

**CITY OF MODESTO OVERSPENDING
WHAT'S HAPPENING NOW?
Stanislaus County Civil Grand Jury
Case #19-02C**

SUMMARY

The 2018-2019 Stanislaus County Civil Grand Jury (SCCGJ) investigation into overspending by the City of Modesto was prompted by a citizen complaint. Several factors contributed to the City of Modesto finding itself in this situation including understaffing, lack of training, underutilization of internal computer systems and lack of adherence to policies and procedures. Understaffing began as a result of the 2008-2009 recession. Several positions were not filled when vacated. Additionally some management and department head positions were filled only on an interim basis. Staff who were assigned with purchasing goods and services, or creating contracts, were not fully trained to understand both the limits and conditions of their responsibilities. Finally no internal alerts were utilized within the City of Modesto's Oracle Computer System to signal approaching termination dates and monetary limits of contracts. SCCGJ also found that City of Modesto staff did not follow the City Municipal Code or the city's purchasing manual when monitoring or getting authorization for contracts. This was a practice that had continued from 2012-2017. Some contracts were paid after termination dates. Others were paid exceeding the limits established by the Municipal Code, without City Council resolution.

BACKGROUND

Between September 2017 and May 2018, the *Modesto Bee* ran a series of articles outlining overspending by the City of Modesto. A citizen complainant asked the grand jury to investigate these issues as a misuse of taxpayers' money.

SCCGJ's investigation was to determine whether or not the City of Modesto was properly reviewing and monitoring contract spending and continues to do so.

METHODOLOGY

SCCGJ reviewed the following documents from the City of Modesto:

- Modesto City Charter
- Modesto Municipal Code
- Modesto City Council agenda reports
- Memo from Public Management Group dated January 23, 2018
- A PowerPoint presented to the Modesto City Council on January 23, 2018 entitled "Review of Purchasing/Contracting Practices & Recommended Corrective Action"
- Modesto City Council Resolution No. 2018-48 through 2018-54 dated January 23, 2018
- City of Modesto finance committee report dated February 9, 2018
- City of Modesto -"Independent Accountants' Report on Agreed upon Procedures for the Year Ended June 30, 2017" prepared by Hudson, Henderson & Company, Inc. dated February 21, 2018

- City of Modesto - Contract Compliance – “Independent Accountants’ Report on Agreed upon Procedures for the Year Ended June 30, 2010” prepared by Hudson, Henderson & Company, Inc. dated June 28, 2018
- “Report of Investigation – Finance Contracts Matter, City of Modesto, California” by Armistead Research and Investigative Services dated August 30, 2018

SCCGJ interviewed personnel from the City of Modesto.

SCCGJ visited the City of Modesto Finance Department and reviewed the Oracle Computer System.

DISCUSSION

News articles in the *Modesto Bee* published between September 13, 2017 and May 21, 2018 alleged several instances of overspending within the finance department and the purchasing division of the City of Modesto. The purpose of this investigation was to determine whether the City of Modesto has taken the necessary steps to ensure that taxpayers’ money is spent within the parameters of the Modesto Municipal Code (MMC).

The purchasing system is a division of the finance department and has the responsibility to supervise purchasing action (MMC § 8-3.201 Organization).

Pursuant to the City of Modesto Municipal Code § 8-3.202 General Responsibilities and Duties, the Department is responsible for contracting goods and services needed by the city from qualified persons, at reasonable prices, and to ensure quality of the purchases. MMC § 8-3.102 states that no contract involving an expenditure in excess of \$50,000 may be authorized or executed without City Council approval. Contracts may not be divided into smaller dollar amounts in order to circumvent monetary limits requiring authorization by the City Council.

After the 2008-2009 financial crisis, understaffing in both the finance department and purchasing division contributed to overspending in contract payments. Several positions were not filled when vacated, or filled only on an interim basis, including some management and department head positions. Additionally the number of staff positions within the City of Modesto were inadequate to meet the workload of entering and monitoring contract information in the Oracle Computer System.

In order for the city to function financially from 2012-2017, practices within the purchasing division ignored requirements of the City Municipal Code. Some contracts were paid past expiration dates, and/or beyond their monetary limits. The Oracle Computer System was not being used properly to monitor contract limits. Staff was neither adequately trained nor supervised in using this system. The purchasing procedures manual had not been revised since March 2007, and the purchasing manual had not been revised since July 2009. Staff was neither trained nor required to read and follow standardized written policies and procedures.

According to the August 30, 2018 investigation by Armistead Research, it became apparent that personnel were unclear regarding whose responsibility it was to oversee purchasing contracts. According to Municipal Codes § 8-3.102, §8-3.103 and §8-3.202, oversight of contracts for

public works differs from that of contracts for purchasing and services. Diverting from standard practice, contracts were not being approved according to Municipal Code.

After the discovery of the contract irregularities, action was taken by the finance department, the purchasing division, and the City Manager to rectify the situation. Staffing was increased and monthly meetings were being held by the finance department to improve training and contract compliance. On January 23, 2018 Modesto City Council adopted a total of seven (7) resolutions (Nos. 2018-48 through 2018-54). Resolutions described actions to be taken to amend contract limits, terms of contracts, or to authorize the Purchasing Manager to increase amounts on blanket purchase orders. Adoption of these resolutions also ratified past expenditures that exceeded the City Manager's financial authority. The City Council approved new annual purchase agreements that included past expenditures and/or increased expenditure limits. Some contract dates were extended to September 30, 2018 to provide time for negotiating new contracts.

SCCGJ's investigation found that change has occurred within the City of Modesto's financial practices. City of Modesto staff is now properly trained. Supervisory and managerial staff maintain accountability for approving all purchases.

The Oracle Computer System is now being fully utilized as a tool for entering, monitoring, and reporting the status of all contracts. Tracking information consists of vendor names, dollar limits, expiration dates, and City Council resolution numbers, if authorization is required. Safeguards are in place to protect from overspending or paying on expired contracts.

SCCGJ observed a demonstration of how information is entered and tracked in the Oracle Computer System. SCCGJ was provided with a copy of the control document given to each division in preparation for monthly meetings between division heads and the finance department. At monthly meetings all contracts are reviewed to assure accuracy and to make staff aware of contracts due for review or renewal. All City of Modesto purchasing contracts have future expiration dates. Alerts are in place within the Oracle Computer System giving early notification of contract dollar limits being reached. Reminders are issued by the system 90 days before contracts are due to expire.

SCCGJ's investigation found that issues which caused the underlying problems in the past years are being substantially addressed.

SCCGJ's investigation found the City of Modesto has demonstrated its recognition of past financial problems. The city hired a consulting firm to provide an independent review of past purchasing practices. The firm made observations and recommendations for corrective action. Based on recommendations the City of Modesto has hired additional staff for the finance department and purchasing division. Staff receives monthly training on proper procedures. Revised purchasing and policy manuals are being drafted. Additionally, an investigative firm hired by the city determined no malfeasance by staff.

On February 5, 2008 citizens of Modesto passed Measure M, "Increase Accountability in City Hall Measure of 2008". A majority vote was required, and the measure passed with over 78% of voters approving. This measure established the "Office of City Auditor". Pursuant to Modesto Municipal Code §902.1, the City Council shall appoint the City Auditor who shall serve at its pleasure. "The City Auditor shall be certified according to standards comparable to a Certified

Public Accountant or Certified Internal Auditor at time of appointment.” The City Auditor is charged with conducting audits of all fiscal transactions and accounts kept by the city and issuing reports and recommendations to the City Council after each audit. This position was not filled for the majority of 9 years since voters passed Measure M and revised the Code. In September, 2008 the first city auditor was hired after the passage of Measure M. The position was vacated in March 2010 after only eighteen (18) months. In 2011 an external firm was contracted for the purpose of conducting performance audits, rather than financial audits, through mid-2017. In April 2018, an internal city auditor was hired by the Modesto City Council, and the position was vacated in December 2018, after only eight (8) months. The City of Modesto has not had an internal auditor since the position was vacated in December 2018.

FINDINGS

- F1. Several high-level and interim positions within the City of Modesto have now been filled.
- F2. The number of staff positions within the City of Modesto currently meets the contract monitoring needs of the city.
- F3. Staff now receive monthly training regarding standardized policies and procedures.
- F4. The purchasing procedures manual has not been revised since March 2007.
- F5. The purchasing manual has not been revised since July 2009.
- F6. The City of Modesto’s purchasing division now has safeguards in effect with regard to contract approvals.
- F7. The City of Modesto’s purchasing division now enters and monitors contract information within the Oracle Computer System.
- F8. The position of City Auditor remains vacant as of the date of this report.

RECOMMENDATIONS

- R1. The City of Modesto should continue to maintain adequate staff who will enter specific contract information and generate reports using the Oracle Computer System.
- R2. The finance department should continue to conduct monthly meetings to assure contract compliance.
- R3. As required by the Modesto City Charter and the Modesto Municipal Code, regular meetings with all city division heads should occur to ensure that contracts nearing monetary or time limits are reported to the Modesto City Council.
- R4. Both of the Purchasing Division’s written policy and procedures manuals should be finalized by September 30, 2019.
- R5. Staff responsible for purchases and contracts should follow the City of Modesto policy and procedures manual and the Modesto Municipal Code.
- R6. Purchasing and finance department staff should receive specific orientation and refresher training regarding utilization of the Oracle Computer System.
- R7. The Modesto City Council should begin the process of recruiting and hiring a new City Auditor as required by Modesto Municipal Code §902.1, no later than September 30, 2019.

REQUEST FOR RESPONSES

Pursuant to Penal Code §933 and §933.05, the Stanislaus County Civil Grand Jury requires responses as follows:

- Modesto City Manager.....F1 - F7, R1 - R6
- Modesto City Council.....F8, R7

APPENDIX

- Modesto Municipal Code §2-3.402
- Modesto Municipal Code §8-3.102
- Modesto Municipal Code §8-3.200
- Modesto Municipal Code §8-3.201
- Modesto Municipal Code §8-3.202
- Modesto Municipal Code §2-3.401
- Modesto Municipal Code §902.1
- Modesto City Charter
- Modesto City Council Agendas
- Modesto City Council Minutes
- Modesto City Council Resolutions 2018-48 through 2018-54
- Measure M
- Independent Accountant's Report, Hudson, Henderson & Company, Inc.
- A PowerPoint presented to the Modesto City Council on January 23, 2018 entitled "Review of Purchasing/Contracting Practices & Recommended Corrective Action"
- Review of Modesto's Purchasing Practices by Public Management Group
- Report of Investigation - Finance Contracts Matter, City of Modesto, California by Armistead Research and Investigative Services

REFERENCES

Modesto Bee Articles:

- *'We Will Fix This' – A Modesto City Manager Apologizes for \$2.2 Million Error*, September 13, 2017
- *Modesto Should Get Busy Finding a City Manager*, September 26, 2017
- *\$2.2M in Overspending is not Modesto's Only Mistake*, October 14, 2017
- *Modesto has Found 11 Instances of Overspending*, October 25, 2017
- *For the Third Time, City of Modesto Staff Spends More than it's Supposed To*, November 13, 2017
- *Modesto Brings Forward More Examples of Overspending*, November 27, 2017
- *Modesto Spent More Than Agreements Allowed 45 Times*, December 24, 2017
- *What Role did 'Group Think' and 'It's Not My Job' play in Modesto's Overspending*, January 21, 2018
- *Modesto Says it Will Fix Culture that Led to \$16M in Overspending*, January 24, 2018
- *New Agreement Could Tell Whether Modesto has Fixed its Problem Purchasing Practices*, May 21, 2018