> | <b>9,380,650</b>    | <b>8,470,110</b>    | <b>(3,208,657)</b> | <b>-27.5%</b>     | <b>61.2%</b>        |
| Interfund Loan Repayments          | 1,923,051         | 2,721,022         | 3,585,000           | 4,165,691           | 2,242,640          | 116.6%            | 30.1%               |
| Interfund Transfers In             | 1,280,000         | 1,440,000         | 1,345,000           | 1,215,000           | (65,000)           | -5.1%             | 8.8%                |
| <b>Total Non-Operating Revenue</b> | <b>3,203,051</b>  | <b>4,161,022</b>  | <b>4,930,000</b>    | <b>5,380,691</b>    | <b>2,177,640</b>   | <b>68.0%</b>      | <b>38.8%</b>        |
| <b>Grand Total Revenue</b>         | <b>14,881,818</b> | <b>14,465,667</b> | <b>14,310,650</b>   | <b>13,850,801</b>   | <b>(1,031,017)</b> | <b>-6.9%</b>      | <b>100.0%</b>       |

Source: *City of Adelanto FY 2009-10 Proposed Budget*, and February 24, 2010, *Resolution: Approval of Resolution Adopting Mid-Year Budget Adjustments for FY 2009-10, Exhibit A*.

As shown, during the four year period FY 2006-07 through FY 2009-10, total Operating Revenues will have declined by approximately \$3.2 million, or 27.5 percent below levels collected in the first year of the period reviewed. The greatest amount of this decline occurred in the Non-Tax accounts, primarily in planning, building and community development service fees, due to a dramatic drop in development activity within the City.

<sup>3</sup> FY 2008-09 and FY 2009-10 are estimated.

During this same period, the City substantially increased the amount of Non-Operating revenue that supports General Fund activities, principally from payments received from the APUA for the purchase of the wastewater and water utilities. As shown in Table 1, Interfund Loan Repayments increased from \$1,923,051 in FY 2006-07 to \$4,165,691 in FY 2009-10.<sup>4</sup> This \$2,242,640 annual increase in receipts, equaling a rate of growth of approximately 116.6 percent, reportedly occurred after a decision by the City to accelerate payments on the approximately \$31.0 million debt balance owed by APUA at the start of the period. As shown in Table 1 and in Table 2, below, these actions allowed the City to replace a significant portion of its lost operating revenue while simultaneously funding a 7.6 percent increase in the General Fund cost of operations.

**Table 2**  
**Schedule of Adelanto General Fund Expenditures**  
**FY 2006-07 through FY 2009-10**

| Department Expenditures    | FY 2007<br>Actual | FY 2008<br>Actual | FY 2009<br>Estimate | FY 2010<br>Estimate | 4-Year<br>Change | Percent<br>Change | Percent<br>Of Total |
|----------------------------|-------------------|-------------------|---------------------|---------------------|------------------|-------------------|---------------------|
| Police (County Sheriff)    | 4,121,197         | 4,827,106         | 4,965,550           | 4,597,632           | 476,435          | 11.6%             | 33.5%               |
| Fire (County Fire)         | 1,767,900         | 2,753,517         | 3,092,000           | 3,187,486           | 1,419,586        | 80.3%             | 23.2%               |
| Community Dev/Planning     | 1,412,019         | 890,390           | 513,885             | 493,411             | (918,608)        | -65.1%            | 3.6%                |
| Building/Code Enforcement  | 848,783           | 885,367           | 655,725             | 644,796             | (203,987)        | -24.0%            | 4.7%                |
| Streets                    | 919,684           | 829,480           | 866,850             | 863,305             | (56,379)         | -6.1%             | 6.3%                |
| Human Resources/Technology | -                 | 310               | 608,170             | 576,034             | 576,034          | N/A               | 4.2%                |
| Non-Departmental           | 934,049           | 1,168,147         | 1,035,760           | 992,806             | 58,757           | 6.3%              | 7.2%                |
| All Other City Activities  | 2,736,253         | 2,821,419         | 2,557,125           | 2,358,494           | (377,759)        | -13.8%            | 17.2%               |
| <b>Total Expenditures</b>  | <b>12,739,885</b> | <b>14,175,736</b> | <b>14,295,065</b>   | <b>13,713,964</b>   | <b>974,079</b>   | <b>7.6%</b>       | <b>100.0%</b>       |

Had the City been unable to accelerate the APUA loan repayments, it would have been faced with a FY 2009-10 operating deficit of approximately \$2.2 million. Had *no* APUA payments been available to the General Fund, the operating deficit would have been nearly \$2.0 million greater, amounting to \$4.2 million, or over 30 percent of the City's total operating budget. In broad terms, this represents the City's "structural deficit", which will only be resolved by finding additional stable sources of General Fund operating income or substantially reducing costs.

This latter remedy may prove difficult. As also shown in Table 2, the City has reduced the cost of operations in virtually every service area except public safety. Much of this is appropriate, given that a significant portion of the loss in income reflects slowing in local development activities and, thus, cost reductions have been made in development-related budget areas. However, the increases in police and fire services purchased from the County were significant during the period reviewed. As shown, the cost of police services purchased from the Sheriff increased by 11.6 percent, despite recent service reductions in FY 2009-10 that produced savings

<sup>4</sup> As will be discussed in the next section of this report, the actual payments received from wastewater and water enterprise activities will be \$5.4 million in FY 2009-10. This includes the \$4,165,691 in Interfund Loan Payments and \$1,234,310 in interest income shown as Non-Tax Operating Revenue.

of approximately \$413,430.<sup>5</sup> Had the City's contract not been modified, costs would have risen 21.6 percent over FY 2006-07 levels, equating to an average annual growth rate of 7.2 percent. The Finance Director reports that the Sheriff recently notified the City that the contract cost will increase by 7.0 percent again in FY 2010-11.

More significantly, the County's charges for Fire services increased by approximately 80.3 percent during the period reviewed, from \$1,767,900 in FY 2006-07 to \$3,187,486 in FY 2009-10. Most of this increase occurred in FY 2007-08 and FY 2008-09 as a result of a unilateral decision by the County to replace pay-call firefighters with full-time firefighter-emergency medical technicians (EMT), providing constant staffing at the facility with EMT trained personnel. However, even after considering this dramatic rise in costs, since FY 2007-08, the City's cost of fire services has increased at rates surpassing those charged by the Sheriff for police services, by an average of approximately 7.9 percent per year. At the time of this report, the County Fire Department had not notified the City of contract cost increases for FY 2010-11. Absent this information, but assuming that these expenses rise at the same average rates as in prior years, the City could face additional costs of over \$580,000 for basic police and fire services next year.

## Financial Outlook

The General Fund financial outlook for the City is not promising. The lingering effects of the recession continue to adversely impact sales tax and other sources of local tax revenue, and financial consequences arising from the State's budget crisis make the reliability of certain tax revenues uncertain. Further, building and development activity remains low. The City's own projections of operating revenues assume that income will remain stagnant or continue to decline in the short term. Based on discussions with the City's Finance Director and as noted in the City's most recent *Interim Financial Report*<sup>6</sup>, payments from APUA for the purchase of the sewer and water systems will be reduced by \$3.2 million in FY 2010-11. According to the Finance Director, these reductions are necessary to conform with the underlying assumptions contained in the \$76.8 million in the 2009 Series A - Adelanto Public Utility Authority Refunding Bonds issued earlier this fiscal year.

Stagnant revenues, the potential for substantial additional costs for police and fire services, and the loss in income from the sale of the sewer and water utilities, present serious financial difficulties for the City. To resolve these financial difficulties, City representatives state that they are relying on the sale of the Adelanto Community Correctional Facility to a private correctional services provider for approximately \$28 million. Reported widely in the press, a final agreement has been entered into with a closing date of June 4, 2010. The City has also taken steps to terminate employees who currently operate the jail facility as of that date, as part of the transition plan from City to private operation of the facility. These actions will provide such staff with a severance package that will extend pay and benefits to August 4, 2010.

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<sup>5</sup> November 17, 2009, *Thirteenth Amendment to Contract with City of Adelanto for the Sheriff's Department to Provide Law Enforcement Services, Schedule A*

<sup>6</sup> *City of Adelanto Interim Financial Report, Fiscal Year 2009/10, 50% of the Fiscal Year Complete, July 1, 2009 – December 31, 2009*

For the long-term, the City has discussed the possibility of asking the voters to create a fire district that would be financed through an additional property tax levy or parcel tax. This may provide a long-term, partial solution for addressing the structural budget deficit. However, the experiences of a neighboring jurisdiction earlier this decade, to extend property taxes established to support fire district operations<sup>7</sup>, failed to obtain approval from a 2/3 voter supermajority that was necessary for passage. In Adelanto, voters may be even more reluctant to impose additional taxes on themselves, given the City's current economic environment and recent decisions by the City to increase water service charges by 229 percent over the next five years.<sup>8</sup>

Lastly, the City should seriously consider long-term cost savings solutions to its structural deficit. This could include reductions in the number of hours that fire stations are manned, based on call volume and activity, as well as the number of hours that patrol deputies are on duty. Although the review of such alternatives was outside of the scope of this analysis, the City should immediately evaluate the impact they would have on the Adelanto community. Further, the City Council should convene a public workshop to evaluate the current and long-term financial condition of the City and to explore solutions to the structural deficit. This process should be designed to obtain input directly from Adelanto taxpayers.

### **Lack of Reliable Financial Data**

It should be noted that this analysis was conducted primarily from data reported in the City's various budget documents and interim financial reports. Audited financial statements were not finalized for the year ending June 30, 2007 until just prior to the release of this report, although a draft report was provided earlier; and, financial statements for the years ending June 30, 2008 and 2009 have not been prepared. This is a significant cause for concern, since the City cannot expect confidence in its financial data without a thorough review by an independent auditor.

This deficiency was noted in the September 2009 LAFCO *Community Service Review*. At that time, the Adelanto Finance Director stated in a letter to LAFCO that the final June 30, 2007 comprehensive annual financial report (CAFR) would be produced in September 2009, a draft June 30, 2008 CAFR would be available in September 2009 and the audit of the June 30, 2009 financial statements would begin in October 2009. When we initially met with the City in early February, we were told that the June 30, 2007 CAFR would be finalized within days, the June 30, 2008 CAFR would be complete within "one to two weeks" and that the June 30, 2009 CAFR would be completed "within six months." At the exit conference for this report, we were provided with a copy of the final 2007 CAFR. However, the City also confirmed that work on the 2008 and 2009 CAFRs had been suspended because the financial auditors needed to complete work on the June 30, 2008 Adelanto Public Utility Authority financial statements and June 30, 2009 Adelanto Redevelopment Agency financial statements. Work on these CAFRs has now resumed with a goal of completing them as expeditiously as possible.

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<sup>7</sup> November, 2002, City of Hesperia, *Measure B*

<sup>8</sup> *2009 Series A - Adelanto Public Utility Authority Refunding Bond Issue*, Page 55

We understand the current challenges facing City staff. However, the successful completion of the City's financial statements is essential for increasing the public's confidence in the reported financial condition of the City. Unless this situation is resolved, it will become even more difficult to convince voters of the need to approve additional local taxes. Given the inability of the City to meet self-imposed deadlines to date, this continues to be an area of concern.

## 2. APUA Asset Purchase Payments

- **The Adelanto Public Utility Authority (APUA) has been making payments to the General Fund for its 1996 purchase of the wastewater and water utilities. The General Fund has relied heavily upon the income from this purchase to finance its ongoing operations and supplement the General Fund balance, receiving reported income of \$5.4 million in FY 2009-10. It is unlikely that the APUA will default on its debt obligations to the City due to recent substantial increases in water utility rates. However, the payments to the General Fund will decline by \$3.2 million in FY 2010-11 and continue at a reduced level until the debt is fully retired in FY 2022-23.**

As discussed previously, the General Fund has been relying on payments from the Adelanto Public Utility Authority (for the purchase of the wastewater and water utilities from the City in 1996) as an operating revenue during the period reviewed. These payments amounted to \$2,075,000 in FY 2005-06. However, beginning in FY 2006-07, the APUA began to accelerate the payment of the debt held by the water utility, providing the General Fund with \$6,802,470 more between FY 2006-07 and FY 2008-09 than would have otherwise been paid had the annual amount remained at the FY 2005-06 level of \$2,075,000.

Under the purchase agreement, payments to the City have consisted of two components: (1) *Scheduled Purchase Payments*, equal to five percent of the outstanding principal balance; and, (2) all remaining *surplus revenues* from operations. Combined, the total payments from the APUA for the wastewater and water asset purchase will equal \$5.4 million in FY 2009-10, of which \$4.2 million has been budgeted as an operating revenue with the balance of \$1.2 million being budgeted as interest income to the General Fund.

According to information contained in the 2009 Series A - Adelanto Public Utility Authority Refunding Bond issue, the wastewater utility has been making interest-only payments to the General Fund on its portion of the debt, amounting to \$386,835 in FY 2009-10. According to that document, the principal balance owed therefore remained at \$6,431,169 between FY 2005-06 and FY 2008-09 and will stay at this amount until FY 2019-20. Under the requirements of the bond agreement, beginning in that year, payments are scheduled to increase substantially until the wastewater utility debt is fully paid off in FY 2022-23.

Conversely, the water utility has been paying interest plus an increasing amount of the principal balance during the past four years to retire its debt on an accelerated schedule. At the beginning of FY 2005-06, the water utility owed the General Fund a balance of \$26,485,464. By June 30, 2009, this balance had declined to \$14,089,328. Although the water enterprise is paying the General Fund \$5,013,165 in FY 2009-10, as an underlying assumption made for the bond agreement, this amount will be lowered to approximately \$1,888,399 in FY 2010-11 and remain at approximately that level each year until the debt is fully paid off in FY 2019-20.

Even after these reductions, however, these two sources of income will provide the General Fund with a stable revenue stream of \$2,230,000 each year until the debt is fully retired in FY 2022-23. These funds are substantial. However, the bond agreement rate model assumes that the City will no longer be able to accelerate payments from the Water Utility to resolve a General Fund deficit, should one occur. Accordingly, beginning in FY 2010-11, the decision by the City to refund APUA debt essentially contributed to a \$3.2 million General Fund operating deficit from FY 2009-10 levels. Because the payments to the General Fund will remain fixed through FY 2022-23, the impact from this decision will grow with inflationary cost increases, unless other sources of income are identified by the City.

The basis for this analysis is provided in Table 3 and Table 4, below.

**Table 3**  
**Schedule of APUA Payments to the General Fund**  
**FY 2005-06 through FY 2008-09**

|                           | <b>Beginning<br/>Balance</b> | <b>Scheduled<br/>Payments</b> | <b>Surplus<br/>Revenues</b> | <b>Total<br/>Payments</b> | <b>Ending<br/>Balance</b> |
|---------------------------|------------------------------|-------------------------------|-----------------------------|---------------------------|---------------------------|
| <b><i>Wastewater</i></b>  |                              |                               |                             |                           |                           |
| FY 05-06                  | 6,431,169                    | 321,558                       | (49,583)                    | 271,975                   | 6,431,169                 |
| FY 06-07                  | 6,431,169                    | 321,558                       | 26,439                      | 347,997                   | 6,431,169                 |
| FY 07-08                  | 6,431,169                    | 321,558                       | 37,613                      | 359,171                   | 6,431,169                 |
| FY 08-09                  | 6,431,169                    | 321,558                       | 46,716                      | 368,274                   | 6,431,169                 |
| Total                     |                              | 1,286,232                     | 61,185                      | 1,347,417                 |                           |
| <b><i>Water</i></b>       |                              |                               |                             |                           |                           |
| FY 05-06                  | 26,485,464                   | 1,324,273                     | 478,752                     | 1,803,025                 | 24,562,413                |
| FY 06-07                  | 24,562,413                   | 1,228,121                     | 2,023,912                   | 3,252,033                 | 21,841,391                |
| FY 07-08                  | 21,841,391                   | 1,092,070                     | 2,848,759                   | 3,940,829                 | 18,255,019                |
| FY 08-09                  | 18,255,019                   | 912,751                       | 3,718,975                   | 4,631,726                 | 14,089,328                |
| Total                     |                              | 4,557,215                     | 9,070,398                   | 13,627,613                |                           |
| <b><i>Grand Total</i></b> |                              |                               |                             |                           |                           |
| FY 05-06                  | 32,916,633                   | 1,645,831                     | 429,169                     | 2,075,000                 | 30,993,582                |
| FY 06-07                  | 30,993,582                   | 1,549,679                     | 2,050,351                   | 3,600,030                 | 28,272,560                |
| FY 07-08                  | 28,272,560                   | 1,413,628                     | 2,886,372                   | 4,300,000                 | 24,686,188                |
| FY 08-09                  | 24,686,188                   | 1,234,309                     | 3,765,691                   | 5,000,000                 | 20,520,497                |
| Total                     |                              | 5,843,447                     | 9,131,583                   | 14,975,030                |                           |

Note: Budgeted payments in FY 2009-10 were \$5.4 million with a note that the transfer will decline to approximately \$2.2 million in FY 2010-11.

**Table 4**

**Schedule of Anticipated APUA Payments to the General Fund  
FY 2009-10 through FY 2022-23**

| Fiscal Year | Wastewater | Water     | Total     |
|-------------|------------|-----------|-----------|
| FY 10       | 386,835    | 5,013,165 | 5,400,000 |
| FY 11       | 341,601    | 1,888,399 | 2,230,000 |
| FY 12       | 344,077    | 1,885,923 | 2,230,000 |
| FY 13       | 347,079    | 1,882,921 | 2,230,000 |
| FY 14       | 350,791    | 1,879,209 | 2,230,000 |
| FY 15       | 355,492    | 1,874,508 | 2,230,000 |
| FY 16       | 361,629    | 1,868,371 | 2,230,000 |
| FY 17       | 369,966    | 1,860,034 | 2,230,000 |
| FY 18       | 381,929    | 1,848,071 | 2,230,000 |
| FY 19       | 1,365,711  | 864,289   | 2,230,000 |
| FY 20       | 2,230,000  | -         | 2,230,000 |
| FY 21       | 2,230,000  | -         | 2,230,000 |
| FY 22       | 2,230,000  | -         | 2,230,000 |
| FY 23       | 1,424,507  | -         | 1,424,507 |

It is important to note that the APUA increased both wastewater and water rates to finance operations and pay its debt obligations in preparation for the 2009 Series A - Adelanto Public Utility Authority Refunding Bond Issue. In August 2009, wastewater fees were increased to levels that would cover operations plus the debt incurred with the 2009 refunding, including the payment of outstanding principal and interest to the General Fund. Similarly, in that same month, water rates were increased by approximately 229 percent through FY 2014-15 for the same purposes. Therefore, it is highly unlikely that the APUA will default on its debt service obligations, so the General Fund can rely on these payments as a stable source of income for the next twelve to thirteen years.

### 3. Redevelopment Debt Obligations

- **The Redevelopment Agency (RDA) has long-term debt obligations that have forced it to borrow from the County through mechanisms defined in a 1996 RDA settlement agreement. These borrowings have risen substantially in recent years as property taxes have declined and the RDA has been unable to service its debt through the Property Tax increment that it receives. Without debt relief or substantial economic development within the redevelopment project areas, the RDA will be faced with continued difficulties with the funding of its current debt obligations and will likely not meet its low and moderate income housing set-aside requirements. Further, it is highly unlikely that the RDA will be able to repay a \$2.5 million loan from the General Fund in the foreseeable future.**

In its 2009 report, LAFCO made the observation that “. . . the inclusion of more than two-thirds of the City’s territory within a redevelopment area will preclude the City from receiving the tax increment above base year that otherwise would have gone to the City.” As a result, Property Tax is not a significant revenue for the General Fund in Adelanto. In addition, although the greatest share of property tax goes to the Redevelopment Agency, the RDA is unable to meet its debt obligations without borrowing from the County of San Bernardino at high interest rates against an accumulating principal balance.

As of June 30, 2009, the RDA had approximately \$68.8 million in debt from a series of bond issues, the 1996 settlement agreement with the County and a settlement agreement with the Intermountain Power Agency from a 1993 property tax appeal. Also included was a long-term advance from the General Fund of \$2,524,243. This debt had increased by a net amount of over \$3.2 million since FY 2006-07, entirely as a result of the conditions of the settlement agreement with the County, since bonded indebtedness was reduced by nearly \$1.7 million during this period. The change in liability by major category of debt is displayed in Table 5, below.

**Table 5**  
**Schedule of Redevelopment Agency Debt**  
**As of June 30, 2009**

| Debt Category                  | FY 2006-07        | FY 2007-08        | FY 2008-09        | 3-Year Change    | Percent Change | 2010 Pmts Due    |
|--------------------------------|-------------------|-------------------|-------------------|------------------|----------------|------------------|
| County Debt                    | 12,370,635        | 14,738,770        | 17,291,314        | 4,920,679        | 39.8%          | -                |
| Tax Allocation Refunding Bonds | 11,315,000        | 11,315,000        | 11,315,000        | -                | 0.0%           | 622,325          |
| Revenue Bonds                  | 37,326,949        | 37,717,029        | 35,649,905        | (1,677,044)      | -4.5%          | 3,270,983        |
| Long Term Advances             | 2,524,243         | 2,524,243         | 2,524,243         | -                | 0.0%           | -                |
| Settlement Agreement Payable   | 1,989,390         | 1,989,390         | 1,989,390         | -                | 0.0%           | -                |
| <b>Total</b>                   | <b>65,526,217</b> | <b>68,284,432</b> | <b>68,769,852</b> | <b>3,243,635</b> | <b>5.0%</b>    | <b>3,893,308</b> |

The County settlement agreement arose from a lawsuit filed against the RDA by the County for the misuse of tax increment money related to the Victor Valley Economic Development Area. To settle the dispute in 1996, the RDA agreed to “relinquish approximately 33% of incremental property taxes to the County, of which approximately one half (16.26%) would be subordinate to the Agency’s existing long-term debt. The County will loan to the Agency, at the rate of 7% per annum, the amount of the deferred incremental property taxes needed to meet debt service requirements on the refunding bonds, plus amounts needed to administer the Agency’s long term debt.”<sup>9</sup> In effect, this action required the RDA to pass 33 percent of its share of property tax increment revenue to the County (along with other more minor “pass-throughs”), pay its required debt service obligations, and borrow the balance of any deficiency from the County. The agreement does not require the City to make payments on the principal balance owed to the County on a regular or set schedule.

During the period of the economic downturn, this agreement has had devastating effects on the Adelanto RDA. As shown in Table 5, the County debt increased by 39.8 percent in the two years between FY 2006-07 and FY 2008-09, amounting to an additional obligation of \$4,920,679. During the same period, the principal owed on the Tax Allocation Refunding Bonds (1995 Series A, B, C and D and the 2007 Tax Allocation Bonds) declined by \$1,677,044. The net result of these transactions resulted in increased debt obligations of approximately five percent over FY 2006-07 levels. In FY 2009-10, the City projects that the County loan principal will increase by an additional \$1.3 million, not including the 7 percent interest on the principal balance, amounting to an estimated additional amount of \$1.2 million. After factoring in reductions in the principal on the bonded indebtedness, the RDA’s total debt obligation at the end of FY 2009-10 will likely increase by a net amount of \$1.3 million.

Due to this situation, the RDA will very likely be unable to reduce its total debt obligation or meet its mandatory 20 percent “set-aside” for low and moderate income housing without substantial increases in the amount of property tax increment that it collects. Alternatively, the City and the County are in active negotiations regarding the terms of the settlement agreement that could involve the exchange of the RDA property in lieu of a cash payment from the City on a portion of the loan principal balance. This property would be used for the construction of a reentry facility for State prisoners, to be constructed by the State. Under scenarios developed by the City, this proposal would permit the RDA to fully retire its debt to the County by FY 2020-21. This proposal is pending and the outcome is uncertain.

The RDA’s financial situation has a direct impact on the General Fund. First, it is highly unlikely that the RDA will be able to repay the \$2,524,243 advance that it received from the General Fund in prior years, since this obligation is subordinate to all other debt. Further, to the extent RDA resources are needed to meet the terms of the County settlement agreement and retire accumulating debt, the City will be hampered in its ability to develop and attract Sales Tax generating retail business or other development that would benefit the General Fund.

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<sup>9</sup> *Adelanto Redevelopment Agency Basic Financial Statements, June 30, 2009, Notes to Basic Financial Statements, Note 7H.*

## 4. Sale of Assets To Resolve Financial Difficulties

- **The City has determined that the only way that it will be able to resolve its immediate financial crisis will be to (1) sell the Adelanto Community Correctional Facility to a private prison operator that is attempting to secure contracts with the federal and/or State governments for the housing of prisoners; and, (2) successfully negotiate with the County to exchange a parcel owned by the RDA for a portion of the City's debt obligation under the 1996 RDA settlement agreement. These proposals are in different stages of negotiation between the parties, and outcome is uncertain.**

Over the years, the City of Adelanto has been able to accumulate various assets that are now being looked at to resolve its ongoing structural budget deficit. According to information obtained for this analysis, the City has executed a contract with a private prison operator that has purchased the Adelanto Community Correctional Facility to house federal and/or State prisoners. The purchase price for the facility is \$28 million.

The sale of this facility is critical to the City's ability to forestall major reductions in services. As shown in previous sections of this report, the City has:

- Experienced a 27.5 percent loss in operating revenue since FY 2005-06, amounting to approximately \$3.2 million annually;
- Seen average annual increases in costs for police and fire services purchased from the County of approximately 7.2 percent and 7.9 percent, respectively (in FY 2010-11, the Sheriff has reported that law enforcement service costs will increase by 7.0 percent and it is probable that the cost of fire services will increase by a similar amount); and,
- Has lost its ability to flexibly fund its significant operating deficit with income generated from the sale of the wastewater and water utilities to the Adelanto Public Utility Authority.

These circumstances have combined to create a situation whereby the City will either have to reduce expenditures between \$2.2 million and \$4.2 million per year (representing between 16.0 percent and 30.7 percent of the FY 2009-10 operating budget), or identify additional resources that will help to fill the budget gap. According to the Adelanto Finance Director, his projected budget deficit for FY 2010-11 will be approximately \$4.75 million, which is only slightly more than the annual cost of the law enforcement services contract with the County after the increase planned for FY 2010-11.

### **Sale of Adelanto Community Correctional Facility**

At the time of this report, City representatives stated that the agreement with the private prison operator is final. However, discussions with the City's representatives suggest that, due to delays in the purchaser's negotiations with the federal government for the housing of prisoners, the transition of City employees to private employment may not occur by the time of closing or

completion of the severance package. According to the Finance Director, in late January 2010, the purchaser requested a six month extension on the execution of a final purchase agreement but was granted only three months by the City Council to April 4, 2010. At a recent City Council meeting, in response to a request by the City, the parties agreed to a second extension of two months to June 4, 2010, so that there will be “a smoother transition” for the City workforce that will be reemployed by the private operator when the City ceases operations.

### **Exchange of RDA Property for Debt Relief**

As part of a second initiative to provide the Redevelopment Agency with an opportunity to reduce debt that is owed to the County, City officials have stated that they are in active negotiations with the County to restructure the 1996 RDA settlement agreement. Based upon interviews with both City and County representatives, the exchange of RDA-owned property, in lieu of a cash payment to the County on a portion of the settlement agreement loan principal, has been made a part of those discussions .

Under one City proposal, the RDA would provide a parcel of land to the County in exchange for reducing its debt obligation, In turn, the County would offer the parcel as a site for the construction of a State-owned prisoner reentry facility for parolees, which conceptually would have made the County eligible for a \$100 million grant to renovate its jail in Adelanto. According to worksheets provided by the City’s Finance Director, this action could substantially reduce the City’s FY 2009-10 debt obligation and allow the RDA to retire the principal balance owed to the County by FY 2020-21. However, without significant increases in the assessed valuation for property within the redevelopment project area, there will be little left to fund development projects that would stimulate Sales Tax and other General Fund revenue growth during this period.

The proposal presented by the City appears optimistic. At the time of this report, there was no clear indication of how much the County would be willing to offer to the RDA for the parcel. Further, County representatives stated during interviews that a separate proposal to offer a County-owned parcel near Apple Valley to the State for the reentry facility is in the final stages of approval, and once approved, the County will not be required to offer additional sites to the State to secure the \$100 million grant. Therefore, the value of the RDA owned parcel to the County has been diminished and the City’s ability to leverage the parcel’s value for significant debt reduction is not as likely as may have previously been thought.

Nonetheless, these measures by the City demonstrate the seriousness of the financial situation that has developed for Adelanto in the past several years. Other proposals to sell or lease the Maverick Stadium have been made, which are akin to the two primary proposals discussed in this report. Given the circumstances, we believe these efforts are appropriate. However, once the City divests itself of interest in the major capital assets that it owns, it will have very little that it can turn to during times of financial difficulty. For example, the City has suggested that the sale of the correctional facility will provide sufficient funding to cover the General Fund deficit for approximately six years. At the end of that period, the City will once again be faced with serious difficulties, unless it can successfully obtain approval from the voters to create a fire district or identifies other stable sources of income.

## **5. Summary of Conclusions and Recommendations**

The Adelanto General Fund has a structural deficit of as much as \$4.2 million that has been exacerbated by the severity of the current recession. In the last three fiscal years, General Fund operating revenues have declined by 27.5 percent and the City has had to make up this structural deficit by using non-operating revenues received from other funds.

### **Scheduled Payments for Purchase of Wastewater and Water Utilities**

Principally, the Adelanto Public Utility Authority (APUA) has been making payments to the General Fund to pay the City for the Authority's 1996 purchase of the wastewater and water utilities. When General Fund operating deficits began to climb during the economic downturn, the City reacted by accelerating the APUA purchase payment schedule to finance the cost of basic General Fund services. In FY 2009-10, the General Fund will receive income of \$5,400,000 from this source, which is \$3,325,000 more than the \$2,075,000 received in FY 2005-06. Going forward, as an assumption underlying the 2009 Series A - Adelanto Public Utility Authority Refunding Bond issue, payments to the General Fund will decline by \$3.2 million to \$2.3 million in FY 2010-11, and continue at that reduced level until the debt is fully retired in FY 2022-23.

It is unlikely that the APUA will default on its debt obligations to the City. In August 2009, wastewater fees were increased to levels that would cover operations plus the debt incurred with the 2009 refunding, including the payment of outstanding principal and interest to the General Fund for the asset purchase. Similarly, in that same month, water rates were increased by approximately 229 percent through FY 2014-15 for the same purposes.

### **RDA Accumulating Debt From 1996 County Settlement Agreement**

Similar to the General Fund, the Adelanto Redevelopment Agency (RDA) is also operating with a structural deficit. Specifically, the RDA has long-term debt obligations that have forced it to borrow from the County through mechanisms defined in a 1996 RDA settlement agreement between the RDA and the County. These borrowings have risen substantially in recent years as property taxes have declined and the RDA has been unable to service its debt through the Property Tax increment that it receives. Without debt relief or substantial economic development within the redevelopment project area, the RDA will be faced with continued difficulties funding its current debt obligations and will be challenged to meet its low and moderate income housing set-aside requirements.

Further, the RDA's financial situation has a direct impact on the General Fund. First, it is highly unlikely that the RDA will be able to repay the \$2,524,243 advance that it received from the General Fund in prior years, since this obligation is subordinate to all other debt. Further, to the extent RDA resources are needed to meet the terms of the County settlement agreement and retire accumulating County debt, the City will be hampered in its ability to develop and attract Sales Tax generating retail businesses.

## **Sale of Assets To Resolve Financial Difficulties**

It is likely that the City will continue to use income from the sale of assets to fund operations in the foreseeable future. Several proposals are in the final stages of negotiation or implementation that would provide some temporary financial relief. Nonetheless, if the City wishes to obtain voter approval of tax initiatives for long-term solutions to its financial difficulties, it must first increase confidence in the perception of its financial difficulties by making the production of up-to-date financial statements a priority.

## **Recommendations**

The Adelanto City Council should:

- 1.1 Direct the City Manager to produce audited comprehensive annual financial reports for the years ending June 30, 2008 and 2009 by no later than July 31, 2010.
- 1.2 Direct the City Manager to produce the audited comprehensive annual financial report for the year ended June 30, 2010, by no later than September 30, 2010.
- 1.3 Direct the City Manager to develop and present a five-year financial projection and plan for resolving the City's structural deficit by no later than July 31, 2010.
- 1.4 Immediately enter into negotiations with the County Sheriff and the County Fire Department to further reduce the cost of services that it purchases for public safety purposes. This could include reductions in the number of hours that fire stations are manned, based on call volume and activity, as well as the number of hours that patrol deputies are on duty.
- 1.5 As soon as practical, convene a public workshop to evaluate the current and long-term financial condition of the City and to explore solutions to the structural deficit. This process should be designed to obtain input directly from Adelanto taxpayers.
- 1.6 Proceed with negotiations with the County to modify the terms of the RDA settlement agreement to permit long-term debt relief, which could include the exchange of property owned by the RDA.

## **Costs and Benefits**

There would be no new costs to implement these recommendations. The City would be provided with a clearer path toward financial solvency that includes input from Adelanto's citizenry.

# RESPONSE ACCOUNTABILITY



**RESPONSE ACCOUNTABILITY COMMITTEE**

**MEMBERS**

**Kent Fogleman, Chair**

**Julie C. Crites**

**Jesus C. Morga**

## **RESPONSE ACCOUNTABILITY COMMITTEE**

In past years, each Grand Jury's Final Report has provided many recommendations to various governmental departments, designed to either improve operations or save taxpayer dollars. Some times these departments have agreed with the recommendations and so indicate in their written responses, along with their intentions to adopt and implement the recommendations made by the Grand Jury. However, currently there is no policy or procedure in place that mandates they do so. Consequently they are under no obligation, other than public pressure after the Final Report is made public, to implement the recommendations, even if they agreed with them. Based on a survey conducted by the 2009-2010 Grand Jury, it was clear that some departments failed to follow through with their agreed to responses.

The 2009-2010 Grand Jury formed the Response Accountability Committee to assist in this regard. The main purpose of this committee is to review the responses to previous Grand Jury's recommendations and ensure that these responses have been complied with by the various departments.

In order to continue this accountability, the 2009-2010 Grand Jury would like to see this committee carried over each year and become a permanent part of the Final Report. It is each Grand Jury's responsibility to confirm that responses were implemented as agreed to, otherwise there is no accountability.

The reports that follow represent the efforts by this Grand Jury to confirm whether past Grand Juries' recommendations were implemented as promised.

## **DEPARTMENT OF AGING AND ADULT SERVICES**

### **BACKGROUND**

The 2008-2009 Grand Jury interviewed Administrators of the Department of Aging and Adult Services (DAAS) to obtain an overview of the DAAS and, specifically, Elder Abuse Program. This Grand Jury learned that reported cases of elder abuse had been increasing in San Bernardino County over the past decade. While the cases of elder abuse were on the increase, state funds to investigate complaints of this nature were on the decline. This Grand Jury also felt that even with the declining funds, it was still imperative that the County's outreach program for reporting of elder abuse be enhanced. Based on their findings, the 2008-2009 Grand Jury recommended that the DAAS provide and display at all County Senior Citizen Centers, large visible 11X17 posters that provide information pertaining to the reporting of elder abuse. The County responded by agreeing to implement this recommendation. They projected a completion date of October 31, 2009, when these posters would be placed at all County Senior Citizens Centers.

### **METHODOLOGY**

During the first two weeks of March, 2010, Grand Jury members of this committee visited various County Senior Citizens Centers including locations in Victorville, Apple Valley, Ontario, Rialto, Chino, Redlands and Fontana to determine if this program had been implemented. In addition, Administrators of the DAAS were interviewed by committee members via a telephone conference call on March 18, 2010.

### **FINDINGS**

1. None of the County Senior Citizens Centers visited by Grand Jury committee members during the first two weeks of March 2010 had been provided these educational posters by the DAAS on reporting of elder abuse.

2. When contacted by Grand Jury Committee members on March 18, 2010, Administrators of the DAAS reported that they were unable to meet the October 31, 2009, deadline due to lack of funds to pay for this program. In addition, the person in charge of implementing this program had been on leave and no progress had taken place due to this absence.
  
3. Efforts were made by the DAAS to try and obtain these educational posters free through various state agencies, as well as the State Attorney General's Office, without any success. These posters were finally created in-house and were completed in February, 2010. DAAS personnel started distributing the posters on March 17, 2010, with completion of their distribution to all County Senior Citizens Centers by March 24, 2010.
  
4. County Senior Citizens Centers were once again visited by Grand Jury Committee members, including the Victorville, Apple Valley, Ontario, Rialto, Chino, Redlands and Fontana Centers at various times on March 19, 22, 23 and 24, 2010. The 11X17 posters, one in English and one in Spanish, with information regarding the reporting of elderly abuse, had been placed on the bulletin boards at all of these locations.

## **FACILITIES MANAGEMENT DEPARTMENT**

### **BACKGROUND**

The Facilities Management Department is responsible for building maintenance activities, custodial services and ground services for county owned and leased buildings and parking facilities. The Department maintains over 3 million square feet of building space in approximately 260 sites. The Department currently is staffed by 118 employees including 16 Supervisors. The Department last year issued approximately 30 contracts for custodial work and 40 general contracts.

During investigations by the 2007-2008 and 2008-2009 Grand Juries a number of recommendations were made with regards to Custodial Contracts and their compliance. The recommendations included providing adequate staffing to monitor contract compliance, paying particular attention to background checks, periodic reviews of existing contracts, checking license status, establishing reasonable distances that a site supervisor can be from a site, and modifying vendor contracts to allow communications between employees and supervisors to include use of either cell phones or pagers. All of these recommendations have received a response from the county agreeing to implement these recommendations.

### **METHODOLOGY**

On February 23, 2010 an interview was conducted by committee members with the Director of Facilities Management and the Deputy Director of Facilities Management. The committee was supplied with a Department Organizational Flow Chart that showed the personnel in each division and their Supervisor. The committee was further supplied with Facilities Maintenance Inspection Checklists of all Contract Buildings for the County. These Checklists showed the Building, Address, Date of Check and Rating for the Inspection. The Checklist included checks on Insurances, MSDS, Supplies and Logbooks.

## **FINDINGS**

1. The Supervisor of Custodians has been assigned to monitor and review contract compliance. The Department also uses a Quarterly Vendor Contract Checklist to check on work performed by the contracted vendors.
2. Contract workers are assigned a supervisor by Facilities Management. Workers are either accompanied by county employees at all times or have passed a background check before starting work for the county.
3. Modifications to the standard contract language have been implemented to allow communications between supervisors and workers by cell phones or pagers.

## **COMMENDATION**

The current Director of Facilities Management assumed his position in December 2008. He is to be commended for his efforts in structuring a department that has been reduced in manpower by 22% over the past two years from 150 to 118 employees. The implementation of the 9/80 work schedule is the kind of innovative thinking required under the current conditions of budget and manpower cuts. Maintaining, renovating, and upgrading the county's numerous facilities while providing a safe and clean environment for customers and employees is the goal of the Facilities Management Department and this is being accomplished while implementing various recommendations from several sources.

## **SENIOR HOME REPAIR PROGRAM**

### **BACKGROUND**

The 2007-2008 Grand Jury reviewed the Senior Home Repair Program administered by the Department of Community Development and Housing. This program provides grants up to a maximum of \$5,000.00 for qualified applicants to have repairs done to their homes. At that time, the work required at an applicant's home was performed by two-man teams, which were usually County employees. The two-man teams, supervised by the County Facilities Management Department, were paid at the rate of \$45.00 per hour per employee. The billing at this rate began at the start of the day and did not end until the employees returned to the County facility. Additional charges included mileage, which was paid at the rate of \$.62 cents per mile, and the cost of all material used to complete the required work.

In its Final Report, the 2007-2008 Grand Jury recommended that the Department of Community Housing and Development review the necessity of routinely sending two-man teams to each project. The County's response was as follows:

“The County is currently studying this and several other options with the goal of reducing costs and performing more services for each eligible homeowner within the \$5,000-per-case limit. The Department plans to complete this review and develop recommendations prior to the end of the 2008-2009 fiscal year.”

### **METHODOLOGY**

On May 6, 2010, Grand Jury members conducted a telephone conference call with the Director of the Department of Community Development and Housing. The purpose of this interview was to obtain an update on the Senior Home Repair Program. Grand Jury members also reviewed the Community Development Block Grant Senior Home

Repair Program Restructuring Recommendation that was presented to the Board of Supervisors for approval at their July 14, 2009, meeting.

### **FINDINGS**

1. The Senior Home Repair Program was revised in the summer of 2009. The revised program was approved by the Board of Supervisors at their meeting of July 14, 2009.
2. The home rehabilitation work required at the home of a qualified homeowner is now being completed by a licensed Contractor. The Department of Community Development and Housing estimates a possible overall savings of 45% by utilizing licensed Contractors.
3. Staff members of the Department of Community Development and Housing provide the quality control inspections on the rehabilitation work that is completed by the Contractors.

### **SUMMARY**

After a review of this revised program, it is evident that the Department of Community Development and Housing exceeded the recommendation made by the 2007-2008 Grand Jury in their Final Report. This Grand Jury committee feels that this Department is administrating this program with the thought of providing this very much needed service to as many qualified homeowners as possible.



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