

**OFFICE OF INDEPENDENT BUDGET ANALYST  
CITY OF SAN DIEGO  
M E M O R A N D U M**

Date: May 5, 2008

To: Honorable Council President Peters and Members of the City Council

From: Andrea Tevlin, Independent Budget Analyst

Subject: Item 330: Response to the Report from the Independent Oversight Monitor

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At the first hearing of this item on April 1, 2008, the City Council requested Jay Goldstone, COO, to review his initial draft response with our office and revise accordingly. Attached for your information is the strike-out/underline version with the suggested revisions that we provided to Mr. Goldstone on April 9, 2008. The draft prepared for Tuesday's docket incorporates all of our substantive changes.

Attachment

April 1, 2008

Mr. Kelly C. Bowers  
Senior Assistant Regional Director  
Securities and Exchange Commission  
Los Angeles Regional Office  
11<sup>th</sup> Floor  
5670 Wilshire Boulevard  
Los Angeles, CA 90036-3648

Dear Mr. Bowers:

This is in response to the 36 recommendations contained in the First Annual Report of the Independent Consultant to the City of San Diego dated March 25, 2008 (Report). For many of the recommendations the City and/or the San Diego City Employee Retirement System (SDCERS) have already taken corrective or proactive action to implement.

### **Financial Control Structure Audit Committee**

#### Recommendation 1:

*The City should submit to the voters for approval in June 2008, and timely take all action to meet that schedule, the establishment of an Audit Committee that meets the following criteria:*

- *Has the requisite independence from financial management.*
- *Has the requisite expertise to perform its oversight functions.*
- *Has a sufficient relationship with the City Council to engender its confidence in view of the Council's role in the City's financial reporting.*

#### Response 1:

The City concurs with this recommendation and has approved and placed on the June 2008 ballot for consideration.

### **Internal Audit Function**

#### Recommendation 2:

*The City should submit to the voters for approval in June 2008, and timely take all action to meet that schedule, the creation of an office of City Auditor that is separate from the current office of Auditor and Comptroller and with direct reporting responsibility to the Audit Committee.*

#### Response 2:

The City concurs with this recommendation. The Office of the City Auditor was established by the Mayor [and City Council](#) in calendar year 2007 by separating the internal audit functions from the comptroller duties. The reporting structure was also

changed so that the City Auditor no longer reports to the Auditor & Comptroller (Chief Financial Officer) but rather to the Chief Operating Officer.

In addition, the Mayor has signed a Statement of Operating Principles (SOP) that provides for the City Auditor to communicate directly with and be responsive to requests of the Audit Committee. The City Council has appended the SOP to the Audit Committee Charter. Until the Charter is amended, this is the most effective segregation of duties permitted. In addition, the City has approved and will place a Charter amendment on the June 2008 ballot which would, among other things, have the City Auditor report to the Audit Committee.

**Deleted:** In addition, there is an informal reporting by the City Auditor to the Audit Committee of the City Council.

Recommendation 3:

*The City should begin the process of significantly increasing the staffing of the internal audit function in order to permit effective internal auditing to be accomplished, including an assessment by the internal auditor of staffing needs, and should periodically report its progress to the Audit Committee.*

Response 3:

The City concurs with this recommendation. As part of the Mayor's fiscal year 2009 recommended budget, staff for the Office of the City Auditor will be increased from the current five full-time equivalent (FTE) to ten FTE's, a 100% increase. This is the first step in a proposed three year plan to bring the staffing levels within the Office to a more reasonable level.

Prior to the development of the Mayor's recommended budget, the Audit Committee engaged a professional audit consultant (Jefferson Wells) to benchmark audit functions of other similar municipalities and determine appropriate staff levels for an organization of our size. They recommended a staffing level of approximately 24 auditors for the City. The City Council will be considering the Mayor's proposal along with the results of the Jefferson Wells study during fiscal year 2009 budget deliberations in April and May 2008. Final budget decisions will be made in June 2008. Attachment 1 is a response prepared by the City Auditor to the Audit Committee in response to a recommendation by Jefferson Wells to bring the staffing level to around 24 FTEs.

### **Whistleblower and Hotline Complaint System**

Recommendation 4:

*The City should implement within 45 days, consistent with the advice of Jefferson Wells for steps prior to Charter revision, the procedure contemplated by the Audit Committee charter for a confidential and anonymous hotline involving the Audit Committee independent of City management for complaints and concerns regarding financial control or financial and auditing matters.*

Response 4:

The City concurs with this recommendation. In anticipation of the proposed Charter amendment on the June 2008 ballot, steps are being taken to transfer oversight of the hotline to the Office of the City Auditor. The proposed Charter amendment changes

include having the City Auditor report to the Audit Committee and the granting the City Auditor the power to investigate any material claim of financial fraud, waste, or impropriety within any City Department.

The City Council is expected to discuss and address the hotline reporting recommendations from Jefferson Wells on April 28, 2008. In the interim period before proposed Charter reform in June 2008, the City Council will consider adopting a resolution providing that hotline complaints and activity be directly reported to the Audit Committee as recommended by Jefferson Wells. Additionally, the Council will consider requesting the City Auditor to audit the hotline process and related reporting.

Deleted: The City Council is expected to address hotline reporting issues at a City Council in April 2008.

### **Improper Influence Ordinance**

Recommendation 5:

*The City should address any remaining issues expeditiously so that an improper influence ordinance can be adopted as promptly as practicable.*

Response 5:

The City concurs with this recommendation. A draft ordinance has been circulated to the Council and the Rules Subcommittee. The outstanding issues deal with what entity should enforce the ordinance, the type of enforcement, and the definition of certain terms. Efforts to resolve these issues are continuing and an ordinance will be presented to Council no later than December 2008.

### **Focused Financial Management Responsibility and Accountability**

Recommendation 6:

*The City should submit to the voters for approval by June 2008, and timely take all action to meet that schedule, the separation of the Auditor and Comptroller position into two and the creation of the position of Chief Financial Officer in order to focus responsibility and related accountability for the City's financial reporting.*

Response 6:

The City concurs with this recommendation and has approved and placed on the June 2008 ballot for consideration.

### **Internal Controls Remediation**

Recommendation 7:

*The City needs to better integrate and coordinate its ERP process and ICOFR process in order to align their objectives, maximize utilization of available resources and achieve optimum results. This should be addressed (to the extent it has not been), with identification of defined tasks, specific individuals with responsibility and specific resources to be employed, within 45 days.*

Response 7:

The City concurs with this recommendation. Steps have already been taken to address this recommendation and include: consolidating both efforts under the direction of the Chief Financial Officer (CFO) and the Comptroller, tasking the Comptroller's ICOFR team with reviewing ERP system design specifications and process documentation and documenting the "to be" process in accordance with COSO internal control methodology and developing the applicable policies and procedures in order to provide effective employee training. The relation between the City's ICOFR initiative and the ERP initiative were defined in a presentation to the City Council Audit Committee on March 10, 2008.

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Recommendation 8:

*The City needs to devote additional resources to the ICOFR process if the internal control remediation activities are to be completed within a reasonable time frame. The City should consider hiring an outside consulting firm with experience in developing, implementing and remediating an internal control structure within a governmental entity. These efforts should be assessed quarterly to determine if adequate progress is being made.*

Response 8:

The City concurs with the spirit of this recommendation. In this regard, the City's [proposed](#) fiscal year 2009 budget provides for two additional staff members for the Comptroller's ICOFR team. [If adopted by the City Council, this would](#) bring the total budgeted labor allocation for the project to 6240 hours which reflects an approximate 25% greater commitment to the project than required by initial estimates. Additionally, temporary resources will be provided to the project on as needed basis to ensure that project needs are met.

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Management does not agree with "outsourcing" the development and documentation of internal controls. It is important to note, that while the documentation and assessment of internal controls is frequently conducted by consultants in the private sector, the recommendation runs counter in spirit to Kroll Recommendation 53 which states: "The City should assign the responsibilities for preparing public documents and filings to the appropriate City employees. Ultimate responsibility for preparing these City documents cannot be assigned to the independent auditor, disclosure counsel, fiduciary counsel, actuary, or other professionals."

Accordingly, because internal controls are based on the objectives set by management and are the processes that are used to construct public documents and filings, management believes that the recommendation is inconsistent with that of the Report of the Audit Committee. Additionally, management believes that employee ownership of internal control design and documentation is critical to the success of continued monitoring and improvement of the City's internal control framework over time.

Recommendation 9:

*The City should establish a reasonable schedule and budget for developing and implementing installation of the ERP system that takes into account integration of the ICOFR process. This should be done within 60 days.*

Response 9:

The City concurs with this recommendation and is currently reviewing the timeline for developing and implementing both projects. The results of this review are planned to be presented to the City Council Rules Committee on April 23, 2008.

Recommendation 10:

*The City should continue to take a top-down, risk-based approach to remediating its internal control weaknesses as a more effective way to timely identify critical internal control processes, and should address the deficiencies and weaknesses identified in the Kroll Report, the Yellow Book reports and the Auditor and Comptroller annual reports, but should go beyond these to look at internal controls on a comprehensive basis. These efforts should be assessed quarterly.*

Response 10:

The City concurs with this recommendation and plans to brief the City Council on these efforts quarterly. Additionally, upon completion of the ICOFR process, management plans to extend its internal control review beyond Reporting and to other elements of the COSO framework including Operational, Compliance and Strategic control objectives and processes.

Recommendation 11:

*In assessing significant accounts and underlying processes as part of the ICOFR process, the City needs to look below the top-level, government-wide financial statements to the individual financial statements that comprise the CAFR. This should be done within 60 days.*

Response 11:

The City concurs with this process and will supplement its quantitative assessment through the use of a qualitative process to identify controls related to unique or significant activities which may impact operating results at the fund level in the City's Financial Statements.

Recommendation 12:

*The City should consider interim remediation options to enhance confidence in the reliability of financial reporting in the near term, including development of period-end financial reporting routines. The City also should prioritize its remediation efforts to address the most critical needs as promptly as possible. It should report to the Audit Committee on the progress of these efforts at least quarterly.*

Response 12:

The City concurs with this recommendation. The City has predefined period-end financial reporting routines; however, they are not documented. Staff plans to present formal documentation of the City's existing period-end financial reporting routines to the Audit Committee no later than May 2008. These processes will reflect the City's current "as is" routine for compiling monthly and fiscal year end financial reports. With the implementation of the ERP system, the City will be moving toward calendar based reporting periods rather than periods based on the City's payroll cycle. As such, the ICOFR process in connection with the implementation of the ERP system will produce completely revised financial reporting routines. These routines will be documented prior to "go live" on the new accounting system.

## Financial Reporting Enhancements Review of CAFRS

### Recommendation 13:

*The Audit Committee, with the assistance of its ad hoc advisory group and its professional consultant, should review within 45 days and improve as necessary its procedures for review of the City's CAFR to determine if any improvements should be made to those procedures.*

### Response 13:

The City concurs with this recommendation. The City has now completed four CAFRs, with three of them being reviewed by the Audit Committee. [The Audit Committee began reviewing the City's fiscal year 2006 CAFR on April 4<sup>th</sup> and will resume its review on April 14<sup>th</sup>.](#) Following the review of this CAFR, the Audit Committee will docket a discussion with management and outside disclosure counsel to discuss what has worked and perhaps what improvements could be made to the CAFR review process.

Deleted: The Audit Committee will begin reviewing the City's fiscal year 2006 CAFR in early April.

[The Audit Committee appointed an ad hoc advisory group in 2007 to analyze the City's CAFR review process and make recommendations for improvement. Additionally, the Audit Committee similarly requested that Jefferson Wells examine the City's CAFR review process. It is expected that reports from the ad hoc advisory committee and Jefferson Wells will be presented to the Audit Committee on April 28<sup>th</sup>.](#)

## Shelf-Like Disclosure System

### Recommendation 14:

*The City, with the assistance of the DPWG, should evaluate within 6 months the desirability of a shelf-like disclosure system to improve the quality and timeliness of its reporting to the financial markets on an ongoing basis and to permit the efficient access to the capital markets for needed financing.*

### Response 14:

The DPWG procedures for review of Official Statements are designed to ensure, to the extent possible, that such Statements contain no material misstatements or omissions and otherwise are consistent with disclosure best practices. The procedures require multiple levels of review, including by a "Financing Group" and the full Disclosure Practices Working Group. The Financing Group is appointed for each transaction, and consists of the Deputy City Attorney for Finance and Disclosure, outside disclosure counsel, and the bond financing team (bond counsel, underwriter, underwriter's counsel, financial advisors, City staff - i.e., those persons generally thought of as the core working group). An Official Statement will be prepared by the bond financing team, reviewed by the Financing Group and the Disclosure Practices Working Group, certified as to its accuracy by the Mayor and the City Attorney, and by the City Auditor as to the financial statements and any abstracts from such statements in the body of the Official Statement.



Such multiple levels of review require a considerable amount of time. There are various alternatives to address this that the City has under consideration. One approach would be to move towards "shelf-like" disclosure. This has been used by municipal issuers, which prepare, for example, annual information statements, quarterly updates to those statements, and a separate bring-down supplement for each financing. This would ensure that at any point in time the City's disclosure was relatively recent and would avoid any delays as the City tries to come to market.

An alternative approach would be for the City's financial staff to carefully monitor the calendar for upcoming financings, and be sure to allow sufficient lead time to accommodate the DPWG review procedures. This is the approach that is, in effect, being utilized today. The DPWG established and published timelines for review of both Official Statements and other disclosure documents. City staff is responsible for monitoring the forward financing calendar with such timelines in mind.

The shelf-like registration would require the City to at all times have a relatively current disclosure document. Whether such approach or the current approach of monitoring carefully the forward calendar is the most efficacious will depend in principal part on the frequency of the City's financings. If the City were to plan on entering the market for City-backed debt, whether general fund secured, water or wastewater revenue secured, or otherwise, on, for example, a quarterly or more frequent basis, the shelf-like review may be preferable. On the other hand, if the City were only entering the market once or twice a year, the constant review and updating necessitated by the shelf-like process may not be efficient.

The City will carefully consider these factors and work closely with the Independent Consultant, the Deputy City Attorney for Finance and Disclosure, and the City's outside disclosure counsel, to arrive at the optimal approach for the City in light of the considerations outlined above.

Recommendation 15:

*The City, with the assistance of the DPWG, should, in connection with planning to reenter the public market, evaluate the relation of the CAFR to the offering disclosure document and, in particular, should consider no later than in connection with the 2007 CAFR the role and coverage of the Letter of Transmittal in relation to the CAFR with a view to eliminating unnecessary repetition and discussion.*

Response 15:

The City concurs with this recommendation. In this regard management will present to the DPWG (a working group composed of City employees) for fiscal year 2007 a significantly revised letter of transmittal which conforms to the consultants' other recommendations and is in keeping with best practices for financial reporting. The DPWG will consider whether certain information in the letter of transmittal should more appropriately be included in any official statement provided to investors.

### **Improved Discussion and Analysis**

Recommendation 16:

*The City, no later than in connection with its 2007 CAFR, should improve the quality of its financial disclosure by providing an analysis, either in the MD&A or Letter of Transmittal, as appropriate, that facilitates an understanding of the City's financial statements and its financial condition, financial results, liquidity and capital needs, including the risks faced by the City.*

Response 16:

Financial Management notes that the recommendation reflects the existing function of both the Letter of Transmittal and Management's Discussion and Analysis and that they are both prepared in accordance with accepted guidance promulgated by the Governmental Accounting Standards Board and Government Finance Officers Association. Management agrees, however, that governmental accounting is a complex topic and that improvements can be made in the context of the SEC's Plain English initiatives. Accordingly, financial management will revise the Letter of Transmittal and Management's Discussion and Analysis in an effort to deemphasize certain topics and better communicate the issues raised in this recommendation.

### **Disclosure of Contractual and Off-Balance Sheet Obligations**

Recommendation 17:

*The City, beginning with the 2007 CAFR, should include in either the Letter of Transmittal or MD&A, a tabular presentation of its contractual and off-balance sheet obligations and other commitments shown by relevant time periods and with totals.*

Response 17:

Financial Management notes that in accordance with Governmental Accounting Standards Board Statements, the City's debt service (principal and interest) obligations, capital and operating lease obligations, pension and post-retirement benefit obligations, purchase commitments and other contractual obligations, and other long-term liabilities shown on the statement of net assets are currently discussed in detail in notes 5, 6, 10, 12, 17 and 18 to the financial statements in recently released CAFRS. For items not yet required to be disclosed in the Notes (OPEB), the City has voluntarily disclosed that liability in its Letter of Transmittal.

### **Loss Contingencies and Risk Assessments**

Recommendation 18:

*The City, through the City Attorney Office, should, prior to the preparation of the 2007 CAFR, improve its systems for dealing with loss contingencies for financial reporting purposes in order to remedy any deficiencies raised not by the City's independent auditors to the extent not already remedied.*

Response 18:

Financial Management agrees with this finding; however, notes that the City Attorney is an independently elected official and that the valuation of contingent liabilities is almost fully under the purview and expertise of the City Attorney. As a supplemental recommendation, financial management recommends that the City Attorney should immediately publish procedures for work product review by supervising attorney's and also publish procedures concerning the compilation of the FASB 5 letter from the City Attorney. This would put in place revised internal controls that would demonstrate that the FASB 5 response of the City Attorney not only reflects what is in the City Attorney's case files but that the case files themselves are maintained in accordance with attorney work product standards. Once these procedures are in place, the City Attorney could request a review by the City's Internal Auditor to ensure they are operating effectively. Additionally, this would strengthen already established procedures for communicating the status of contingent liabilities to the City's director of risk management.

**Disclosure Practices Working Group (DPWG)**

Recommendation 19:

*City officials should, to the extent they have not done so, appoint designees to the DPWG within 30 days to ensure availability of quorums and continuity from meeting to meeting.*

Response 19:

The City concurs with this recommendation and will request permanent appointees designate alternates to the DPWG to formally substitute representatives to the DPWG to ensure that there will be a quorum at all scheduled DPWG meetings. In addition, steps will be taken to assure that permanent appointees and their substitutes stay abreast of the principal disclosure matters being addressed by DPWG from time to time to ensure the quality of the disclosure.

Recommendation 20:

*The DPWG should continue to establish a regular meeting schedule.*

Response 20:

The City concurs with this recommendation and the DPWG has already established a set meeting schedule. The DPWG meets the 1<sup>st</sup> and 3<sup>rd</sup> Wednesday of every month and more frequently as necessary.

Recommendation 21:

*Any necessary changes to the Disclosure Controls and Procedures to reflect changes to the Municipal Code should be effected within 45 days.*

Response 21:

The City concurs with this recommendation. A draft of a revised Disclosure Controls and Procedures to conform to the Municipal Code and to make other appropriate changes has been circulated and will be adopted within the recommended timeframe.

Recommendation 22:

*The DPWG should assess the effectiveness of its review of the form and content of "press releases, ... web-site postings, and other communications reasonably likely to reach investors or the securities markets" as set forth in Section 22.4107(a)(1) of the Municipal Code and within 45 days recommend changes, if any, to reflect actual practices within the City.*

Response 22:

The DPWG has discussed on several occasions the impracticality of reviewing and commenting on press releases, web-site postings and other communications. In recognition of this, it has been suggested and consistent with Recommendation 23, below, the Management is establishing an Investor Information web page on which City financial information that has been reviewed and signed off by the DPWG will be posted. The DPWG will review Section 22.4107(a)(1) of the Municipal Code and will recommend changes as appropriate.

Recommendation 23:

*In connection with the foregoing, the City should revise its website within 90 days to have a dedicated portal where official documents reviewed by the DPWG can be posted.*

Response 23:

The City concurs with this recommendation. The City's Investor Information webpage shall provide a portal in which official statements for outstanding bond issuances will be archived. In addition, official statements for new bond offerings, which have been reviewed by DPWG, shall also be posted on the webpage. This site will also maintain all material event notices and the continuing disclosure annual reports disseminated to the market. A prototype of the Investor Information webpage, created with the City disclosure counsel's assistance, is scheduled to be reviewed by the DPWG on April 2, 2008, and the webpage is anticipated to go live by mid-April, 2008. The City staff will administer ongoing updates to the website in consultation with the DPWG.

Recommendation 24:

*The DPWG should, as required by the Municipal Code, continue to assess at least annually the adequacy of its existing processes and propose modifications to enhance the efficiency and overall effectiveness of its operations.*

Response 24:

The City concurs with this recommendation and the DPWG will at least annually assess the adequacy of its existing processes and propose modifications to enhance the

efficiency and overall effectiveness of its operations. This review will be especially critical as the City prepares to re-enter the public bond markets for the first time since the DPWG was established. The DPWG has conducted such internal reviews on an annual basis, and the third annual report was released on December 15, 2007.

Recommendation 25:

*The DPWG, in conjunction with City financial management and the IBA, should assess the current training program for City officials and staff and recommend and implement changes, if any, within 45 days.*

Response 25:

The City concurs with this recommendation. A panel including representatives from the DPWG, the IBA, and financial management will review the current training program and make recommendations regarding the current training program for city officials and staff and make recommendations and implement changes, if any, within 45 days.

### **Role of Counsel in Legal Compliance**

Recommendation 26:

*The City should consider whether any steps are necessary to ensure the availability of legal counsel that will foster the ability of City officials to consult with and obtain legal advice based upon a relationship of trust and confidence designed to promote legal compliance.*

Response 26:

The City concurs with this recommendation. There is some disagreement among City officials on the role of the City Attorney. The City Attorney as a city-wide elected official, currently views his client as the public rather than the City and its officials. As such, the City Attorney on occasion pursues policy and/or legal positions that are contrary to the legal/policy positions adopted by the Council and/or the Mayor. The City Attorney also believes that he can initiate civil proceedings without authorization by the City Council. A committee that reviewed the City Charter recommended that changes be made to the Charter to better clarify that the role of the City Attorney, whether elected or not, is to represent the City and its officials and that litigation can only be initiated with Council approval. Those recommendations were not included in ballot measures coming before the citizens in June 2008. Nonetheless, City officials work to promote procedures that foster compliance with disclosure and all other legal requirements, including work on the DPWG, the completion of 4 CAFRs, cooperation with the SEC independent monitor, and implementation with Kroll recommendations. The issues of authorization and identity of the client may require judicial resolution.

## San Diego City Employees Retirement System (SDCERS)

### Recommendation 27:

*The City Council should address within 30 days the “technical corrections ordinances and the “waterfall” ordinance. It also should act on the matters required by the compliance statement with the IRS within the time specified therein.*

### Response 27:

City concurs with this recommendation. Docketed for the April 1, 2008 City Council meeting is the first reading of an Ordinance to implement the Settlement Agreement between SDCERS, The City of San Diego and the Internal Revenue Service. In addition, SDCERS and City Management have been attempting to modify the Municipal Code to “officially” eliminate the use of “surplus earnings” to pay for certain retirement benefits. The actual use of “surplus earnings” ended with the City’s June 30, 2006 actuarial valuation. At that time, SDCERS directed its actuary to include the payment of the 13<sup>th</sup> check and Corbett Benefits in its valuation liabilities and as a result these two benefits are now being paid for by the City as part of its Annual Required Contribution. As such, no benefits are being paid from “surplus earnings.” Several attempts to bring the Municipal Code into conformity with this practice have not been successful and staff will continue to attempt to bring this matter forward for City Council action.

For additional information, please refer to SDCERS’ response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

### Recommendation 28:

*To the extent necessary, SDCERS should be asked to adopt promptly any necessary amendments to its other “controlling documents,” following final action by the City Council regarding the matters listed in the preceding recommendation.*

### Response 28:

Please refer to SDCERS’ response to the First Annual Report of Independent Consultant to the City of San Diego March 27, 2008 (**Attachment 2**).

### Recommendation 29:

*The Mayor should make reasonable efforts to appoint or reappoint trustee to fill the current vacant and holdover positions on the SDCERS Board within 90 days.*

### Response 29:

The City concurs with this recommendation. The Mayor has appointed several new members to the SDCERS Board and regularly searches and solicits qualified individuals to fill vacancies on the Board. Recently, the SDCERS Board purchased Directors and Officers insurance, which should assist in process of filling positions because there are

concerns about lawsuits being initiated against the directors. Because of the importance of the position and the extensive qualifications necessary, the appointment process is necessarily slower than desired.

For additional information, please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

Recommendation 30:

*SDCERS should continue to develop and implement a comprehensive training program for its trustees and staff, including training in pension finance and investing and in prudent trustee requirements. It should report quarterly on these training activities.*

Response 30:

Please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

Recommendation 31:

*SDCERS, in conjunction with the City management, should evaluate the communication process and information flow between SDCERS and the City and adopt necessary modifications, if any, to this process to ensure the complete and timely flow of pension and benefit-related information to the City necessary for fiscal planning and the preparation of the City's financial statements.*

Response 31:

Financial Management concurs with this recommendation and notes that several mitigating procedures have already been put in place. These procedures include monthly meetings between the SDCERS CFO and the City Comptroller and a mutual review of each entity's CAFR prior to issuance. Additionally, the two organizations regularly communicate as necessary concerning issues of mutual interest. Management recognizes, however, that effective communication is sometimes hampered by ongoing litigation between the two entities.

For additional information, please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

Recommendation 32:

*SDCERS should report quarterly on the actions taken to remediate its failures to comply with applicable legal requirements and to ensure that similar failures do not reoccur.*

Response 32:

Please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

Recommendation 33:

*The City, working with SDCERS and with the assistance of an experienced pension consultant, should explore the range of alternatives for funding the City's pension and post-retirement benefits commitments. Alternatives might include, for example, funding alternatives, reduction or freezing of benefits, or establishing, as some private entities have done, a separate employee/union controlled plan that relieves the employer of further obligations. While all such alternatives are subject to legal, contractual and employee relation considerations, a comprehensive report should be issued by December 31, 2008.*

Response 33:

The City concurs in this recommendation. The City has taken significant steps to reduce its pension obligations and its post-retirement benefits commitments. The City is funding not only its full pension yearly obligations but also paying in excess of its obligations. The City is also proposing a new pension system for new employees that reduces City obligations significantly. Based upon court decisions, reduction of obligations for existing employees has not been possible. The City has also reduced post-retirement commitments. By agreement effective July 2005, the City eliminated retiree health benefits. The City has also taken steps to fund its current health benefits by establishing a trust that with CalPERS and has deposited approximately \$30 million into this account during fiscal year 2008.

For additional information, please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

Recommendation 34:

*SDCERS' plan actuary should perform an experience study to assess the correctness of the actuarial assumption being used as promptly as practical but within 120 days. This and future experience studies, as well as future actuarial reports, should reflect the effect of the DROP program.*

Response 34:

Please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

## Training

Recommendation 35:

*The City, with the involvement of the DPWG and the IBA, as applicable, should develop within 90 days a comprehensive and coordinated training program for City officials and personnel on disclosure and financial reporting and then should report quarterly on the implementation and effectiveness of that program and any changes made to it.*

Response 35:



The City concurs with this recommendation. In December 2006, the City Council adopted a comprehensive financial training program developed by the Office of the Independent Budget Analyst (IBA) at their request. Trainings to date covering disclosure (March 2007) and financial reporting (April 2007) have effectively been coordinated with certain members of the DPWG and City fiscal/legal consultants. The City Council training program is: comprehensive for elected official needs/purposes; systematic in requiring that certain important financial topics be covered once every two years; and available to City staff/public live and via 7/24 replay on the City's website.

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A panel including representatives from the DPWG, the IBA, and financial management will review the current training programs for the City Council and City staff. The panel will make recommendations regarding the current training programs and implement changes, if any, within 45 days.

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## Fiscal Integrity

### Recommendation 36:

*The City should assess the value of its current Five-Year Financial Outlook as a planning tool, and consider use of additional planning tools, for ensuring that the City is able to meet its goals for providing services to the citizens of San Diego at a cost they are willing to bear.*

### Response 36:

The City's Five Year Financial Outlook (Outlook) provides the framework for informed budgetary planning and the adoption of the City's annual budget. The City currently works with state and regional agencies to incorporate relevant economic research and policy trends to inform the City's forecast. The City incorporates this research and continual in-house analysis in periodic updates to the Outlook throughout the year as economic conditions and demands on city resources change to keep the forecast relevant to current conditions. The City continues to evaluate best practices for long term fiscal planning and intends to implement any enhancements that can be realistically supported by available resources.

Additionally, IBA Report #08-9 noted items that were not considered in the Outlook that are likely to impact the City's General Fund. The IBA Report also compared the City's Outlook to other municipal forecasts and suggested common features that could add value in future updates (i.e., a discussion of risks). City management has reviewed the IBA's recommendations and indicated that they will incorporate them into the next Outlook.

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The City will continue to work with the Independent Consultant to not only implement these recommendations but also to go beyond in order to ensure that the City continues to establish best practices in its financial reporting and ultimate disclosure.

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Mr. Kelly C. Bowers  
April 1, 2008

Sincerely,

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JERRY SANDERS  
Mayor

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SCOTT PETERS  
City Council President

Attachments

Cc: Honorable Members of City Council/Audit Committee Members  
Michael Aguirre, City Attorney  
Stanley Keller, Independent Consultant  
Jay M. Goldstone, Chief Operating Officer  
Andrea Tevlin, Independent Budget Analyst

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