

MARY JO LANZAFAME
ASSISTANT CITY ATTORNEY

BRANT C. WILL
DEPUTY CITY ATTORNEY

OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO

JAN I. GOLDSMITH
CITY ATTORNEY

CIVIL ADVISORY DIVISION
1200 THIRD AVENUE, SUITE 1620
SAN DIEGO, CALIFORNIA 92101-4178
TELEPHONE (619) 236-6220
FAX (619) 236-7215

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REPORT TO THE AUDIT COMMITTEE

AUDIT COMMITTEE ORDINANCE

At the September 14, 2009 meeting of the Audit Committee, the Committee discussed a draft (August 31, 2009 version) of the Audit Committee Ordinance ("Ordinance") and requested that the City Attorney make certain revisions to the Ordinance, with such revision to be presented at the October 5, 2009 meeting of the Committee. This memorandum discusses those revisions and explains why certain revisions were not included in the current draft (October 1, 2009 version) or were included using language different than that requested by the Committee. Revisions are discussed in the order in which they appear in the text of the Ordinance.

§26.1702 Other Duties

The Committee requested an additional subsection under §26.1701 to add a requirement that the Committee "review any issues pertaining to the confidence of the general public or other stakeholders in the City's financial statements or financial practices." This concept, in a modified form, was added in §26.1702 because §26.1701 deals expressly with those duties of the Committee drawn directly from Charter section 39.1. The language was modified to make it permissive. The Committee would not be required to consider matters the members did not consider legitimate or reasonable. The language was further modified to provide greater clarity as to the public interest being protected and to limit the application to areas within the purview of the Committee.

§26.1707 Annual Audit

The Committee requested an additional subsection under §26.1707 to allow for a "due diligence" session to review the draft City audited financial statements before the audit is completed. This language was added as §26.1707(c). Due to the necessity of holding such a session outside of a public meeting, language was inserted to limit such a session to one or two members of the Committee and on an ad hoc basis. Due to the requirements of the Brown Act, it is not possible to include members of another legislative body, e.g., the City Council. Therefore, the subsection provides only for the attendance of Committee members, who may require the participation of City management, the outside auditor, or both.

Similarly, the Committee requested the addition of a provision whereby the Chair of the Audit Committee would regulate the ability of the Council members to attend meetings of the Disclosure Practices Working Group ("DPWG"). This was not added because DPWG serves an administrative function under the authority of the Mayor and the City Attorney, rather than the Audit Committee. To the extent that the City Council wishes to amend the Municipal Code regarding the nature of DPWG, the Council should amend Division 41 of the Code, entitled, "Securities Disclosure." The Committee should also be aware that the City Attorney's office will be bringing proposed amendments to Division 41 to the Rules Committee shortly.

The Committee raised concerns with respect to §26.1707(f) (August 31 version), which calls for the Committee to review certain types of off-balance sheet transactions or other courses of dealings that do not appear in the City's financial statements. The concern raised was that there could be too many such material items for the Committee to review. However, this subsection is conjunctive: the arrangement or course of dealing must be both material and "relevant to an understanding of the City's financial statements." To the extent that a transaction is material but not relevant to an understanding of the City's financial statements, the Committee would not be required to review it. The formatting of this subsection has been changed to provide greater clarity.

§26.1710 Audited Financial Statements of Related Entities

The Committee requested that language in §26.1710(c)(2) be conformed to similar language in §26.1707(c) (August 31, 2009 version) regarding Committee member attendance at DPWG meetings where audited financial statements are discussed. Specifically, the Committee wanted to make §26.1710(c)(2), relating to the financial statements of City "related entities," permissive, as is §26.1707(c), regarding City financial statements. However, all actions under §26.1710(c) are permissive. The subsection is intended to provide the Committee with the opportunity to require DPWG certification and send a representative to DPWG meetings in the event that DPWG determines related entity financial statements are "disclosure documents," within the meaning of the DPWG Disclosure Controls and Procedures. Were the language changed as requested by the Committee, the provision would contain duplicative permissive verb forms.

§26.1712 Oversight and Direction of City Auditor

The Committee requested the removal of language in §26.1712(a) designed to protect the professional discretion of the City Auditor with respect to the Annual Audit Plan ("Audit Plan"). This suggestion is based on the belief that the provisions in the City Charter designed to protect the City Auditor's independence are sufficient to protect the City Attorney's professional discretion in creating the Audit Plan. Because the City Auditor is required under the Charter to follow the Audit Plan and the Committee must approve the Audit Plan, the Committee's approval should be expressly limited to protect the City Auditor's professional discretion.

The Committee requested the addition of language in §26.1712 to expressly provide the City Auditor with the authority to unilaterally initiate audits. This concept is included in new subsection §26.1712(i) with the further requirement that the City Auditor provide notice of the

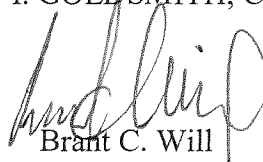
new audit to the Committee and that the notice describe the impact of the new audit on the City Auditor's ability to complete the audits already approved in the Annual Audit Plan.

The current draft of the Ordinance also contains a number of changes dealing with typographical errors and formatting issues. We look forward to addressing any concerns you may have with respect to this memorandum at the October 5, 2009 meeting of the Audit Committee.

Sincerely yours,

JAN I. GOLDSMITH, City Attorney

By

A handwritten signature in black ink, appearing to read "Brant C. Will", is written over the printed name.

Brant C. Will
Deputy City Attorney

BCW:jdf
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