



DATE: February 4, 2025  
TO: Honorable Members of the Audit Committee  
FROM: Andy Hanau, City Auditor  
SUBJECT: **Office of the City Auditor's FY2026 Proposed Budget Mitigation – UPDATE**

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The purpose of this memorandum is to provide updates to the Office of the City Auditor's (OCA) budget mitigation memorandum submitted to City Council and the Audit Committee on January 7, 2025. After issuing that memorandum, OCA continued to consult with the Department of Finance and other stakeholders to evaluate additional areas for budget reductions. Based on those consultations, OCA has identified additional proposed reductions, bringing our total proposed reductions to \$406,871 (7 percent of OCA's budget).

### **Summary**

The Office of the City Auditor (OCA) is an independent City department that delivers Charter-mandated core City services. Specifically, OCA conducts audits and investigations that save taxpayer money; identify opportunities for the City to increase revenues; increase the efficiency, effectiveness, and equity of City programs; and help identify and prevent fraud, waste, and abuse. We note that OCA's core mission directly aligns with recent budget mitigation directives from the Mayor and Chief Operating Officer. OCA's ability to execute these critical functions is especially essential as the City faces an ongoing General Fund structural deficit. And while the General Fund comprises about one-third of the City's total budget, OCA is mandated to audit and investigate all General Fund, Enterprise Fund, and all other City programs, operations, agencies, offices, and contracts. Consequently, substantial cuts to OCA's budget commensurately diminish our capacity to carry out those large and growing responsibilities.

The Administration has established a FY2026 target budget reduction of 20 percent for most General Fund departments, including OCA. For OCA, this equates to a target budget reduction of approximately \$1,118,170. OCA fully understands the urgent state of the City's financial condition and the need for budget reduction measures, and we have thoroughly explored all options for OCA budget reductions without impairing the department's ability to execute our Charter-mandated duties. Specifically, we have examined costs associated

with our leased space, personnel, and each line in our discretionary expenses to identify potential reductions that would not impact the services we provide.

We have concluded that the requested 20 percent budget reduction would have a significant negative impact on OCA's operational capacity to deliver Charter-mandated core services, especially given the composition of OCA's budget. Specifically, because OCA is a small department wherein personnel expenses comprise 85 percent of our total budget, OCA could only achieve a 20 percent budget reduction through significant salary reductions and/or personnel cuts. It is important to note that OCA is currently fully staffed (zero vacancies), and such reductions would erode staff morale and capacity, and limit OCA's ability to attract and retain talent. Despite being fully staffed, OCA is still currently under-resourced compared to peer audit organizations and significant cuts would further limit our audit coverage.

Crucially, personnel and salary cuts would impair OCA's ability to carry out its core mission on behalf of the City and its residents at a time when OCA's demonstrated ability to identify savings, revenues, and programmatic efficiencies are most needed. **Attachment 1** provides illustrative, but not exhaustive, examples of the return-on-investment OCA routinely delivers, as evidenced by both implemented recommendations and recommendations pending implementation. For example, our 2021 Performance Audit of Lease Management found that the City should address a major backlog of leases in holdover status. Bringing these leases up to current market rates would bring in approximately \$2.2 million per year—more than one-third of OCA's annual budget.

Under Charter Section 39.1, the Audit Committee recommends OCA's budget to the City Council. Based on our examination and consideration of the City's financial needs and OCA's operational necessities, we provide the following proposal for consideration by the Audit Committee, which we believe provides a balanced solution. This proposal includes a net reduction of \$406,871 or approximately 7 percent of OCA's budget.

In addition, OCA's core audit management system, MK Insight, requires an upgrade or replacement for compatibility with the new Windows 11 operating system the City is implementing Citywide in early FY 2026. The total cost is expected to be up to \$100,000, but will likely be far less. We are awaiting information from the Administration on what actual costs, if any, will be.

**OCA requests that any targeted budgetary reductions to OCA for FY2026 should not exceed:**

- **Potential reductions of leased office space (\$282,072), provided the City can identify alternative space that accommodates OCA's 24 FTEs, that is private and secure to facilitate the legally-required confidentiality of OCA's work, and can relocate productivity tools OCA has invested in (conference room video conferencing equipment, Wi-Fi, etc.);**
- **Extension of one-time salary budget reduction incurred in FY2025 (\$69,889); and**
- **Only those reductions to Non-Personnel Expenditures identified in this memorandum (\$54,910).**

**In addition, we request the Audit Committee recommend that sufficient funding be provided for upgrading or replacing the MK Insight audit management system, up to \$100,000.**

**Overview of OCA's Projected FY2026 Baseline Budget**

For background, **Exhibit 1** includes the Office of the City Auditor's projected FY2026 baseline budget. This is an estimate based on currently-available information to show what OCA's FY2026 budget would be if no changes are made. Under City Charter Section 39.1, the Audit Committee recommends to the City Council the annual budget for the Office of the City Auditor.<sup>1</sup>

**Exhibit 1**

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<b>Office of the City Auditor's FY2026 Projected Baseline Budget – Updated</b>		
<b>BUDGET ITEM</b>	<b>EST. BUDGET AMT</b>	<b>% OF TOTAL BUDGET</b>
Salaries and Wages	\$ 3,683,342	61.12%
Fringe Benefits	\$ 1,451,958	24.09%
<b>Total Personnel Expenses (PE)</b>	<b>\$ 5,135,300</b>	<b>85.22%</b>
ACFR Contract (Charter-required outside independent financial audit)	\$ 350,000	5.81%
Non-Discretionary	\$ 243,774	4.05%
Misc. Discretionary	\$ 86,874	1.44%
Independent Legal Counsel (Measure A)	\$ 180,000	2.99%
Compliance Line (Hotline Service/ Software)	\$ 14,887	0.25%
MK Insight (Audit Management Software)	\$ 15,219	0.25%
<b>Total Non-Personnel Expenses (NPE)</b>	<b>\$ 890,754</b>	<b>14.78%</b>
<b>Total Projected FY2026 Base Budget</b>	<b>\$ 6,026,054</b>	<b>100.00%</b>

Source: OCA analysis of projected budget information provided by the Department of Finance.

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<sup>1</sup> Per our established process, OCA will present this budget proposal at the February 7, 2025 Audit Committee meeting, which will be the first meeting since the Administration requested the 20 percent reduction on December 9, 2024.

### **The Composition of OCA's Budget Complicates Reductions**

The Administration has established a 20 percent target budget reduction for OCA for FY2026. If the FY2026 budget includes this reduction, it would have a significant negative impact on OCA operations. As shown above, 85 percent of OCA's budget is comprised of personnel expenses, and the remaining 15 percent is comprised of non-personnel expenses that in most cases cannot be reduced because:

- The outside audit contract to prepare the City's Annual Comprehensive Financial Report (ACFR) must be fully funded for the City to comply with financial reporting and Charter-mandated requirements;
- The \$243,774 for non-discretionary expenses are set by the Department of Finance and cannot be adjusted by OCA;
- OCA must retain sufficient budgetary resources for non-personnel expenditures to fund contracts for critical Fraud, Waste, and Abuse and audit systems, as well as fund staff continuing professional education that is required by Government Auditing Standards; and
- It is important to preserve funding that Council allocated to OCA in FY2025 to implement the March 2024 voter-approved Measure A, *Independent Legal Counsel for the Office of the City Auditor and Audit Committee*.

Consequently, a 20 percent overall reduction could only be achieved through substantial staffing reductions and/or salary cuts.

As the Audit Committee and City Council are aware, the City and our residents and taxpayers benefit from our performance audits and Fraud Hotline investigations, which provide increased operational revenue, efficiencies, savings, and accountability.

**Attachment 1** provides illustrative, but not exhaustive, examples of the return-on-investment OCA routinely delivers, as evidenced by both implemented recommendations and recommendations pending implementation. In the face of the City's budgetary challenges, OCA is a key municipal asset to ensure that limited public funds are used appropriately, effectively, and efficiently. Moreover, OCA's mission is in direct alignment with the Mayor's stated directive in his December 2024 budget mitigation memorandum calling on City departments to prioritize opportunities for cost savings, efficiencies, and additional revenues in budget mitigation efforts. In short, diminishing OCA's operational capacity during periods of fiscal austerity is counterproductive.

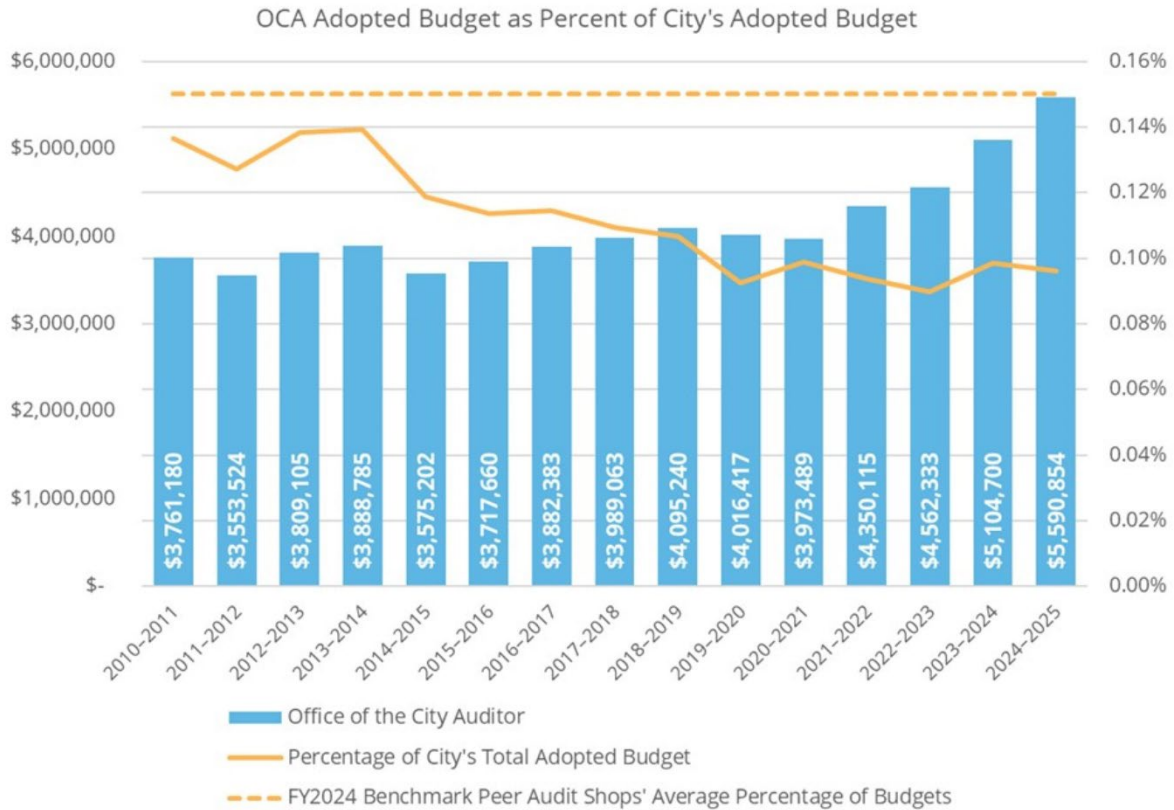
### **OCA is Currently Under-Resourced and Additional Cuts Would Further Limit Audit and Investigative Coverage**

For further context, **Exhibit 2** shows OCA's budget as a percentage of the City's budget for FY2011 through FY2025. While OCA made up approximately 0.14 percent of the City's budget in earlier years, this declined to only 0.09 percent by FY2023, due to years of growth in the City's overall budget, relative stagnation in OCA's budget, and a 3 percent reduction to OCA's budget in FY2018. Additionally, OCA absorbed a 2 percent salary budget reduction in FY2025 to support the City's budget mitigation efforts. At the same time, the City's budget increased by 12.4 percent from FY2024 to FY2025. In short, OCA's ability to provide sufficient audit coverage of City operations declined over a number of years. In addition, OCA staff salaries fell far behind those of peers, which compromised OCA's ability to attract and retain highly qualified staff.

The Audit Committee unanimously supported an increase in OCA's FY2024 budget to add positions, help right-size OCA and increase audit coverage, and make OCA staff salaries highly competitive. Thanks in part to the Audit Committee's support, the Mayor and City Council included additional resources in OCA's budget, which reversed the previous downward trend, and OCA is currently fully staffed (zero vacancies). While we greatly appreciate this increase, we note that it only brought OCA up to less than 0.10 percent of the City's overall budget, meaning we are still under-resourced compared to earlier years. In other words, for every \$100 the City spends, only about 10 cents is spent on OCA. By comparison, our recent benchmarking study of peer audit organizations showed that those entities comprise an average of 0.15 percent of their respective organizational budgets. This means that peer audit shops are 50 percent larger, on average, than OCA as a portion of the organization they audit.

**Exhibit 2**

**OCA Is Under-Resourced Compared to Peer Audit Organizations**



Source: OCA based on the City's adopted budgets and benchmarking with peer audit organizations.

**OCA's Proposed FY2026 Budget Reductions**

While OCA is under-resourced, we recognize the urgency of the City's budgetary situation. As noted above, we have explored multiple options to meet the requested budget reduction target and have determined that a 20 percent budget reduction would not be feasible without significantly reducing our ability to perform Charter-mandated core responsibilities that voters have entrusted OCA with. Therefore, we propose the following alternatives, which total a net reduction of **\$406,871 (7 percent of OCA's budget)** for FY2026. There is a possibility that OCA will also require funding to upgrade our core audit management system for compatibility with Windows 11. We are awaiting further information from the Administration on potential costs (if any), expected to be \$100,000 or less.

**Leased Office Space Reduction: \$282,072**

OCA currently occupies leased office space at 600 B St., which expires on September 30, 2029. The City identified and leased this space for OCA's use following OCA's evacuation from the Executive Complex and the shutdown of 101 Ash St. OCA is amenable to being relocated to alternative office space, provided the City can identify a space that accommodates OCA's 24 FTEs and that is private and secure to facilitate the legally-required confidentiality of OCA's work, and that we can relocate productivity tools we have invested in (conference room video conferencing equipment, wifi, etc.).

**Extension of FY2025 Salary Budget Reductions: \$69,889**

In FY2025, OCA incurred a one-time reduction of 2 percent to our salary budget to assist the City's budget mitigation efforts. OCA proposes that this reduction be extended on a one-time basis for FY2026. The projected reduction based on current information is \$69,889. All OCA positions are currently filled, and this reduction is the maximum achievable without reducing staffing or salaries.

**Targeted Non-Personnel Expenses (NPE) Reductions: \$54,910**

In support of the City's budget mitigation efforts, OCA has thoroughly examined each line in our budget to determine where reductions could be made. Of the portion of NPE that is within OCA's control (as summarized above), we have identified potential reductions to multiple areas, including office supplies, non-mandatory professional memberships, non-essential travel, tuition reimbursements, and certain service expenditures, among other areas. It is important to note that additional reductions to these areas would impede OCA's service delivery. Further, OCA consulted with the Department of Finance, and determined that the FY2026 budget for the outside audit contract could be reduced by \$40,000, which would still provide full funding for essential audit needs such as the ACFR.

**Additional Funding May Be Required for Upgrade or Replacement of OCA's Audit Management System: \$0 up to \$100,000**

OCA's core audit management system, MK Insight, requires an upgrade or replacement for compatibility with the new Windows 11 operating system the City is implementing Citywide in early FY2026. The total cost is expected to be up to \$100,000, but will likely be far less. We are awaiting information from the Administration on what actual costs, if any, will be.

**Conclusion**

We recognize the City's budget constraints in the coming year and going forward, and OCA is committed to helping the Administration achieve a workable budgetary solution without sacrificing OCA's ability to serve the public interest. Given the composition of OCA's budget and the need to maintain operational capacity, a 20 percent budget reduction would increase the City's risk and diminish our ability to serve the City and our residents and taxpayers by identifying savings, potential revenues, and efficiencies through our audits and investigations.

OCA appreciates and values the City Council's and the Audit Committee's support of our mission, and we highly value these bodies' input on this challenging issue. Please contact me with any questions about the Office of the City Auditor's proposed budget for FY2026.

Respectfully submitted,



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Andy Hanau  
City Auditor

cc: Honorable Mayor Todd Gloria  
Honorable Members of the City Council  
Eric Dargan, Chief Operating Officer  
Matt Yagyagan, Director of Policy, Office of the Mayor  
Matthew Vespi, Chief Financial Officer  
Rolando Charvel, City Comptroller and Department of Finance Director  
Charles Modica, Independent Budget Analyst  
Erin Noel, Fiscal and Policy Analyst, Office of the Independent Budget Analyst



## **Attachment 1 — OCA Findings with Revenue Generation, Efficiency, and Cost Reduction Opportunities**

The Office of the City Auditor has a significant positive return on investment for residents and taxpayers. Below are selected examples of opportunities to increase City revenues, improve the efficiency of City programs, and reduce or avoid costs that have been identified in recent OCA reports. This includes both recommendations that have been recently implemented and recommendations still in process of implementation.

### **EXAMPLES OF RECENTLY IMPLEMENTED RECOMMENDATIONS**

- **Pothole Truck** ([2024 audit](#)) – We found that one extra patch truck would increase productivity by 11%, with only a 1% cost increase over 5 years. This truck was included in the FY2025 budget, which will significantly increase pothole repair productivity and cost-effectiveness for years to come.
- **CARES Act Overcharge** ([2021 audit](#)) – We found \$1.12 million in overcharging for portable showers, which the City Attorney’s Office recovered from the vendor through a settlement in 2023.
- **Major Building Acquisitions** ([2021 audit](#)) – We found that Management did not provide the City Council and public with complete and accurate information on several past building acquisitions, leading to major cost overruns and limiting the usefulness of some acquisitions to the City. We recommended the City adopt a Council Policy requiring checklists of due diligence and best practices that should be conducted, and that the IBA retain a real estate consultant to assist the City Council in evaluating proposed acquisitions. These have been implemented and will provide the City Council and the public with essential information to evaluate the costs, benefits, and risks of proposed major building acquisitions.

### **RECOMMENDATIONS PENDING MANAGEMENT IMPLEMENTATION**

#### **Revenue Generation:**

- **Leases of City-Owned Property** ([2022 audit](#)) – At the time of the audit, the City had more than 100 properties (25%) in holdover and the City’s property portfolio collected about \$80 million in lease revenue annually. Based on the agreements we reviewed, renewal would result in an average 11% increase in rent. Economic Development recently reported that 25% of leases still remain in holdover. Based on the information available, updating these leases could result in approximately \$2.2 million in additional revenue annually.

- **Boat Storage** ([2024 Hotline investigation](#)) – We found that the City only collects about \$30,000 per year in revenue for the boat storage program because fees are lower than other jurisdictions, and because the City did not issue over 100 available permits. Increasing fees to reflect benchmarking with other agencies and correcting clerical errors to ensure all permits are issued could increase revenues to approximately \$108,000—nearly four times the amount currently collected.
- **Stormwater Reinspection Fee** ([2018 audit](#)) – We found that Stormwater does not charge a reinspection fee when storm water violations are not corrected timely by property owners. A reinspection fee would help recover staff costs associated with inspection of storm water violations and help encourage timely compliance. Stormwater engaged a consultant that developed a re-inspection fee, a fee implementation schedule, and standard operating procedures. According to Stormwater, the program will initially recover 50% of its costs in the first year and increase by 10% each successive year until it reaches full cost recovery (in 6 years). However, as of September 2024, Stormwater lacked the resources to implement the fee and indicated additional resources will be requested for FY2026.

#### **Efficiencies:**

- **Police Investigative Service Officers** ([2024 audit](#)) – We found that in April–June 2023, 13% of calls for service could have been dispatched to Police Investigative Service Officer (PISOs). However, PISOs make up only about 1.4% of SDPD’s sworn officer staffing. In a [subsequent analysis](#), we estimated that hiring 100 PISOs would cost approximately \$2.8 million to \$10 million less per year than hiring 100 Police Officers. Per our recommendation, SDPD is currently working on a staffing analysis to determine how many PISOs and other similar civilian positions would be needed.
- **Centralizing Police Overtime** ([2024 audit](#)) – The same audit found that SDPD overtime is assigned on a first-come, first-serve basis, which can lead to high-priority assignments going unfilled when officers select lower-priority assignments. Centralizing SDPD overtime would help ensure that the more than \$50 million a year SDPD spends on overtime goes towards filling high-priority assignments first. Chief Wahl has indicated that SDPD is already taking steps to centralize overtime as recommended.
- **Grouping Pothole Requests Geographically** ([2024 audit](#)) – We found that by grouping pothole assignments in closer proximity, productivity could have increased by 27% and miles driven could have decreased by 40%. This would also reduce the buildup of large pothole repair backlogs that have caused Transportation to divert crews from other types of critical work in recent years.

**Cost Reduction / Cost Avoidance:**

- **Brush Management** ([2023 audit](#)) – Effective brush management is essential to reduce the risk of wildfires which have cost lives and caused billions of dollars in property damage in San Diego County. We found that the City's efforts to manage brush on City-owned land were uncoordinated and lacked oversight. Since the audit, the City has taken some recommended steps to improve brush management on City-owned land, but indicates that additional resources are needed to fully implement the recommendations. For example, Fire-Rescue indicates that additional staff are needed to provide oversight of various City departments' brush management to ensure it complies with regulations.
- **Workplace Safety** ([2022 audit](#)) – We found that costs associated with City employee workplace injuries—when including both direct and indirect costs—could exceed \$220 million. Given the magnitude of these costs, even moderate reductions in workplace injuries could save the City millions of dollars annually. Recommendations to improve controls around potential workers compensation fraud have been implemented, but recommendations to improve workplace safety policies Citywide to prevent injuries remain in process.
- **Unsafe Driving by City Employees** ([2023 Hotline investigation](#)) – We received numerous Hotline complaints of unsafe driving by City employees, and upon investigation found that liability claims for City vehicle accidents cost the City \$31.2 million from FY2017 to FY2021. The investigation also found that the City did not utilize existing technology or follow existing policy to proactively identify and correct unsafe driving by City employees. The Compliance Department recently hired a program coordinator to develop and implement a program and updated policy to increase safe driving behaviors by City employees.