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January 8, 2010

REPORT TO AUDIT COMMITTEE

AUDIT COMMITTEE ORDINANCE

This report is in response to Chairman Faulconer's December 3, 2009 memorandum [Memorandum] to the Council President requesting that the proposed Audit Committee Ordinance [Ordinance], scheduled for introduction before the City Council on December 7, 2009, be returned to the Audit Committee [Committee] for further consideration. The City Council returned the item to Audit Committee, where it will be discussed on January 10, 2010.

The Memorandum raised concerns stemming from the fact that the version of the Ordinance presented to Council had been revised subsequent to Committee approval on October 5, 2009. Specifically, the Memorandum raised concerns regarding the removal of Committee approval of the City Auditor's Audit Plan, the removal of certain responsibilities designated to the Committee Chair [Chair], and the alteration of Committee duties pertaining to retention of the outside auditor. These changes were made after a final review of the proposed Ordinance by the City Attorney's office prior to docketing with the City Council. The revisions made are explained below.

In San Diego Municipal Code [SDMC] section 26.1710(a) of the proposed Ordinance, the requirement that the Committee "approve" the City Auditor's annual Audit Plan was deleted. San Diego Charter [Charter] section 39.2 requires the City Auditor to create and follow the annual Audit Plan. There is no mention of Committee approval of the Audit Plan in either Charter section 39.2 (Office of the City Auditor) or Charter section 39.1 (Audit Committee). However, under Charter section 39.1, the Committee is "responsible for directing . . . the work of the City Auditor." The issue is whether the Committee's power to "direct" the Auditor's work includes the authority to approve the Audit Plan.

In interpreting the Charter, we must ascertain the intent of the voters in adopting the relevant charter provisions. *Howard Jarvis Taxpayers Ass'n v. County of Orange*, 110 Cal. App. 4th, 1375, 1381 (2003). Words are construed using usual, commonsense meanings. *Id.* The word "directing" means "[t]o manage or conduct the affairs of; regulate . . ." or "[t]o have or take charge of; control." American Heritage Dictionary of the English Language, (4th ed. 2009). The common meaning of the word "directing" used in Charter section 39.1 could mean

the Committee is responsible for “regulating” the work of the City Auditor or it could mean the Committee is responsible for “controlling” the work of the City Auditor.

However, charter provisions must be read as a harmonious whole with related sections interpreted within the broader context of their collective purpose. “The words of the statute must be construed in context, keeping in mind the statutory purpose, and statutes or statutory sections relating to the same subject must be harmonized.”¹ *San Francisco Int’l Yachting Ctr. Dev. Grp. v. City and County of San Francisco*, 9 Cal. App. 4th 672, 680 (1992). In the event of uncertainty, consideration must be given to the consequences that flow from a particular interpretation. *Id.*

Under section 39.2, the City Auditor is required to follow Government Auditing Standards [GAS]. GAS establishes various independence standards for auditors: “the audit organization and the individual auditor . . . must be free from personal, external, and organizational impairments to independence.” *Government Accountability Office, Comptroller General of the United States, Government Auditing Standards* (GAO-07-731G) § 3.02 (2007). External impairments to independence include “pressure, actual or perceived, from management and employees of the audited entity or oversight organizations” that restrict the auditor’s work or interferes with the auditor’s ability to form independent conclusions. *Id.* § 3.10. Mandating Committee approval of the Audit Plan could impair the independence of the City Auditor or create the impression that his independence is impaired. This would be contrary to the requirement that the City Auditor conduct his work in accordance with GAS. The Committee should carefully consider this issue with the input of the City Auditor.

SDMC section 26.1701(b)(2) was changed to remove specific reference to the Committee Chair. It is not necessary to specify the Chair because, in this context, the Committee acts through the Chair. The Chair is responsible for the Committee’s agenda and, therefore, is responsible for addressing the agenda requests of members of the Committee and the City Council.

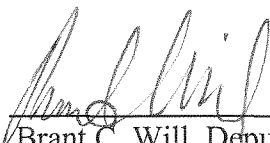
SDMC section 26.1711(b) was revised to remove language requiring the Committee to administer the City’s engagement with the outside auditor. This does not alter the Committee’s responsibilities regarding retention of the outside auditor in the Charter nor does it alter the Committee’s responsibility for monitoring the City’s engagement with the outside auditor or resolving disputes between management and the outside auditor. Charter section 39.1 specifies that the Committee shall recommend to the City Council the retention of the outside auditor, monitor the outside auditor’s engagement and resolve disputes between the City management and the outside auditor. The Charter does not require the Committee to administer the contract with the outside auditor and it is not necessary for such a requirement to be placed in the Municipal Code. Having the Committee administer the contract with the outside auditor would not violate any City law however, because the Committee does not have staff available to carry out this function, we recommend that the administrative duties be undertaken by the City Auditor. It is worth noting that the current contract with the outside auditor is being administered by the City Auditor’s office.

¹ “The fundamental rules of statutory construction apply equally to the interpretation of city charter provisions.” *Id.* at 682.

The proposed Ordinance contains a number of other revisions that have not been previously presented to the Committee. Attached with this memorandum, please find a blackline showing all other changes between the October 1, 2009 version presented to the Committee and the proposed Ordinance docketed with the City Council (including typographical errors addressed in a corrected copy of the Ordinance filed with the City Clerk on December 4, 2009). We are available to discuss these revisions at the convenience of the Committee.

Respectfully submitted,

JAN I. GOLDSMITH, City Attorney

By 

Brant C. Will, Deputy City Attorney

BCW:jdf
Attachments
RC-2010-1

cc: Ben Hueso, Council President
Sherri Lightner, Councilmember
Todd Gloria, Councilmember
Anthony Young, Councilmember
Donna Frye, Councilmember
Marti Emerald, Councilmember
Eduardo Luna, City Auditor
Andrea Tevlin, Independent Budget Analyst
Mary Lewis, Chief Financial Officer

ORDINANCE NUMBER O-_____ (NEW SERIES)

DATE OF FINAL PASSAGE _____

AN ORDINANCE AMENDING THE SAN DIEGO MUNICIPAL CODE BY AMENDING CHAPTER 2, ARTICLE 2, DIVISION 1, SECTION 22.0101.5 ENTITLED "PERMANENT RULES OF THE COUNCIL" BY AMENDING RULE 6.1 AND REPEALING RULE 6.11.6, AMENDING CHAPTER 2, ARTICLE 2, DIVISION 43 BY REPEALING DIVISION 43, TITLED "AUDIT COMMITTEE" IN ITS ENTIRETY AND AMENDING CHAPTER 2, ARTICLE 6 BY ADDING NEW DIVISION 17 TITLED "AUDIT COMMITTEE" BY ADDING SECTIONS 26.1701 THROUGH 26.1713, ~~AND AMENDING CHAPTER 2, ARTICLE 2, DIVISION 1, SECTION 22.0101.5 ENTITLED "PERMANENT RULES OF THE COUNCIL" BY AMENDING RULE 6.1 AND REPEALING RULE 6.11.6, 1711,~~ ALL RELATED TO THE AUDIT COMMITTEE CREATED PURSUANT TO CHARTER SECTION 39.1.

WHEREAS, on June 3, 2008, the citizens of the City of San Diego approved Proposition C approving, among other things, an amendment to the City Charter by adding Charter section 39.1, creating an independent Audit Committee, composed of two members of the City Council, one of whom shall serve as Chair of the Audit Committee, and three members of the public possessing the independence, experience and technical expertise necessary to carry out the duties of the Audit Committee; and

WHEREAS, this ordinance ~~repeals Division 43 of~~ amends the San Diego Municipal Code and Council by amending Chapter 2, Article 2, Division 1, section 22.0101.5 by amending Rule 6.1 and repealing 6.11.6, amending Chapter 2, Article 2, Division 43 by repealing Division 43 both of which applied to the Council Audit Committee; and

WHEREAS, this ordinance adds a new Division 17 to Chapter 2, Article 6 of the Municipal Code, which applies to the Audit Committee established by Charter section 39.1; and

WHEREAS, Charter section 39.1 provides that the City Council may specify additional responsibilities and duties of the Audit Committee by ordinance as necessary to carry out the provisions of Charter section 39.1; NOW, THEREFORE,

BE IT ORDAINED, by the Council of the City of San Diego, as follows:

Section 1. That Chapter 2, Article 2, of the San Diego Municipal Code is hereby amended by repealing Division 43, titled "Audit Committee" in its entirety.

Section 2. That Chapter 2, Article 6, of the San Diego Municipal Code is hereby amended by adding a new Division 17, titled "Audit Committee", and by adding new sections 26.1701 through 26.1713, to read as follows:

Article 6: Boards and Commissions

Division 17: Audit Committee

§ 26.1701 ~~Charter Section 39.1~~ Audit Committee Duties

- (a) Pursuant to Charter section 39.1, the Audit Committee shall:
- (1) have oversight responsibility over the City's auditing, internal controls and any other financial and business practices required of the Audit Committee by the Charter;
 - (2) have responsibility for directing and reviewing the work of the City Auditor, who shall report directly to the Audit Committee;
 - (3) recommend to the Council the annual compensation of the City Auditor and the annual budget of the Office of the City Auditor;
 - (4) conduct an annual performance review of the City Auditor;
 - (5) recommend to the Council the retention of the City's outside audit firm and, when appropriate, the removal of such firm; and

- (6) monitor the engagement with the City's outside auditor and resolve any disputes that may arise between the outside auditor and City management with regard to the City's annual financial reports.

~~§26.1702~~ ~~Other Duties~~

(b) ~~The~~In addition to the duties and responsibilities required by the Charter,
the Committee shall have the following duties:

- (1) review the results of significant investigations, examinations or reviews performed by government and regulatory authorities and any management response thereto;~~;~~
- (2) ~~The Committee chair shall place any item within the scope of the Audit Committee's authority on the Audit Committee's agenda at the request of any Committee member or City Council member.~~
Councilmember; and
- (3) ~~The Committee may review any issues that come to its~~the
Committee's attention which pertain to the accuracy and reliability of the City's financial statements and practices and representations and which could have a negative impact on the ability of the public to reasonably rely upon such financial statements, practices and representations.

~~§ 26.1703~~ ~~Membership~~1702 ~~Removal of the Audit Committee Members~~

~~The members of the Audit Committee are appointed by the City Council and consist of two sitting Councilmembers, one of whom shall be the Chair of the Committee, and three members of the public having the requisite skill and~~

~~experience as specified in Charter section 39.1.~~ Audit Committee members may be removed for cause by a majority vote of the members of the Council.

§ 26.17041703 **Meetings**

The Committee shall meet periodically, as it determines, but not less than once per quarter. The Committee shall conduct its meetings in accordance with the requirements of ~~California law, including the Ralph M. Brown Act.~~

§ 26.17051704 **Resources**

The City Manager, the City Attorney, the Chief Financial Officer and the Independent Budget Analyst shall ~~fully cooperate with the Committee and provide such assistance and resources as are reasonably necessary to allow the Committee to carry out its responsibilities. The Committee may request the City retain professional consultants it considers necessary to carry out its responsibilities. The Committee shall be provided with appropriate funding, as recommended by the Committee and approved by the Council, for payment of compensation to any such consultants, as well as for any ordinary administrative expenses of the Committee it determines are necessary and appropriate in carrying out its responsibilities.~~

§§ 26.1706 ~~Delegation;~~ 1705 **Subcommittees**

The Committee may create a ~~subcommittee~~ ad hoc subcommittees of one or more members of the Committee and ~~may delegate any of its duties and responsibilities to such subcommittee, or to an individual member of the Committee, unless otherwise prohibited by applicable law.~~ Any subcommittee or other member of

~~the Committee will~~ accomplish specific tasks within a limited time period.

Subcommittees shall provide a written or oral report to the Committee regarding any activities undertaken ~~pursuant to such delegation.~~ The Committee may terminate such ~~subcommittee and revoke any such delegations~~ subcommittees at any time.

§ ~~26.1707~~1706 **Annual Audit**

(a) The Committee shall have direct access to the City's outside auditor in conducting its review of the City's annual audit. In connection with the annual audit of the City's financial statements, the Committee ~~shall~~:

- (1) ~~receive from the Chief Financial Officer a~~ shall review the City's calendar of milestones for the preparation of the City's annual audit;
- (2) shall request from the outside auditor a formal written statement delineating all relationships between the outside auditor and the City consistent with Independence Standards Board Standard No. 1 and any other applicable auditing requirements, discuss with the outside auditor any such disclosed relationships and their impact on the outside auditor's objectivity and independence, and take appropriate action to oversee the independence of the outside auditor;
- (3) ~~at its discretion,~~ may appoint up to two members of the Committee, in an ad hoc capacity, to meet with City management and the outside auditor, together or separately, prior to the completion of

the audit, to review and discuss the draft financial statements and the conduct of the audit;

(4) may appoint a Committee member ~~who may~~to attend meetings of the Disclosure Practices Working Group at which the audited financial statements of the City are considered;

(5) shall review with the Chief Financial Officer and the outside auditor:

(A) the audited financial statements and the notes to the audited financial statements in the City's Comprehensive Annual Financial Report (~~CAFR~~) upon the issuance of the audit opinion and provide to the City Manager and the City Council any comments or recommendations it may have, and review and discuss with the outside auditor the matters required by Statement on Auditing Standards No. 114;

(B) significant accounting policies and practices applied in the preparation of the City's financial statements;

(C) any material financial or other arrangements of the City that do not appear in the City's financial statements; and;

(D) any transactions or courses of dealing with third parties that are material in size or involve terms or other aspects that differ from those that would likely be negotiated with independent parties and which arrangements or transactions

are relevant to an understanding of the City's financial statements; and

(1) ~~based on the process above,~~ Shall recommend to the City Council whether the ~~annual~~ audited financial statements should be received by and filed for use ~~by~~ with the City for all purposes Council.

(b) ~~In considering the City's audited financial statements, the~~ The Committee may ~~require~~ request certifications from any City employee regarding that employee's role in preparing the City's financial statements that the Committee deems necessary and appropriate to support the Committee's recommendation to the City Council.

§ 26.17081707 Accounting Policies

The Committee shall review periodically, not less than annually, with the Chief Financial Officer and the outside auditor the quality and appropriateness of the City's significant accounting policies, as set forth in the notes to the City's audited financial statements. Such review shall include discussion of the following:

- (a) how the City's significant accounting policies compare with those of similar municipalities;
- (b) any alternative treatments of financial information under GAAP that were considered ~~by~~ or used by the City;
- (c) the ramifications such alternative treatments would have on the City's financial statements; and
- (d) the treatment preferred by the outside auditor.

§ ~~26.1709~~1708 **Internal Controls**

The Committee shall review periodically, not less than annually, with the Chief Financial Officer, the City Auditor ~~and~~, the outside auditor, as or other appropriate City officials, the City's internal controls over financial reporting and internal auditing procedures. Such review shall include discussion of the following:

- (a) how the City's financial systems, controls and practices compare with similar municipalities;
- (b) any significant deficiencies in the design or operation of internal controls, including material weaknesses in such controls reported by the outside auditor, the City Auditor or management, and any additional audit procedures adopted in light of material control deficiencies, which could adversely affect the City's ability to record, process, summarize or report financial data; and
- (c) any substantiated fraud or impropriety, material or not, that involves any officer of the City or other employees who have a significant role in the City's internal controls over financial reporting, to the extent that such matters may legally be disclosed to the Committee.

§ ~~26.1710~~1709 **Audited Financial Statements of ~~Related Entities~~Component Units**

(a) The Committee shall review the audited financial statements of the following City related ~~entities~~, ~~as such term is defined in section 22.4102 of the Municipal Code~~component units:

- (1) Redevelopment Agency
- (2) Housing Commission

- (3) Centre City Development Corporation
 - (4) Southeastern Economic Development Corporation
 - (5) San Diego City Employees' Retirement System
 - (6) San Diego Data Processing Corporation
- (b) At its discretion, the Committee may review the audit financial statements of other ~~related entities~~City component units it deems appropriate.
- (c) In considering ~~related entity~~component unit audited financial statements, the Committee may request certifications from any City employee, or component unit employee of, regarding such ~~related entities,~~employee's involvement in the preparation of a component units audited financial statements, if the Committee deems such certification necessary and appropriate.
- (d) If a ~~related entity~~component unit issues debt publicly and such ~~related entity's~~component unit's audited financial statements are ~~determined to be disclosure documents~~reviewed by the Disclosure Practices Working Group as a disclosure document, the Committee shall be informed of such review and may:
- (1) require the certification of the Disclosure Practices Working Group, in such form as determined by that body; and
 - (2) appoint a Committee member to attend any meetings of the Disclosure Practices Working Group at which such audited financial statements are considered.

~~§ 26.1711 — Appointment and Removal of the City Auditor~~

~~Pursuant to Charter section 39.2, the City Auditor shall be appointed by the City Manager in consultation with the Committee and subject to confirmation by the Council. The Committee may recommend to the Council the removal of the City Auditor for cause, such removal requiring a two-thirds vote of the Council.~~

§ 26.1712 § 26.1710 Oversight and Direction of the City Auditor

The Committee shall oversee and direct the work of the City Auditor as follows:

- (a) ~~review and approve the Annual Audit Plan prepared by the City Auditor, which shall not impinge upon the professional discretion of the City Auditor;~~
- (b) review the Annual Risk Assessment prepared by the City Auditor in conjunction with the Annual Audit Plan;
- (c) review the Annual Activities and Accomplishments Report ~~prepared by~~of the City Auditor;
- (d) receive the quarterly report on the City's Fraud, Waste, and Abuse Hotline ~~prepared by the City Auditor;~~
- (e) receive quarterly updates on the activities and accomplishments of the City Auditor;
- (f) review with the City Auditor audit plans, budget and staffing needs, and relevant processes and programs of the City's internal audit function;
- (g) provide a mechanism for the City Auditor to discuss confidential audit-related matters with the Committee, provided such mechanism complies with the Brown Act;

- (h) allow the City Auditor to bring any matter before the Committee ~~at the discretion of the City Auditor~~; and
- (i) notwithstanding the Annual Audit Plan, permit the City Auditor ~~may~~to initiate any audit the City Auditor deems necessary and appropriate, so long as notice is provided to the Committee, with such notice describing the impact, if any, of the new audit on the ability of the City ~~Attorney Auditor~~ to complete the audits approved in the Annual Audit Plan.

§ 26.17131711

Retention of the Outside Auditor

- (a) In order to fulfill its responsibility to recommend to the Council the retention of the City's outside auditor, the Committee shall:
 - (1) designate a member of the Committee to work with the City Auditor in the preparation of a Request for Proposals for the retention of the outside auditor not less than once every five years and the Committee shall approve the form of the Request for Proposals before it is disseminated to prospective outside audit firms; and
 - (2) ensure that the City Auditor, in cooperation with the Chief Financial Officer and the Independent Budget Analyst, has undertaken a full review of the all responsive proposals.
- ~~(b) — The Committee or its designee shall be responsible for administering the contract with the outside auditor and approving payments for services rendered.~~

~~(e)(b) The Committee shall pre-approve, or establish procedures for representatives of the Committee to approve, in advance, all audit services and all permitted non-audit services to be provided to the City by the outside auditor in order to ensure the independence of the outside auditor.~~

Section 3. That Chapter 2, Article 2, Division 1, of the San Diego Municipal Code is hereby amended by amending section 22.0101.5, Rule 6.1, ~~and by repealing Rule 6.11.6,~~ titled "Audit Committee."

Section 4. That a full reading of this ordinance is dispensed with prior to its passage, a written or printed copy having been available to the City Council and the public prior to the day of its passage.

Section 5. That this ordinance shall take effect and be in force on the thirtieth day from and after its final passage.

APPROVED: JAN I. GOLDSMITH, City Attorney

By _____
Brant C. Will
Deputy City Attorney

BCW:jdf
~~xx/xx~~10/14/2009
12/04/09.COR.COPY
Or.Dept:Audit
O-2010-7

I hereby certify that the foregoing Ordinance was passed by the Council of the City of San Diego, at this meeting of _____.

ELIZABETH S. MALAND
City Clerk

By _____
Deputy City Clerk

Approved: _____
(date)

JERRY SANDERS, Mayor

Vetoed: _____
(date)

JERRY SANDERS, Mayor