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January 13, 2020

The Honorable Rudy Salas, Chairman
Joint Legislative Audit Committee
1020 N Street, Room 107
Sacramento, California 95814

RE: Local Government High Risk Audit Program – City of El Cerrito

Dear Chairman Salas:

Government Code section 8546.10 permits the California State Auditor's Office (office) to develop a high-risk local government agency audit program for the purpose of identifying, auditing, and issuing reports on any local government agency, including a city, county, special district, or other publicly created entity, that the office 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. Pursuant to this provision, I am respectfully requesting the committee's approval of an audit of the City of El Cerrito.

El Cerrito is a city in Contra Costa County with a population of roughly 25,000. In November 2018, El Cerrito became a charter city, which provides it with authority over municipal affairs and enables it to establish certain local taxes beyond those allowed to general law cities. The city operates a full-service government and also provides fire services, though a contractual agreement, to its neighboring city, the City of Kensington. El Cerrito had fiscal year 2018–19 general fund revenues of \$35.8 million.

In October 2019, my office identified El Cerrito as the seventh most fiscally challenged city in the State due to its inadequate general fund reserves, cash flow and liquidity challenges, and escalating pension costs. However, El Cerrito has not developed a long-term approach to improve its financial condition and has not addressed its increasing pension costs. During the great recession, El Cerrito used its general fund reserve to maintain service levels rather than scaling back on costs of services and, by fiscal year 2016–17, the city depleted this reserve entirely. As of fiscal year 2017–18, the city was operating with a deficit of \$2.2 million. El Cerrito has significant cash flow problems and has relied on short-term loans to cover its expenses since fiscal year 2012–13. The amounts of these loans have increased from \$5 million in fiscal year 2012–13 to \$9 million in fiscal year 2019–20. Further, the city's annual pension costs are expected to rise from \$5.7 million in fiscal year 2017–18 to \$9 million by fiscal year 2024–25. Moreover, as of June 30, 2018, El Cerrito had a \$2.8 million liability for other post-employment benefits such as retiree health care, but it had no current plans for funding this liability.

Regarding its fire department, the city has incurred significant costs in overtime and it has not assessed whether it fully recovers the cost of the fire protection services it provides to the city of Kensington. Additionally, although the city has recently elected to temporarily defer facility maintenance and equipment replacement in an effort to reduce spending in fiscal year 2019–20, it has not identified more permanent cuts. In its fiscal year 2017–18 financial report, the city acknowledged the potential for a recession, and it reaffirmed its commitment to establish and maintain a general fund balance that will sustain the city's operations during such an event. However, it does not yet have an effective plan to reduce expenses and increase its general fund balance, or to address its worsening cash flow problems.

An audit of the city of El Cerrito will help identify the scope of its financial challenges and possible solutions. The proposed audit will address the following questions:

- What is El Cerrito's ability to meet its short- and long-term financial obligations, and what are its plans to address its budget deficit, rising pension costs, and general fund deficit? How can El Cerrito resolve its worsening cash flow problems?
- Are El Cerrito's existing programs and services sustainable? What are the city's options for potential revenues from new or increased fees, and what potential cost savings exist from reducing expenditures for programs that rely on the general fund to operate?
- What steps does the city need to take to reduce the overtime for its fire department? Is El Cerrito's contract for providing fire services to the city of Kensington adequate to recover all costs associated with providing services to that city?
- What is the impact of deferred maintenance and delayed replacement of equipment and capital assets on El Cerrito's long-term costs and ability to provide services?

If you have any questions regarding this audit proposal, please contact me or Paul Navarro, Chief Deputy State Auditor, Operations, at (916) 445-0255.

Sincerely,



ELAINE M. HOWLE, CPA
California State Auditor