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April 28, 2011

REPORT TO THE AUDIT COMMITTEE

REVENUE RECOVERY PROGRAM BUDGET OPTIONS

### INTRODUCTION

On April 11, 2011, the City Auditor presented a follow-up report on revenue recovery auditing.<sup>1</sup> City Auditor Report (April 1, 2011). The City Auditor suggests hiring an outside firm that would audit the City's accounts payable activities; reverse sales tax audits; and revenues generated through the courts, such as assessed fines. Councilmember DeMaio requested a report from the Office of the City Attorney on legislative options available to incorporate a revenue recovery function into the Fiscal Year 2012 Budget.

On April 12, 2011, the Independent Budget Analyst (IBA) presented a "Second Update to Menu of Budget Options."<sup>2</sup> IBA Report No. 11-21 (Mar. 25, 2011). The IBA noted the Fiscal Year 2012 Proposed Budget did not include a revenue recovery auditing option, but this option "may still be implemented in 2012" and "the potential budgetary relief . . . could be significant." *Id.* The City Council accepted IBA Report No. 11-21 and requested that the Mayor report to the City Council during the budget review process on the potential cost savings associated with the IBA's budgetary proposals, including the revenue recovery auditing option, so that the City Council could decide whether to incorporate any of those options into the budget.

### DISCUSSION

This Report briefly discusses how the City Council can take action on the revenue recovery auditing option to include it in the Fiscal Year 2012 Budget.

#### I. REQUEST A REPORT FROM THE MAYOR ON REVENUE RECOVERY AUDIT SERVICES

The City Treasurer is part of the City's Financial Management and under Mayoral control. San Diego Charter § 45. "Whenever any person is indebted to the City in any manner and the means of collection of such debt is not otherwise provided for by law or ordinance, the Treasurer shall be authorized to demand and receive the same." *Id.* Further, the City Treasurer is responsible for collecting "special assessments previous to certification to the County Auditor,

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<sup>1</sup> The City Auditor presented his preliminary report to the Audit Committee on January 10, 2011.

<sup>2</sup> The IBA presented her initial menu of budget options to the City Council on February 14, 2011.

charges for permits for private use of public streets, and such other miscellaneous taxes, fees, assessments, licenses and privilege charges as may from time to time be assigned to him or her.” *Id.* Once assigned to collect these revenues, the City Treasurer must “maintain a continuous inspection of the records and accounts of such taxes, licenses and privilege charges in order to effectuate their collection.” *Id.* The City Treasurer accomplishes this function by using the Revenue Audit Division to periodically inspect the records of the tax-regulated businesses and those businesses remitting percentage-based franchise fees and rents for City-leased lands. City Att’y MOL No. 2010-12 (June 10, 2010). The City Treasurer initiates appropriate collection action if deficiencies are found during these inspections.

The City Council may request a report from the Mayor concerning the City Treasurer’s collection actions when deficiencies are found during inspections. If the City Treasurer is not currently conducting the inspections suggested by the City Auditor or IBA, or is not conducting such inspections to the extent desired by the City Council, the City Council may request a report from the Mayor outlining the ability of the City Treasurer to undertake additional revenue recovery responsibilities given budget and staffing restraints.

The City Council may also explore whether the addition of staff for revenue recovery purposes is economical and efficient, or whether it is in the City’s best interest to contract with a third party for some or all such services.

The City Council and City management should fully explore the legal implications associated with the option of outsourcing this function before procuring third party revenue recovery audit services.

## **II. ISSUE A REQUEST FOR PROPOSALS (RFP) FOR REVENUE RECOVERY SERVICES**

If there are no legal impediments to engaging an outside firm, the City could issue an RFP for revenue recovery audit services.

The City Auditor represented there are a number of third party firms that specialize in revenue recovery audit services. City Auditor Report (April 1, 2011). The selected contractor receives a percentage from the recoveries made on the City’s behalf as compensation. *Id.* The City has, for instance, retained MuniServices to audit sales/use and property taxes owed the City, and MuniServices receives as compensation 18 percent of recoveries made on the City’s behalf.

The IBA also recommends the Chief Financial Officer (CFO) have a lead role in procuring and administering the revenue recovery audit contract with support from the City Auditor and/or the IBA since the selected contractor will work cooperatively with various departments under the CFO. IBA Report No. 11-21 (Mar. 25, 2011).

If the City elects to issue a RFP for revenue recovery audit services, it is unlikely a contract will be in place by July 1, 2011, and also unlikely the City can garner an estimate of resulting revenues. Nevertheless, if resources are available, the City may be able to have a contract for revenue recovery audit services in place by the end of the first quarter of Fiscal Year 2012.

As noted in IBA Report No. 11-21, the City has a contract with MuniServices to audit sales, use, and property taxes owed to the City. This existing contract may not be amended to include the revenue recovery auditing services suggested by the City Auditor because the RFP to which MuniServices responded is narrow in scope and did not invite proposals for services other than sales, use, and property tax audits. A new RFP must be issued.

### **III. PARTICIPATE IN A COOPERATIVE PROCUREMENT**

The City Auditor states there are a number of third party firms that specialize in revenue recovery audit services. City Auditor Report (April 1, 2011). Compensation structures range from flat fees to contingencies. The City Auditor also reports that some government agencies place a cap on maximum payments to firms to mitigate abnormally high contingency payments. *Id.* Given the availability and widespread use of such services, a cooperative procurement may be a more efficient and economical alternative to initiating a RFP.

The San Diego Municipal Code describes the circumstances under which contracts for goods, services, and cooperative procurement and consultant contracts may be entered into and whether a contract for goods, services and cooperative procurement must be competitively bid. San Diego Municipal Code § 22.3212. A cooperative procurement contract is a contract entered into by the City and another agency to obtain goods or services or an agency contract utilizing a bidding process that complies with City requirements. SDMC § 22.3003. This arrangement is sometimes referred to as “piggybacking.”

As explained in San Diego Municipal Code section 22.3212, the City is not required to competitively bid a cooperative procurement contract if the contract is for an amount less than \$10,000, or the cooperative procurement contract will be administered by another agency so long as (1) the City Manager certifies in writing that the cooperative procurement contract is in the City’s best interests; (2) the cooperative procurement is to the City’s economic advantage; and (3) the other agency’s bidding process substantially complies with the City’s competitive bidding requirements.

We found, for instance, that on March 21, 2011, following a competitive bidding process, the City Council of the City of Clovis authorized its’ City Manager to enter into an agreement with HdL to audit the sales and use tax revenue received by the City of Clovis. HdL will receive as compensation 15 percent of the revenue received by the City of Clovis as a result of HdL’s audit findings. The audit fee applies to monies received in the first eight consecutive reporting quarters and includes retroactive back quarter adjustments obtained by HdL. If the City of

Clovis' competitive bidding requirements substantially complies with that of the City of San Diego, and City management certifies that a cooperative procurement with the City of Clovis is in the City of San Diego's best interests and an economic advantage, then the City Council may authorize a competitive procurement contract for revenue recovery audit services.

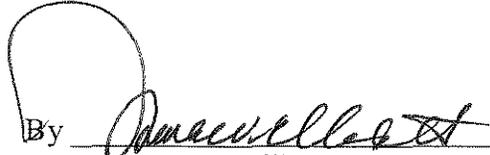
The City Council may request the Mayor's Office to review recent government agency procurements within and outside of the State of California to determine whether a cooperative procurement contract is in the City's best interests and economically advantageous to the City, with such findings to be presented to the City Council.

### CONCLUSION

In summary, we have identified three legislative actions the City Council may take:

1. Request a report from management on the City Treasurer's current revenue recovery efforts and City Treasurer resources available to satisfactorily perform this function; and
2. Request the issuance of an RFP for revenue recovery audit services; or
3. Request management to explore the possibility of participating in a cooperative procurement contract.

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