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REPORT TO THE AUDIT COMMITTEE

**IMPLEMENTATION OF PROPOSITION C RELATING TO
ESTABLISHMENT OF THE NEW AUDIT COMMITTEE**

INTRODUCTION

Proposition C was passed by the voters on June 3, 2008. The proposition included an amendment to the Charter to establish a new Audit Committee consisting of five members - two members of the City Council and three members of the public. It is anticipated that the Charter amendment will be effective in mid-July, when the Secretary of State has chaptered the new language. In the meantime, we believe that the City may begin the process of implementing the provisions of new Charter section 39.1.¹

A report issued June 19, 2008, by the Office of the Independent Budget Analyst, titled *Implementing Proposition C: Suggested Process for Appointing New Audit Committee* raised three questions for the City Attorney:

1. How will public Audit Committee terms be structured to comply with the Charter requirement that “not more than one term of office expire in any one year”?
2. Will screening committee meetings be subject to the Brown Act?
3. Should the City Council adopt a Conflict of Interest Code for Audit Committee members?

The answers to these questions are discussed below.

DISCUSSION

1. Q: How will public Audit Committee terms be structured to comply with the Charter requirement that “not more than one term of office expire in any one year”?

¹For instance, we have advised that it is appropriate for the Council to select a Councilmember to serve on the screening committee with the Chief Financial Officer and the Independent Budget Analyst so that the process to select the two public members of the screening committee may begin.

A: The three public members of the Audit Committee should be appointed for staggered terms, one each for a two-year, three-year, and four-year term.

Charter section 39.1 provides that the public members of the Audit Committee serve staggered terms. This type of provision ensures that a committee does not lose all of its experienced members should their terms end at the same time. Charter section 39.1 states in relevant part:

The public members of the Audit Committee shall serve for terms of four years and until their successors have been appointed and qualified. Public members of the Audit Committee are limited to two full consecutive terms, with one term intervening before they become eligible for reappointment. Notwithstanding any other provision of this section, *appointments shall be made so that not more than one term of office shall expire in any one year.*

Based on this language, we recommend that one each of the three public members of the Audit Committee be appointed for a two-year, three-year, and four-year term. Each of the members would be eligible for an additional four-year term.

2. Q: Will screening committee meetings be subject to the Brown Act?

A: Yes, because the screening committee was created by Charter, it is subject to the Brown Act.

In general, the Brown Act requires that public commissions, boards, and councils and other public agencies conduct their deliberations and take actions in open meetings. Cal. Gov't Code § 54950. The Act provides that a commission, committee, board, or other body of a local agency created by charter, ordinance, resolution, or formal action of a legislative body is subject to the Brown Act. Cal. Gov't Code § 54952(b).

With respect to the screening committee, Charter section 39.1 provides:

The three public members of the Audit Committee shall be appointed by the City Council from a pool of at least two candidates for each vacant position, to be recommended by a majority vote of *a screening committee comprised of a member of the City Council, the Chief Financial Officer, the Independent Budget Analyst and two outside financial experts* appointed by the other three members of the screening committee and confirmed by the City Council.

Because the screening committee is created by the Charter, it must comply with the Brown Act. When a majority of the members of the screening committee meet at the same time and place to hear, discuss, or deliberate on any item within the subject matter jurisdiction of the committee, they must follow the provisions of the Brown Act. For instance, the meetings are subject to the 72-hour noticed meeting requirements that an agenda be posted of the items to be

discussed at the meeting. Cal. Gov't Code § 54954.2. There are many other provisions of the Brown Act that also would apply to the screening committee.

The screening committee must meet in open sessions unless an exception applies to allow it to meet in a closed session. One of the exceptions is a meeting to consider "the appointment, employment, evaluation of performance, discipline, or dismissal of a public employee. . ." Cal. Gov't Code § 54957(b). However, the term "employee" does not include a "member of a legislative body." Cal. Gov't Code § 54957(b)(4). Because the screening committee is considered a "legislative body" under the Brown Act, a member would not be considered a "public employee." Accordingly, the three other members must discuss and deliberate on the appointments of the outside financial experts in an open session.

Charter section 39.1 provides that "the two outside financial experts are appointed by the other three members of the screening committee and confirmed by the City Council." We interpret this to mean all three City members must agree on the appointments. This is consistent with the general rule that a vote of the majority of a body is necessary to take any action. In this case, a majority of the screening committee is three members, even though two of the membership positions are vacant.

Once all members of the screening committee have been appointed and confirmed, it is tasked with recommending to the City Council a pool of at least two candidates for each of the three public member positions on the Audit Committee. These public members must "possess the independence, experience and technical expertise necessary to carry out the duties of the Audit Committee." Charter § 39.1. The screening committee must hold its discussions and actions determining the pool of candidates for the public members of the Audit Committee in accordance with the Brown Act.

3. Q: Should the City Council adopt a Conflict of Interest Code for Audit Committee members?

A: Yes. The Audit Committee has decision making authority and, therefore, the Council must adopt a conflict of interest code for the Committee.

The purpose of the conflict of interest provisions of the California Political Reform Act is to ensure public officials, whether elected or appointed, perform their duties in an impartial manner, free from bias caused by their financial interests or those of persons who have supported them. By disclosing relevant financial interests, public officials can determine whether a conflict of interest exists and avoid participating in a matter. The Act also makes this information available to the public to help ensure government decisions are free from undue influence or improper financial motives.

In particular, the purpose of these laws is "to promote and accomplish several state policies including: (1) assuring the independence, impartiality and honesty of public officials; (2) informing citizens regarding those economic interests of officials which might present a conflict of interest; (3) preventing improper personal gain by persons holding public office;

(4) assuring that governmental decisions are properly arrived at; and (5) preventing special interests from unduly influencing governmental decisions.” *County of Nevada v. MacMillen*, 11 Cal. 3d 662, 667 (1974), citing legislative findings in then-Government Code section 3601. See, Cal. Gov’t Code § 81001(b).

“Public officials” include elected officers and other high-ranking public employees. In addition, certain “designated employees” are considered “public officials.” The “designated employees” are the persons holding positions set forth in the City’s conflict of interest code who are required to make financial disclosures. In addition, the Council is required to adopt a conflict of interest code for salaried or unsalaried members of committees, boards or commissions with decision making authority. A committee, board or commission possesses decision making authority whenever:

- (i) It may make a final governmental decision;
- (ii) It may compel a governmental decision; or it may prevent a governmental decision either by reason of an exclusive power to initiate the decision or by reason of a veto that may not be overridden; or
- (iii) It makes substantive recommendations that are, and over an extended period of time have been, regularly approved without significant amendment or modification by another public official or governmental agency.²

Cal. Code Regs. tit. 2, § 18701(a)(1).

The Audit Committee has oversight responsibility regarding the City’s auditing and internal controls. It is responsible for directing and reviewing the work of the City Auditor and the City Auditor reports directly to the Audit Committee. The Audit Committee recommends the annual compensation of the City Auditor and annual budget of the office of the City Auditor. The Audit Committee recommends to Council the retention of the City’s outside audit firm and, when appropriate, the removal of such firm. The Audit Committee resolves all disputes between City management and the outside auditor with regard to the presentation of the City’s annual financial reports. The Council may specify additional responsibilities and duties of the Audit Committee by ordinance. Charter § 39.1.

The Audit Committee has authority to make final governmental decisions when it

²A committee, board, or commission does not possess decision making authority under subsection (a)(1)(A)(i) of this regulation if it is formed for the sole purpose of researching a topic and preparing a report or recommendation for submission to another governmental body that has final decision making authority. Cal. Code Regs. tit. 2, § 18701(a)(1). The responsibilities of the Audit Committee are more extensive than researching and preparing a report. See, Charter §§ 39.1 and 39.2.

resolves disputes between City management and the outside auditor. It also appears to have the final decision when directing the work of the City Auditor. It also may compel a government decision whenever the Audit Committee's recommendation is required before a governmental decision can be made. This occurs, for example, when it makes the appointment of the City Auditor to be confirmed by the Council, or when it makes a recommendation that the City Auditor be removed for cause. Charter section 39.2.³

For the above reasons, and the public policy reasons that ensure the Audit Committee members perform their duties in an impartial manner, free from bias caused by their financial interests or those of persons who have supported them, we recommend that the Council adopt a conflict of interest code for the Audit Committee.

CONCLUSION

The implementation of Proposition C and, in particular, Charter section 39.1 poses new challenges for the City. Our office is ready to assist with further analysis and in making recommendations to assist the implementation.

Respectfully submitted,

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³Because the Audit Committee will be newly created, it is not necessary to analyze whether it makes substantive recommendations that are, and over an extended period of time have been, regularly approved without significant amendment or modification by another public official or governmental agency.