

CITY OF HEMET

Its Ongoing Budget Deficit and Organizational Inefficiency Threaten Its Financial Stability and Delivery of Public Services

Report 2015-806

HIGH RISK

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August 4, 2016

2015-806

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

Dear Governor and Legislative Leaders:

As approved by the Joint Legislative Audit Committee, the California State Auditor presents the results of our audit of the city of Hemet (Hemet), conducted as part of our high-risk local government agency audit program.

This report concludes that Hemet is a high-risk city due to its financial and organizational risks. Specifically, Hemet's budget deficit has persisted for many years and our projection indicates that it will continue through at least fiscal year 2019-20, raising concerns about the city's ability to fund its services. Although the city developed a five-year plan to address its deficit, inaccurate information and overly optimistic assumptions distort the validity of the city's projection. In addition, we identified inefficiencies in the city's management. For example, Hemet has not adequately funded its fire department resulting in minimal staffing. The low staffing level combined with high demand for services results in potentially unsafe conditions. Further, the city lacks a coordinated approach to community engagement, and interrelated functions of city government do not have shared reporting relationships. To address these concerns, we present several recommendations, such as implementing a fee for services that the city currently provides but does not charge for as a way to generate additional revenues and outsourcing its parks maintenance to reduce costs. We also recommend changing the city's organizational structure, such as assigning its code enforcement division to report to the police or fire department to better address the city's high crime rate.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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HIGH RISK ISSUES

City of Hemet, Riverside County

Risk Designation: High Risk

ISSUE	PAGE
EXPENDITURES CONTINUE TO OUTPACE REVENUE, IMPEDING HEMET’S ABILITY TO MEET ITS FINANCIAL OBLIGATIONS	
<i>Ongoing budget deficit</i>	
<ul style="list-style-type: none"> Projected a \$5 million budget deficit for fiscal year 2015–16 and continues to experience dwindling reserves. Developed an inaccurate and overly optimistic five-year plan to address its budget deficit. 	5
<i>Rising pension costs</i>	
<ul style="list-style-type: none"> Has maintained employer contributions but faces increasing costs because of its large unfunded liability. Will incur additional payments if it fills vacant positions. 	11
<i>Use of city-supported library by nonresidents</i>	
<ul style="list-style-type: none"> Spent \$1.8 million in fiscal year 2014–15 on library operations. Serves patrons throughout the region, of which nearly half are not Hemet residents. 	13
<i>Significant retiree medical costs and unfunded liability</i>	
<ul style="list-style-type: none"> Had large retiree medical obligations, but has since shifted many participants to lower-cost health plans. Continues to incur a large unfunded liability. 	14
INEFFECTIVE AND INEFFICIENT ORGANIZATIONAL MANAGEMENT NEGATIVELY AFFECTS HEMET’S PROVISION OF PUBLIC SERVICES	
<i>Underfunded fire department</i>	
<ul style="list-style-type: none"> Faces critical needs for sufficient staffing and repairs to its infrastructure. Handles high demand for services with minimal staffing, resulting in potentially unsafe conditions. Incurs costs for emergency medical services but does not recover these costs through charges. 	17
<i>Lack of coordinated approach to promote community engagement</i>	
<ul style="list-style-type: none"> Does not have a citywide coordinated effort for community engagement. Has not sufficiently communicated information on citywide concerns to members of the public. 	21
<i>Inefficient structure of city government</i>	
<ul style="list-style-type: none"> Has experienced disproportional reporting relationships within city operations Has some functions that are related, but do not share reporting relationships or locations. 	22
<i>Turnover of key positions and lack of consistent leadership</i>	
<ul style="list-style-type: none"> Has experienced frequent turnover in its city manager and fire chief positions. Is likely to have some city departments heavily affected by upcoming retirements. 	26
<i>Inconsistencies in outsourcing maintenance activities</i>	
<ul style="list-style-type: none"> Outsources some landscape maintenance, but maintains its parks, resulting in additional costs. 	28
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RISKS FACING THE CITY OF HEMET

In July 2015, the California State Auditor (State Auditor) informed the city of Hemet (Hemet) that it had been selected for review under the high-risk local government agency audit program. The program authorizes the State Auditor to identify local government agencies that are at high risk for potential waste, fraud, abuse, or mismanagement, or that have major challenges associated with their economy, efficiency, or effectiveness. We initially identified Hemet as an entity that might be classified as a high-risk local government entity based on publicly available information. The State Auditor conducted an initial assessment of Hemet in July and August 2015. Although we did not observe any conditions related to fraud or abuse, we did identify concerns regarding Hemet's persistent budget deficits and high retiree medical benefit costs.

In December 2015, Hemet provided the State Auditor with an update on its progress in addressing the risk factors we identified. In particular, Hemet indicated that it had made substantial progress in reducing its retiree medical costs by creating an incentive program to encourage retirees enrolled in its most expensive health care plan to switch to a lower-cost plan. However, based on our continuing concerns regarding its budget deficit, we recommended an audit of Hemet, which the Joint Legislative Audit Committee approved in January 2016.

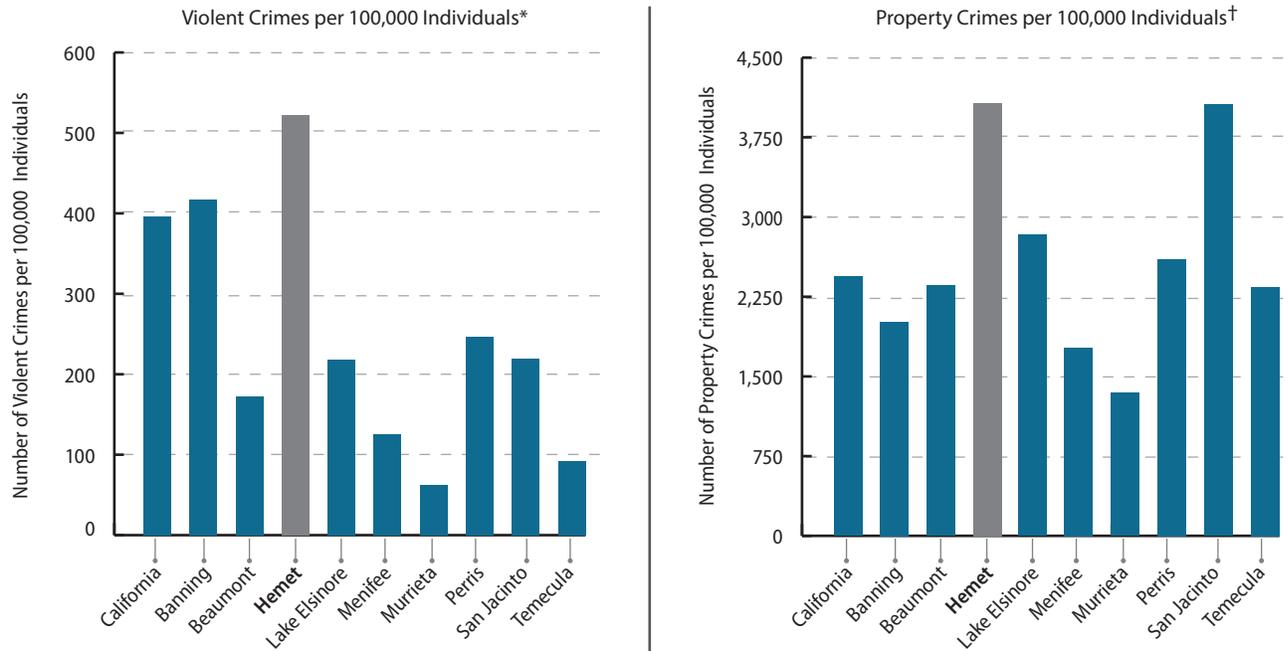
To generate additional revenue to fund its police and fire departments, Hemet proposed a 10-year 1 percent special-purpose sales tax designated for public safety. However, the proposed tax measure, which Hemet placed on the ballot in the June 2016 election, failed to achieve the necessary two-thirds approval

by voters. Had the measure passed, Hemet estimated that it would have generated an additional \$10 million to \$13 million in revenue annually for the 10-year life of the tax. Hemet intended to use this new revenue to hire additional police and fire staff, along with other spending related to public safety, such as purchasing needed equipment. The tax measure would have required Hemet to split the proceeds from the tax between the police and fire departments, with two-thirds designated for the police department and one-third designated for the fire department.

One of the reasons Hemet proposed the special-purpose tax for public safety was to address its high crime rates. Hemet's 2014 violent and property crime rates were higher than those in surrounding communities and in California as a whole, as depicted in Figure 1 on the following page. Further, Hemet police department statistics show that the number of violent crimes increased by 30 percent between 2014 and 2015. Various changes in Hemet's demographic profile over the previous decade may have affected crime rates. However, Hemet's police chief has specifically identified the reduction in sworn police officers as a factor contributing to the increased crime rates in Hemet. Although the budgeted number of sworn police officers increased by 16 positions between fiscal years 2011–12 and 2014–15, Hemet reduced the number of budgeted officers by 31 between fiscal years 2006–07 and 2011–12, and the number of officers has yet to recover fully to the 2006–07 level. According to the police chief, the reduction in police staffing has forced officers to focus on only immediate needs and limited their time for proactive crime prevention.

Figure 1

The City of Hemet's Crime Rate Is Greater Than That of California as a Whole and Surrounding Cities



Source: Federal Bureau of Investigation (FBI) Uniform Crime Report for 2014, which is the most recent complete year of data available from the FBI.

* Violent crime includes murder and nonnegligent manslaughter, rape, robbery, and aggravated assault.

† Property crime includes burglary, larceny-theft, and motor vehicle theft.

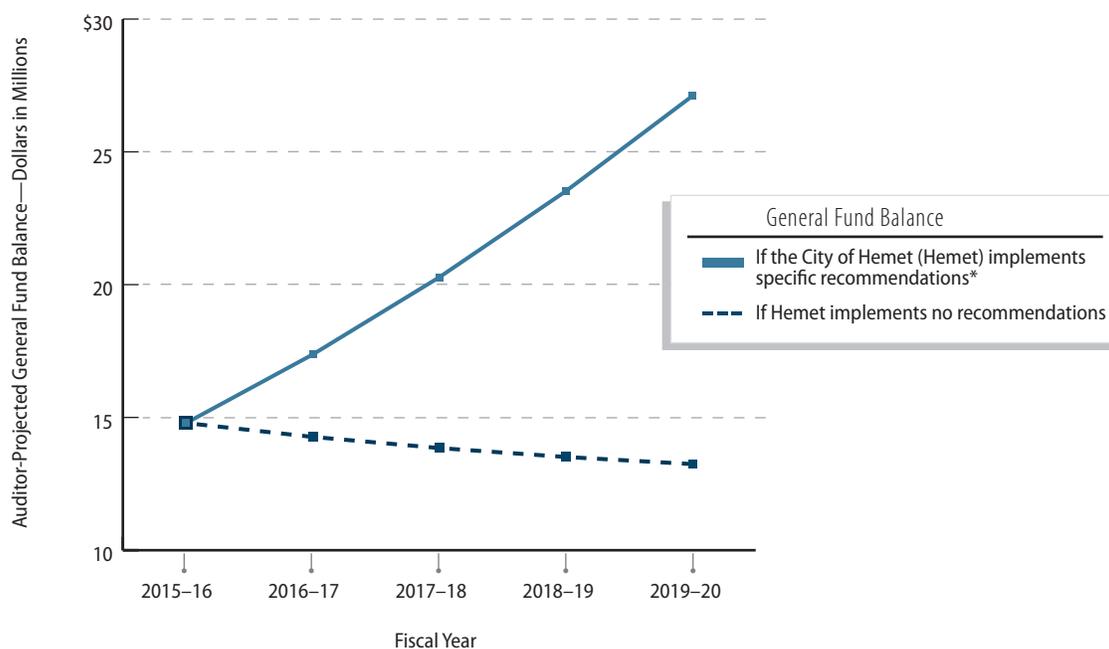
Despite Hemet's recent actions to address our identified risk factors, our analysis concludes that Hemet should be classified as a high-risk local government agency due to substantial risk factors in the city's financial management and organizational management. Specifically, Hemet developed a plan to address its financial challenges, but we project that this plan will not eliminate its budget deficit. As a result, its financial condition has the potential to hinder its ability to efficiently deliver public services, particularly in the area of public safety.

In addition, some aspects of city government continue to be ineffective and inefficient, impairing the provision of public services. For example, Hemet's fire department is understaffed, presenting a public safety risk. Further, high turnover of key leaders in city government—chiefly the city manager—has limited Hemet's ability to plan for the future.

To help Hemet address the identified risk factors, we have developed numerous options the city could implement, including increasing the cost effectiveness of certain services, charging fees for services it currently provides at no cost, engaging in strategic and succession planning, and revising the structure of city government for increased efficiency. As seen in Figure 2,

our projections show that by implementing specific recommendations, Hemet could increase the balance of its general fund over time. Specifically, our projections show that it could generate additional revenue annually, ranging from \$3.1 million to \$3.8 million, and would result in annual revenues exceeding its expenditures over the next four fiscal years.

Figure 2
Implementation of Specific Recommendations Could Increase the City of Hemet's General Fund Balance



Sources: California State Auditor (State Auditor) analysis based on Hemet's five-year projections corrected by the State Auditor, fiscal year 2014-15 comprehensive financial report, and State Auditor review.

* Specific recommendations addressed in our report include \$2.1 million to \$2.8 million additional revenue generated annually by charging for emergency medical services provided by its fire department (based on a 50 percent collection rate), \$835,000 additional revenue generated annually for charging for nonresident use of the city library (based on a \$50 annual fee collected from 50 percent of the patrons that would be required to pay), and \$183,000 annual savings from outsourcing maintenance of city parks (based on \$0.15 per square foot).

Agency's Proposed Corrective Action

Hemet disagreed with our designation of the city as high risk. It plans in August 2016 to submit its corrective action plan, in which it will outline how it will address our recommendations.

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EXPENDITURES CONTINUE TO OUTPACE REVENUE, IMPEDING HEMET'S ABILITY TO MEET ITS FINANCIAL OBLIGATIONS

Hemet's persistent budget deficit, fluctuating revenue, and long-term obligations have affected its financial stability and put it at high risk of being unable to meet its future financial obligations.¹ For eight of the past nine fiscal years, Hemet's general fund expenditures have exceeded its revenue, resulting in the city having to rely on one-time revenues and its general fund reserves to balance its budget. In addition, Hemet's significant long-term obligations—particularly its unfunded pension liability—threaten the city's ability to meet its future financial obligations. Although Hemet has recently taken steps to address its long-term obligations, financial challenges remain. To address these concerns, we have identified additional opportunities for Hemet to increase its revenue, including implementing a fee for nonresidents who use the city library and, as we discuss in a later section, charging for emergency medical services provided by its fire department.

Hemet's Budget Deficit Will Persist Unless It Takes Action

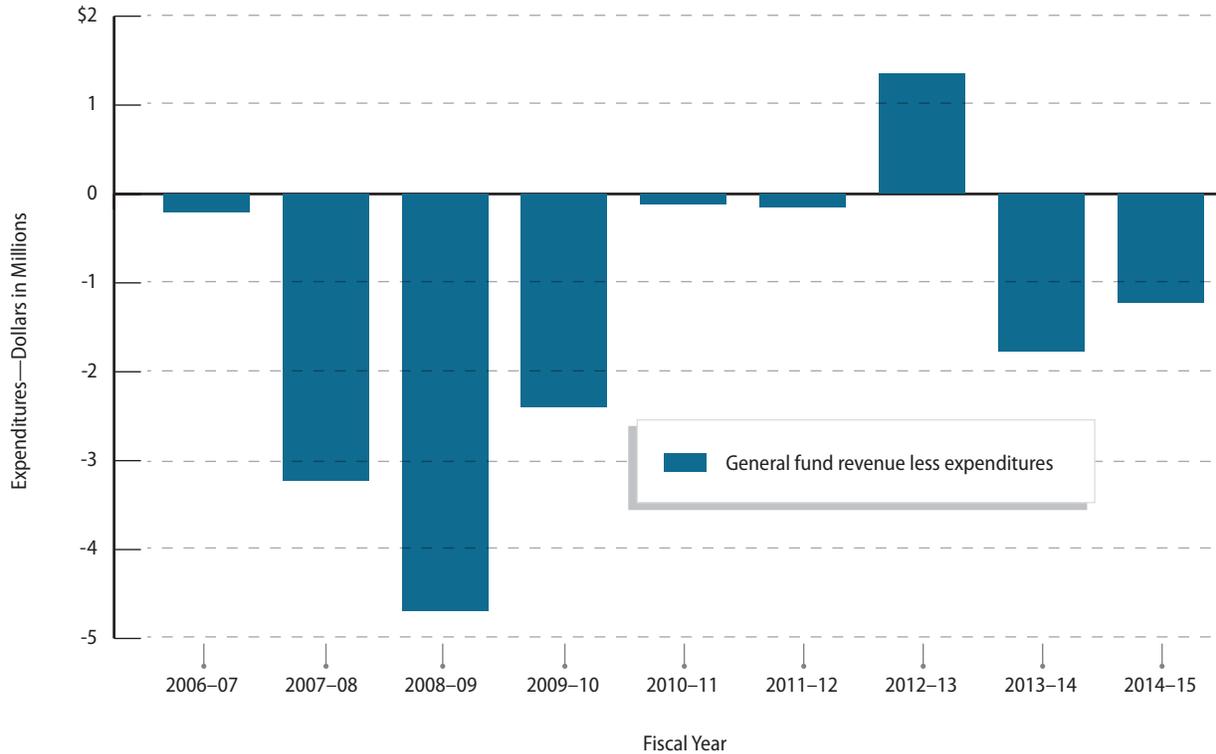
Hemet's ongoing budget deficit threatens its financial stability. Its general fund expenditures have exceeded its revenue in all but one of the past nine fiscal years, as shown in Figure 3 on the following page. The city projects a similar outcome for fiscal year 2015–16. This trend affects Hemet's financial stability because, when its revenue is insufficient to meet its financial obligations, the city has to tap into its

limited reserve funds and generate revenue through other means to cover the difference. Hemet's continued reliance on reserve funds is causing these funds to dwindle and potentially become depleted, affecting the city's future ability to pay for public services. In October 2015, Hemet developed a five-year revenue and expenditure projection to address its ongoing budget deficit. However, our review identified concerns that limit the projection's effectiveness as a road map to address the city's financial concerns.

Hemet has identified declining tax revenue and increased costs as the primary reasons for its persistent budget deficit. Hemet's largest sources of general fund revenue are various taxes, specifically sales and property taxes. In its fiscal year 2011–12 budget, the city reported that the high unemployment rate and decreased housing values during the recession caused a steep decline in Hemet's sales and property tax revenue. In fact, between fiscal year 2006–07 and fiscal year 2010–11, Hemet's annual general fund tax revenue declined by approximately 25 percent. Further, Hemet's general fund incurred additional costs at the same time that it was experiencing declining revenue. In its fiscal year 2012–13 budget, the city reported that the dissolution of redevelopment agencies was a contributing factor to Hemet's financial difficulties, noting that with the loss of redevelopment funds, its general fund had to pay for costs that redevelopment funds had previously covered. For example, in fiscal year 2010–11, Hemet budgeted for 60 percent of the city manager's salary and 55 percent of the deputy city manager's salary to be paid for by

¹ We refer to the extent to which Hemet's general fund expenditures exceed its revenue as its *budget deficit*.

Figure 3
 General Fund Expenditures Exceeded Revenue for Eight of the Past Nine Fiscal Years



Source: City of Hemet's comprehensive annual financial reports.

redevelopment funds. Since the redevelopment agencies have dissolved, the city has had to pay for the majority of these positions out of its general fund.

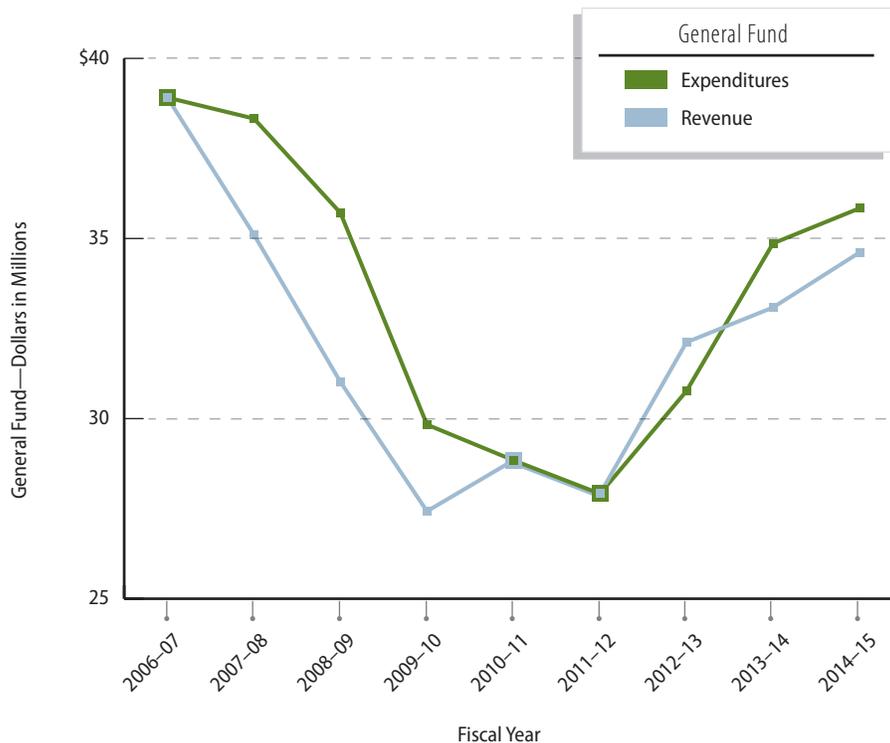
Hemet reduced its expenditures for a number of years in an attempt to close its budget deficit, but expenditures have grown in recent years. From fiscal year 2006–07 to fiscal year 2011–12, Hemet made a concerted effort to reduce expenditures as a means of offsetting the impact of its declining revenue. During those years, Hemet reduced the number of city employees by 153 positions, representing a decrease of nearly 35 percent.

The city also implemented furloughs, sought voluntary demotions of staff members in lieu of layoffs, and required employees to pay the entire employee share of retirement contributions and a portion of the employer's share. Nevertheless, as shown in Figure 4, expenditures exceeded revenue for eight of those nine years and have increased each year since fiscal year 2012–13.

To make up for the gap between general fund revenue and expenditures, Hemet has relied on one-time revenues and its general fund reserve balance. In October 2011, Hemet outsourced its refuse services, resulting in the city receiving

Figure 4

Hemet's General Fund Revenue and Expenditures Fluctuated Between Fiscal Years 2006–07 and 2014–15



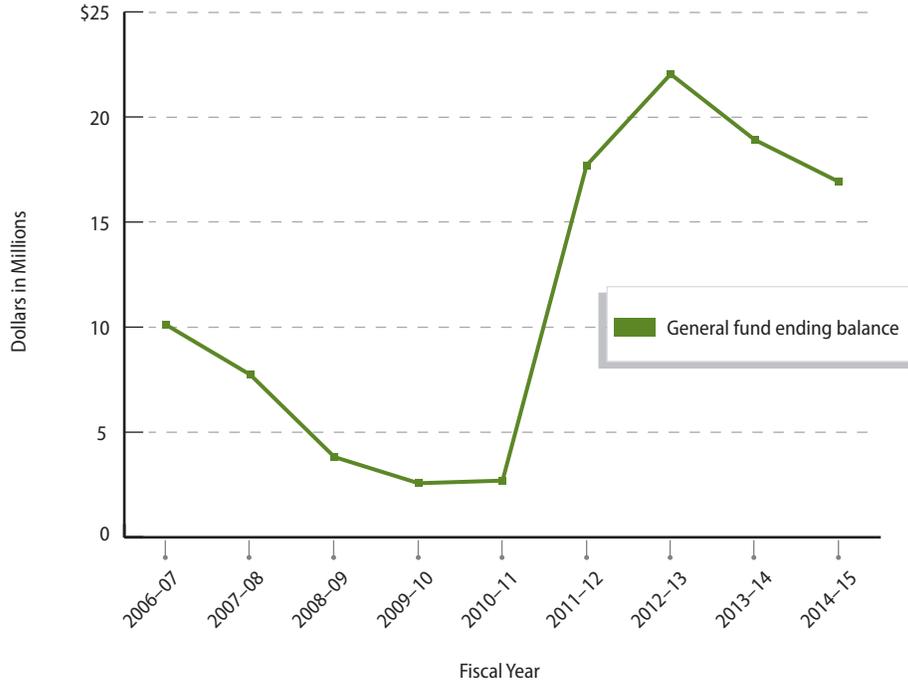
Source: City of Hemet's comprehensive annual financial reports.

a lump sum amount of \$12.5 million from the contracted vendor, with an additional \$12.5 million in total to be received over the subsequent 19 years. As seen in Figure 5 on the following page, this lump sum amount temporarily augmented Hemet's general fund balance, which was nearly depleted by the end of fiscal year 2010–11. Further, in fiscal year 2012–13, Hemet closed its refuse fund and transferred the remaining balance of more than \$5 million to its general fund. Despite these one-time influxes of revenue, Hemet's

general fund balance has recently declined because Hemet has been forced to use a portion of the balance to cover each successive year's budget deficit. If Hemet's current annual spending continues at the pace presented in its adopted budget for fiscal year 2015–16, which projected a \$5 million deficit, the city will exhaust the remaining balance in its general fund by fiscal year 2017–18, thereby directly affecting Hemet's ability to respond to emergencies and forcing the city to drastically cut additional services.

Figure 5

Despite Replenishing Its General Fund, the City of Hemet's Fund Balance Has Recently Declined



Source: City of Hemet's comprehensive annual financial reports.

Hemet recently developed an approach to address its ongoing budget deficit. In October 2015, the city developed a five-year revenue and expenditure projection to use as the basis for addressing its ongoing general fund deficit. The projection included revised spending plans for fiscal year 2015-16 that reduce the \$5 million budgeted deficit for that year to a deficit of \$1.9 million. Hemet based the reduction on several factors, including actions it took to reduce spending on retiree health care benefits and a moderate projected increase in tax revenue. We discuss Hemet's retiree health care spending in a later section. In the remaining four years of its five-year projection, the city assumes conservative increases in revenue while holding flat or minimally increasing the majority of expenditures. The projection shows

considerably smaller annual deficits starting in fiscal year 2016-17, with a nearly balanced budget by fiscal year 2019-20. In particular, the projection shows the annual deficit dropping from about \$1.9 million in fiscal year 2015-16 to \$334,163 in fiscal year 2016-17, primarily due to reductions in expenditures, such as merging the vacant positions of two high-level officials into a single position.

However, our review of the projection identified some concerns about the plan's effectiveness as a means to address Hemet's financial issues. Specifically, the projection assumes a savings of \$1 million in fiscal year 2015-16 and \$500,000 in fiscal year 2016-17 due to changes in the medical plans offered to its retirees. Using the documentation

supporting the projection, however, we estimated savings that are closer to \$736,000 in fiscal year 2015–16 and \$612,000 in fiscal year 2016–17, increasing Hemet’s projected budget deficit in fiscal year 2015–16 to more than \$2.1 million and its fiscal year 2016–17 budget deficit to more than \$500,000. The deputy city manager stated that the difference occurred because Hemet developed the five-year projection based on initial estimates of savings from its plan to reduce retiree health care costs, but has not updated the projection based on the actual changes in health plan participation. The deputy city manager indicated that the city intends to update its projection annually. However, we believe that the city should update the projection when substantial changes occur, which may happen more frequently than once a year. Failing to update its five-year projection will result in inaccurate estimates being carried forward for each of the remaining years of the projection, as shown in Table 1. In fact, this difference results in Hemet’s projected budget deficit for fiscal year 2019–20 being closer to \$268,000 rather than the nearly \$17,000 included in its projection. We discussed this difference with the deputy city manager, who did not dispute our calculations.

In addition, we believe that some of the assumptions in the projection are overly optimistic. Specifically, the projection does not include any allowances for unanticipated costs. The deputy city manager stated that this was done to keep the expenditure projection as low as possible. Although Hemet cannot foresee the exact impact of unanticipated costs, it should, nonetheless, expect that these types of situations will arise and that this spending will further deplete its reserves. An example of this type of unanticipated cost occurred in January 2016, when the city spent \$32,000 to hire a demographer to help it establish council districts. Hemet has also recently incurred another unexpected one-time cost—spending approximately \$130,000 in its efforts to place a public safety tax measure on the June 2016 ballot. This amount includes \$63,000 for two contracts with a consultant to develop the tax measure and an estimated \$67,000 for Riverside County to place the measure on the ballot. Because Hemet’s projection does not include any allowance for unanticipated costs, its total actual costs will be greater than projected if unanticipated costs arise and all other expenditures occur as expected.

Table 1
The Budget Deficit Will Likely Remain Higher Than the City of Hemet Originally Projected

	FISCAL YEAR				
	2015–16	2016–17	2017–18	2018–19	2019–20
Projected budget deficit prepared by the City of Hemet (Hemet)	\$1,867,046	\$334,163	\$213,376	\$107,651	\$16,906
Projected budget deficit as adjusted by the California State Auditor (State Auditor)*	2,127,522	522,102	420,319	335,510	267,781
Difference between State Auditor’s projection and Hemet’s projection	260,476	187,939	206,943	227,859	250,875

Sources: State Auditor analysis based on our review of Hemet’s five-year projections, fiscal year 2015–16 budget, and accounting system data.

* This State Auditor-adjusted projection corrects for the errors identified during our review.

We believe another unrealistic assumption is that there will be no staffing increases over the next five years. Even small staffing changes can have a significant impact on Hemet's projection. For example, a 2015 operational review of the fire department conducted by a consultant identified that the Hemet fire department's staffing levels are very low. Even if Hemet decides to hire only one additional firefighter during fiscal year 2016–17, the projected budget deficit for that fiscal year would increase by approximately \$124,000, and the projected budget deficit for fiscal year 2019–20 would increase by more than \$132,000. As a result, the overall deficit would be \$646,000 in fiscal year 2016–17 and more than \$400,000 in fiscal year 2019–20, far greater than Hemet's projected deficit of \$17,000.

Of note, Hemet proposed a 1 percent sales tax measure for public safety on its June 2016 ballot, which voters did not approve. Although this special-purpose tax measure would have generated significant revenue, it would have had minimal impact on the budget deficit. Under the provisions of the measure, Hemet could have spent the additional revenue only on public safety services and, further, could not have reduced the percentage of the general fund that it already spends on its police and fire departments. Thus, even if the tax measure had passed, the additional revenue could not have been used to replace any of the city's current general fund expenditures for public safety, which represented nearly three-quarters of its budgeted general fund expenditures in fiscal year 2015–16.

In June 2016, the city council approved Hemet's operating budget for fiscal year 2016–17. This adopted budget projects a general fund deficit of just under \$350,000. Although the budget is consistent with the deficit portrayed in Hemet's five-year projection for fiscal year 2016–17, the approved budget projects revenue and expenditures that are approximately \$1 million greater than the five-year projection. However, we believe that

several of the approved budget's projections appear overly optimistic and that the actual budget deficit will likely be greater. Specifically, the budget projects an increase of \$700,000 in property tax revenue, an increase of more than 15 percent from the previous fiscal year. In addition, the city projects a 12 percent increase in motor vehicle license fees. Hemet based these projections on information provided by a consultant it hired to forecast future tax revenue. However, the city was unable to provide any perspective to justify the reasonableness of the consultant's information, particularly in light of the fact that Hemet projected only a 2 percent annual increase in its property tax revenue in its five-year projection. In total, the city projects a \$2.1 million increase in revenue, equating to an increase of 5.9 percent, which, in our opinion, appears unreasonable.

We also question the appropriateness of Hemet's projected reductions in expenditures. For example, the city reduced its budget for engineering by \$400,000, or 34 percent, from the previous fiscal year, despite engineering costs remaining at approximately the same level over the past three fiscal years. The deputy city manager indicated that this decrease is due to an expected slowdown in development in Hemet. However, this statement appears to conflict with the deputy city manager's statement about the preparation of the five-year plan, in which she indicated that the city assumed a 2 percent increase in development revenue going forward. Further, Hemet increased its fiscal year 2015–16 budget for building-related fees based on an increase in actual building applications received and the size and scope of the projects, which also contradicts the expectation of a slowdown. In addition, the city reduced the budget for police department overtime to \$450,000 and fire department overtime to \$400,000, despite the police department incurring an average of nearly \$918,000 per year in overtime from fiscal year 2012–13 to 2014–15 and the fire department incurring an average of nearly \$1.3 million in overtime per year during the

same period. In total, these questionable reductions in projected expenditures amount to nearly \$1.7 million.

Adjusting for the overly optimistic revenue projections and expenditure reductions leads us to conclude that Hemet’s budget deficit will likely be substantially larger than the amount it projects. Accordingly, Hemet will not reduce its budget deficit to the level portrayed in its five-year projection and will need to take additional actions to address its budget deficit.

Recommendations to Address This Risk

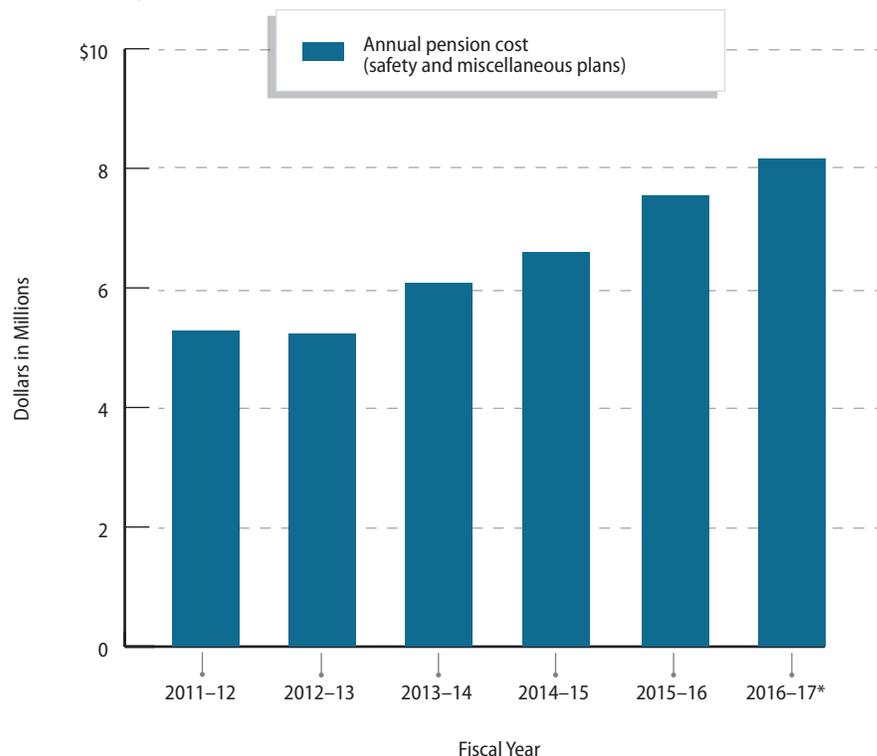
- To address its ongoing budget deficit, Hemet should identify additional sources of revenue and reduce costs, such as establishing and collecting fees for services it currently provides without charge and other options identified in this report.

- To ensure that its projection remains valid and useful for decision making, Hemet should reassess its assumptions and revise its projection, both annually and after it becomes aware of any significant changes to either its revenue or its expenditures.

Hemet Continues to Experience Rising Pension Costs

Projected pension cost increases and a large unfunded liability create uncertainty regarding Hemet’s future ability to make its pension payments while also maintaining city services. As presented in Figure 6, actuarial valuations by the California Public Employees’ Retirement System (CalPERS) predict that Hemet’s total pension payments, representing the combined cost of its pension plans for public safety employees and miscellaneous employees, will increase by about \$2.9 million,

Figure 6
The City of Hemet Faces Rising Pension Costs



Sources: City of Hemet’s comprehensive annual financial reports and actuarial valuation reports by the California Public Employees’ Retirement System (CalPERS).

* Estimates from CalPERS’ actuarial valuation reports.

or 55 percent, during fiscal years 2011–12 through 2016–17. These increases are largely due to the performance of CalPERS investments and the general economy. Hemet’s pension payments make up a high percentage of its operating costs and are the second largest category of expenditures after staff salaries, requiring the dedication of a substantial portion of the city’s limited budget. As an example of the increases in pension payments, in fiscal year 2012–13, approximately 11 percent of Hemet’s total operating expenditures were for pension payments, whereas by fiscal year 2014–15, this percentage had risen to 13 percent, an increase of more than \$1 million. If Hemet’s pension costs continue to increase in the future, it will have less funding available for the other public services it provides. Therefore, it is essential that Hemet plan for and consider options to address its mounting pension costs.

Although Hemet has been making its required payments, its pension costs are projected to increase because of its large unfunded liability. An unfunded pension liability is the difference between the amount CalPERS expects an entity will need to pay for all benefits earned by retirees and the fiduciary net position of the plans, which includes the actual value of the pension plans’ assets. Table 2 shows the recent

increases in Hemet’s unfunded pension liability. Hemet’s annual payments for its pension plans consist of the annual cost for the active employees in each plan and payments to reduce the size of its unfunded liability. The assets for both of its pension plans are invested by CalPERS, and therefore their value is dependent on CalPERS’ rate of investment returns, which has fluctuated significantly in recent years. CalPERS bases its projections for future pension payments on a certain assumed rate of investment returns. Therefore, if CalPERS’ investment returns are much higher than projected, Hemet’s annual payments could decrease. However, if CalPERS’ investment returns are lower than projected, as has occurred in recent years, Hemet’s annual payments would increase. In fact, during fiscal year 2013–14, Hemet’s unfunded liability increased substantially because its pension liability increased at the same time that the value of its plans’ assets decreased, thus causing an increase in the required payments. According to the deputy city manager, Hemet is in the process of researching options to adjust the payment schedule for its unfunded liability, which may reduce its payments. However, the city is still exploring this option, and the deputy city manager does not expect to present any resulting recommendations to the city council until at least 2017.

Table 2

The City of Hemet’s Unfunded Pension Liability Has Increased Substantially in Recent Years

	FISCAL YEAR			
	2011–12	2012–13	2013–14	2014–15
Pension liability	\$208,317,838	\$215,864,604	\$222,090,425	\$242,261,374
Value of assets	160,651,471	166,940,228	153,659,468	177,071,000*
Total unfunded liability	47,666,367	48,924,376	68,430,957	65,190,374†

Source: Comprehensive annual financial reports for the City of Hemet (Hemet).

* To comply with changes in accounting standards, Hemet changed how it reports this value, beginning with its fiscal year 2014–15 comprehensive annual financial report. It now reports “fiduciary net position,” which equals assets minus liabilities and also takes into consideration amounts that are deferred due to other accounting rules.

† To comply with changes in accounting standards, Hemet changed how it reports this value, beginning with its fiscal year 2014–15 comprehensive annual financial report, to “net pension liability,” which represents the total pension liability less the fiduciary net position.

Hemet's annual pension payments may increase at an even greater rate than anticipated. Hemet has planned for annual 5 percent increases in its pension costs based on the costs of its public safety employees' plan and its significant unfunded liability. However, other conditions exist that could further increase that rate. According to the deputy city manager, Hemet currently has staff positions, such as a media and intelligence analyst in the police department, that are fully budgeted but unfilled. If it fills that position and other vacant positions, the city's pension costs would increase, which, in turn, could increase the projected budget deficit. To address such concerns, the deputy city manager indicated that Hemet would update its five-year general fund projection with new information annually.

Recommendations to Address This Risk

- To ensure that it adequately plans for changes in its pension costs, Hemet should continue to update its five-year projections at least annually to reflect changes to annual pension costs.
- To attempt to reduce its pension costs, Hemet should continue to explore options and work with CalPERS to reduce payments for its unfunded liability.

Although the Library Is Supported With City Funds, Nearly Half of the Library Patrons Live Outside of the Incorporated City

As one of seven cities in Riverside County to operate its own public library, Hemet spent about \$1.8 million of its limited general fund resources in fiscal year 2014–15 to fund library operations and has spent similar amounts during the past several fiscal years. Despite the investment of city resources, the library is open

to the public fewer hours than other nearby libraries that serve as branches for the Riverside County public library system.

Even though it faces an ongoing budget deficit, Hemet has no current plans to make the library self-sufficient or to reduce its impact on the general fund. According to the deputy city manager, the library continues to innovate, using automation such as self-checkout machines and book sorters, in order to provide services without the need for additional staff. The library also receives support from two private nonprofit organizations, Friends of the Hemet Public Library and the Hemet Library Foundation. According to the senior librarian, the Friends of the Hemet Public Library raises approximately \$36,000 from book sales annually, and the Hemet Library Foundation raises \$3,000 to \$5,000 from fundraisers each year. We acknowledge that the city's efforts to hold down staffing costs through innovation and seeking alternative sources of funding are helpful. Nevertheless, the vast majority of the library's support comes from the city's general fund.

Further, despite Hemet's investment from its general fund for its library, nearly half of the library's patrons do not actually live in Hemet. According to the library's records, an estimated 44 percent of patrons are not residents of the incorporated city, as shown in Figure 7 on the following page. The public's interest in using Hemet's library may be attributed to the large size of the building and breadth of its collections and reference material.

Charging a library user fee to those who do not live within the city limits could both reduce the burden on Hemet's general fund and provide additional revenue to support the library and make it more self-sufficient. State law requires that municipal libraries be free to the inhabitants and nonresident taxpayers of the municipality, but not to other users. The law does not provide clarification on identifying

nonresident taxpayers. However, Hemet should seek legal guidance about establishing a user fee to the extent permitted under state law. Some other public library systems in California charge such fees—including the cities of Beverly Hills, Cerritos, Santa Ana, and the Lassen Library District—and the fees they charge range from \$28 to \$257 annually. As shown in Table 3, using differing levels for the percentage of current nonresident patrons who would pay for library resource privileges and a conservative annual user fee ranging from \$40 to \$75, we calculated that Hemet could generate annual revenue ranging from \$333,890 to \$2.5 million.

If Hemet implemented a fee, nonresident patrons who chose not to purchase library privileges or who could not afford the fee would have other alternatives for accessing library services. Nonresident patrons would still be able to access services without charge at a library within their own community. Specifically, there are two county libraries within five miles of Hemet in nearby San Jacinto and Valle Vista.

Recommendation to Address This Risk

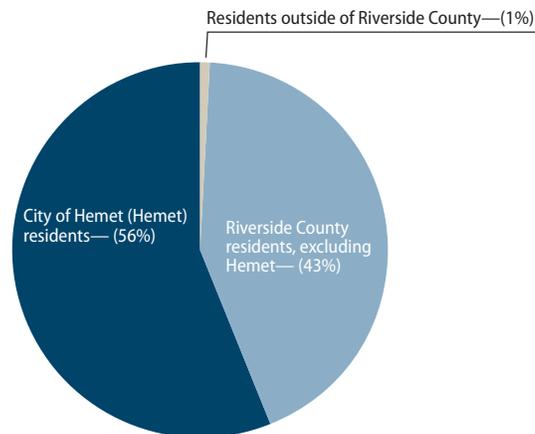
Hemet should seek legal guidance to adopt an annual library user fee structure to charge individuals other than city inhabitants and nonresident taxpayers for the use of library resources.

Hemet Has Largely Addressed Its Retiree Medical Costs

In the 1990s, Hemet promised full lifetime medical coverage to all eligible retirees, but beginning in 1998 the city no longer offered this benefit to new hires. According to the deputy city manager, Hemet ended the policy due to the high cost. Nevertheless, the remaining pool of retirees and current employees of the city hired before 1998 continues to be eligible for full lifetime medical coverage. In fiscal year 2014–15, the annual cost of that obligation amounted to \$3.3 million after steadily rising since fiscal year 2010–11, as presented in

Figure 7

Many Patrons of the Hemet Public Library Do Not Live Within the City Limits



Source: Hemet Public Library database.

Note: We identified the proportion of patrons by location based on the total number of library cards issued as of March 2016.

Table 3**The City of Hemet Has the Potential to Generate Additional Revenue by Establishing Library User Fees for Nonresident Patrons**

ANNUAL FEE	IF PAID BY 100% OF NONRESIDENT LIBRARY USERS	IF PAID BY 75% OF NONRESIDENT LIBRARY USERS	IF PAID BY 50% OF NONRESIDENT LIBRARY USERS	IF PAID BY 25% OF NONRESIDENT LIBRARY USERS
\$75	\$2,504,174	\$1,878,131	\$1,252,087	\$626,044
50	1,669,450	1,252,087	834,725	417,362
40	1,335,560	1,001,670	667,780	333,890

Source: California State Auditor analysis based on Hemet Public Library user data.

Note: The calculations in the table are based on our estimate of nonresident patrons with library cards who have borrowed material within the past two-and-a-half years, rather than all individuals with library cards. Nonresident patrons include those individuals who reside outside of the city of Hemet boundaries.

Table 4 on the following page. Further, in fiscal year 2014–15, retiree health plan costs alone were 6.8 percent of the city’s annual general fund operating expenditures. According to a September 2012 presentation made by the city’s insurance broker to the city council, Hemet expected retiree health insurance costs to increase greatly when the “Cadillac tax” of the federal Patient Protection and Affordable Care Act (Affordable Care Act), a 40 percent tax on excessive benefits provided by an employer, was scheduled to go into effect in 2018. However, the federal government has since postponed the implementation of the tax until 2020.

Recognizing that Hemet’s retiree health plan costs were growing to an unsustainable level, the city council approved a proposal in 2015 to move retirees with high-cost plans to lower-cost ones that Hemet asserted provided comparable coverage. The comparable plans are much more affordable for the city, and the deputy city manager believes these plans will not incur a penalty at this time under the Affordable Care Act. To implement this proposal, Hemet conducted an outreach effort and successfully transitioned all but 20 retirees away from the high-cost plan, thus

saving the city’s general fund approximately \$736,000 in fiscal year 2015–16. The city’s outreach effort included sending letters to the applicable retirees, hosting public meetings about retiree health plans, and offering an incentive of \$5,000 to retirees who switched to a lower-cost plan by September 30, 2015. In September 2016, the city expects to terminate the high-cost health care plan and, according to the deputy city manager, will move the remaining enrollees to a lower-cost plan. According to the deputy city manager, the city expects that the \$1.5 million in its retiree health care fund, which is not a part of its general fund, will be sufficient to cover any potential litigation resulting from retirees who refuse to change plans.

Despite the efforts Hemet has made to reduce its retiree health plan costs, its unfunded liability for these benefits remains significant, with its most recent valuation reported at approximately \$74 million as of January 2015. In particular, the city currently does not have any assets dedicated to offset its retiree health plan cost liability. Further, although Hemet pays the full cost of retiree health benefits incurred each year, it does not make

Table 4
Retiree Health Insurance Costs Steadily Increased Between Fiscal Years 2010–11 and 2014–15

	FISCAL YEAR					
	2010–11	2011–12	2012–13	2013–14	2014–15	2015–16*
Retiree medical costs	\$2,362,000	\$2,839,000	\$3,113,000	\$3,186,000	\$3,330,000	\$3,191,000

Source: Comprehensive annual financial reports for the city of Hemet (Hemet), Hemet's retiree health care plan cost projections, and California State Auditor review.

* The fiscal year 2015–16 costs represent our estimate based on Hemet's projected health care plan costs, the total retiree health plan enrollment as of June 2016, and the number of participants who accepted Hemet's \$5,000 incentive to change plans.

payments toward its unfunded liability, which continues to grow as more benefits are earned over time by current and former employees.

In 2009 the U.S. Government Accountability Office (GAO) reported that unfunded retiree health benefit liabilities at the state and local level raise concerns about future fiscal pressures that these governments could face. The GAO identified the use of a trust as a method to reduce a government's unfunded liability in the long term. To address its unfunded liability, Hemet has begun to research the viability of establishing a trust. The deputy city manager indicated that she intends to propose that Hemet establish a trust into which savings from changes to its retiree health benefits and some of the fund balance from its retiree health fund could be deposited. According to a 2009 report by the Center for State and Local Government Excellence, by establishing and funding a trust, governments can reduce long-term

costs because the trust's investment earnings help pay for future retiree health plan costs. The deputy city manager projects that, after the trust is established, it would take approximately 20 years for the city to accumulate enough resources generated through deposits and investment earnings in the trust to cover its unfunded liability for retiree health plan costs. However, Hemet is still developing this strategy, and the deputy city manager stated that she does not intend to propose the issue to the city council for consideration until the summer of 2016.

Recommendation to Address This Risk

Hemet should continue to research the feasibility of ways to pay down the city's unfunded liability for retiree health plan costs and take appropriate action based on the research performed.

INEFFECTIVE AND INEFFICIENT ORGANIZATIONAL MANAGEMENT NEGATIVELY AFFECTS HEMET'S PROVISION OF PUBLIC SERVICES

Several of Hemet's operations and management practices contribute to ineffective and inefficient provision of public services. In particular, Hemet has consistently underfunded its fire department. As a result, firefighters must work chronic overtime and frequently operate with insufficient equipment, putting themselves and the public at risk. Despite its struggles, Hemet's city government has not made a consistent effort to reach out to the community, creating the possibility that residents who are unaware of the city's risk will resist necessary reforms.

The existing organizational structure of Hemet's city government also leads to some inefficiencies. For instance, there are currently eight individuals who report directly to the city manager, and this imbalanced ratio may inhibit the city manager's ability to provide meaningful direction. In addition, the city government lacks a strategic plan and a succession plan. A strategic plan serves as the vision for an organization and helps ensure that the individuals within the organization work together toward the same goals. A succession plan helps ensure that an organization has the right people in the right positions and is developing staff members' competencies so they will be prepared to fill the key positions eventually vacated by retirements or natural attrition. We also identified potential annual savings if the city outsourced the handling of parks maintenance.

Hemet Has Critically Underfunded Its Fire Department

Hemet has historically underfunded its fire department—which consists of five fire stations—resulting in insufficient staffing levels and substandard infrastructure, creating a risk to public safety. Operational reviews by two different consultants, one in 2013 and another in 2015, cited concerns about the fire department's level of staffing. For example, the 2015 review concludes that the Hemet fire department's staffing was very low compared to other agencies of similar size. The review states that Hemet has 0.55 firefighter per 1,000 residents, as opposed to the regional median of 0.92 firefighter and the national median of 1.3 firefighters per 1,000 residents. Hemet uses a principle called *constant staffing*, which means that the fire department should have exactly the same number of filled positions as individuals needed for a day's shifts. Because Hemet had nine vacancies in firefighter and fire captain positions as of May 2016, existing staff members must work overtime to compensate for these vacancies.

Our concerns about low staffing are exacerbated by high demand for fire services. The 2015 review notes that the Hemet fire department is exceedingly busy, handling more than twice as many emergency incidents as other fire departments of similar size on the West Coast. The 2015 review also considers the combination of low staffing and

high demand for services to be potentially dangerous and unproductive. Further, the 2015 review concludes that the fire department improperly staffed shift command positions with captains rather than appropriately trained battalion chiefs. Captains are typically trained to supervise a single unit and small incidents, whereas a battalion chief is trained to supervise three to seven fire stations and manage large-scale incidents.

In addition to staffing, the fire department has critical needs for equipment and infrastructure repairs. For example, in a May 2015 presentation to the city council, the fire chief stated that the firefighters' personal protective equipment—protective clothing critical to firefighter safety—had not been replaced in the last five to eight years. The chief also informed us that the personal protective equipment was riddled with holes and substandard repairs. In fiscal year 2015–16, Hemet finally purchased new personal protective equipment. The fire stations are also in need of significant structural changes, including seismic retrofits and alterations to comply with building codes. State law indicates the Legislature's intent that an essential services building, such as a fire station, should be designed and constructed in such a way as to be capable of providing essential services to the public after a disaster. However, three of Hemet's five fire stations are vulnerable to seismic activity. Although the fire stations were built before the passage of the state law, their location raises concerns, given that Hemet is in an area prone to earthquakes. The city also maintains a list of needed repairs for the fire stations but has not estimated the costs or budgeted for the repairs.

According to the deputy city manager, city management does not consider these improvements to be as critical as other needs, such as repairing aging water and sewer lines and making street repairs. She also stated that, with limited general fund resources, Hemet is unsure as to when and how it will

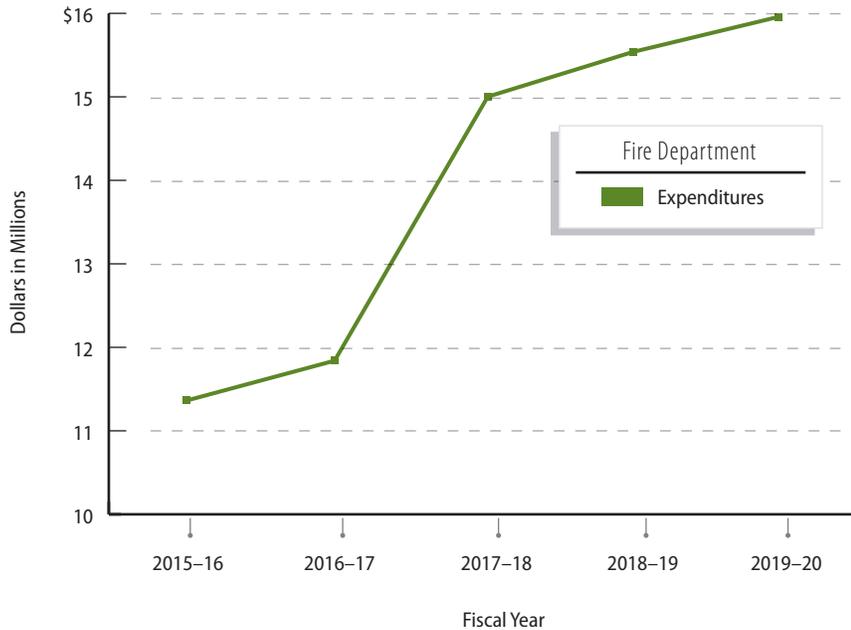
address the capital improvements needed for the fire department. Although Hemet may view other infrastructure repairs as more critical, by not addressing the seismic safety and other structural needs of the fire stations, it could be placing residents at risk in the event of an emergency.

Hemet's plan to address the staffing needs of its fire department relied primarily on a tax measure that failed to pass in June 2016. If the tax measure had passed, Hemet had planned to hire 25 fire department staff, including three battalion chiefs, over the next three fiscal years. The fire chief believed the additional staff members were necessary to address the staffing concerns identified by its consultants. Without the additional tax revenue, Hemet will have to reconsider its ability to meet the needs of its fire department. According to the deputy city manager, the city intends to hire battalion chiefs even though the tax measure failed.

In addition to staffing, the fire department has critical needs for equipment and infrastructure repairs.

However, as previously discussed, the city's five-year projection to address its budget deficit assumed no additional staffing. As shown in Figure 8, not including the undetermined costs of necessary capital improvements, the cost to operate the fire department will rapidly increase with the additional staffing Hemet has identified as needed. The fire chief informed us that he is currently working on contingency staffing plans. Moreover, Hemet has not planned how it will fund the fire department's needed capital improvements.

Figure 8
Projected Costs of the City of Hemet’s Fire Department Will Increase Significantly To Address Critical Staff and Equipment Needs



Source: City of Hemet (Hemet) fire department projections.

Note: The main contributor to the increases in projected expenditures is the increase in staffing costs. Hemet management has stated that to operate effectively the fire department needs additional staff, and planned to add most of those additional positions between fiscal years 2016-17 and 2017-18 if the city’s tax measure had passed. The remaining increase in projected expenditures is attributable to increases in existing costs for the fire department, including costs such as equipment and overhead.

Despite the tax measure failing to pass, other options exist for Hemet to increase revenue for the fire department. Currently, some cities, special districts, and counties charge fees for providing first responder services for emergency medical calls. Examples include the city of Long Beach, the city and county of San Francisco, and the Sacramento Metropolitan Fire District. However, the Hemet fire department does not charge for its services when it is the first responder to calls for emergency medical services. We did not locate any law that would prohibit Hemet from imposing a fee on those who receive emergency medical services and, unlike the failed special tax measure, Hemet may impose such a fee without voter

approval as long as the fee does not exceed the cost of providing the services. In 2015 the fire department responded to more than 13,000 emergency medical calls, representing more than 80 percent of its total calls. Based on our calculations, the city could have generated from \$941,000 to \$3.8 million in fiscal year 2015-16 if it had charged for these types of calls, depending on the number of calls for which it could collect a fee. As shown in Table 5 on the following page, even if the fire department was able to collect only 50 percent of all bills for medical calls, it could recover between \$2.1 million and \$2.8 million annually from fiscal year 2016-17 through 2019-20. In addition, since the fire department already recovers fees for

Table 5
The City of Hemet's Fire Department Could Increase Revenue by Recovering the Cost of Emergency Medical Services

FISCAL YEAR	100% COLLECTED	75% COLLECTED	50% COLLECTED	25% COLLECTED
2016-17	\$4,170,802	\$3,128,102	\$2,085,401	\$1,042,701
2017-18	4,621,249	3,465,937	2,310,624	1,155,312
2018-19	5,120,344	3,840,258	2,560,172	1,280,086
2019-20	5,673,341	4,255,006	2,836,670	1,418,335

Source: California State Auditor analysis based on the City of Hemet fire department's call history and costs of operations.

Note: Collection percentages provide a range, with an assumption that some bills may not be collectible for a variety of reasons, including financial hardship or debt avoidance.

responding to motor vehicle accidents, vehicle fires, arson investigations, and nonresidential false alarms, it has an existing relationship with a cost recovery collection service that could also handle billing for emergency medical services.

Despite the fire department's need for additional revenue, the city has not charged for emergency medical services in the past. According to the city manager, Hemet has concerns about charging the community fees in addition to taxes, and believes that this action would require city council consideration and public input. However, as previously mentioned, the city charges fees for many other services it provides.

Because its tax measure did not pass, Hemet will need to identify other significant sources of additional revenue to adequately support the fire department. If it decides not to impose charges for emergency medical services as we recommend, Hemet should consider other service options to secure an adequate level of assistance to ensure the public's safety. Hemet previously considered outsourcing its fire services, but it ultimately decided against doing so. In September 2014, the city council voted 3 to 2 to outsource fire services to Riverside County, believing outsourcing would provide Hemet the most service for the best value. However, in November 2014, a new city council member was voted in, replacing one of

the members who had supported outsourcing. Subsequently, in December 2014, the city council reversed the decision to outsource the fire department. One alternative Hemet could pursue is a joint powers authority with other local governments for shared fire services. In June 2016, the city council for the neighboring city of San Jacinto voted to pursue a joint powers authority for fire protection with the community of Idyllwild. The city manager of Idyllwild stated that a joint powers authority could provide greater flexibility and allow for the ability to partner with other local agencies.

Recommendations to Address This Risk

- To ensure that it can adequately fund its operations and recover the costs of its services, Hemet should generate additional revenue, such as charging fees for emergency medical services provided by the fire department.
- If it implements a fee for emergency medical services, Hemet should conduct a comprehensive fee analysis to determine the fully burdened hourly rates for providing emergency medical service, specific to the duration of emergency medical calls, and ensure that first responder fees do not exceed the cost to provide the service.

- If Hemet does not adequately fund its fire department to address the concerns identified in its 2013 and 2015 consultant reviews, it should pursue alternatives for providing services, such as shared fire services with other local governments.

Hemet Could Do More to Engage Its Community

To address risk conditions such as its budget deficit and high crime rates, Hemet needs to be able to engage with the community to provide information on the challenges facing the city and to solicit relevant perspectives from the public. If city leaders fail to communicate with the public regarding the issues and concerns that are relevant to these conditions, Hemet may face increased resistance to the actions it proposes to address them. Hemet communicates with the public primarily through city council meetings and other commission and committee meetings. It does not have a public information officer, which, in conjunction with turnover in city leadership, contributes to the lack of a coordinated message and approach to public outreach. Instead, efforts are left up to individual departments. As a result, the community is not always informed about issues of concern and may be resistant to needed reform.

Many residents have been critical of Hemet's efforts to engage the community. At a city council meeting in September 2015, a member of the public expressed concern that the city council was not trying to engage the community and recommended that more effort be made by the entire city council. She also stated that she feels there is no follow-through unless the city council is forced to do so. Another individual expressed concern that Hemet has not communicated to the public the facts that led to the city's financial situation and, at a subsequent meeting, stated that residents want to understand why Hemet has a budget

deficit and what needs to be done to fix it. Among the many opinions voiced at council meetings was that the city would get support from the community if the city council could communicate its long-term plan.

Hemet could bridge this communication gap by actively engaging the community. For example, the city manager could conduct regular town hall meetings that would facilitate increased community interaction with the city government. As evidenced by the estimated 800 participants who attended a city council meeting to learn about the public safety tax measure when it was formally proposed, Hemet appears to have individuals who are eager to understand the city's challenges. Creating a plan for consistent and transparent communication with residents could help mitigate inaccurate assumptions about the city's efforts to address its financial situation and economic outlook.

During fiscal year 2015–16, Hemet took steps to conduct more focused outreach to address specific issues. For example, it sent mailers and held educational meetings for retirees to discuss its retiree health plan obligations. In addition, Hemet directed the police and fire chiefs to manage outreach for its June tax measure. The chiefs made themselves available to conduct a number of town hall-style meetings specific to the tax measure with a wide variety of interest groups.

Hemet could also pursue activities to engage members of the public in the concerns faced by the city government. An example of this type of successful public collaboration occurred in the city of Brea (Brea), which created a Budget Strategic Plan Committee consisting of 40 city staff members and 25 residents. The committee helped set priorities to balance the budget by preparing Brea's five-year projections. The committee generated nearly 200 budget suggestions, resulting in a reduction of \$6.4 million in expenditures over two fiscal years.

Brea received an organizational excellence award from the Municipal Management Association of Southern California for its advancement of local government service. Similarly, rather than attempting to address Hemet's challenges alone, city leaders could help facilitate community involvement in addressing the city's problems.

Recommendation to Address This Risk

Hemet should create and implement a plan for community engagement, including strategies to educate and engage the community in the city's needed reforms and its efforts toward achieving financial stability. This plan should focus on seeking public involvement in a more participatory, deliberative, inclusive, and collaborative manner.

Restructuring City Operations Could Improve Efficiency and Effectiveness

In an effort to cut costs, Hemet reduced its staff from 432 positions in fiscal year 2006–07 to 286.5 positions in fiscal year 2014–15, a reduction of 34 percent. Part of the reduction involved the elimination of some middle management positions, resulting in a flat organizational structure with many functions reporting directly to executive management. For example, under the city's current structure, eight individuals report directly to the city manager. Having too many individuals report directly to a single executive can make it difficult for the executive to provide effective oversight and may also create other inefficiencies, such as leaving the city manager unable to focus efforts on citywide issues.

In addition, Hemet's current organizational structure results in inefficiencies in some reporting relationships. For example,

engineering is a stand-alone department in Hemet, unlike comparable functions in many other cities. This structure creates inefficiencies in the handling of building inspections and planning activities, which involve the engineering, public works, and community development departments. The community development and engineering departments are not only led by different individuals but are also located in different buildings, causing an inconvenience for developers and builders who have to go back and forth between departments. Additionally, the public works department handles sewer, streets, and water—key areas that also involve community development and engineering—yet the public works department is in another facility located across town. The police chief, who has worked for the police department for more than 23 years and also served previously as acting city manager, believes that the current organizational structure was designed based on the strengths of certain individuals, rather than focused on the health of the city.

Reorganization of city operations could result in considerable improvements in efficiency and effectiveness. Since the appointment of the current fire chief, the police and fire departments have made efforts to share staff. Specifically, the fire chief informed us that the fire department and police department share one staff person responsible for recruiting and background checks for new hires, and that they have experimented with sharing a data analyst. By sharing staff, the departments leverage their resources more efficiently and gain additional opportunities for cross-training that can positively affect succession planning. For example, because the engineering and community development departments work closely in their operations, a collaborative effort to cross-train technicians and administrative assistants across these departments' functions

could allow for more flexibility and increase Hemet's internal talent pool. According to the directors of the engineering and community development departments, there may be opportunities to share staff and cross-train across other departments, but they have not explored these possibilities. To further

By sharing staff, the departments could leverage their resources more efficiently and gain additional opportunities for cross-training. . .

identify potential areas of improvement in staffing and training, Hemet could conduct a comprehensive organizational analysis, including work assignments, workloads, reporting relationships, and coordination points.

Realigning some city departments could increase efficiency and aid in succession planning. Under the current organization, community development, economic development, engineering, public works, and the Hemet Public Library all report directly to the city manager, along with the public safety departments and the deputy city manager. To regroup some of these functions, Hemet could move economic development and the library into the current community development department, creating a new community development and services department, as shown in Figure 9 on the following page. Further, Hemet could include engineering as a division of its public works department. The city previously had a public works department that included engineering. These changes would streamline Hemet's

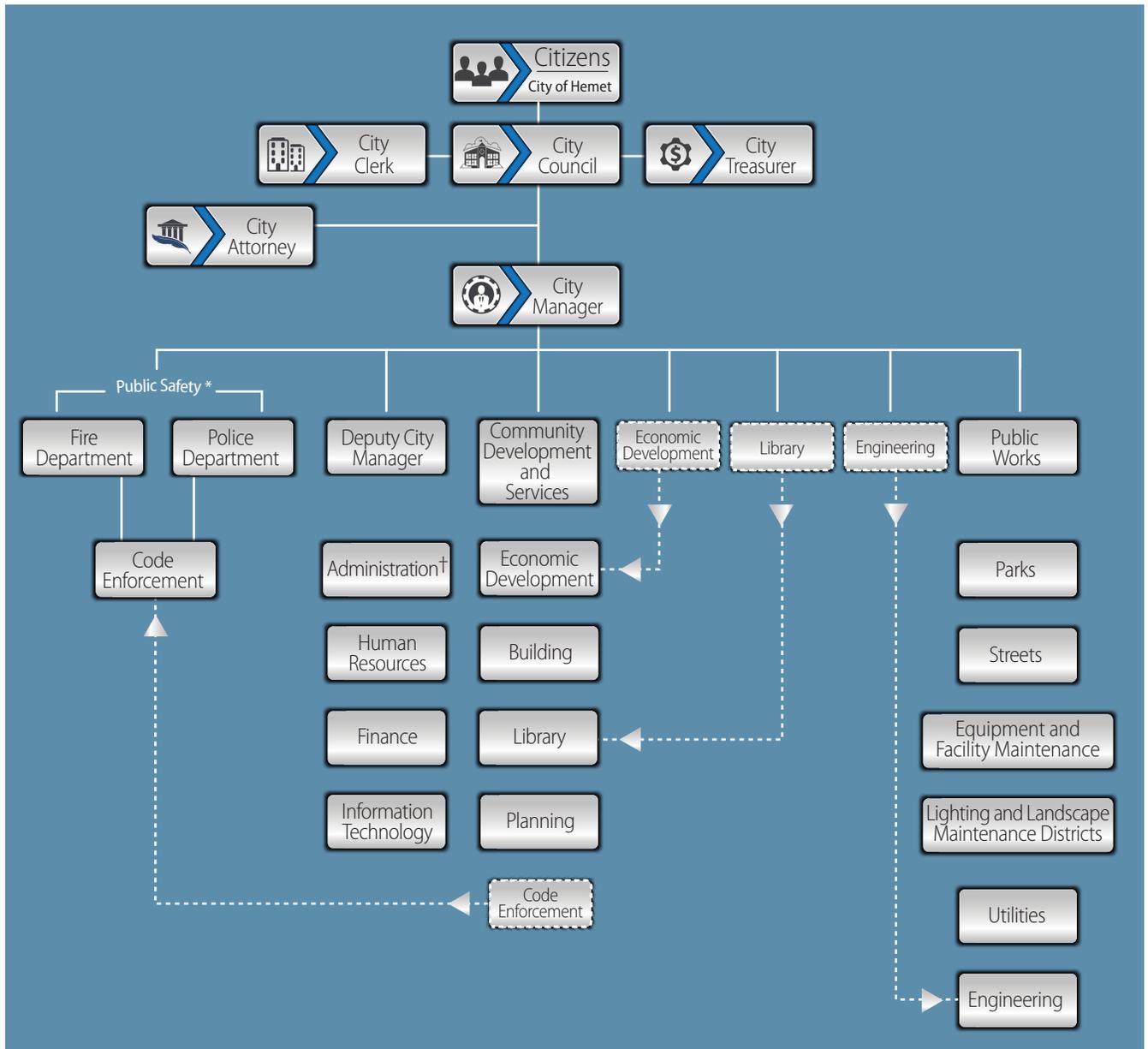
management by reducing the number of individuals reporting directly to the city manager from eight to five. By realigning the reporting relationships, the city could establish midlevel management positions under the community development director and public works director without the need for additional staffing. Establishing these positions would also help promote succession planning. Under the proposed structure, the community development director and public works director could proactively develop managers from any of their subdepartments as potential successors. The city manager stated that he supports having engineering as a division of public works and physically located with community development.

The current reporting structure of code enforcement within Hemet's government is another critical consideration in improving efficiency and better serving the needs of the community. Code enforcement is currently managed under the community development department, where its focus is to respond to complaints from members of the public and identify violations occurring on public and private property. According to the community development director, who currently manages the code enforcement division, a city's decision as to where it organizationally aligns its code enforcement division depends upon the needs and focus of that city. Hemet has clear needs in the area of public safety and, as we describe at the beginning of the report, Hemet's crime rate is well above that of neighboring cities and the State as a whole. Further, code enforcement already has significant involvement with public safety, efforts it could improve upon if public safety was its priority. For example, in fiscal year 2015–16, the city reported that code enforcement worked with the city attorney to shut down eight marijuana grow operations and worked with the police department to inspect 14 massage parlors. In addition, in its fiscal year 2016–17 budget, the

goals of code enforcement are closely linked to public safety, including working with the police department to address homelessness and gang issues. Code enforcement might

better focus its efforts to address public safety concerns as well as the needs of the city if it were managed by the police or fire department.

Figure 9
 Reorganization of the Government Structure for the City of Hemet Could Increase Efficiencies



Source: California State Auditor analysis based on the current and proposed organizational chart for the City of Hemet.

* We present these departments under public safety due to sharing of administrative staff, but the police chief and fire chief would each still report to the city manager.

† Administration includes purchasing, utility billing, and risk management.

In comparison, the city of Banning (Banning) has its code enforcement officers organized under its police department. The police sergeant who oversees Banning's code enforcement division stated that being organized under the police department helps to address crime by making officers more aware of code violations that can aid in combating criminal activity. For example, the sergeant described a criminal complaint in which one of the parties lived in a garage, which is a violation of Banning's code. Through his work with code enforcement, he was able to address both the criminal complaint and the code violation, which provided him the authority to remove the party from the residence.

Management within Hemet's government has mixed opinions on the placement of code enforcement. Hemet's police chief stated that he is open to restructuring code enforcement under the police department and does not see a significant impact on police department staff, other than designating a sergeant to oversee code enforcement activities. According to the fire chief, the synergy between code enforcement and the fire department would facilitate both departments working together efficiently, thus contributing to the city's goal of creating an enhanced community risk reduction program. The fire chief noted that code enforcement could also assist the fire department with activities that it does not have the staffing to cover, such as required inspections for restaurants and multifamily residential buildings. In contrast, the community development director, who currently manages the code enforcement division, believes the division should remain within the existing reporting structure due to its current functions of building and property review. When the current city manager assumed his position in January 2016, he initially expressed interest in reorganizing code enforcement to better align with Hemet's public safety needs. However, he later stated that, through ongoing evaluation of personnel, budget, and other aspects of the present organization, he now believes

that code enforcement is properly located with community development. Nevertheless, this existing structure does not specifically address the city's high crime rate. Although code enforcement currently helps to address public safety issues, it could do more to address the city's challenges if public safety was its main concern. Hemet should consider how its organization can best meet the needs of the community, given its high crime rate, and take appropriate action to address those needs.

Restructuring city government could also provide additional focus on Hemet's volunteer programs. Code enforcement personnel acknowledge that their department has many activities that volunteers could assist with in the field, such as removing signs, taking photos, and addressing boarded-up buildings, but there are currently no field volunteers. The code compliance manager stated that, although the code enforcement department once had volunteers who worked in the field, they left for various reasons, and it has not sought other individuals to replace them. Further, the code compliance manager indicated that Hemet had concerns about safety, liability, and misuse of authority regarding the code enforcement field volunteers.

However, according to the police sergeant who oversees the police volunteer program, the Hemet police department has a significant number of volunteers who receive training in areas that address the code compliance manager's concerns, such as in the use of police radios in the event volunteers need police assistance and in report writing to properly address issues and avoid potential misuse of authority. The fire chief stated that aligning code enforcement with the fire department would allow both departments to better engage and train volunteers, similar to the robust police department volunteer program. Further, this shift would allow the police volunteers to assist with clerical work across the fire department, police department, and code enforcement division. When we asked the city manager about involving police volunteers

with code enforcement, he stated that he has not spent enough time with the police volunteers to provide an opinion.

Recommendation to Address This Risk

To streamline oversight, better align similar functions, and provide opportunities to leverage staff, Hemet should reorganize the structure of its city government. Specifically, it should conduct a comprehensive organizational analysis, including work assignments, workloads, reporting relationships, and coordination points, and pursue options to improve efficiency and effectiveness, such as creating a combined community development and services department, shifting engineering to become a division under public works, and shifting its code enforcement division to public safety.

Turnover and Lack of Consistent Leadership Have Inhibited Critical Planning Efforts

Hemet has faced a high degree of management turnover, which can result in a lack of consistent leadership, thereby reducing the effectiveness of services. Over the past nine years, the city has had eight different individuals serve as city manager—four in a permanent role and four others in an interim capacity. In addition, the city did not have a permanent fire chief for nearly two years, from July 2013 to April 2015. The city hired a fire chief in April 2015 and a permanent city manager in January 2016. However, the city's economic development director left in July 2015, and the position has remained vacant since that time. In addition, according to the fire chief, the fire department has not had anyone serve in the role of battalion chief—a critical management position—since 2009. The city's 2013 and 2015 consultant reviews of the fire department recommended that it be staffed with three battalion chiefs. The

city intends to hire battalion chiefs, but these positions remained unfilled as of June 2016. The fire chief stated that he intends to present class specifications for the battalion chief position to the city council in the third quarter of 2016.

High turnover in city government has contributed to a lack of leadership and, in some cases, a lack of management oversight. For example, Hemet's current fire chief stated that when he was first appointed to his position, he inherited a culture in which employees were allowed to do as they pleased. He attributed the previous culture to a lapse in leadership in prior administrations and a lack of organizational accountability. According to the deputy city manager, turnover and staff reductions have resulted in a loss of institutional knowledge and reduced efficiency, as staff members were forced to learn new roles and experienced increased workloads.

Hemet has some plans to address management positions that remain unfilled. Rather than hire both an assistant city manager and an economic development director, positions that have been vacant for some time, the city manager believes that, because of budgetary constraints and current city needs, it will be more useful to hire an administrative analyst with expertise in areas such as public information, risk management, human resources, and economic development.

According to the deputy city manager, turnover and staff reductions have resulted in a loss of institutional knowledge and reduced efficiency. . .

According to the city manager's plan, this analyst would also be tasked with marketing Hemet to prospective businesses, creating

media that spotlight areas of interest and unique features of Hemet, and coordinating community engagement and outreach efforts, including unifying public information messages across departments. He stated that hiring an individual to fill this position, in conjunction with a reorganization of departments to improve efficiencies, should eliminate the need for an assistant city manager at this time.

As a result of frequent turnover in the city manager position, city staff members have been unable to build the momentum needed to develop and finalize a citywide strategic plan. According to the city manager, he has been unable to locate any prior strategic plans for the city. In addition, the city's mission and vision statements were last revised in 2005. The police department has its own strategic plan, which it hired a consultant to assist with, that includes annual strategic objectives, implementation strategies, and associated costs, allowing the police department to proactively review funding needs and the status of implementation. However, other departments have not taken a similarly proactive approach to planning. Although we do not expect each department to have its own strategic plan, we believe that Hemet should formalize an overall strategic plan to serve as the city's vision and to ensure that staff members are working together toward the same goals.

Hemet is currently in the early stages of developing a citywide strategic plan. In April 2016, the current city manager initiated strategic planning efforts with the city council and department directors, stating his commitment to completing the plan by January 2017. As part of the planning process, the city should coordinate citywide goals with each department's responsibilities and identify funding sources for each strategic initiative to facilitate the plan's execution. The plan it develops should include departmental

initiatives, implementation strategies, and associated costs that connect to Hemet's overall vision. In addition, the plan should include performance measures to determine if the city is meeting its objectives and goals. Without such a plan, Hemet is operating without clear direction and unified goals.

Once the strategic plan is complete and the city has a clear direction, it should begin developing a succession plan for continuing its leadership in key roles. Despite the fact that nearly a third of its employees are approaching retirement age and many departments could be substantially affected by their absence, the city does not currently have such a plan. City management acknowledges the need for a succession plan to avoid the loss of valuable institutional knowledge.

A formal succession plan establishes an effective framework for recognizing, developing, and retaining key management employees. In addition, it ensures that staff members are being trained to step into positions when a more senior staff member leaves or retires. Succession plans can also identify gaps in expertise that should be addressed through internal training or recruiting. In Hemet's case, succession planning can assist the city in identifying the appropriate individuals to assign to roles that promote the efficiency and effectiveness of its operations. Three department directors informed us that they conduct general succession planning and cross-training efforts; however, these efforts are not coordinated under a citywide succession plan. The city manager pointed to the high turnover in management as the reason why Hemet has not formalized any succession planning. However, he stated that he will embark on succession planning after the strategic plan is completed.

Recommendations to Address This Risk

- Hemet should complete a strategic plan that identifies goals, initiatives, responsibilities, funding requirements, potential funding sources, and key performance measures by January 2017.
- Upon completion of its strategic plan, Hemet should complete a succession plan that coincides with its strategic goals by June 2017. The succession plan should analyze staffing needs, identify internal and external talent pools, and create employee development plans.

Outsourcing Maintenance of the City Parks Could Generate Savings

Although Hemet outsources landscape maintenance of some of its grounds and properties, we question its decision not to outsource the remainder of this maintenance, including for its parks, which could generate cost savings. The parks division continues to maintain seven parks, the city's corporate yard, and some streetscapes near the entrance to the city. It has already taken steps to outsource other park functions, such as the administration of community interest classes and recreational sports leagues, to a special district. The city has also outsourced maintenance of some city streetscapes and neighborhood parks. This maintenance is overseen by its public works department and is funded through assessments to landscape and lighting districts—subsidiary special districts designed to provide streetlights and landscaping.

We reviewed a summary of bids obtained by another city for park and streetscape maintenance and determined that the annual cost of contracting with a private company to fully maintain a park ranges from 10 cents to 20 cents per square foot. In addition to landscape maintenance, the request for proposals required functions such as picking up trash, emptying trash bins, cleaning and restocking restrooms, caring for trees, and

inspecting playground equipment for safety hazards. Graffiti removal was not included in that city's scope of work, but Hemet could include this provision in the scope of its request for proposals to address the public works director's concern that graffiti is an ongoing problem in Hemet. As shown in Table 6, the city could save between \$64,208 and \$300,956 per year if a private company maintained city parks at a cost of 10 cents to 20 cents per square foot. The city would still be responsible for some related expenditures, such as electricity, water, and liability insurance. In addition, Hemet would continue to incur some personnel costs, such as a portion of a supervisor's salary for overseeing the contract with the outsourced maintenance provider. Nevertheless, outsourcing parks maintenance should result in a net savings for the city.

Hemet previously decided against outsourcing its parks maintenance but did not conduct a thorough analysis of all services that could be outsourced. In 2011 city staff members conducted an evaluation to determine potential savings from outsourcing and determined that it was more cost-effective to continue to maintain its parks within city operations. However, the analysis did not include other costs such as janitorial supplies and tree-trimming services that are included in the savings displayed in Table 6.

Currently, city staff is reluctant to outsource and eliminate the groundskeeping staff entirely, despite the opportunity for cost savings. The director of public works explained that the parks division's groundskeeping staff conducts maintenance on some streetscapes leading into town and has been correcting issues caused by the groundskeeping company contracted to handle the majority of city streetscapes. The public works director indicated that Hemet has experienced a number of challenges with the current contracted landscape service, and that staff and management have spent many hours rectifying these issues. However, she agreed that it may be beneficial to conduct a cost-benefit analysis of retaining in-house

Table 6
The City of Hemet Could Reduce Costs by Outsourcing Park Maintenance

MAINTENANCE COST PER SQUARE FOOT	PROJECTED MAINTENANCE CONTRACT*	COSTS RETAINED BY CITY†	TOTAL COST IF OUTSOURCED	FISCAL YEAR 2015-16 BUDGETED COST	ANNUAL SAVINGS TO CITY
\$0.10	\$236,749	\$465,295	\$702,044	\$1,003,000	\$300,956
0.15	355,123	465,295	820,418	1,003,000	182,582
0.20	473,497	465,295	938,792	1,003,000	64,208

Sources: California State Auditor analysis based on the fiscal year 2015-16 budget for the city of Hemet (Hemet), interviews with city staff responsible for parks maintenance, and bids for service to the city of Pomona.

* Projected cost based on an estimated 2,367,486 square feet of maintained park area multiplied by the applicable cost per square foot.

† If Hemet outsources park maintenance, the public works director indicated that the city would still pay some related costs, including water, facility repairs, utilities, a portion of the salary of a staff person to monitor the maintenance contract, and retiree benefits costs for previous maintenance staff.

maintenance versus outsourcing with an appropriate contracted company. Alternatively, since Hemet already outsources maintenance of select parks and streetscapes under its landscape maintenance districts, it could issue a request for proposals for services that combines maintenance of all parks and streetscapes throughout the city.

Recommendation to Address This Risk

To increase the cost-effectiveness of its park maintenance, Hemet should initiate a request for proposals to consider the costs and benefits of outsourcing citywide maintenance of all streetscapes and parks and take appropriate action based on the information it obtains.

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

Respectfully submitted,



ELAINE M. HOWLE, CPA
 State Auditor

Date: August 4, 2016

Staff: Linus Li, CPA, CMA, Audit Principal
 Nathan Briley, J.D., MPP
 Kelly Reed, MSCJ
 Karen Wells

Legal Counsel: Scott A. Baxter, Sr. Staff Counsel

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

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APPENDIX A

Scope and Methodology

In January 2016, the Joint Legislative Audit Committee approved a proposal by the California State Auditor (State Auditor) to perform an audit of the city of Hemet (Hemet) under the State Auditor's high-risk local government agency audit program. We conducted an initial assessment of Hemet in July and August 2015, in which we reviewed Hemet's financial and operating condition to determine whether it demonstrated characteristics of high risk pertaining to the following six risk factors specified in state regulations:

- The local government agency's financial condition has the potential to impair its ability to efficiently deliver services or to meet its financial or legal obligations.
- The local government agency's ability to maintain or restore its financial stability is impaired.
- The local government agency's financial reporting does not follow generally accepted government accounting principles.

- Prior audits reported findings related to financial or performance issues and the local government agency has not taken adequate corrective action.
- The local government agency uses an ineffective system to monitor and track state and local funds it receives and spends.
- An aspect of the local government agency's operation or management is ineffective or inefficient; presents the risk for waste, fraud, or abuse; or does not provide the intended level of public service.

Based on our review, we identified concerns about Hemet's financial condition and financial stability as well as aspects of its operations that were ineffective or inefficient. Table A.1 on the following page lists the audit objectives and related procedures that address those three specific risk factors. We did not identify concerns during our initial assessment pertaining to the remaining three risk factors.

Table A.1
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant laws, regulations, and other background materials applicable to the city of Hemet (Hemet).
2 Evaluate Hemet's financial position and options to address its structural deficit, including its ability to meet short-term and long-term financial and legal obligations.	
a. Review and assess the city's five-year revenue and expenditure projection.	<ul style="list-style-type: none"> • Reviewed Hemet's five-year revenue and expenditure projection and verified the reasonableness of the assumptions and numbers presented. • For errors and out-of-date information, we revised the projection to correct the information and determined how these changes affected the projection.
b. Assess the city's use of grant funding and options in using grants to address the city's deficit.	<ul style="list-style-type: none"> • Reviewed Hemet's methods for obtaining grant funding. • Compared grant funding obtained by Hemet to the grant funding received by other cities in the surrounding area. Due to limitations in available information to compare Hemet's success in obtaining grant funding, we were unable to determine how well Hemet performed. However, Hemet has not had a centralized process for obtaining grant funding. The deputy city manager indicated that each department assigns staff to seek and manage grants in addition to their daily tasks. However, it is not evident that a different approach would yield additional funding.
c. Review and assess options for Hemet to reduce its costs, including, but not limited to: <ul style="list-style-type: none"> i. The use of personal services contracts ii. Streamlining city operations, and iii. Outsourcing city departments or functions. 	<ul style="list-style-type: none"> • To ensure that Hemet did not waste limited resources on contractors, we reviewed eight personal services contracts from fiscal year 2010-11 to March 1, 2016—the date the contract list was provided—to determine if they were properly bid and approved and if any contracts appeared excessive. We selected various contracts to obtain a range in the levels of approval authority. We discuss this issue in Appendix B. • Interviewed department directors and reviewed mission statements to identify areas where reorganization of city functions could result in greater efficiency. • Identified the fire, police, library, and parks departments as candidates for outsourcing. • Based on our interviews with city staff and research conducted, we identified areas where city departments could increase revenue or decrease costs. • Identified charging for the costs of emergency medical services as a method to increase revenue. To determine the cost of one emergency medical service call, we used the fire department's fiscal year 2015-16 fully burdened hourly rate—a measure reflecting all of the costs of operating a fire engine, and used by Hemet for other cost recovery efforts—and multiplied it by the average length of a call, which was just under 20 minutes. For the projected number of emergency medical service calls, we calculated the average annual increase in emergency medical service calls from 2012 to 2015, which was 10.8 percent. Using 2015 as a base year, we increased the number of calls each year by 10.8 percent.
d. Review the potential impact of Hemet annexing unincorporated communities or merging with a neighboring city to address its deficit.	<ul style="list-style-type: none"> • Reviewed Hemet's process for identifying possible areas for annexation. • Reviewed recent staff analyses of potential areas for annexation. • Determined that a merger with a neighboring city would not be feasible due to the neighboring city contracting for public safety services. We discuss this issue in Appendix B.
e. Model the revenue and cost-saving options identified in steps (a) through (d) and project how they will affect the budget deficit.	Identified and quantified revenue-generating and cost-saving options where possible.

AUDIT OBJECTIVE	METHOD
<p>3 Compare economic and other indicators such as unemployment and crime rates for Hemet to neighboring communities and determine the extent to which these factors may impact the efficiency or effectiveness of Hemet's delivery of public health and safety services.</p>	<ul style="list-style-type: none"> • Documented the crime and unemployment rates for Hemet, neighboring communities, and California as a whole from 2003 to 2014 (crime rates) and from 2003 to 2015 (unemployment rates) based on federal data. • Determined that Hemet's 2014 violent and property crime rates are higher than crime rates in surrounding communities and California as a whole. Hemet has a higher unemployment rate than California as a whole and many of the surrounding communities. Only the cities of Perris and San Jacinto had higher unemployment rates in October 2015. • Concluded that high crime rates and high unemployment rates may affect Hemet's ability to deliver services, as both can result in decreases to its revenues. This, in turn, hinders Hemet's ability to maintain or increase staffing levels, thus limiting the services it can provide.
<p>4 Determine the extent to which turnover of city staff affected efficiency and effectiveness of city operations.</p>	<ul style="list-style-type: none"> • Reviewed turnover of key officials and the impact on city operations. • Reviewed strategic and succession planning efforts by city departments and Hemet in general.
<p>5 Determine the extent to which the city has sought to engage with the community, including, but not limited to, public information efforts, and how those efforts have affected the efficiency and effectiveness of city operations.</p>	<ul style="list-style-type: none"> • Reviewed community engagement efforts by Hemet in general and by each department. • Identified community engagement plans, if any. • Identified areas where community engagement affected the provision of city services.
<p>6 Review and assess any other issues that are significant to the audit.</p>	<p>During the course of the audit, we identified other options for revenue generation and cost savings that we investigated, including designating an area for redevelopment, modifying the assignment of police department vehicles, and tracking business licenses. These options are summarized in Appendix B as activities we determined were not beneficial for the city to pursue at this time.</p>

Sources: California State Auditor's analysis of Joint Legislative Audit Committee audit proposal number 2015-806, and information and documentation identified in the table column titled *Method*.

In performing this audit, we relied upon reports generated from the information systems. The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that is used to support our findings, conclusions, or recommendations. Table A.2 on the following page describes the analyses we

conducted using data from these information systems, our methodology for testing them, and the conclusions we reached as to the reliability of the data. Although these determinations may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.

Table A.2
Methods Used to Assess Data Reliability

INFORMATION SYSTEM	PURPOSE	METHODS AND RESULTS	CONCLUSION
City of Hemet's (Hemet) five-year projection database	To conclude on Hemet's budget deficit going forward.	<ul style="list-style-type: none"> • To verify the completeness of the data, we compared amounts for initial fiscal years in the projection to comprehensive annual financial reports and found no errors. • To verify the accuracy of the data, we compared the projection data to supporting documentation and found errors, as described on pages 8 and 9. 	Not sufficiently reliable for this audit purpose. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.
Eden Accounting Software Purchasing Module	To select contracts by dollar value and type for testing.	<ul style="list-style-type: none"> • To verify the completeness of the data, we selected contracts and compared them to the database. No errors were identified. • To verify the accuracy of the data, we randomly selected items and compared the data to contract files. We found five errors. Four of the five errors were information unsupported by the contract files, such as lack of support for the original contract date listed in the database. 	Not sufficiently reliable for these audit purposes. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.
SirsiDynix Horizon (Hemet's library database)	To determine the residential location of users of the Hemet Public Library.	Because the data are entirely electronic, it is not possible to conduct accuracy and completeness testing. Alternatively, we could have reviewed the adequacy of selected information system controls that include general and application controls, but we determined that this level of review was cost-prohibitive.	Undetermined reliability for the purposes of this audit. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.
Hemet's human resources database	To determine the likelihood of employees retiring and the impact of the retirements on succession.	Because the information in the database is confidential and individuals can be easily identified due to their small number, we cannot state with specificity the extent of turnover Hemet is likely to experience without potentially revealing protected personal information. Therefore, we chose not to conduct accuracy or completeness testing.	Undetermined reliability for the purposes of this audit. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our audit findings, conclusions, and recommendations.

Sources: California State Auditor's analyses of documents, interviews, and data obtained from Hemet.

APPENDIX B

Other Issues Reviewed

As part of our audit, we reviewed several areas in which we saw potential for the city of Hemet (Hemet) to increase efficiencies or adopt policies to reduce its risk. However, for those areas listed in this appendix, we determined that changes are unlikely to significantly benefit the city at this time.

Outsourcing of the Hemet Police Department

We reviewed the potential for outsourcing the Hemet police department to determine if it would be a cost-effective option for the city. The fiscal year 2013–14 per capita cost of operating the police department is only 2 percent higher than the combined average of five nearby cities' per capita costs to outsource this function to the Riverside County sheriff (sheriff). Further, Hemet's per capita cost is 15 percent lower than the combined average of three nearby cities' per capita costs to operate their own police departments. Additionally, eight cities in Riverside County that currently contract with the sheriff for police services are working with a consultant to determine if there are more cost-effective ways of delivering police services due to increases in the amounts charged by the sheriff for its services. Therefore, maintaining the police department appears to be a more practical option at this time than outsourcing this function.

Use of Police Department Vehicles

The police department's policy for police vehicles allows officers to take their assigned patrol cars home at the end of work shifts. The policy does have restrictions in place requiring the commute to be no more than 15 miles beyond the city limits and the vehicle

to be stored securely. Although this policy requires the police department to maintain a larger number of vehicles than would be needed in a pooled vehicle system, the take-home policy is necessary for Hemet under its current staffing levels. The police chief explained that if the city switched to a pooled vehicle policy to reduce the number of vehicles, it would take an officer off the street for roughly half an hour at the beginning and end of each shift due to the time associated with switching vehicles. This transition time equates to two fewer hours of police coverage over a 24-hour period due to the fact that all Hemet patrol officers work one of two 12-hour shifts. In comparison, a police officer with an assigned vehicle does not require paid time to transfer gear into or out of a vehicle. Therefore, until such time that Hemet has sufficient staffing to create more than the two shifts and cover vehicle changes, it would not be beneficial to switch to a pooled vehicle system, as such a system would reduce the level of police service and challenge the police department's ability to provide public safety services.

Annexing Territory

In the past five years, Hemet has considered annexing two areas within geographical proximity. In 2010 it completed a fiscal impact analysis for the residential area east of the city's boundary and found that annexing that land would result in a fiscal deficit. However, in March 2016, Hemet completed annexation of about 995 acres west of the city in an uninhabited area, which it believes will generate nearly \$1.8 million annually after the land is developed for business and other uses.

As part of our audit objectives, we reviewed a suggestion by a city official of merging Hemet with a neighboring city, San Jacinto, to leverage economies of scale. Upon further review, we found that San Jacinto contracts for public safety services, whereas 72 percent of Hemet's budget is dedicated to its city-operated public safety services. For the merger to achieve meaningful cost savings due to economies of scale, the two entities would need to have the same structure for public safety services, with the services being either administered in their entirety by the combined city or administered through a contractor. Given the benefits realized by each city through its current method of providing public safety services, a merger of the two cities would be impractical at this time.

Use of Personal Service Contracts

Our review of personal service contracts found no inappropriate contracts and that Hemet followed its tiered approval process. To ensure that it makes appropriate use of contracts, Hemet has a multilevel process for contracts, in which different individuals have the ability to approve contracts within certain dollar thresholds. For example, city policy requires all contracts over \$50,000 to be approved by the city council. We reviewed contracts from each tier of approval authority and found that city staff and the city council, when appropriate, properly approved the contract. Our review also focused on personal service contracts—contracts with individuals to provide services such as consulting, planning, and advisory functions—because they present a greater risk of wasteful spending, since there is typically less accountability over the quality and quantity of work provided. None of the personal service contracts we reviewed appeared inappropriate or wasteful.

Business Licenses

We reviewed Hemet's management of business licenses to ensure that it received all of the revenue due for regulating businesses. To ensure that all licenses are paid, Hemet contracts with a company that searches for businesses that do not have valid licenses. Hemet's contract requires it to pay the company only for those businesses the company identifies as having delinquent licenses, and the amount to be paid is a percentage of the additional revenue generated from the license fees. Additionally, Hemet has other ways of identifying businesses that have not obtained licenses. For example, before a business can begin water service, it must have an active business license. Therefore, because Hemet has active controls through its contractor as well as passive controls through its utility billing, we determined that Hemet has sufficient controls to ensure that it obtains business license revenue.

Community Revitalization and Investment Authority

In 2015 the Governor approved Assembly Bill 2 (Chapter 319, Statutes of 2015), which enabled cities to establish a community revitalization and investment authority (CRIA) that would adopt and carry out a community revitalization and investment plan. A CRIA may receive tax increment money with the affected governmental entities' permission. Tax increment money is the incremental increase in property tax revenue resulting from the development of a parcel of land. We investigated the use of this state law to aid development in Hemet and determined that it is too early to conclude whether the option is feasible for the city. To establish a CRIA, Hemet would need to verify that the area it intends to designate as a plan area meets the necessary criteria. The criteria include an annual median household income that is less than 80 percent of the

statewide annual median income and at least three other conditions, which may include a deteriorated or inadequate infrastructure, crime rates, and nonseasonal unemployment rates that exceed defined thresholds. The state law also requires 25 percent of the tax increment funds the CRIA received to be allocated to affordable housing. To revitalize its downtown area, Hemet is currently developing a “downtown specific plan” with a consultant, who has identified a

CRIA as one of several potential funding mechanisms for the plan. The community development director indicated that although the city council had discussed potentially implementing a CRIA, it would not formally explore the option until after the plan is finalized. At that time, Hemet will be able to determine if a CRIA is a viable funding mechanism for its plan. Hemet expects to receive the final draft of the plan from its consultant by the fall of 2016.

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APPENDIX C

The California State Auditor's High-Risk Local Government Agency Audit Program

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

CALIFORNIA CITIES

To identify local entities that may be high risk, we analyzed publicly available information, such as financial reports and prior audit reports or analyses, for more than 450 California cities. Using this analysis, we identified various cities for which we performed a more detailed financial analysis. This detailed analysis included using the financial data to calculate fiscal indicators that may be indicative of a city's fiscal stress. We also reviewed publicly available information to assess the city's fiscal outlook over the next five years, using financial and budgetary reports and other information that could affect the city's operations. We then analyzed the results to determine whether each city is at risk for potential waste, fraud, abuse, and

mismanagement, or has major challenges associated with its economy, efficiency, or effectiveness.

Based on our initial analyses, we identified six cities, including the city of Hemet (Hemet), which appeared to meet the criteria for being at high risk. To better understand the factors that led us to this determination, we visited each of the six cities and conducted an initial assessment to determine the city's awareness of and responses to those issues and to identify any other ongoing issues that could affect our determination of whether the city is high risk. After conducting our initial assessment, we concluded that Hemet warranted an audit. In January 2016, we sought and obtained approval from the Audit Committee to conduct an audit of Hemet.

If the local agency is designated as high risk as a result of the audit, it must submit a corrective action plan. If it is unable to provide its corrective action plan in time for inclusion in the audit report, it must provide the plan no later than 60 days after the report is published. It must then provide written updates every six months after the audit report is issued regarding its progress in implementing the corrective action plan. This corrective action plan must outline the specific actions the local agency will perform to address the conditions causing us to designate it as high risk, and the proposed timing for undertaking those actions. We will remove the high risk designation when the agency has taken satisfactory corrective action.

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City of Hemet

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From the Office
of the

CITY MANAGER
Alexander P. Meyerhoff

July 11, 2016

Elaine M. Howle, CPA*
State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Re: Response to State Auditor

Dear Ms. Howle,

It is with pleasure that we prepare this response to your correspondence dated July 5, 2016 regarding the draft report to the Joint Legislative Audit Committee entitled "Local High Risk - City of Hemet: Its Ongoing Budget and Organizational Inefficiency Threaten Its Financial Stability and Delivery of Services."

Pursuant to California Government Code Section 8545(b) and 8545.1,

"The California State Auditor may establish a high-risk local government agency audit program for the purpose of identifying, auditing, and issuing reports on any local government agency, including, but not limited to, any city, county, special district, or any publicly created entity, whether created by the California Constitution or otherwise, that the California State Auditor identifies as being at high risk for the potential of waste, fraud, abuse, or mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness."

The City of Hemet is pleased to learn that, through the high risk local government agency audit program, the State Auditor has found no evidence of waste, fraud, abuse, mismanagement or other malfeasance. This is an important finding which the City of Hemet would like to highlight in the report to the Joint Legislative Advisory Committee. ①

Furthermore, the City strongly disagrees with the State Auditor's Designation of the City as High Risk. Since 2008, the City has undertaken numerous cost saving measures to improve its financial position. The actions include a series of concerted and coordinated efforts to place the ②

* California State Auditor's comments begin on page 45.

Elaine M. Howle, CPA

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City on a sustainable path to end the City's historic practice of deficit spending. These steps include:

1. Reduction in Staffing Levels

Between FY 08-09 and FY 16-17, city staffing was reduced by 38% from 442 to 293, including a loss of 25 police officers and 10 firefighters.

2. Balancing Services with Revenues

Over the same period, the Hemet Public Library reduced operating hours by 50%. Operation of the City of Hemet Simpson Senior Center was contracted to Valley Wide Parks and Recreation and the YMCA of Riverside.

3. Employee Compensation and Benefit Reductions

Beginning in 2008, city employees agreed to a number of significant pay and benefit reductions. These included layoffs, salary cuts, furloughs and increased employee contributions to medical and retirement benefits. Reforms also included a reduction in benefits for new employees.

4. Retiree Medical Benefit Reductions

Due to decisive action taken by the City Council, the city is projected to save over \$30 million in retiree medical expenses over the next 10 years.

5. Public Private Partnerships

In 2011, the Hemet City Council voted unanimously to approve a "Franchise Agreement for Comprehensive Refuse Services" with CR&R, Inc. This action resulted in the elimination of 28 city jobs and shifted the entire city-run refuse operation to CR&R, Inc. The city received a lump sum payment of \$12.5 million, an annual franchise fee totaling \$12.5 million (\$657,895 per year) and monthly payments totaling \$63 million over 19 years. This agreement resulted in an infusion of cash in the city's general fund as well as an on-going revenue stream to help off-set the city's structural deficit.

6. Contracts for Service

The city currently contracts with the private sector or non-profits for over 40 functions city-wide including, but not limited to: animal control services, forensic crime-lab analysis, fire plan check, background investigations, vehicle towing service, custodial services, landscape maintenance, and refuse and solid waste collection and disposal.

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7. Grant Funding

The City continues to aggressively pursue grants resources, having applied for over \$30 million in grant funding to offset general fund expenditures since 2008. Public safety grant awards during this 7 year period total over \$20.5 million for public safety expenses including police and fire safety equipment, police and fire personnel in support of innovative public safety enhancement programs such as the Hemet Restoring Our Community Strategy (ROCS) and traffic safety and gun violence reduction programs. Grant funding has also been used extensively to offset general fund expenditures for the purchase of police, fire and public works vehicles and apparatus. Last year alone, the city was awarded \$4,489,674 in Federal grant dollars.

8. External Funding Sources

General fund operations funded by sources other than the general fund or grants totaled \$757,737 in 2014. The city continues to aggressively pursue outside funding sources to offset general fund expenditures.

9. Financial Sustainability

In 2015, the City Council adopted the Five-Year Financial Plan which ends the City's historic practice of deficit spending by FY 19-20 while maintaining at least a 20% General Fund Reserve (Fund Balance) as required by city ordinance. (3)

Key elements of the 5-year plan include:

- general fund savings generated by the retiree medical reform;
- capital improvement projects (CIP) not supported by general fund; and
- "Status quo" service and staffing in general fund departments.

10. Responsible Financial Practices

In 2016, the City Council adopted the FY 16-17 Annual Budget, which includes a nearly balanced budget, with a deficit of \$350,000, which is less than 1% of the General Fund. (4)

Staff has the opportunity of five business days to review the report recommendations. On a go forward basis, it is the City of Hemet's intent to submit a Corrective Action Plan to the State Auditor on August 4, 2016, in which the City will outline its plan to address the State Auditor's recommendations. In the meantime, the City will review the recommendations to address each risk area.

The City of Hemet has worked closely with the State Auditor over the last several months. This has been an arduous process in which the City provided detailed financial, organizational and

Elaine M. Howle, CPA

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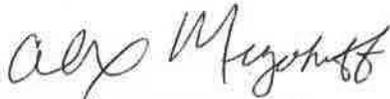
historical data to the State Auditor. This information is critical to both understanding the history of the City, and developing a complete and accurate picture of the current financial and organizational state of the City.

- ⑤ As the City of Hemet moves forward in the drafting of a Corrective Action Plan, it is the intent to clarify items contained in the State Auditor's report, including mischaracterizations, inaccuracies, and unsubstantiated items. Additionally, the City will address each topic within the report to provide a timeline for the ongoing tasks to be undertaken in furtherance of the goal to achieve financial stability and address service delivery expansion.

The State Auditor's efforts to understand the unique challenges of the City of Hemet are appreciated and each risk area will be thoroughly reviewed and addressed by the City Council and staff with the goal of eliminating the "high risk" designation.

If you wish to discuss the report and the City's response, please contact Jessica Hurst, Deputy City Manager at (951) 765-2330.

Sincerely,



Alexander P. Meyerhoff
City Manager

APM/ka

COMMENTS

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CITY OF HEMET

To provide clarity and perspective, we are commenting on the city of Hemet's (Hemet) response to the audit. The numbers below correspond to the numbers we have placed in the margin of Hemet's response.

Although we state on page 1 that we did not observe any conditions related to fraud or abuse, our report clearly does identify instances of ineffective and inefficient management. For example, on page 17, we state that Hemet has historically underfunded its fire department, resulting in insufficient staffing levels and substandard infrastructure, creating a risk to public safety. Further, we note on page 28 that Hemet has not reduced costs by outsourcing the remaining maintenance of its parks, despite outsourcing other park and streetscape maintenance.

①

We stand by our designation of Hemet as high risk. Although throughout the report we acknowledge that Hemet has undertaken various actions focused on achieving cost savings, the city's expenditures continue to outpace revenue, impeding its ability to meet its financial obligations as we highlight on page 5. In addition, despite the city's actions, we note on page 17 that ineffective and inefficient organizational management negatively affect its provision of public services.

②

Hemet's statement that its five-year plan will end its historic practice of deficit spending by fiscal year 2019–20 is misleading. As noted on page 5, we refer to the extent to which Hemet's general fund expenditures exceed its revenue as its *budget deficit*. On page 9, we state that Hemet's projected budget deficit for fiscal year 2019–20 is closer to \$268,000 rather than the nearly \$17,000 deficit included in its projection.

③

In June 2016, the city council approved Hemet's operating budget for fiscal year 2016–17. This adopted budget projects a general fund deficit of approximately \$350,000, consistent with the deficit portrayed in Hemet's five-year projection for that year developed in October 2015. However, Hemet's budget deficit for fiscal year 2016–17 will likely be greater than the \$350,000 it projects due to overly optimistic expenditure and revenue projections, as we note on pages 10 and 11. Specifically, we question Hemet's projection of a more than 15 percent increase in property tax revenue and a 12 percent

④

increase in motor vehicle license fees. Further, we question a total of nearly \$1.7 million in reduced expenditures including reductions in engineering and overtime costs.

- ⑤ We strongly disagree with Hemet's contention that the report contains mischaracterizations, inaccuracies, and unsubstantiated items. The audit was conducted according to generally accepted government auditing standards and the California State Auditor's thorough quality control process. We gave Hemet ample opportunities to review the items contained in the draft report and correct any items it believed to be inaccurate. Throughout the audit, we communicated our concerns to Hemet. Further, we shared the body of the draft report, which detailed our findings and conclusions, with city staff at our exit conference before we sent the draft report for Hemet's formal review. We considered all the comments and suggestions Hemet made regarding the draft report's accuracy and clarity and made those changes we believed were warranted based on the evidence. We reviewed all documentation provided, and all our conclusions are fully supported and factually correct.

We expected Hemet to address any concerns regarding the draft report either in its formal response or through discussions with us during the formal review period. However, Hemet states that it will instead clarify these concerns in its corrective action plan that it intends to submit in early August 2016. We will review the plan and provide any further perspective and clarity, as needed, at that time.