OFFICE OF

THE CITY ATTORNEY

CITY OF SAN DIEGO

MARA W. ELLIOTT

CITY ATTORNEY

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January 27, 2023

REPORT TO HONORABLE COUNCILMEMBERS

ITEM 604 - AUDIT COMMITTEE PUBLIC MEMBER APPOINTMENT PROCESS

INTRODUCTION

On January 30, 2023, the Independent Budget Analyst (IBA) will seek direction from the San Diego City Council (Council) regarding the reappointment of Stewart Halpern, a Public Member of the Audit Committee.

In a letter dated April 21, 2022, Valerie Silverman Massey, this Office's Chief of Ethics and Compliance, informed Mr. Halpern that he has an impermissible conflict of interest and requested that he immediately resolve the conflict. See Attachment A. In response, Mr. Halpern's attorney, Gil Cabrera, sent a letter to this Office denying that a conflict exists. Although preliminary discussions with Mr. Cabrera were productive, Mr. Halpern ultimately declined to take one of the two actions that would have resolved his conflict: stepping down from his appointments at SANDAG in favor of his appointment at the City, or vice versa.

On October 5, 2022, in anticipation of Mr. Halpern's appointment terminating on January 5, 2023, I sent a memorandum to the IBA describing the conflict and recommending an open recruitment so that the Council could consider and approve an applicant who is not conflicted. See Attachment B. The IBA and I have spoken about this issue several times since the issuance of that memorandum. The IBA informed me that he has spoken with Mr. Halpern to no avail, and that he has met with the Council about the reappointment. Per the IBA, the Councilmembers "like Stewart" and wish to consider his reappointment despite the conflict. Accordingly, the IBA has docketed a discussion of Mr. Halpern's appointment for January 30, 2023.

To this Office's knowledge, this is the first time a department head has presented a matter for Council action despite being informed that the proposed action violates the law and that the City Attorney will not sign off. As such, there is no precedent to guide next steps should the Council wish to reappoint Mr. Halpern despite the unresolved conflict.

These events illuminate a few issues that we wish to bring to your attention.[1]

[1] Some of these issues were previously identified in my Office's Report of February 15, 2022 titled "Proposed Ballot Measure Amending the City Charter to provide the Office of the City Auditor and the Audit Committee with access to Independent Legal Counsel." See City Att'y Report 22-1 (Feb. 15, 2022), attached as Attachment C.

The IBA has Struggled to Recruit Audit Committee Members

The IBA, who has traditionally handled Audit Committee recruitment, has faced challenges filling its three Public Member positions for many years despite our City's population (approximately 1,382,000 people in 2021). To fill seats, the IBA often recruits members from outside City limits. Currently, one of the three Public Members resides in Carlsbad.[2] The Council may wish to dig deeper to understand why it is challenging to fill Audit Committee positions and whether the City compromises applicant independence and qualifications to address vacancies. Equally important is whether this practice reflects the Council's commitment to ensuring equity in City government. The Audit Committee has only had one female Public Audit Committee member since its creation in 2008, and few people of color have served.

The City Should Determine Whether a Proposed Appointee has a Conflict of Interest Before Making an Appointment

Although Mr. Halpern disclosed that he sat on the SANDAG Audit Committee and its TransNet Independent Taxpayer Oversight Committee (ITOC) in the application materials he submitted to the IBA in 2018, neither he nor the IBA sought guidance from the San Diego Ethics Commission, my Office, the California Attorney General, or SANDAG's General Counsel concerning any potential conflict of interest.

To protect the public's interests, the Council may wish to direct City staff to vet conflicts before an appointee is presented to Council for approval. This Office used to review potential appointments to major boards, commissions, and committees before the Council would consider the appointment. See, for instance, the memorandum attached as Attachment D. It appears that this practice ended about a decade ago.

Appointee Conduct Should be Assessed Before Reappointment Occurs

Audit Committee members hold a position of trust and are responsible for protecting public assets. As with all City appointees, their conduct must be beyond reproach. To that end, the Council should have a process to assess the performance, attendance, and conduct of all City board, committee, and commission members before approving a second term.

[2] This Office informed the Council of the conflicts that exist with the two other Public Members nearly one year ago. City Att'y Report 22-1 (Feb. 15, 2022). Mr. Halpern's conflict is explained in Attachments A and B. Public Member Toufic Tabshouri, formerly employed by the City of San Diego's Auditor, is now employed by MTS as its Auditor. The Auditor is in the chain of command that reports to the MTS Board, which includes the two City Councilmembers who currently sit on the Audit Committee.

CONCLUSION

This Office recommends a more robust vetting process to ensure that conflicts are identified before applicants to boards, committees, and commissions are presented to the Council for potential appointment. We are available to assist as needed to improve this process.

CITY ATTORNEY

By */s/ Mara W. Elliott*
MARA W. ELLIOTT

MWE:se
RC-2023-1
Doc. No. 3204032
Attachments
cc: Independent Budget Analyst Charles Modica

Attachment A

VALERIE SILVERMAN MASSEY
CHIEF ETHICS & COMPLIANCE OFFICER

OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO

Mara W. Elliott
CITY ATTORNEY

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FAX (619) 236-7215

April 21, 2022

Stewart Halpern
2531 Via Viesta
La Jolla, CA 92037
SHalpern@sandiego.gov

Sent via email

Re: Audit Committee

Dear Mr. Halpern,

It has come to the attention of this Office that you are a sitting member of the City of San Diego's Audit Committee (City)[1] and the San Diego Association of Governments Audit Committee (SANDAG)[2]. It appears that you were appointed to SANDAG's inaugural Audit Committee in September 2018, and the City's Audit Committee in January 2019. Although you disclosed your appointment to SANDAG's Audit Committee when applying for the City's Audit Committee, it does not appear that you sought guidance about a potential conflict of interest from this Office, SANDAG's General Counsel, the San Diego Ethics Commission, or the State Attorney General.

It is this Office's opinion that you currently hold incompatible offices; and, a conflict of interest under California law exists. The "incompatible offices" doctrine restricts the ability of public officials, such as an Audit Committee member, to hold two different public offices simultaneously if the offices have overlapping and conflicting public duties. Cal. Gov't Code § 1099. A person may not simultaneously hold two public offices if:

- Either of the offices exercises a supervisory, auditing, or removal power over the other office or body;
- There is a significant clash of duties or loyalties between the offices; or,
- There are public policy considerations that make it improper.

A recent Attorney General opinion provides helpful guidance:

> To find that two offices are incompatible based on a significant clash of duties or loyalties, a conflict need not have actually

[1] See San Diego Charter sections 39.1 and 39.2; San Diego Municipal Code sections 26.1701 through 26.1711.
[2] See https://www.sandag.org/organization/about/pubs/policy_039.pdf

> occurred; it is enough that a conflict *may* occur in the regular operation of the statutory plan. (Citation omitted). It is not necessary that the clash of duty exist in all or in the greater part of the official functions; incompatibility exists when the holder of the two offices cannot in every instance discharge the duties of each. (Citation omitted). Indeed, "[o]nly one potential significant clash of duties or loyalties is necessary to make offices incompatible." (Citation omitted). When two offices are deemed incompatible, the conflicted officeholder may not escape the effects of the doctrine by choosing not "'to perform one of the incompatible roles. The doctrine was designed to avoid the necessity for that choice."' (Citation omitted).

21 Op. Cal. Att'y Gen. 103 at *5-6 (2021).

The City and SANDAG Audit Committees have similar responsibilities and can audit one another. For instance, the SANDAG Audit Committee could include in its work plan a performance audit of the City's use of SANDAG grant funds or a project involving both the City and SANDAG. Similarly, under San Diego Charter section 39.2, "[a]ll City contracts with consultants, vendors, or agencies will be prepared with an adequate audit clause to allow the City Auditor access to the entity's records needed to verify compliance with the terms specified in the contract." This language would allow the City Auditor to audit SANDAG's records relating to a contract with the City. Such audits by City or SANDAG auditors would be presented to their respective Audit Committees.

This Office is unable to provide you with legal advice on how to resolve this conflict of interest. However, now that you are aware of the conflict, it must be resolved as expeditiously as possible. The Attorney General's Office has issued numerous opinions on the subject, which are available on its website and may provide helpful guidance. You may also wish to contact your own legal counsel.

Please let this Office know how you will resolve this issue no later than the close of business on Friday, April 29, 2022.

Sincerely,
MARA W. ELLIOTT, City Attorney

By: _____
Valerie Silverman Massey
Chief Ethics & Compliance Officer

VSM:se
Doc. No.: 2959282
Cc: John Kirk, SANDAG General Counsel
Audit Committee Chairman Stephen Whitburn

Attachment B

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: October 5, 2022

TO: Independent Budget Analyst Charles Modica

FROM: City Attorney Mara W. Elliott

SUBJECT: Public Audit Committee Member Stewart Halpern

Under San Diego Charter (Charter) section 39.1, the Audit Committee is comprised of two members of the City Council and three members of the public. The two Councilmembers are appointed by the City Council, and the three public members are appointed by the City Council upon recommendation by a screening committee composed of the Audit Committee Chair, the Independent Budget Analyst (IBA), and at least two outside financial experts appointed by the other members of the screening committee and confirmed by the City Council. Public members of the Audit Committee must possess the independence, experience, and technical expertise necessary to carry out the duties of the Audit Committee, including knowledge of accounting, auditing, and financial reporting. They must also possess at least 10 years of experiences as a certified public accountant or as a certified internal auditor, or 10 years of other professional financial or legal experience in audit management. The IBA has traditionally led the search for public Audit Committee members and, in doing so, leads the recruitment, screens applications, assembles the screening committee, completes reference and background checks, and then prepares and dockets the item for City Council consideration and potential appointment.

In August 2018, the IBA began soliciting public member candidates to fill an Audit Committee vacancy scheduled to occur in January 2019.[1] On May 20, 2019, the City Council appointed Mr. Halpern to the Audit Committee for a term ending January 5, 2023. [*See* San Diego Resolution R-312465 (May 20, 2019).] At that time, Mr. Halpern was serving as a public member on the San Diego Association of Governments (SANDAG) Audit Committee and a member of SANDAG's TransNet Independent Taxpayer Oversight Committee (ITOC).

The SANDAG Audit Committee assists SANDAG's Board of Directors to fulfill "its oversight responsibilities and provide a forum for pursuing the opportunities for improvements in operations, financial reporting and internal controls identified through the agency's audit products." SANDAG Board Policy No. 039. With these duties and responsibilities, the likelihood

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[1] Then-Audit Committee member Thomas Hebrank had been appointed to the Ethics Commission. Upon consultation with this Office, we advised Mr. Hebrank that he could not simultaneously serve on both the Audit Committee and the Ethics Commission. Mr. Hebrank opted to sit on the Ethics Commission, thus creating the vacancy that Mr. Hebrank now fills.

exists that one entity could audit the other or for a significant clash of duties or loyalties in serving in both offices.

The TransNet ITOC oversees the implementation of the TransNet program, the San Diego region's half-cent sales tax for transportation improvements. The City of San Diego is a recipient of TransNet funding.

Although Mr. Halpern disclosed that he sat on the SANDAG Audit Committee and ITOC in the application materials he submitted to the City's screening committee, Mr. Halpern did not seek guidance from my Office, SANDAG's General Counsel, the San Diego Ethics Commission, or the California Attorney General concerning any potential conflict of interest with simultaneously serving on the City's Audit Committee and the SANDAG committees. In addition to our legal concerns, the potential clash of duties or loyalties between both offices in this situation is not consistent with best practices or good government principles. *See* Cal. Gov't Code § 1099(a)(2); *see also*, 104 Op. Cal. Att'y Gen. 58, 63 (2021) ("[t]o find that two offices are incompatible based on a significant clash of duties or loyalties, a conflict need not have actually occurred; it is enough that a conflict *may* occur in the regular operation of the statutory plan").

Upon learning of Mr. Halpern's appointments to the SANDAG committees, this Office contacted SANDAG's General Counsel who agreed that Mr. Halpern is likely prohibited from simultaneously holding public offices at SANDAG and at the City.

On April 21, 2022, this Office issued a letter to Mr. Halpern, opining that his simultaneous service on the City's Audit Committee and SANDAG's Audit Committee[2] creates a conflict of interest under California law. *See* Cal. Gov't Code § 1099(a). The Office expressed concern that Mr. Halpern would have competing loyalties and responsibilities given his appointments to the City's Audit Committee and SANDAG's committees.

On May 10, 2022, Mr. Halpern's attorney, Gil Cabrera, responded to this Office on behalf of his client. Although preliminary discussions with Mr. Cabrera were productive, Mr. Halpern ultimately decided that he would not step down from his appointments at SANDAG in favor of his appointment at the City, or vice versa. Either action would resolve this Office's concern. Mr. Halpern instead advised this Office through Mr. Cabrera that he would only step down if forced to do so by court order or by City Council action.[3]

As Mr. Halpern's term ends on January 5, 2023, this Office opted not to participate in political theater by bringing a removal request to the City Council, or by bringing a court action. We are instead informing the IBA of this conflict and our legal concerns. We recommend that the IBA open a recruitment so that the City Council can consider and approve an applicant who is not conflicted and who possesses the independence necessary to carry out the duties of the Audit Committee under Charter section 39.1.

[2] This Office did not learn of Mr. Halpern's service on ITOC until after the letter was sent.
[3] Pursuant to San Diego Municipal Code section 26.1702(b), "Audit Committee members may be removed for cause by a majority vote of the members of the Council."

This Office also recommends a more robust vetting process to ensure that conflicts are identified before an Audit Committee applicant is presented the City Council for potential appointment. We are available to assist as needed to improve this process.

Sincerely,

MARA W. ELLIOTT, CITY ATTORNEY

By: Mara W. Elliott
Mara W. Elliott
City Attorney

MWE:se
Doc. #3108505
Attachment: Audit Committee Chair Stephen Whitburn

Attachment C

OFFICE OF

THE CITY ATTORNEY

CITY OF SAN DIEGO

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FAX (619) 236-7215

February 15, 2022

REPORT TO THE HONORABLE MEMBERS OF RULES COMMITTEE

ITEM 1 - PROPOSED BALLOT MEASURE AMENDING THE CITY CHARTER TO PROVIDE THE OFFICE OF THE CITY AUDITOR AND THE AUDIT COMMITTEE WITH ACCESS TO INDEPENDENT LEGAL COUNSEL

INTRODUCTION

Since 2018, the San Diego City Council (Council) has twice asked voters to amend the San Diego City Charter's (Charter) provisions on the Audit Committee and the Auditor (Auditing Function). In 2018, voters agreed to change the appointment process of Audit Committee members, and in 2020, the voters approved changes to the process for appointing and terminating the Auditor.[1] The Auditor now requests that the Council advance a measure that would give him and the Audit Committee authority to "retain legal counsel, independent of the City Attorney, for any project or task if the City Auditor or the Audit Committee determines it is in the best interest of the City to do so. Such independent legal counsel would serve under the direction of the City Auditor and the Audit Committee, except as otherwise required by the Rules of Professional Conduct of the California State Bar." Although its responsibilities are impacted, this Office has never been asked its opinion of the Auditor's proposal.

This Report raises issues the Rules Committee may wish to consider before incurring the expense of a third amendment to the Auditing Function in just four years. We suggest that any further revisions to the Charter's Auditing Functions involve the thoughtful and inclusive approach former Mayor Sanders took when he created a 15-member Charter Review Committee (CRC) in 2008 to implement remediation recommendations made by Kroll, Inc. (Kroll) in a comprehensive public report concerning the City's disclosure practices (Kroll Report). Over a 7-month period, the CRC gathered input from residents and subject matter experts throughout the City on how to best protect the City's finances. This process resulted in a final public report that included recommendations for creating an Auditor position and an Audit Committee, as well as other measures intended to strengthen City governance (CRC Report).[2] Continued piecemeal modification of the Auditing Functions without appreciating the issues that led to its creation in 2008 could lead to structural deficiencies. The issues raised in the Kroll and CRC Reports must be considered before further changes are made.

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[1] According to the City Clerk, the City paid a combined total cost of $780,865 to place these measures before the voters, which is an average of $390,000 per election.

[2] Applicable excerpts of the CRC Report are attached hereto as Attachment 1.

We further note the importance of public engagement. Amendments to the City's Auditing Functions in 2018 and 2020 garnered little public attention or scrutiny, particularly those adopted during the 2020 pandemic. Contrary to the inclusive approach the Council has embraced in selecting a new Independent Budget Analyst (IBA), the prior Council's appointment of an Auditor in November 2020 included little public discussion and no inquiry about vision or a plan for serving all of San Diego's neighborhoods.

This Report provides background information on the creation of the Auditing Function, suggestions for the Committee's consideration, and issues to consider should the Rules Committee proceed with the measure as written.

BACKGROUND

The creation of an Auditor position and of the Audit Committee stems from the near financial collapse of the City of San Diego in the early 2000s, which occurred due to mismanagement, misrepresentation, and a lack of checks and balances.[3]

In 2003, Diann Shipione, a trustee of the San Diego City Employees Retirement System (SDCERS), noticed the omission of important financial information from the City's prospectus on a proposed sewer bond. As The New York Times explained:

> The prospectus did not mention that the city had for years been shortchanging its public pension fund, leading to an unfunded liability of more than $1.15 billion, or that the city owed nearly $1 billion more in health care benefits to retirees and did not have the money. And it implied that the pension fund's actuary had approved the underfunding when Ms. Shipione knew that he had not.[4]

Ms. Shipione blew the whistle in a letter to City officials and the San Diego Union-Tribune, which eventually resulted in structural changes in the City's handling of finances, a downgrading of the City's credit rating, and the City's admission that it had misstated its financial condition for several years. The City's underfunding of its pension led to the resignation of senior City officials, a lawsuit by retired City employees concerned about their benefits, and a credible discussion of municipal bankruptcy. The Securities and Exchange Commission, the United States Attorney's Office, the San Diego County District Attorney's Office, and the San Diego City Attorney's Office opened investigations into possible fraud and potential political

[3] Attachment 2 is the Executive Summary to the "Report of the Audit Committee of the City of San Diego: Investigation into the San Diego City Employees' Retirement System and the City of San Diego Sewer Rate Structure," dated August 8, 2006, and prepared by Kroll, Inc. This is a portion of the "Kroll Report," which comprises 239 pages plus appendices. The complete Kroll Report is available here: X:\Kroll Report. It should be required reading for an elected official holding office in the City of San Diego.

[4] John M. Broder, *Sunny San Diego Finds Itself Being Viewed as a Kind of Enron-by-the-Sea*, The New York Times, Sept. 7, 2004, https://www.nytimes.com/2004/09/07/us/sunny-san-diego-finds-itself-being-viewed-as-a-kind-of-enronbythesea.html

corruption, ultimately earning the City the nickname "Enron-by-the-Sea."[5] City officials hired Kroll, a New York-based risk management firm headed by former SEC Chairman Arthur Levitt, to prepare a comprehensive public report concerning the City's disclosure practices.[6] A synopsis of the Kroll Report findings pertinent to the Auditor's proposal is in Attachment 3.

On January 22, 2007, then-Mayor Sanders established a 15-member CRC and created a four-part work plan to explore "[w]hat Charter modifications are necessary to implement the Kroll recommendations and other financial reforms."[7] Mayor Sanders tasked the CRC with holding two noticed public meetings per month under California's open meeting laws and created subcommittees that would hold separate public meetings up to twice per month. Work began on March 1, 2007, and concluded before the 2008 election cycle. Consultants and City staff, including the City Attorney and IBA, supported the CRC with its work.

On October 4, 2007, the CRC presented its 85-page report to Mayor Sanders and the Council that reflected public testimony received at 51 public meetings from representatives of 53 different organizations, 72 individuals, and various public officials and experts. *See* 2007 San Diego Charter Review Committee Final Report (Oct. 4, 2007), www.sandiego.gov/sites/default/files/legacy/iba/pdf/11_24Attachment2.pdf.

Consistent with the CRC's recommendation, San Diego voters amended the Charter on June 3, 2008, to address the City's deficient financial reporting structures by, among other things, adding section 39.1, which creates an Audit Committee, and section 39.2, which adds an Office of City Auditor. The Auditing Function has not been reviewed since to determine whether it is working as expected or requires amendments.[8] Accordingly, a holistic review of the Auditing Function has not occurred for 15 years. The fact that a third measure is now proposed in just four years indicates that it may be time for a comprehensive review of the Auditing Function to determine whether the cumulative impact of these changes is moving the City in directions inconsistent with the CRC's recommendations.

CITY ATTORNEY ANALYSIS AND RECOMMENDATIONS

The City Attorney's Office has worked with the Auditor and the Audit Committee since its inception in 2008 and assigned Deputy City Attorneys (DCAs) to serve as the department's General Counsel and DCAs to serve as counsel to the Audit Committee. DCAs assigned to the department assist in drafting the Auditor's policies, reviewing draft performance audits, and providing day-to-day guidance on an as-needed basis. DCAs assigned to the Audit Committee

[5] Michael Smolens of the San Diego Union-Tribune recently revisited this "decade-old pension scandal that continues to put pressure on city finances" in the article *Timing Will Help San Diego Move on from Pension Nightmare*, dated April 16, 2021, available at https://www.sandiegouniontribune.com/columnists/story/2021-04-16/column-timing-may-facilitate-negotiations-to-end-san-diegos-pension-nightmare.

[6] KPMG, the City's outside auditor, refused to issue its audit of the City's 2003 financial statement until it could review Kroll's conclusions, thus impeding the City's ability to restore its diminished credit rating or to access the public bond market to pay for upgrades to City infrastructure.

[7] Mayor Sanders also tasked the CRC with addressing issues that had arisen during the first year of implementing the Strong Mayor form of government.

[8] The CRC of 2015 reviewed the Charter for potential amendments but did not discuss or review the City's Auditing Function.

advise the committee during its meetings on open meetings law, conflict of interest law, and other applicable laws and regulations. They prepare memos at the request of the body and assist the Audit Committee consultant with meeting preparation, including review of the agenda for Ralph M. Brown Act compliance. Over the years and based on direct experience in advising the Auditor and Audit Committee, this Office has noticed issues with the Auditing Function that warrant review and possible action.[9]

I. Potential Charter Changes to Ensure Auditor Independence and Accountability.

The Auditor and the two auditors who preceded him have sought to define the meaning of independence under the Charter, and my Office has issued numerous memoranda defining the meaning of that term. See, for instance, 2014 City Att'y MS 304 (2014-16; Aug. 4, 2014); 2011 City Att'y MS 683, (2011-10; Aug. 12, 2011); City Att'y MOL No. 2018-4 (Mar. 13, 2018). The Auditor's argument for legal counsel independent of the City Attorney's Office is not new. Former Auditor Eduardo Luna advanced the argument for years, as did Interim Auditor Kyle Elser. In this Office's view, even if the voters agree that the Auditor should have legal counsel separate from the City Attorney's Office, there remain systemic issues that compromise the Auditor's independence that have not been discussed since the creation of the Auditor position in 2008. Below are two issues worthy of consideration.

A. Should the Council appoint the Auditor?

On July 31, 2019, the Rules Committee approved then-Audit Committee Chairman Scott Sherman's proposal to place amendments to the Auditor selection process before the voters. As amended, the Audit Committee and the IBA would screen and recommend to Council at least three qualified candidates for appointment as the City's Auditor.[10] Chair Sherman's proposal – Measure D on the March 2020 ballot – argued that the Mayor should not be involved in hiring the Auditor because it was "like having the fox guard the hen house." He argued that by substituting the Council for the Mayor, "Prop D removes the fox and replaces it with a guard dog." He also argued that Measure D would fix the current flaw in the City Auditor selection process by removing the entity that the Auditor would audit from the hiring process, thus "offer[ing] complete independence from the Mayor and mayoral staff." Ballot Pamp., Gen. Elec. (Mar. 3, 2020), argument for Prop. D at 80.

[9] Before being elected City Attorney in 2016, Mara Elliott advised the Audit Committee between 2009 and 2016, and the Auditor between 2009 and 2010. She previously advised the County of San Diego Auditor and Controller for 5 years and managed its outside auditing function as Deputy General Counsel at MTS.,

[10] Following nationwide recruitment through a reputable hiring firm, former Mayor Faulconer put forward a female candidate selected by a hiring committee comprised of Audit Committee Chair Sherman, the IBA, the City Attorney, an Audit Committee member, and the Chief Operating Officer. Chair Sherman's proposed Charter amendment derailed the hiring process, and the City began anew. The candidate who had previously accepted the position withdrew from the hiring process, clearing the way for Sherman's preferred candidate. The Council appointed Andy Hanau to the position in November 2020.

By substituting the Council for the Mayor in the hiring process, Measure D effectively exempted the City's legislative branch from audits, perhaps inadvertently creating the very same situation Measure D sought to fix. A review of audits performed since the creation of the Auditing Function reveals that the Auditor has never audited the City's legislative branch,[11] including programs like Community Projects, Programs, and Services, which allocate funding to community groups. This vacuum of oversight and accountability potentially exposes the City to liability and leads us to question whether that was the result voters desired when they created the Auditing Function in 2008.

The Council may wish to discuss whether the City's legislative branch should be exempt from audits. If the answer is no, then the Council should consider requesting that the voters create an appointment process that excludes City officials. Alternatively, the Council could ask the voters if they prefer to elect an Auditor who is directly accountable to the people of the City of San Diego.

B. Should the Auditor be Elected?

Although CRC members agreed that the Auditor must be independent, there was a split in opinion as to the method for doing so. Some believed the Auditor should be elected and accountable to the voters, and others advocated for selection by the Mayor in consultation with the Audit Committee followed by Council confirmation. The CRC Report notes:

> [T]he only disagreement was over what method would best achieve auditor independence. Those who favored either election or an appointment process devoid of participation by management believed that these two selection methods would ensure that the City Auditor would be independent in both fact and appearance. Those who favored the Committee recommendation held that appointment would assure the competence of the auditor and that therefore the recommendation above would secure both the independence and the expertise that San Diego needs in its City Auditor.

CRC Report at 18.

The IBA Report observed: "It is likely that requiring the Auditor General[12] to be elected would secure the greatest degree of independence. In this case, the establishment of an Audit Committee would probably be unnecessary, as the Auditor General would report directly to the voters of the City of San Diego." IBA Report 06-35 at 7 (Aug. 30, 2006). The IBA explained that the "election of an Auditor General would first require a Charter change, by the vote of the people at an election, and then a subsequent election to choose the Auditor General. This makes the timeframe for implementing an elected position several years out, at the very least." *Id*. at 8.

[11] The Auditor does perform close-out audits of outgoing elected officials as required by Article VII, Section 111 of the Charter.

[12] The CRC referred to the Auditor in its report as the "Auditor General." The measure presented to the voter by the Council changed the title to "Auditor."

Due to the immediate need to respond to the crisis at hand by creating an independent auditing function, the City asked voters to approve an appointed Auditor instead of an elected Auditor who would be accountable to City voters. As originally approved by the voters in 2008, the Mayor would recommend an Auditor to the Council, and the Council would ultimately make the appointment.

The Council may wish to revisit whether the current structure provides the independence the voters envisioned. In the current structure, the Council appoints the Auditor to an initial 5-year term, determines whether to extend that term, sets his salary and budget, ultimately determines whether he should be terminated, occupies two of five seats on the Audit Committee, and is effectively exempt from being audited.

The cities of Oakland, Los Angeles, Berkeley, and Long Beach all have elected auditors who are accountable to the people and not to audit committees, therefore holding all branches of government accountable. See Attachment 4 for a brief synopsis. An elected Auditor has true independence to ask uncomfortable questions and to perform politically sensitive audits.[13] Excluding the legislative branch from audits creates an accountability loophole.

C. Are the Auditor's Areas of Focus Consistent with Voter Intent?

The fundamental reform suggested in the Kroll Report addressed the process by which the City budgets, monitors, and reports its finances. Kroll Report at 6. The authors suggested creating an independent Auditor who would be responsible "for internal audits of the City's (1) internal controls; (2) financial accounting, reporting and disclosure; (3) operations; and (4) fraud, waste, and abuse." Kroll Report at 250. The Audit Committee was established to "ensure objective oversight of the City's financial reporting process." Kroll Report at 251.

The Kroll Report recommended that the Auditor and Audit Committee give equal weight to all four areas of fiscal concern, yet the Auditor has traditionally focused on performance audits and not financial accounting.[14] Although performance audits are valuable, they are a review of past conduct coupled with suggestions to prevent the recurrence of identified problems.[15]

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[13] See Kerry Chan, *Oakland City Official's Misuse of Power Sparks Audit*, The Pioneer, May 9, 2013, http://thepioneeronline.com/16556/metro/oakland-city-official%E2%80%99s-misuse-of-power-sparks-audit/; and *Oakland City Auditor's Report: "A Culture of Interference,"* OakTalkHere Blog, March 22, 2013, https://oaktalk.com/2013/03/22/oakland-city-auditors-report-a-culture-of-interference/, which documents elected City Auditor Ruby's audit of the Oakland City Council that exposed unethical misuse of power from elected officials stretching back for years.

[14] Performance audits are defined as audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action and contribute to public accountability. U.S. Government Accountability Office, (April 2021). *Government Auditing Standards: 2018 Revision, Technical Update April 2021*, ¶1.21, at 10-11, 217 (Publication No. GAO-21-368G), https://www.gao.gov/assets/gao-21-368g.pdf.

[15] Note, for instance, that the Auditor never proactively questioned the purchase of 101 Ash Street, or subsequent upgrades.

Further, performance audits are vulnerable to being driven by the agenda of the Councilmembers assigned to the Audit Committee. For instance, Chair Sherman had an interest in reforming community planning groups (CPGs) and advocated for a performance audit of CPGs that would support his policy agenda. Audit Report, OCA19-013 (Dec. 13, 2018).

The Council may wish to provide more specificity in the Charter to ensure equitable oversight of the City's finances and prioritize the community's interests over those of the Councilmembers who are assigned to the Audit Committee.

II. Potential Changes that Would Strengthen the Audit Committee.

The City has faced challenges filling Audit Committee vacancies for at least five years. It often recruits members from outside City limits because, despite being the eighth largest city in the United States, applicants are scarce. This does not seem to be the case for other jurisdictions.[16] The Council may wish to dig deeper to understand why it's challenging to fill positions and whether the City compromises applicant independence and qualifications to address vacancies.

A. Should Conflicts of Audit Committee Members Be Vetted Before Appointment?

Attracting Audit Committee members has been a challenge for many years, and the Council may wish to understand why. In 2018, the IBA requested that the Charter be amended to address the City's difficulty in recruiting and seating Audit Committee members. In a memorandum to City Clerk Elizabeth Maland dated January 2, 2018, the IBA described the difficulty in recruiting Audit Committee members and advocated for eliminating the requirement that two applicants be considered, opting instead for the ability to reappoint an incumbent member without recruiting competition. The staff report accompanying this request did not analyze what impact, if any, the proposed reappointment process would have on the City's oversight function, nor did it discuss the Kroll or CRC Reports.

At the Rules Committee on January 10, 2018, IBA analyst Lisa Byrne explained that the Charter amendment would expedite appointments to the Audit Committee and preserve resources. As the Charter existed then, the screening committee was required to present at least two qualified candidates per open position to the Council. Ms. Byrne said that "oftentimes the lack of at least two applicants has stalled the appointment process extending it by multiple months." The proposed amendment did not address whether the Audit Committee member seeking reappointment would first be evaluated or rescreened and contains no mechanism for reassessment of the candidate. The Council approved the placement of Measure M before the voters in November 2018. The Measure, which passed, did not include any arguments in favor of or against the proposal.

[16] The Board of Port Commissioners recently informed this Office that there is an abundance of qualified applicants for open positions on its Audit Committee.

There are numerous resources available to guide the creation and continued maintenance of public sector audit committees, including the publication released in June 2014 and titled "Global Public Sector Insight: Independent Audit Committees in Public Sector Organizations" by The Institute of Internal Auditors (IIA). See attachment 5. The guide advises that Audit Committee performance be assessed from time to time and includes tools for self-assessment. Criteria for assessment of individual members include whether the audit committee members conduct themselves in a "professional statesmanlike manner with internal and external stakeholders," are credible based on interactions, are independent and objective, and are consistently prepared for meetings, among other attributes. *Id*. at 19. The City does not currently evaluate its Audit Committee members, which the Council may wish to consider since the Charter now allows members to serve a second term without soliciting competition. In addition, the Council may want to consider updating the San Diego Municipal Code to require the Audit Committee to periodically self-assess to ensure it is performing at its best. In the 14 years since its creation, such as assessment has never occurred.

In addition, the Charter requires that public members of the Audit Committee "possess the independence, experience, and technical expertise necessary to carry out the duties of the Audit Committee," but these qualifications are not explained, which the City may want to address through Charter amendments. Conflicts may exist on the current Audit Committee that violate the Charter's call for independence. Of the three public appointees to the current Audit Committee, one is a former colleague of the current Auditor who now works as an auditor for SANDAG. Another public appointee serves on SANDAG's audit committee, which oversees SANDAG's auditing function, meaning that there exists an employer-employee relationship on the City's Audit Committee that may influence decision-making.[17] The member who serves on the SANDAG audit committee frequently contributes to campaigns for elective office, including that of a current elected Audit Committee member. Although it is legal for a public Audit Committee member to make campaign contributions to an elected colleague on the Audit Committee, it could cause the public to question the committee's objectivity. *See* U.S. Government Accountability Office, (April 2021). Government Auditing Standards: 2018 Revision, Technical Update April 2021, ¶¶3.19-3.22, at 29-30 (Publication GAO-21-368G), https://www.gao.gov/assets/gao-21-368g.pdf ((GAS or GAO-21-368G). The third public appointee resides outside of City limits.

B. Should Councilmembers Seated on the Audit Committee Meet Minimum Qualifications?

The Audit Committee is "an independent body" comprised of two Councilmembers and three public members. The public members must "possess the independence, experience, and technical expertise necessary to carry out the duties of the Audit Committee. This expertise includes knowledge of accounting, auditing, and financial reporting. The minimum professional standards for public members must include at least 10 years of experience as a certified public accountant or as certified internal auditor, or 10 years of other professional financial or legal experience in audit management." San Diego Charter § 39.1.

[17] See https://www.sandag.org/index.asp?committeeid=107&fuseaction=committees.detail

The CRC acknowledged that in recommending this hybrid Audit Committee makeup of public members with high degrees of specific expertise and elected officials with no required expertise it "was unable to follow the Kroll recommendation" that the Audit Committee consist "primarily of individuals with expertise in accounting, auditing and financial reporting" to "provide the City with needed oversight of its fiscal affairs." CRC Report at 16. The CRC stated it "would prefer to follow the Kroll model more fully" noting that the Council "may or may not at any given time have a sufficient number of members qualified to serve on its Audit Committee." CRC Report at 17. Despite this being the "broad consensus" of its members, the CRC noted that the City Charter would need to be amended to allow creation of an Audit Committee without Council members.

We further not that the Audit Committee does not receive training pertinent to their role. Audit Committee members are left to educate themselves and obtain the training they need to perform their responsibilities for the City. The City should consider employing a consultant to provide Audit Committee members with the training and guidance they need to properly assess the City's finance and accounting, business, auditing, risk management, compliance, and information technology. This training should be conducted, at a minimum, when a new Audit Committee member joins the committee. Currently, Audit Committee members only receive training provided by this Office on municipal subjects like open meeting laws.

C. Members of the Audit Committee Must Remain Objective at All times to Earn the Public's Trust.

The conduct of the Audit Committee's members is critical to credibility. In its guide, The IIA, "[i]n addition to being independent from the organization, audit committee members are expected to conduct their work in a diligent and professional manner; demonstrate inquisitiveness, outspokenness, and courageousness; and collectively be knowledgeable of, or have expertise in, finance and accounting, business, auditing, risk management, compliance, and information technology." The Institute of Internal Auditors, *Global Public Sector Insight: Independent Audit Committees in Public Sector Organizations*, at 5, June 2014, https://global.theiia.org/standards-guidance/Public%20Documents/Independent-Audit-Committees-in-Public-Sector-Organizations.pdf. "[A]udit committees provide oversight by offering objective advice and recommendations to the board [here, the Council] on whether the organization's governance, risk management, and internal control processes are suitably designed and working as intended to achieve the objectives. Audit committees help build trust and confidence in how the organization is managed. The audit committee should exercise due care in fulfilling its oversight responsibilities." *Id*. at 7.

To that end, Audit Committees should be objective and not political, and should not use the Audit Committee to assail employees of the City departments audited by the Auditor. Their conduct must be beyond reproach to instill confidence in City taxpayers. A consultant to advise on the conduct of Audit Committee meetings may be appropriate.

D. Whether the City Would Attract More Competition for Public Audit Committee Appointments if it Reduced the Meetings to Four Times per Year or Compensated Public Members for Their Time.

In support of the 2018 Amendment, the IBA explained that it is extremely challenging to recruit Audit Committee members. This is not a new issue, and we cannot explain why recruitment is a problem, as the IBA widely advertises vacancies among professional organizations. The City should consider assessing whether Audit Committee appointments can be made more enticing to the public by following recommendations in the Kroll Report which, for instance, suggested quarterly meetings instead of monthly meetings, and compensation for public Audit Committee members.[18] Kroll Report at 252.

E. Whether the Audit Committee Should be an Advocate or an Overseer.

At the CRC's urging, the voters approved amendments to the Charter to create an Audit Committee with responsibilities described in Charter section 39.1:

> [O]versight responsibility regarding the City's auditing, internal controls, and any other financial or business practices required of this [Audit] Committee by this Charter.
>
> [D]irecting and reviewing the work of the City Auditor, and the City Auditor must report directly to the Audit Committee.
>
> [R]ecommend[ing] the annual compensation of the City Auditor and annual budget of the Office of City Auditor to the City Council and conducts an annual performance review of the City Auditor.
>
> [R]ecommend[ing] to the City Council the retention of the City's outside audit firm and, when appropriate, the removal of such firm.
>
> [M]onitor[ing] the engagement of the City's outside auditor and resolv[ing] all disputes between City management and the outside auditor with regard to the presentation of the City's annual financial reports.

San Diego Charter § 39.1.[19]

As explained to voters on June 3, 2008, Proposition C would create a reporting structure as follows:

> The Audit Committee would oversee the City's internal auditing and control practices; direct the Auditor's work; and recommend

[18] The City has long struggled to recruit Audit Committee members. A recently replaced Audit Committee member, who was recruited by the former Auditor, served beyond two terms due to difficulty recruiting.
[19] San Diego Municipal Code section 26.1701 sets forth additional Audit Committee responsibilities.

> the City's outside auditor, monitoring its work. The Audit Committee would consist of two Councilmembers, one of whom would chair the Committee, and three public members. The public members must have at least 10 years of professional financial experience, and would be appointed from candidates recommended by a screening committee comprised of the Chief Financial Officer (CFO), the IBA, a Councilmember, and two outside financial experts.

Prop. C, Primary Elec. (June 3, 2008)

In support, proponents argued that Prop C would put needed checks and balances back into the City Charter by placing three "independent financial experts" on the five-member Audit Committee, and therefore creating a majority of members who were "not city employees or politicians." Further, that "[u]nder this system, responsibility for reform is shared by independent financial experts, the mayor and the council + each providing a check and balance to the other." Ballot Pamp., Primary Elec. (June 3, 2008), argument for Prop. C at 16.

Over the past few years, the Audit Committee has functioned as an advocate for the Auditor and not as an overseer. For instance, the Audit Committee has: (a) publicly supported the Auditor's efforts to reveal the identity of whistleblowers in violation of State law and supported his effort to seek a "second opinion" on this unambiguous matter, (b) supported the Auditor's attempts to meet with the City's legislative body behind closed doors in violation of the Brown Act, a law that, like the whistleblower statute, exists to protect the public from government abuse, (c) advocated for the disclosure of attorney work product and attorney-client privileged communications without authority from the privilege holder, and (d) called for "independent counsel" that will agree with the Auditor's interpretation of the law, an "attorney shopping" practice that was faulted in the Kroll Report.

With the passage of Measure D, the checks and balances that sold the public on the Charter Amendments in 2008 no longer exist as the Mayor no longer serves as a monitor. The Auditor's proposal further weakens accountability by removing the elected City Attorney from reviewing the Auditor's and Audit Committee's work and actions. As the Kroll and CRC Reports describe, the Audit Committee's oversight function cannot be overstated. They are the Auditor's bosses, and accountability is essential to earning the public's trust. The Audit Committee must do its job, or the unelected Auditor is accountable to no one – and every City official should be held accountable.[20] Query whether giving the unelected Auditor authority commensurate with that of his bosses – the ability to hire legal counsel of his choosing whenever he pleases – creates the accountability voters envisioned.

[20] When covering allegations of misconduct at the City Auditor's Office in 2013, the Voice of San Diego appropriately observed: "But the auditor and his staff, like all city employees, should be held accountable as well. That principle is amplified when it comes to the watchdog for everyone else." Liam Dillon, *Why the Auditor Investigations Matter*, Voice of San Diego, Apr. 8, 2013, https://www.voiceofsandiego.org/topics/government/why-the-auditor-investigations-matter/.

III. Whether Authorizing the Auditor and Audit Committee to Hire their own Legal Counsel Instead of Using the City Attorney's Office Bolsters Independence that Protects the City.

Over the last few years, the Auditor has claimed a conflict and requested his own attorney or "second opinion" counsel when the advice rendered by the City Attorney's Office does not support his desired outcome.[21] When disputes have arisen, the Office has accommodated the Auditor's request for a second opinion at additional expense to the General Fund. The language proposed by the Auditor indicates he and his immediate supervisor, the Audit Committee, may seek separate legal counsel, which they refer to as "independent counsel," when they deem it appropriate and, in the City's "best interests."

A. Neither the Kroll nor CRC Reports Recommended Independent Counsel for the Auditor Instead Relying on the Independence of the Elected City Attorney.

Notably, the Kroll and CRC Reports did not discuss or consider independent legal counsel for the Auditor or Audit Committee. In fact, in its review of the events that led to the pension crisis, the Kroll Report faulted SDCERS for replacing its legal counsel, who had advised against underfunding the City's pension system, with new counsel selected to agree with the illegal financial plan developed by SDCERS officials. This Office fails to see how a rubber-stamp by a "independent" outside law firm will provide the Auditor and Audit Committee with unbiased legal opinions and protect San Diegans.

It is my Office's view that even the Auditor must have oversight. An elected City Attorney is 100% independent and accountable to the people, and not to any one individual or department. It is important to note that we were unable to find a single auditor in the State of California that has the arrangement proposed by the Auditor; all use their City's appointed or elected City Attorney for legal advice. Before moving forward with the proposal, the Committee may wish to have the IBA review and report on the practices of other auditors throughout the State, as well as the costs and operational impacts associated with setting up the function.

In addition, the Charter already authorizes the use of outside counsel when my Office has a conflict of interest, lacks expertise, or does not have sufficient resources available to handle a particular matter. San Diego Charter § 40. The need to retain outside legal counsel rarely materializes. Accordingly, it is worth exploring whether a Charter revision is necessary when the need for outside counsel is rare.

[21] *See* Op. City Att'y LO-2020-1 (Sept. 8, 2020, rev'd Sept. 9, 2020). Also see City Att'y MS 2020-3 (Feb. 6, 2020), which discusses the Auditor's erroneous assertion that a conflict exists between his department and the City Attorney's Office, attached in Attachment 6.

B. The Ethics Commission is a Regulatory Agency With Enforcement Power.

The Auditor claims to be an enforcement arm of the City, like the Ethics Commission, and should therefore have his own attorney. The Auditor is not an enforcement or regulatory arm of the City, and his position that he has that authority conflicts with Government Auditing Standards and the City Charter. San Diego Charter § 39.2.[22]

The Auditor and Ethics Commission have fundamentally different roles and legal needs. The Ethics Commission is a regulatory enforcement entity with the power to enforce the City's governmental ethics laws and to issue legally binding administrative enforcement orders regarding violations of these laws. *See* San Diego Municipal Code (SDMC) §§ 26.0414(e) and 26.0439. Furthermore, the Ethics Commission has the authority to levy fines of up to $5,000 per violation. SDMC § 26.0440. Their enforcement role necessitates the need for subpoena power and independent counsel. San Diego Charter § 41(d).

The Auditor, on the other hand, provides recommendations on how to improve the efficiency and effectiveness of City departments and programs, and on how City management should address substantiated findings of fraud, waste, or abuse. *See* San Diego Charter § 39. As noted in a prior Memorandum, the Auditor does not oversee City departments and cannot assume their functions, particularly when the San Diego Charter assigns such functions to City officials or departments:

> This independent City audit system meets necessary GAGAS independent standards because "the audit function is organizationally placed outside the reporting line of the entity under audit and the auditor is not responsible for entity operations." GAGAS § 3.13. It permits the City Auditor to fulfill an essential City role: to provide "objective nonpartisan assessment of the stewardship, performance, or cost of [the City's] policies, programs, or operations." GAGAS § 1.01. This permits the public, City Council, and other City Officials to know how well or poorly the City manages public resources and provides public services, and holds accountable those City Officials who perform poorly.

City Att'y MOL No. 2010-12 (June 10, 2010).

Complex legal issues arise if the Auditor now seeks to assume an enforcement role and seeks legal counsel of his choosing for this purpose. An enforcement role contradicts "Government Auditing Standards" (GAGAS) (referred to as "GAS" in the San Diego Charter) and the San Diego Charter. Further, the broadening of the Auditor's role may impermissibly impede the Charter responsibilities delegated to other City officials.

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[22] The Auditor claims he "investigates" the City Attorney's Office but offers no authority in support of this expansive view of his role. The Auditor raises issues of concern through audits but cannot force implementation of recommendations. As he has no enforcement power, he must refer suspected criminal activity or wrongdoing to the appropriate law enforcement agencies, including the City Attorney's Office.

C. The Commission on Police Practices is an Investigatory Body.

The Commission on Police Practices is "an investigatory body of the City of San Diego, independent of the Mayor and the Police Department." San Diego Charter § 41.2. As described in the ballot summary, the Commission "would be required to independently investigate all deaths occurring while a person is in the Police Department's custody, all deaths resulting from interaction with a City police officer, and all City police officer-related shootings. The Commission may also investigate allegations against officers of inappropriate sexual conduct, physical assault, and domestic violence." Ballot Pamp., Gen. Elec. (Nov. 3, 2020), argument for Measure B at 34. It would also "be required to receive, register, review, and evaluate all complaints against City police officers," and "may investigate complaints, unless the complainant has requested that a complaint be handled without investigation or where no specific allegation or police officer can be identified." *Id.* "The Commission would be required to review the Police Department's compliance with reporting laws" and "have authority to review and advise on Police Department investigations, policies, and imposition of discipline," with the Police Chief retaining authority over discipline as provided in the San Diego Charter. *Id*. at 35.

The San Diego Charter does not ascribe to the Auditor the ability to make recommendations to the audited entity and undertake enforcement action. Rather, the Auditor reports to an oversight body – the Audit Committee – which can refer Auditor recommendations to the City Council for consideration and possible action. The Auditor can monitor recommendations he has made, but he cannot force action; to assume he can is overreach.

IV. City Attorney Concerns with the Language as Proposed.

The measure as proposed has significant flaws that must be fixed before it can be presented to the voters. It states, in part, that the Auditor and the Audit Committee would have authority to "retain legal counsel, independent of the City Attorney, for any project or task if the City Auditor or the Audit Committee determines it is in the best interest of the City to do so. Such independent legal counsel would serve under the direction of the City Auditor and the Audit Committee, except as otherwise required by the Rules of Professional Conduct of the California State Bar."

We will not provide an in-depth analysis at this time other than to point out that extending the same authority to hire legal counsel to the Auditor and the Audit Committee, to whom he reports, will likely lead to disputes between the two and a lack of accountability to the Council and the public. The reference to State Bar rules does not make sense, i.e., does the language mean the City Attorney's Office can veto a counsel retention or a legal opinion rendered if State Bar rules allow? And there is no arbiter if the City Attorney's Office disagrees with outside counsel, thus placing the dispute in the hands of a court. It's not clear that entrusting an unelected City Official and appointed body with discretion to determine what is in the City's "best interests" instead of those elected to serve the public provides appropriate transparency and accountability. And how do we resolve competing loyalties between the Auditor's attorney and the City's attorney?

Putting legal concerns aside, it is this Office's position that if the Council wishes to proceed with the proposal, there should be a complete separation between the City Attorney's Office and legal counsel hired by the Auditing Function. This means that the Office would not advise at Audit Committee meetings, would not review or advise on legal advice rendered by legal counsel retained by the Auditor and the Audit Committee, and would not defend conduct by these bodies that results in litigation or legal disputes. Outside legal counsel carries malpractice insurance that should adequately protect the Auditor and Audit Committee if advice rendered is improper, illegal, or negligent. Further, outside counsel should assume the defense of Auditor and Audit Committee decisions instead of leaving the aftermath of such decisions and actions to the City Attorney's Office.

A. The City Attorney's Office Should Not Bear Responsibility for Legal Problems Created by Outside Counsel or be Forced to Defend that Legal Advice in Court.

Recent incidents at the San Diego Housing Commission (Housing Commission) exemplify our desire to be extricated from legal guidance provided to the Auditor and Audit Committee by separate counsel. The Housing Commission has its own legal counsel separate and independent of the City Attorney's Office.

In the Spring of 2021, this Office became aware of a potential conflict of interest involving real estate transactions approved by the Housing Commission and vetted by the Housing Commission's outside counsel. The Office reviewed the situation and confirmed that the Housing Commission's purchase of two hotels to be used to house unsheltered individuals was potentially void because the Housing Commission's real estate consultant invested heavily in a company that owned one of the hotels. My Office identified other issues of concern, including the breach of internal policies intended to provide accountability and transparency in real estate transactions. The Council, acting as the Housing Authority, directed my Office to bring a lawsuit to recover the real estate consultant's ill-gotten gains, which we did. We are now in the middle of complex and time-consuming litigation that is occupying the time of one of my most senior litigators to the detriment of her other cases. She is litigating against defendants who are represented by four large law firms. My Office does not have sufficient resources and will likely need to retain outside counsel to assist the litigator.

In addition, depending on Housing Commission referrals to the Housing Authority or requests by members of the Housing Authority to review a Housing Commission matter, three senior DCAs monitor Housing Commission meetings, duplicate actions by the Housing Commission's legal counsel by re-reviewing all legal work referred to the Housing Authority, and drafting letters to the Housing Commission intended to ensure appropriate due diligence has occurred, and further legal issues will not arise. The taxpayers pay for legal services that duplicate the work performed by legal counsel for the Housing Commission. We do not have extra staff to perform this oversight function, yet we're doing it until a permanent solution is put into place. The Council will be creating a new committee this week that will review Housing Commission governance for potential reforms. We will staff that Committee and assist them with their work, which will likely go on for a couple of years and include modifications to the San Diego Municipal Code and new or amended policies, processes, and procedures. This

unanticipated and unbudgeted work impacts my Office's ability to focus on core City issues. It also arises from work my Office did not perform yet now must correct.

The structure the Auditor proposes creates a situation that is no different from that of the Housing Commission. If experience proves true, and legal issues arise, the Council will look to my Office to address and resolve resulting problems or to defend individuals who acted on poor legal advice or advice intended to appease the Auditor and Audit Committee and not to protect the City. My Office does not want to accept that dubious responsibility and prefers to have no role whatsoever in advising the Auditor and Audit Committee if the Auditor is awarded easy access to compliant counsel.

B. As Proposed, if the Auditor or Audit Committee Do Not like the Legal Advice Rendered, They Can Seek the Advice of Outside Counsel, a Practice Faulted in the Kroll Report.

The work of DCAs who advise the Auditor is scrutinized not on legal merit but based on whether they agree with the Auditor's desired outcome. If the DCAs' legal advice does not match the Auditor's desired outcome, he claims there is a "conflict" that interferes with his independence. This has been the standard for a couple of years, as the Auditor's request for separate legal counsel reached a fever pitch during the last election cycle while the City Attorney was on the ballot.

The circumstances described above have created a difficult work environment such that it's a challenge to assign DCAs to the Auditor or the Audit Committee because they know that their work will be assessed through a political lens and ultimately rejected if it's inconsistent with the Auditor's desired result. They also know a public fight over their work will ensue, leading to negative media coverage and a demand by the Auditor for a second opinion in the name of "auditor independence." We have reduced the likelihood of workplace grievances and morale issues by assigning a group of DCAs to assist the Auditor and assigning them work on an alternating basis.[23]

C. As Proposed, the Auditor or Audit Committee Would Direct the Work of Outside Attorneys "For Any Project or Task" if They Think it is "in the City's Best Interest."

Voters typically entrust elected officials with determining whether the City's interests are served and do not entrust such decisions to an unelected City official or an appointed City committee. This Office cautions the Council to tread carefully with the delegation of authority in this manner and to consider (1) whether this is the transparency and accountability voters expect, and (2) whether Council is prepared to square off with the Auditor or Audit Committee if the Council disagrees with actions taken by either body. As we've witnessed of late, the delegation

[23] The Committee may want to review video from last year's Audit Committee meetings, particularly during the summer months. Newly appointed Chairman Stephen Whitburn has reset the tenor of these meetings and we are hopeful that the Audit Committee will again find its footing.

of authority to the Housing Commission has created unintended consequences that we're wrestling with today.

We note, too, that there is risk in placing oversight of the legal function in the hands of non-attorneys. When hiring outside counsel, municipal law specialists in my Office hire and monitor outside counsel to ensure their work is competently performed, consistent with the scope of work, and accurately invoiced. Auditing staff and the Audit Committee are not trained to undertake this function.

CONCLUSION

The City of San Diego is still recovering from the devastating decisions that led to the City's underfunding of its pension. To ensure mistakes that ruined careers and nearly led to municipal bankruptcy do not recur, City voters wisely heeded the advice rendered in the Kroll and CRC reports: they created an Auditing Function that would demand accountability by all City officials. This Office urges a thoughtful and inclusive approach that allows for meaningful discussion before undertaking additional significant changes to the Auditing Function. Ultimately, decisions that impact the Auditing Function should ensure accountability, vigorous oversight, and trust in the checks and balances important to our City's fiscal health.

MARA W. ELLIOTT, CITY ATTORNEY

By _____
Mara W. Elliott
City Attorney

MWE:sne
RC-2022-1
Doc. No. 2894331
Attachment: See below
cc: Jay Goldstone, Chief Operating Officer
Paola Avila, Chief of Staff, Office of the Mayor
Charles Modica, Interim Independent Budget Analyst

List of Attachments

1. Excerpt October 4, 2007 San Diego Charter Review Committee Final Report
2. The Executive Summary to the "Report of the Audit Committee of the City of San Diego: Investigation into the San Diego City Employees' Retirement System and the City of San Diego Sewer Rate Structure," dated August 8, 2006
3. Excerpts from the Kroll Report
4. Elected Auditors
5. "Global Public Sector Insight: Independent Audit Committees in Public Sector Organizations" by The Institute of Internal Auditors (IIA).
6. City Attorney Mara Elliott's Miscellaneous Memorandum MS-2020-3, titled "Preliminary Response to Interim Auditor's Request for Independent Legal Counsel", 2020.

ATTACHMENT 1

2007 SAN DIEGO CHARTER REVIEW COMMITTEE

FINAL REPORT

October 4, 2007

management-related functions. In San Diego, there were problems because, as Kroll noted, "the auditor audits his own work." In examining the duties of the City Auditor and Comptroller, as they appear throughout the Charter, it is clear that this officer is a Comptroller rather than an Auditor. Only one Charter section deals with the auditing functions of this Officer, and that section concerns the retention of the City's outside auditors. The recommendation is to re-name the City Auditor and Comptroller the CFO; other recommendations offered below would transfer the auditing responsibilities to a separate officer and its oversight committee. The Committee supported the recommendation unanimously, and no one who addressed the Subcommittee or Committee raised any concerns about it.

The second part of the recommendation alters the appointment process for the City Treasurer. The City Treasurer reports to the CFO (City Auditor and Comptroller) in disbursing City funds to honor the CFO's warrant or check-warrant. The Kroll Report recommended that the City clarify the reporting relationship that exists between the CFO and the City Treasurer. To require that the Council confirm the CFO, and then confirm another officer who acts as the CFO's subordinate, does not make sense and clouds accountability. To establish ambiguous reporting relationships and provide subordinate officers with independent power bases is a recipe for trouble. Only with clear lines of responsibility is it possible to fairly assess performance, and place credit and blame appropriately. The Committee supported this recommendation unanimously, and again, did not receive any concerns about it.[1]

VOTE: SEPTEMBER 21, 2007; 13 AFFIRMATIVE, 0 NEGATIVE, 2 ABSENT. VOICE VOTE: AFFIRMATIVE = CHANNICK, CLEVES ANDERSON, DAVIES, GORDON, JONES, KWIATKOWSKI, MCDADE, MUDD, NELSON, ROTH, SORENSEN, SPARROW, WILSON; ABSENT = BERSIN, MILLIKEN.

6. Adds a new Section 39.1 (Audit Committee) to establish an Audit Committee consisting of five members composed of two members of the City Council, one of whom shall serve as Chair, and three members of the public. The public members shall be appointed by the City Council from a pool of candidates to be recommended by a majority vote of a screening committee comprised of the Chief Financial Officer, the Independent Budget Analyst, the City Attorney or his or her designee, a member of the City Council and two outside financial experts.

The absence of an Audit Committee was another structural deficiency that the Kroll Report emphasized. Kroll recommended that the City establish an Audit Committee, consisting primarily of individuals with expertise in accounting, auditing and financial reporting. This would provide the City with needed oversight of its fiscal affairs. The City was unable to follow the Kroll recommendations in this regard because of conflict with the City's Charter provisions regarding the delegation of legislative responsibility. Consequently, the City Council created an Audit Committee, which

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[1] The Committee voted this language on August 23, and at that time the vote included the City Treasurer's appointment. However, the Committee returned to the issue on September 21 so as to ensure full notification had been performed. During the September 21 vote, the Committee did not expressly include the City Treasurer in the motion and vote. Consequently, the Committee voted on September 27 to approve the recommended appointment process for the City Treasurer. The Committee approved the recommendation by voice vote; the margin was 14 affirmative, 0 negative, 1 absent. The absence was that of Committee member Lei-Chala Wilson.

has already begun to yield benefits in the form of increased transparency. Yet the San Diego Charter Review Committee would prefer to follow the Kroll model more fully, because the majority on the Audit Committee it contemplated would be comprised of financial experts. The Council may or may not at any given time have a sufficient number of members qualified to serve on its Audit Committee. The recommendation above would institutionalize an Audit Committee, rather than leaving it up to the Council to continue this oversight role, and ensure that the majority of Audit Committee members possess the requisite qualifications to perform the needed monitoring. There was broad consensus favoring this recommendation by both the Subcommittee and the full Committee. The only opposition appears to have centered on the issue of accountability; one Committee member thought that the Council's Audit Committee should continue to provide oversight of auditing. If the Council did not place members with adequate expertise on the Audit Committee, then they could be held accountable by voters. The City Attorney has opined that the creation of an Audit Committee which includes anyone other than Council members would require Charter change.

It is imperative that the City seriously consider any responsible measure that could prevent the kind of national publicity that San Diego received for its financial woes of the recent past. The City might never have experienced the assignment of an SEC monitor, failure to release accurate CAFR's, and under-funding of its infrastructure and pension systems, if its Charter had created a proper financial structure. The Committee heard no testimony favoring a return to the financial practices of the past. This recommendation would institutionalize the hard lessons that have been learned. The Subcommittee also formulated possible Municipal Code language delineating the workings of the Audit Committee, in order to clarify its "legislative intent", and the operations that it favored in recommending the concept of such a Committee. The language offered for codification of the Audit Committee's operations appears elsewhere in this Report.

VOTE: SEPTEMBER 21, 2007; 12 AFFIRMATIVE, 1 NEGATIVE, 2 ABSENT. ROLL CALL: AFFIRMATIVE = CHANNICK, CLEVES ANDERSON, DAVIES, GORDON, JONES, MCDADE, MUDD, NELSON, ROTH, SORENSEN, SPARROW, WILSON; NEGATIVE = KWIATKOWSKI; ABSENT = BERSIN, MILLIKEN.

7. Adds a new Section 39.2 (City Auditor) to establish a City Auditor who shall be appointed by the City Manager in consultation with the Audit Committee and confirmed by the City Council. The City Auditor shall be a Certified Public Accountant or Certified Independent Auditor. The City Auditor shall serve for a term of ten (10) years and report to the Audit Committee. The Audit Committee with a four-fifths vote may terminate the City Auditor for cause with a right to appeal to the City Council who can override the Audit Committee's action with a two-thirds vote. Amends Section 111 (Audit of Accounts of Officers) to transfer auditing responsibilities of City Auditor and Comptroller to City Auditor and Audit Committee.

Yet another major remedy offered by the Kroll Report was the creation of an independent auditor, serving in a ten-year term with removal by the Audit Committee for cause or by a supermajority of the City Council. The recommendation follows the Kroll model in most respects. Kroll called the officer the Independent Auditor General, but the Committee found in its research that both Auditor General and Internal Auditor are terms of art, and must be used carefully. The Committee preferred the title City Auditor, with the basic guarantees of independence that the

Kroll Report favored. One small change is that rather than allowing a two-thirds majority of the Council to remove the City Auditor, the Committee favored clarity in reporting relationships. The Audit Committee may remove the officer for cause by a four-fifths vote, but the Council may override the Audit Committee by a two-thirds vote. The Council can prevent the City Auditor from being wrongly terminated, but may not terminate that officer on its own without cause, as the Kroll model would allow. Some proponents favored the recommendation because they contended that the appointment process, long term and for-cause standard for dismissal would ensure the independence of the City Auditor. Some opposed the recommendation because they thought that the only way to grant the City Auditor complete independence would be to either make the office elective or deny the Mayor any role in appointing someone to it. From their perspective, the City Auditor reports to the Audit Committee, and therefore the Audit Committee should have a more significant role in selecting this officer. Others opposed the recommendation because they felt the Council should be authorized to terminate the City Auditor.

Both those members of the Committee that favored the recommendation and those that opposed it thought that the City should have a City Auditor. Both groups wanted this officer to possess authority to perform the kind of thorough, state-of-the-art audits that are proposed for codification elsewhere in this report. Both saw a proper application of the principles of auditing as an improvement that would prevent the City from repeating the financial mistakes of the past. The only disagreement was over what method would best achieve auditor independence. Those who favored either election or an appointment process devoid of participation by management believed that these two selection methods would ensure that the City Auditor would be independent in both fact and appearance. Those who favored the Committee recommendation held that appointment would assure the competence of the auditor and that therefore the recommendation above would secure both the independence and the expertise that San Diego needs in its City Auditor.[2]

VOTE: SEPTEMBER 21, 2007; 7 AFFIRMATIVE, 6 NEGATIVE, 2 ABSENT. ROLL CALL: AFFIRMATIVE = CHANNICK, DAVIES, JONES, MCDADE, MUDD, NELSON, ROTH; NEGATIVE = CLEVES ANDERSON, GORDON, KWIATKOWSKI, SORENSEN, SPARROW, WILSON; ABSENT = BERSIN, MILLIKEN.

8. Amends Section 69 (Fiscal Year and Manager's Estimate) to require that the Manager propose and the Council adopt a balanced budget annually. The term "balanced budget" will mean sufficient funds are available to cover projected expenditures. The Manager shall monitor and report on the budget throughout the fiscal year and if he or she determines there will no longer be sufficient funding from all available sources to cover projected expenditures and encumbrances, the Manager shall propose revisions to keep the budget balanced. Within 60 days of the Manager's submission of these revisions, the Council shall adopt them or offer alternative ones to ensure a balanced budget. The Manager and Council shall take the necessary steps to ensure a balanced budget by the end of each fiscal year. The City shall post copies of the budget on appropriate electronic media, such as the internet, to allow the public full access to the document.

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[2] For a fuller discussion of the position of those Committee members who opposed this recommendation, please see the Minority Report, which is included in the attachments.

ATTACHMENT 2

REPORT OF THE AUDIT COMMITTEE OF THE CITY OF SAN DIEGO:

Investigation into the San Diego City Employees' Retirement System and the City of San Diego Sewer Rate Structure

EXECUTIVE SUMMARY

Overview

Evidence made available in this investigation demonstrates numerous failures of San Diego City government – on the part of government officials and outside professional "gatekeepers" alike – to conform to the law, to adhere to principles of sound governance and financial reporting, and to protect the financial integrity of the City's pension system and thereby the welfare of the City itself. In addition, the evidence demonstrates that City officials deliberately failed to obey legal requirements as to the allocation of costs with regard to the City's sewage treatment with the effect that San Diego homeowners were improperly overcharged on their monthly sewage bills with the excess being unlawfully used to subsidize the sewage costs of large industrial users. The evidence demonstrates not mere negligence, but deliberate disregard for the law, disregard for fiduciary responsibility, and disregard for the financial welfare of the City's residents over an extended period of time. Among the consequences, the City now faces an unfunded actuarial pension liability of $1.4 billion and an inability to gain access to public financial markets. Among the laws violated were the California Constitution, the San Diego City Charter, the San Diego Municipal Code, and the federal securities laws.

In particular, the evidence demonstrates the following:

- The City's pension system was not brought to a crisis merely as a result of abnormally low investment returns. Nor was the system brought to a crisis as a result of a "perfect storm" of unpredictable catastrophes. What brought the system to a crisis was a number of completely foreseeable financial challenges to a pension system debilitated by years of reckless and wrongful mismanagement involving any number of City and pension board officials.
- In enacting the pension system modification commonly referred to as "Manager's Proposal 1" or "MP-1," the City's pension board and the City acted illegally and improperly and thereby allowed the City, with full knowledge and acquiescence of numerous participants in the approval process, to avoid financial obligations imposed by state and local law.
- In enacting MP-1, the City pension board, with the active encouragement of City officials, reduced the flow of funds to the City's pension system in order to benefit the City while creating no compensating benefit for the pension system itself. In so doing, the City pension board violated its fiduciary responsibilities to protect

the financial stability of the system and its independence from political influence.

- With the active encouragement of City officials, the City pension board also violated its fiduciary duties with the passage of the pension system modification commonly known as "Manager's Proposal 2" or "MP-2."

- The passage of MP-2 was unlawful for a number of reasons including that it was predicated upon the fiction that the modification would provide some benefit to the City pension system. In fact, the effect of MP-2 was to further erode pension system viability and the supposed benefits to the pension system from MP-2 were illusory.

- The approval of MP-2 was obtained only through the award of new retiree pension system "benefits," one of which, when stripped of its descriptive veneer, was made available only to a single individual then serving on the pension board whose support was viewed as critical to the passage of the MP-2 modification.

- The City further eroded the financial soundness of its pension system by using pension system assets to finance City retiree healthcare costs.

- Subsequent to the enactment of MP-1 and MP-2, the pension board made false and misleading public statements to disguise the extent to which pension system assets would be insufficient to pay the promised benefits to City retirees.

- Beyond violations of law as to its pension system, the City knowingly failed to comply with federal and state requirements applicable to its municipal wastewater system which mandated that sewer rates reflect the costs of treating sewage and be proportionately allocated to residential and industrial users. Not only did this result in City homeowners being overcharged on their monthly bills for sewage costs with the excessive payments being used to subsidize the City's industrialized water users; the City thereby breached arrangements with the state and rendered itself liable for the return of $265 million in state funds.

- The City's derelictions as to both its pension and wastewater treatment systems resulted in numerous violations of the federal securities laws as the City repeatedly obtained money from public investors through financial statements and related disclosures that were false.

- Among its fraudulent misrepresentations to investors, the City (1) falsely claimed that it was making contributions to its pension system at actuarially determined rates, when in fact it was not; (2) falsely claimed that it was using an "excellent method" of pension funding when in fact its funding method was not in accordance with legal requirements; (3) falsely stated that the City had amended its municipal code to accommodate the pension system modification known as MP-1 when in fact it had not; (4) failed to

disclose the conflicts of interest resulting from the participation of members of the pension board in decisions that both threatened the pension system's soundness and increased their own individual benefits; (5) falsely stated that the cost of a settlement of a lawsuit calling into question the City's pension system funding would not be borne by the City's "general fund" thereby fraudulently implying that the settlement would have no impact on the City; (6) failed to disclose that the funding method used to pay for the retiree healthcare benefits was from the pension system's surplus earnings; and (7) falsely stated that the City believed it was "in compliance with all federal and state law" relating to its wastewater sewage treatment system.

The Underlying Causes

While this conduct was plainly unlawful, the evidence does not demonstrate that City officials set out with the objective of defying legal mandates. Rather, the evidence suggests that at root San Diego City officials fell prey to the same type of corruption of financial management and reporting that afflicted municipalities such as Orange County and such private sector companies as Enron, HealthSouth, and any number of other public corporations. That is, San Diego officials cultivated and accepted a culture of financial management and reporting premised upon non-transparency, obfuscation, and denial of fiscal reality. Under the pressure of short-term needs, City officials gave expedience a higher priority than fiscal responsibility and came to view the law as an impediment to be circumvented through artful manipulation. A rare and abrupt departure from that culture was found in a whistleblower who, contrary to prevailing attitudes at the time, explicitly pointed to governmental inadequacies and falsehoods regarding the City's pension system. Like whistleblowers at any number of public companies, her pronouncement that "the emperor has no clothes" was dismissed out of hand.

Exacerbating the City's culture was a deplorable lack of accountability and organization built within the structure of the City government itself. It seems that no one within City government viewed himself or herself as accountable for the accuracy of City financial disclosures. As to some financial information, responsibility for its preparation was placed upon the City's outside auditor, a structure that is completely at odds with the auditor's role as independent examiner, rather than preparer, of financial statements. This inadequate structure was compromised further by the fact that no one from the City took responsibility for seeing to it that information provided to, or prepared by, the auditor was actually correct. As to financial information the City prepared itself, statements were rendered false not only as a result of design but simply due to incompetence and neglect.

Professionals engaged by the City to serve as "gatekeepers" failed at critical junctures to fulfill their professional obligations. In fairness, some professionals at important points did seek to draw attention to the impropriety of City actions. However, little by little, such professionals were pressured into compliance with the prevailing culture of expedience. For example, pension fund actuary Rick Roeder to his

credit initially offered resistance to MP-2 in correctly asserting that the pension board's role should be independent of the establishment of pension benefits and that the proposal itself was "outside the norm for generally accepted actuarial funding policies." But under pressure from City officials, the clarity of this resistance melted away and, by the end, Roeder had not only given up his opposition but acquiesced in providing tepid endorsement. An outside law firm engaged by the City similarly expressed the opinion that the MP-2 pension system modification was unlawful. When the pension fund administrator decided the proposal should go forward nonetheless, the administrator obtained a differing legal opinion by simply directing the law firm to change its mind. One gatekeeper that did not surrender the strength of its convictions was law firm Morrison & Foerster, which refused to go along with the City's demands. Pension officials had it replaced.

Along the way, special committees were formed, reports issued, and public inquiry made, all creating an appearance of efforts to come to grips with the pension and other problems. However, these efforts too were compromised by the prevailing culture of political expedience. An important illustration was the City Council's formation of a Blue Ribbon Committee to evaluate, among other things, the pension system's problems. That pension review was headed by a business leader who, by all accounts, was determined to do his best to understand and report the underlying truth of the City's pension crisis. However, once the seriousness of the Blue Ribbon Committee's approach became clear, City officials undertook a concerted effort to water down the vividness of its determinations. The publication of even these watered-down determinations was thereafter delayed, as concern was expressed that disclosure of the truth would derail the City's efforts to issue bonds to build a new baseball stadium.

Nor were City officials entitled to believe that the requirements of the law placed upon them less rigorous standards of honesty and accountability than those applicable to comparable officials at public companies. In the wake of the bankruptcy of Orange County, the SEC issued a highly publicized report "to emphasize the responsibilities under the federal securities laws of local government officials who authorize the issuance of municipal securities and related disclosure documents and the critical role such officials play with respect to the representations contained in the Official Statements for those securities." The report stated:

> [T]he antifraud provisions of the federal securities laws impose responsibilities on a public official who authorizes the offer and sale of securities. A public official who approves the issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading; nor may the public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading.

San Diego City officials cannot claim ignorance of these legal requirements. Not only were the events of Orange County the subject of high-profile news reports that would have been followed closely by leaders of municipal government; the legal consequences and lessons of Orange County were communicated both orally

and in writing to the San Diego City Council by its own outside lawyers, one of whom had represented the Orange County Board of Supervisors before the SEC.

Only when the City's new auditor, KPMG, refused to issue an audit report on the City's financial statements – thereby blocking City access to the municipal bond markets and accelerating the City's need to confront its looming financial crisis – did City officials begin to face reality. Even then, early investigative efforts were haphazard, poorly structured, and encountered steadfast resistance from various pockets of City government. Among those resisting, it bears mention, was *not* the City Council which, while acting too late, did ultimately recognize the need for a thorough and independent investigation as a critical step out of the City's fiscal woes. Alas, the same may not be said of the City Attorney's Office which, while publicly bemoaning the cost and length of investigative effort, behind the scenes and through public pronouncements created roadblocks that operated to increase cost and delay progress. Also offering steadfast resistance to the investigation was the City's pension board itself, which for months sought to keep the truth under wraps through an unwillingness to provide documents that it claimed were protected by the attorney-client privilege. In the end, the documents were provided (there would be no audit report without them), and the reason for the pension board's unwillingness to make them available then became clear. The secret documents readily acknowledged that the pension board had, in fact, violated the law.

As to the early investigations themselves, they predictably foundered. The City engaged the law firm Vinson & Elkins, but inexplicably gave the firm the conflicting responsibilities of serving as independent investigator while at the same time seeking to defend the City's wrongful conduct before the SEC. Its resulting report, which failed to reach conclusions as to culpability, was understandably found by KPMG to be inadequate as the predicate for an audit report. The City Attorney, for his part, had seemingly little difficulty making charges of illegality. However, so frequently was the City Attorney's support for his charges found to be superficial, in many respects the City Attorney's investigative efforts only served to harden the cynicism with which investigative efforts came to be more generally regarded.

Even today, there are serious indications that the City government has not completely come to grips with the depth of its problems and the need for fundamental reform. More than two years after the fact, the City still has not found a way to successfully perform such fundamental bookkeeping tasks as reconciling the balance in its cash accounts with the cash balance on its financial statements for the fiscal year 2003. The City continues to be months behind in assembling and providing to KPMG the schedules and other financial data necessary for KPMG to complete its 2003 audit. Even as to the $1.4 billion pension deficit, City government does not seem prepared to face up to fiscal reality. It has been suggested that the City address the deficit through the issuance of pension obligation bonds which would use borrowings from investors to increase pension assets, but which would not reduce the City's underlying obligation to fund the pension liability. In so doing, the City would continue to push off the funding of these obligations to future generations of taxpayers while avoiding the difficult fiscal decisions that must be made.

Needed Reform

At the most basic level, fundamental reform is needed in the process by which the City budgets, monitors, and reports its finances.

Foremost, accountability for fiscal decision-making and disclosure must be built into the City's financial reporting system. To build in such accountability, the City must strengthen the role and accountability of its Chief Financial Officer. The CFO should be the individual primarily responsible and accountable for the accuracy and timeliness of the City's financial management, reporting, and disclosure functions. The CFO should have responsibility for the supervision of both a Comptroller, which should have experience in government accounting, and a Director of Financial Reporting, which should have specific responsibility for preparation of the City's financial statements. In addition, the CFO should supervise a Director of Budget and Planning, to be responsible for assisting the CFO in budget preparation and monitoring. Further, the CFO should see that the City attracts, hires, and retains qualified personnel into its finance and accounting functions.

To further build accountability into the system, both the Mayor and the CFO should annually include with the City's financial statements a statement of their responsibility for establishing and maintaining an effective system of internal control over financial reporting. In addition, the principal officer and executive of component units of the City, including its pension board, should be required to provide analogous certifications as to their standalone financial statements.

Beyond enhanced accountability, the City should protect the independence and integrity of its financial reporting system through the creation of a permanent Audit Committee. Audit Committees have been recommended by the Government Finance Officers Association for almost a decade. This committee should be comprised of three individuals, two of whom should be independent of the City and its government and possess significant financial expertise in accounting, auditing, and financial reporting. The third member should be a member of the City Council. The Audit Committee should have the power, in its sole discretion, to engage and fund outside advisors and to make inquiry into all aspects of City governance and financial reporting. Reporting to the Audit Committee should be a newly-created independent Auditor General. Also reporting to the Audit Committee should be the independent outside auditor of the City's financial statements.

As to the City's pension board, the City's unfortunate history – which arises against a backdrop of other failures of pension system financing in other municipalities – demands the installation of governance systems providing for increased pension system independence, accountability, and transparency. Pursuant to those ends, the independence and accountability of the pension system board should be strengthened by reducing its size to nine members, five of whom should be mayoral appointees. The

chairman of the pension board and its principal executive should include with the pension system's annual financial statements a signed management report on financial reporting internal control.

To minimize the extent to which future budgetary dislocations might create pressure resulting in short-term expedience and financial misreporting, the City's budgeting and planning process should also be strengthened. We credit and support the Mayor's initiative to develop a five-year financial plan for City government. The five-year financial plan should specify such items as anticipated capital expenditures, deferred maintenance, debt payments, other major contractual expenditures, and expected major sources of revenues. At the end of each successive year, the City Council should require a final budget that compares actual to budgeted performance and is accompanied by written explanations by each department manager for variances.

The installation of such an enhanced system of financial management and reporting should be overseen by a newly-appointed independent Monitor. The Monitor should possess oversight responsibility as to all aspects of the City's system of budget, finance, and internal control over financial reporting. The Monitor should also have the responsibility to evaluate the City's compliance with the laws and regulations applicable to financial reporting and the implementation of the remedial actions being recommended in this report. The Monitor should make quarterly reports both to the City's permanent Audit Committee and to the Division of Enforcement of the SEC. Those reports should simultaneously be made available to the citizens of San Diego.

The details of the factual determinations summarized in this Executive Summary, and the reform being recommended as a result, are set forth below.

ATTACHMENT 3

EXCERPTS FROM THE KROLL REPORT

The Kroll Report – an extensive assessment that cost the City approximately $20 million – summarized its finding as follows:

> Evidence made available in this investigation demonstrates numerous failures of San Diego City government – on the part of government officials and outside professional "gatekeepers" alike – to conform to the law, to adhere to principles of sound governance and financial reporting, and to protect the financial integrity of the City's pension system and thereby the welfare of the City itself. In addition, the evidence demonstrates that City officials deliberately failed to obey legal requirements as to the allocation of costs with regard to the City's sewage treatment with the effect that San Diego homeowners were improperly overcharged on their monthly sewage bills with the excess being unlawfully used to subsidize the sewage costs of large industrial users. The evidence demonstrates not mere negligence, but deliberate disregard for the law, disregard for fiduciary responsibility, and disregard for the financial welfare of the City's residents over an extended period of time. Among the consequences, the City now faces an unfunded actuarial pension liability of $1.4 billion and an inability to gain access to public financial markets. Among the laws violated were the California Constitution, the San Diego City Charter, the San Diego Municipal Code, and the federal securities laws.

Kroll Report at 1.

Mr. Levitt delivered his report to the Mayor and Council in open session on August 8, 2006. As reported by Alison St. John of KPBS on August 9, 2006, "Levitt spoke of a culture based on lack of transparency, obfuscation and denial of financial reality. He said even the warnings of the city's independent watchdogs were gradually eroded. If outside lawyers didn't agree, they were replaced, or their objections were gradually worn down and turned into consent. Levitt blames this all-pervasive culture of expediency, rather than the individuals within it."

The Kroll Report championed remediation efforts intended to address the City's failings, including the creation of the auditing function.

A. Findings

The Kroll Report findings were plentiful, so we highlight those that are most pertinent to this Report:

- The Council Failed to Ask Questions. "Despite the plain language of the controlling statutes, and their obligation as elected officials to uphold the laws of the City and State, there is no evidence the Council members ever bothered to inquire whether these agreements [allowing the City to underfund its pension] were permissible under California law." Kroll Report at 129.

- Expediency Outweighed Fiscal Responsibility. "San Diego officials cultivated and accepted a culture of financial management and reporting premised upon non-transparency, obfuscation, and denial of fiscal reality. Under the pressure of short-term needs, City officials gave expedience a higher priority that fiscal responsibility and came to view the law as an impediment to be circumvented through artful manipulation." Kroll Report at 3.

- Lack of Accountability. "Exacerbating the City's culture was a deplorable lack of accountability and organization built within the structure of the City government itself. It seems that no one within the City government viewed himself or herself as accountable for the accuracy of City financial disclosures. As to some financial information, responsibility for its preparation was placed upon the City's outside auditor, a structure that is completely at odds with the auditor's role as independent examiner, rather than preparer, of financial statements. This inadequate structure was compromised further by the fact that no one from the City took responsibility for seeing to it that information provided to, or prepared by, the auditor was actually correct." Kroll Report at 3.

- Gatekeepers Failed to Blow the Whistle on the Impropriety of City Actions. "Professionals engaged by the City to serve as "gatekeepers" failed at critical junctures to fulfill their professional obligations." Kroll Report at 3. For instance, when the City's fiduciary counsel opined that pension modifications were illegal, the pension fund administrator pressured the firm to change its opinion. When the firm refused to cave into pressure, it was replaced by a law firm that provided SDCERS with the advice it wanted to hear, leading to an "improper agreement" that blessed the City's decision to continue to underfund its pension liability. Kroll Report at 4, 42.

- Misinforming the Public to Hide Unlawful Decisions. The City's longstanding systemic deficiencies led to repeated violations of laws and regulations and to fiscally irresponsible decisions. "The failures have had enormously negative consequences for the City's reputation, infrastructure, and current and future generations of taxpayers. Yet these deficiencies and failures were shielded from public attention by misleading, inaccurate, and unreliable financial statements and debt financing disclosures. These weaknesses have transcended several administrations and call into question both the management of the City's financial accounting systems, and, at core, whether anyone is accountable." Kroll Report at 240.

- The City Lacked Sufficient Financial Management, Reporting, and Disclosure Functions. The Kroll Report indicated that the "City must strengthen the role and accountability of its Chief Financial Officer" and create reliable support positions to build an accountable financial reporting system. Kroll Report at 6. It also suggested that the City "protect the independence and integrity of its financial reporting system through the creation of a permanent Audit Committee... The Audit Committee should have the power, in its sole discretion, to engage and fund outside advisors and to make inquiry into all aspects of City governance and financial reporting. Reporting to the Audit Committee should be a newly-created independent Auditor General. Also

reporting to the Audit Committee should be the independent outside auditor of the City's financial statements." Kroll Report at 6 and 250-251.

The Kroll Report offered other suggestions to remediate the problems identified in its report, including mechanisms to ensure pension system independence, accountability, and transparency, and the implementation of a five-year financial plan for City government. Kroll Report, at 6-7.

ATTACHMENT 4

Elected Auditors

The CRC considered an elected Auditor but opted to recommend an appointed Auditor to expeditiously address the issues raised in the Kroll Report. To adopt the elected Auditor option, the voters would need to take two separate actions: the first would be to create the Auditor function, and the second to consider a candidate to fill the seat. The hiring process, as altered in 2020, places the final decision with elected officials whose own offices and programs should be subject to audit. California cities comparable to San Diego, including Long Beach, Oakland, Los Angeles, and Berkeley, have all opted to enhance auditor independence by empowering voters to elect an Auditor accountable to them and not to city officials. As the IBA stated in Report 06-35, "[i]t is likely that requiring the Auditor General to be elected would secure the greatest degree of independence. In this case, the establishment of an Audit Committee would probably be unnecessary, as the Auditor General would report directly to the voters of the City of San Diego." IBA Report No. 06-35 (Aug. 30, 2006). A synopsis of elected auditor positions and the reason behind their creation is as follows:

- The City of Long Beach. Long Beach has had an elected Auditor since 1907. In 1979, when the City's Charter Advisory Committee sought to convert the position to an appointed one and prohibit operational audits unless approved by the Council, City Auditor Robert Fronke objected, explaining that the appointment of a City Auditor would forfeit the office's independence. *See* Long Beach City Auditor (Feb.14, 20022), https://www.cityauditorlauradoud.com/timeline/#1976-2005. Long Beach City Auditor Laura Doud has been in office since 2006.

- The City of Oakland. Oakland also has an elected Auditor. According to their website, "Oakland's City Auditor is an elected official and works for, and reports to, the residents of Oakland. The Auditor's job is to provide oversight to the City's activities…To make sure this work is done objectively and without bias, the City Auditor is not connected to any other City department and has no day-to-day financial or accounting duties for the City of Oakland. This autonomy allows for independent analyses, ensuring tax dollars and other resources serve the public interest." City of Oakland Office of the City Auditor (Feb. 14, 2022), https://www.oaklandauditor.com/about/our-purpose/. In the FAQs, and in response to the question about why the City Auditor is elected, the Auditor explains: "As an independently elected official, I am able to be objective, impartial and resolute when auditing the City. No one within Oakland's administration can influence what I look at, how I go about investigating it, or what I find. I am your eyes and ears inside City Hall." City of Oakland Office of the City Auditor (Feb. 14, 2022), https://www.oaklandauditor.com/about/frequently-asked-questions/. The department is led by Auditor Courtney Ruby.

- The City of Los Angeles. Los Angeles has had an elected City Auditor since 1889. In 1925, the voters changed the name of the position to City Controller, and in 2000, City voters granted the position the power to conduct performance audits of all City departments. The Los Angeles City Controller is Ron Galperin. *See* Los Angeles Office of the Controller (Feb. 14, 2022), https://www.lacontroller.org/our-office.

- The City of Berkeley. This city's Charter states that "[t]he independence and public accountability of the Auditor can be assured by provision for an elected Auditor as provided for in the City of Berkeley Charter." City of Berkeley Charter section 2.24.010 (E). It further provides, "It is vital to the independence of the Auditor that decisions made about audit resources are made after public discussion, to avoid any appearance that resource decisions may be made so as to influence the Auditor's choice of audit subjects or findings and recommendations." Berkeley Charter section 2.24.010 (M). City Auditor Jenny Wong, who was elected in 2018, said that "transparency and public communication will be at the top of her priorities" and that "she plans to seek out public input on issues that she should "shine a light on." Brandon Yung, *Jenny Wong Wins Berkeley City Auditor Election*, The Daily Californian, Nov. 7, 2018, https://www.dailycal.org/2018/11/07/jenny-wong-projected-to-win-berkeley-city-auditor-election/. *See* City of Berkeley City Auditor (Feb. 14, 2022), https://www.cityofberkeley.info/auditor/.

In all cases where the cities have elected city auditors, there is no audit committee; elected auditors report directly to the voters. The terms are four years, and qualifications for the position are described in the laws of each city.

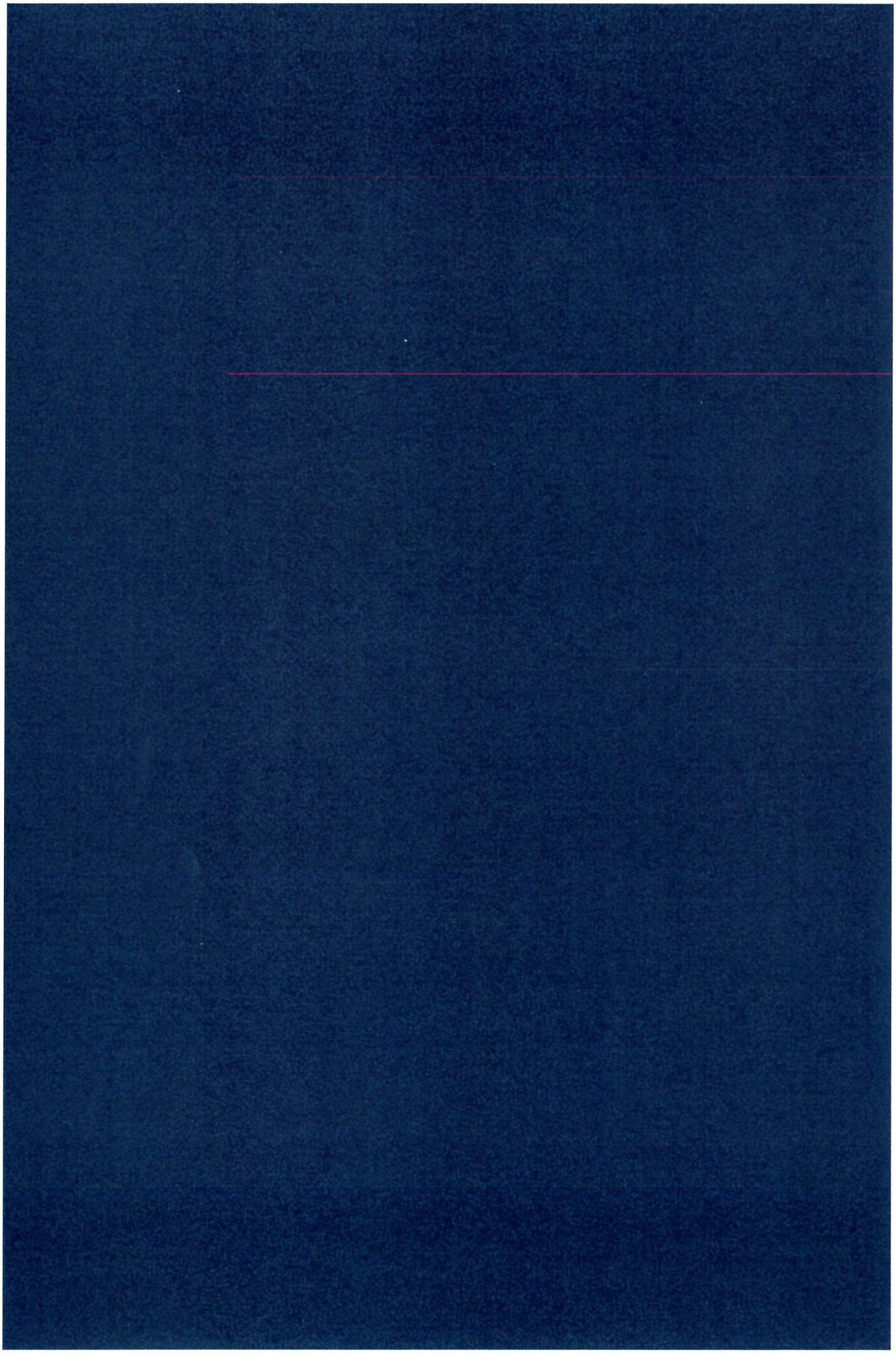
ATTACHMENT 5

Global Public Sector Insight:

INDEPENDENT AUDIT COMMITTEES IN PUBLIC SECTOR ORGANIZATIONS

Release Date: June 2014

The Institute of Internal Auditors | Global



Global Public Sector Insight: INDEPENDENT AUDIT COMMITTEES IN PUBLIC SECTOR ORGANIZATIONS

Various nations and jurisdictions govern audit committee makeup, including the concept of independence. Please note the following terms as used in this document.

Board – In the public sector, the definition of the term *board* varies by jurisdiction and among levels of government. For example, in countries with a structure referred to as the "Westminster Model," the board's responsibilities are vested in a single individual, often referred to as a permanent secretary or accounting officer. In countries with a congressional system, the board's responsibilities are vested in an individual with such titles as secretary, director, or chief executive officer (CEO). Other jurisdictions use different terms. In some jurisdictions, state-owned corporations have independent boards, similar to the structure used in the private sector. The term *board* also can refer to legislative bodies such as a state legislatures or city councils in state or local governments, respectively.

As used in this insight publication, the term *board* refers to the highest level of the governing body charged with the responsibility to direct and/or oversee the activities and management of the organization. Typically, this includes an independent group of directors (e.g., a board of directors, a supervisory board, or a board of governors or trustees). If such a group does not exist, *board* may refer to the head of the organization.

Independent board member – An independent board member is not an employee, immediate family member, or member of the public sector organization. An independent board member may not carry out any other activities on behalf of the organization

Independent audit committee – A public sector organization board-level committee made up of at least a majority of independent members with responsibility to provide oversight of management practices in key governance areas.

Audit committee – Unless otherwise noted, "audit committee" means independent audit committee.

Executive Summary

Independent audit committees help public sector organizations meet taxpayers' increasing demands for transparency and accountability by providing oversight of management practices in key governance areas, including:

- Values and ethics.
- Governance structure.
- Risk management.
- Internal control framework.
- Audit activity.
- External assurance providers.
- Management action plans.
- Financial statements and public accountability reports.

The audit committee charter documents information about the audit committee's mandate, membership, authority, responsibilities, and processes for developing, reviewing, and updating the charter. Audit committee member independence is a key concept expressed in the charter. In addition to being independent from the organization, audit committee members are expected to conduct their work in a diligent and professional manner; demonstrate inquisitiveness, outspokenness, and courageousness; and collectively be knowledgeable of, or have expertise in, finance and accounting, business, auditing, risk management, compliance, and information technology.

The charter also serves as a benchmark for assessing audit committee performance. Compliance with charter standards is one pillar of high performing audit committees. Two additional pillars — participation of audit committee members and value-added activities pursued and outcomes achieved — also support overall contribution to the organization. Strong audit committees build trust and confidence in how organizations are managed and strengthen independence of the audit activity.

Introduction

The audit committee supports public sector organization boards by providing oversight of governance, risk management, and internal control practices. This global public sector insight is designed to serve two primary purposes:

- To communicate the importance of independent public sector audit committees and the value they provide.
- To provide detailed insights and leading practices to those who will be charged with establishing audit committees.

The leading practices presented in this publication have proven to be important in strengthening public sector audit departments. Appendices include a model public sector audit committee charter and a series of tools for committee member use.

Business Significance

Audit committees play a significant role in improving and providing transparency around governance, risk management, and internal control practices of public sector organizations. The audit committee should play an independent oversight and advisory role, with responsibility for decision making resting with management. If the audit committee is involved in making decisions, its objectivity may be impaired, which, in turn, may negatively impact its ability to remain independent.

The audit committee is a key component of an organization's governance structure. Examples of how effective committees assist the board and the chief audit executive (CAE) include facilitating decision making, implementing a system of risk oversight and management, and ensuring high-quality internal and external reporting.

Audit committees also strengthen the independence of the audit activity. The functional reporting of the CAE to the audit committee is the ultimate source of an audit activity's organizational independence. The committee's composition also is critical. It should include a majority of external members, and the chair and members should demonstrate inquisitiveness, outspokenness, and courageousness.

Worldwide, public sector organizations employ a variety of governance structures, all with the underlying principles of accountability and transparency. These insights on establishing and maintaining effective audit committees should be adapted to the organization's unique circumstances while respecting the principles of accountability and transparency.

Related Risks

Public sector audit committee responsibilities typically include oversight of risks associated with financial statements, internal control, audit activity services, external assurance providers, and compliance.

Related IIA Standards

IIA Standard 1111: Direct Interaction With the Board

The [CAE] must communicate and interact directly with the board.

IIA Standard 2060: Reporting to Senior Management and the Board

The [CAE] must report periodically to senior management and the board on the audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

Purpose of the Audit Committee

Independent audit committees are an important part of an organization's governance structure. Establishing an audit committee — the majority of whose members are independent of the organization — supports the board in fulfilling its oversight responsibilities. These audit committees provide oversight by offering objective advice and recommendations to the board on whether the organization's governance, risk management, and internal control processes are suitably designed and working as intended to achieve the objectives. Audit committees help build trust and confidence in how the organization is managed. The audit committee should exercise due care in fulfilling its oversight responsibilities.

Mandate of the Audit Committee

An audit committee's mandate can be derived from many sources. In some jurisdictions, the responsibilities of an audit committee and its members are established in legislation and/or regulation. In other jurisdictions, the mandate may be set out in government policy.

Regardless of how the mandate is established, good governance dictates that public sector entities have an independent audit committee and leading practices suggest it formalize a high-level statement of the audit committee's responsibilities.

The Audit Committee Charter

A written charter should establish the audit committee's mandate and:

- Outline roles and responsibilities of the audit committee and its members.
- Establish authority to obtain information and required resources.
- Outline respective roles and responsibilities of internal and external stakeholders who have an obligation to interact with the audit committee.
- Outline the process for developing, reviewing, and updating the charter and the frequency of review. Leading practices suggest that the charter be reviewed annually and modified as required.

The organization's board should review and approve the charter. Some governments establish formal policy requirements for audit committees and their members.

Once established, the charter should be maintained and communicated within the organization. It is a leading practice to publish the audit committee charter in publicly available material and on the organization's website so that key stakeholders are aware of their respective responsibilities.

Key Steps in Developing the Charter

Key steps to consider in establishing and maintaining an effective independent audit committee and its charter include:

- Obtain the board's support of the audit committee. The board should serve as the audit committee's champion, enabling the committee to successfully carry out its responsibilities. Ideally, governments adopt clear policy requirements and establish clear expectations for performance.
- Establish a working group to develop a draft charter. The working group should include the organization's most senior executive (e.g., CEO) and CAE.
- Adopt best practices identified through benchmarking with leading public sector organizations.
- Prepare and review the draft charter.
- Obtain audit committee endorsement of the charter.
- Obtain board approval of the charter.
- Develop an annual work plan for the audit committee that will enable it to meet the requirements set out in the charter.

Audit Committee Responsibilities

While the board may establish additional responsibilities based on the organization's need or the particular needs of various forms of government, key areas of audit committee oversight generally include:

Values and ethics: Review and provide oversight on the systems and practices management establishes to:

- Set and sustain high ethical standards.
- Monitor compliance with laws, regulations, policies, and standards of ethical conduct.
- Identify and quickly address any legal or ethical violations.

Governance initiatives: Review and provide oversight on governance initiatives established by the board and maintained by the organization.

Risk management: Review and provide oversight on the establishment, implementation, maintenance, and effectiveness of risk assessment, risk management, and risk reporting practices.

Internal control framework: Review and provide oversight on the organization's internal control framework. Keep informed on all significant matters arising from work performed by any governance, risk, and control assurance providers.

Audit activity: Approve and periodically review a departmental audit policy or charter. Review and approve an internal audit plan. The audit plan should be risk-based and supported by appropriate risk assessments. Monitor and assess the audit activity's performance in accomplishing the approved plan through periodic reports by the CAE.

The audit committee should review audit reports and corresponding management action plans to address recommendations. The audit committee should be advised of any internal audit engagements or tasks that do not result in a report, and it should be informed of all significant matters arising from such work.

The audit committee should advise the board on the adequacy of resources of the audit activity in terms of the number of resources and the sufficiency of its skills and abilities to successfully execute the audit plan.

The audit committee also should provide advice to the board on the recruitment, appointment, retention, and removal of the CAE. Leading practice suggests that this oversight normally includes providing input regarding the CAE's annual performance review and remuneration plan.

External assurance providers: The audit committee should be advised of all audit work to be undertaken by external assurance providers, including management's response and subsequent audit-related issues and priorities. In many jurisdictions, public sector entities are subject to audit by auditors general who have an independent legislative mandate to conduct a broad range of audits. It is a leading practice for auditors general to brief audit committees, as appropriate, on their annual audit plans.

Follow up on management action plans: The audit committee should review regular reports on implementation status of approved management action plans resulting from prior internal audit recommendations. The audit committee also should review management action plans resulting from the work of external assurance providers.

Financial statements and public accountability reporting: The audit committee should review and provide advice to the board on the key financial management and performance reports and disclosures issued to the public.

For audited departmental financial statements, the audit committee should review the financial statements with the external assurance providers and senior management and discuss any significant accounting estimates and adjustments therein, adjustments required to the statements as a result of the audit, and any difficulties or disputes encountered with management during the course of the audit.

If the organization prepares an annual statement of management responsibility, the audit committee should review it together with oversight of the procedures used to prepare the statement. Such management statements may include representations on internal control over financial reporting.

Audit Committee Composition

The key to an audit committee's effectiveness is having members with an appropriate mix of skills and experience relevant to the organization's responsibilities. The ideal composition of the audit committee and attributes of its members depends on a variety of factors such as the organization's size, complexity, and responsibilities.

Generally, audit committees have between three and eight members with the typical audit committee having four or five. As a general rule, the minimum number of members for an effective audit committee is three. This ensures that a sufficient range of skills and experience is available. See Exhibit 1.

Exhibit 1: Determining the Number of Audit Committee Members

Respondents to a March 2009 survey of CAEs listed seven organizational characteristics that should be considered when determining the ideal number of audit committee members. In order of importance, they listed:

1. The complexity of the organization (e.g., decentralized versus centralized, public versus private) and industry.
2. The size of the organization.
3. The extent of responsibilities and expertise assigned to the audit committee.
4. The size of the board of directors and number of board committees.
5. The culture of the organization and its needs.
6. The assignment of members to other board committees and external commitments.
7. The roles and responsibilities of the audit committee as outlined in the charter.

Source: The IIA's Audit Executive Center, Knowledge Report: Audit Committee Trends and Activities (November 2009).

It is important that audit committees maintain institutional memory while providing new perspectives and fresh insights. Audit committee members should, therefore, be appointed to terms long enough to maintain continuity but not so long that an individual becomes vested in the organization's current policies and direction. Generally, terms less than two years are too short. Terms of greater than eight years may be too long. If length is restricted, terms should be staggered to achieve the greatest continuity. The audit committee chairman should review committee member performance annually to determine whether obligations are appropriately discharged.

Committee Member Independence

An essential feature of an effective audit committee is independence from management. By providing an independent source of advice to the board, audit committees play a key role in an organization's governance structure. To ensure the audit committee's independence, it is a leading practice for the majority of its members to be independent from the organization. An independent audit committee member is a person who is not employed by, or providing any services to, the organization beyond his or her duties as a committee member.

Various governments express similar independence requirements. The government in the Australian state of New South Wales mandates that an audit committee must have a majority of independent members and that these independent members must not be involved in any public sector roles in the state. The auditor general of New Zealand and the International Federation of Accountants, recommend most of the audit committee members should be external appointments. The Canadian government requires that a majority of the members be from outside government.

Capability Requirements of the Chair and Committee Members

Personal Attributes

In determining the composition of an audit committee, consideration of the personal attributes of members is critical. According to The IIA Audit Executive Center's Knowledge Report from 2009, *Audit Committee Trends and Activities*, CAEs say the top three attributes audit committee members should demonstrate are inquisitiveness, outspokenness, and courageousness. Other personal attributes valued by CAEs, as well as recommended by best practice guides, include sound judgment; objectivity and integrity; a healthy, constructive skepticism; a high level of ethics; and strong communication skills.

Expertise and Skills

CAEs also were asked to describe the areas of expertise that should collectively be represented in the audit committee. CAEs surveyed responded that members should collectively be knowledgeable, or have expertise in, finance and accounting, industry-specific and overall business knowledge, internal and external auditing, risk management, regulatory compliance, legal, and IT and information security. In addition, certain skills and experience may be required due to the nature of the organization's operations.

As a leading practice, many organizations require that an audit committee include at least one person who is a financial expert. The U.S. Securities and Exchange Commission (SEC) defines an *audit committee financial expert* as a person who has all of the following attributes:

- An understanding of financial statements and Generally Accepted Accounting Principles.
- An ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves.
- Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that generally are comparable to those that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities.
- An understanding of internal controls and procedures for financial reporting.
- An understanding of audit committee functions.

If audit committee members are to be effective, it is important that they have sufficient knowledge of the organization. All audit committee members should have — or acquire as soon as possible after appointment — an understanding of:

- The organization's mission and current significant issues.
- The organization's structure, including key relationships.
- The organization's culture.
- Any relevant legislation or other rules governing the organization.
- Key risks the organization faces in meeting its objectives.
- The government environment, particularly accountability structures.

The organization should provide its committee members with orientation training within a reasonable time following appointment.

Chair

The board or audit committee members should designate the audit committee chair. He or she is the focal point of communication and the key to an effective and independent audit committee. When appointing the chair, the board should particularly consider the candidates' personal attributes. In addition to leadership skills, a good chair must have personal courage to raise and tackle difficult issues and support others to do the same; understand the importance of relationships with key stakeholders; and have interpersonal skills to foster those relationships and build and maintain effective working relationships. Exhibit 2 lists the qualities of an effective audit committee chair.

Exhibit 2: Qualities of an Effective Audit Committee Chair

- Has the active support of, and maintains regular dialogue with, the board.
- Ensures the committee undertakes its responsibilities as outlined in the committee charter.
- Maintains an open and constructive relationship with senior management, internal and external audit, and other organization committees.
- Has a clear understanding of the responsibilities of the committee, its position within the organization's governance structure and the organization's work, and maintains a dialogue with senior managers about the committee's work.
- Arranges for committee members to maintain an up-to-date knowledge of the organization and its activities.
- Is a good communicator who facilitates discussion and focuses on important matters.
- Has the ability to plan and manage committee meetings effectively.
- Devotes sufficient time to prepare for committee meetings and to engage with the chief executive/board, senior management, and other stakeholders outside committee meetings.

Source: The Australian National Audit Office.

Appointing Audit Committee Members

Due to the importance of having the appropriate mix of skills, experience, and personal attributes, leading practices suggest that organizations employ an explicit, competency-based selection process in selecting new members. A list of the competencies the audit committee needs — including areas of expertise, skill sets, perspectives, and personal attributes — should be developed. Often, this is included in the audit committee's mandate. As the responsibilities of the audit committee will evolve in response to regulatory, economic, and reporting developments, it is important to periodically evaluate competencies to align with emerging needs. When a vacancy occurs, current competencies should be assessed against required competencies to identify gaps. Responsibility for nominating and appointing audit committee members varies considerably depending on the jurisdiction. As examples:

- In some jurisdictions in Australia, the CEO appoints audit committee members.
- In Scotland, the board (or accounting officer) appoints the audit committee members.
- In Ireland, the secretaries general (human resources) appoint internal members from within their own departments and external members are invited from other government departments, the wider public sector, and the private sector.
- In Canada, appointments to audit committees of crown corporations are made by the board, on the recommendation of the president of the board, through an appointment order specifying the tenure of the appointment. Appointments to audit committees of federal government departments are made jointly by the board (deputy minister) and the comptroller general of Canada.
- In South Africa, the board of an institution appoints audit committee members in consultation with the relevant executive authority (minister).
- In Egypt, the board appoints audit committee members.
- In New Zealand, the auditor general recommends that the chair of the governing body or departmental CEO should appoint the chair of the audit committee first and then consult the audit committee chair before making further appointments to the audit committee.

Assessing Audit Committee Performance

Rationale for Assessments

A capable, balanced, and committed audit committee can make a significant difference in the public sector by ensuring effective accountability and transparency. While there are many similarities between the features of audit committees operating in the public and private sectors, one significant difference is the "public interest" feature that applies to public sector audit committees.

> ***Public interest* is defined as** "the net benefits derived for, and procedural rigour employed on behalf of, all society in relation to any action, decision or policy."
>
> *Source: International Federation of Accountants, Policy Position Paper,* A Definition of Public Interest, *June 2012.*

A high-performing public sector audit committee helps to ensure that objective analyses and credible information support decisions to help create a better future for the community in which it operates and, ultimately, across all society.

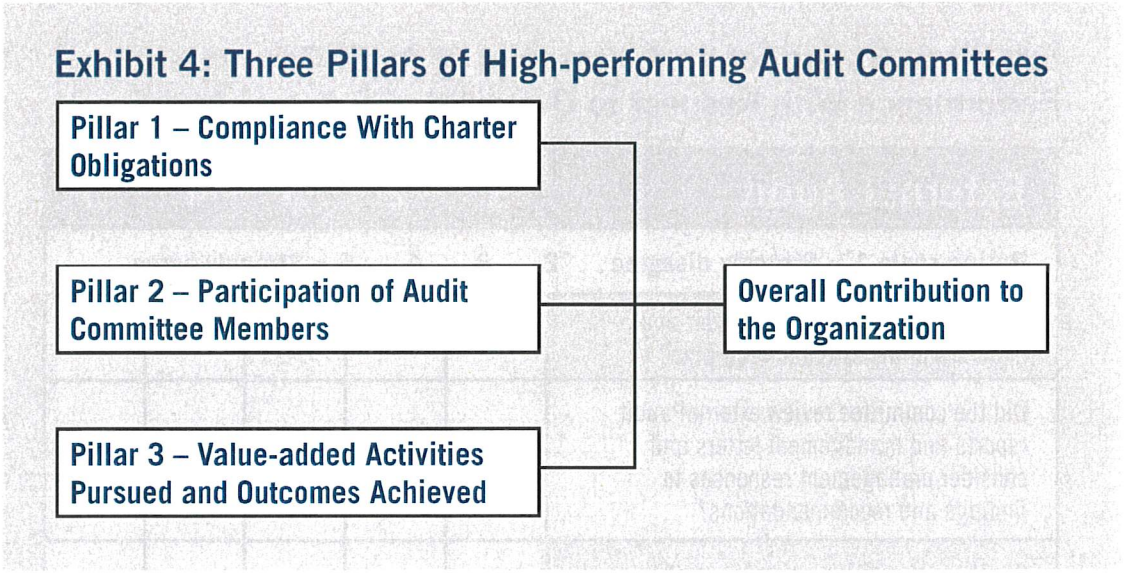
A Three-pillars Approach to Assessing Audit Committee Performance

Audit committee performance should be assessed on a set periodic basis as established in the audit committee charter. Assessments ensure that the audit committee is meeting the requirements outlined in its charter and that its contribution is consistent with the needs and expectations of the organization and, ultimately, the government. Overall audit committee performance and individual member performance are typically assessed annually (Exhibit 3).

Exhibit 3: Sample Audit Committee Charter Assessment Provision

The CEO, in consultation with the chair of the committee, will establish a mechanism to review and report on the performance of the committee, including the performance of the chair and each member, at least annually. The review will be conducted on a self-assessment basis (unless otherwise determined by the board) with appropriate input sought from the board, the internal and external assurance providers, management, and any other relevant stakeholders as determined by the board.

Source: Modified from TPP09-05 Internal Audit and Risk Management Policy for NSW (Australia) Public Sector, Annexure C page 48, Office of Financial Management Policy and Guidelines paper, August 2009.



High-performing audit committees are typically founded on three key pillars (Exhibit 4):

- The audit committee's compliance with its formal charter.
- The level of participation of audit committee members.
- The committee's ability to drive value-added activities and outcomes that are congruent with the organization's vision, statutory objectives, and strategies.

Assessing Compliance With Charter Obligations

The audit committee charter provides a formal mandate under which the audit committee operates. It outlines the roles, responsibilities, and breadth of expected coverage.

Exhibit 5: Excerpt of an Assessment of Audit Committee Performance With Respect to Oversight of External Audit[1]

External Audit	1	2	3	4	5
Rating scale 1 = Strongly disagree	2	3	4	5 = Strongly agree	
Did the audit committee consider and understand the external audit plan?	❐	❐	❐	❐	❐
Did the committee review external audit reports and management letters and consider management responses to findings and recommendations?	❐	❐	❐	❐	❐
Did the committee provide input and feedback on external audit coverage and performance?	❐	❐	❐	❐	❐

An assessment questionnaire may facilitate an assessment of compliance with charter obligations. The example provided in Exhibit 5 is based on the assumption that the approved charter mandated specified external audit oversight responsibilities. A comprehensive sample assessment questionnaire is included in the appendices.

Assessing Audit Committee Member Performance

Audit committee chairs can use assessment tools to help assess each member's performance and contribution to the committee. Exhibit 6 provides a sample assessment tool. The assessment also should include a review of the independence of audit committee members.

[1] A more detailed questionnaire is contained in Public Sector Audit Committees – Independent Assurance and Advice for Chief Executives and Boards – Better Practice Guide, Auditor General of Australia, August 2011.

Exhibit 6: The Chair's Assessment of Individual Members

Did the audit committee member:

1. Regularly attend meetings (with valid and, ideally, reasonable pre-approved absences only)?
2. Demonstrate a thorough understanding of the organization's statutory objectives and activities?
3. Demonstrate a high level of understanding of the audit committee's role, obligations, and responsibilities?
4. Conduct himself or herself in a professional statesmanlike manner (with a professional presence demonstrated in dealings with internal and external stakeholders)?
5. Contribute to the overall credibility of the committee through the manner in which he or she operated and interacted?
6. Consistently demonstrate an independence of mind and objectivity?
7. Challenge the status quo by being prepared to take difficult but constructive positions at meetings, where required?
8. Demonstrate a well-rounded understanding of the organization's risk management and compliance arrangements and the associated internal control framework?
9. Demonstrate an ability to strike at the heart of a problem and offer practical solutions through a well-considered and well-informed analytical approach?
10. Consistently prepare for audit committee meetings with this demonstrated in the quality of his or her participation?

Source: Shared insight from members of The IIA's Public Sector Committee, 2014.

However the assessment is conducted, and regardless of the attributes evaluated, the audit committee chair should discuss the results of the assessment with the individual members and an action plan for further development should be agreed upon, as required.

Assessing Value-added Activities Pursued and Outcomes Achieved

High-performing, contemporary audit committees tend to operate at a strategic level with a high degree of alignment with the organization's statutory objectives, vision, and strategic direction (Exhibit 7).

Exhibit 7: Examples of Audit Committees Adding Value

While there are many ways an audit committee can add value to an organization, following are some examples that illustrate how an audit committee could help the CAE and/or drive the vision of the organization to achieve the statutory objectives:

- Facilitate well-informed, efficient, and effective decision-making.
- Promote and monitor an ethical culture.
- Ensure compliance with a well-designed code of conduct.
- Oversee an effective system of risk oversight and management.
- Oversee an effective and efficient internal control system.
- Oversee internal and external reporting of financial and nonfinancial information.
- Promote effective communication with audit activity and external assurance providers and respond appropriately to matters they raise.

Source: Shared insight from members of The IIA's Public Sector Committee, 2014.

Audit Committee Reporting

While an audit committee might be fulfilling its obligations under the approved charter and individuals might be participating in a diligent manner, the true worth of the audit committee is reflected in the outcomes achieved. In this regard, leading practice organizations have the audit committee contributions captured in an annual report to the board and in the organization's published annual report. Audit committee performance results can be reported from either an internal or external perspective, or both.

Exhibit 8: Sample Excerpt From an Audit Committee's Annual Report

The audit committee oversaw the review and update of the codes of conduct that apply to both organization staff and the board. Existing staff was informed of these updates through a structured communication strategy, and the orientation package for new staff was updated accordingly. Additionally, in recognizing the greater reliance on third-party suppliers, the high volume of supplier spending, and the trend in perceptions of supplier fraud, the audit committee championed the introduction of a statement of business ethics,[2] which was distributed to all existing suppliers and has been incorporated in the procurement policy and tender pack for all future procurement.

Source: Shared insight from members of The IIA's Public Sector Committee, 2014.

Externally Focused Annual Report

Suitable commentary includes insights on the role and mandate of the audit committee, how it has functioned during the year, and the contribution that it has made to the organization. In addition to this type of commentary, a practice adopted in some jurisdictions includes an audit committee attestation in the organization's published annual report encompassing features such as those illustrated in Exhibit 9.

[2] Statements of business ethics detail the way in which an organization interacts with third parties (e.g., suppliers, contractors, government, and other external parties) and their expectations of how ethically third parties do business with them.

Exhibit 9: Sample Audit Committee Attestation for Inclusion in an Organization's Annual Report

I, <name of chief executive officer>, am of the opinion that <name of organization>:

i) Operated effective audit and risk management processes for the <period> financial year that were, in all material respects, compliant with the core requirements of the approved audit committee charter.

ii) Maintained a balanced and capable audit committee that operated independently and effectively.

These processes provided a reasonable level of assurance that enabled the senior management of the <name of organization> to understand, manage, and satisfactorily control risk exposures.

The audit committee chair and members are listed below together with their term and attendance for the year:

Name*	Role	Date Appointed	Term (Years)	Number of Meetings Eligible to Attend	Number of Meetings Attended
	Independent Chair				
	Independent Member				
*					

**List all members, including nonindependent internal members, if applicable.*

<signed by chief executive officer>

<name of chief executive officer>

Source: Modified from TPP09-05 Internal Audit and Risk Management Policy for NSW (Australia) Public Sector, Annexure D1 page 51, Office of Financial Management Policy and Guidelines paper, August 2009.

Internally Focused Annual Report

The audit committee should provide an annual report to the board. The report would, at a minimum, typically include:

- A summary of the work the audit committee performed to discharge its responsibilities during the year.
- A summary of the organization's progress in addressing the findings and recommendations made in internal and external audit reports.
- An overall assessment of the organization's risk control and compliance framework, including details of any significant emerging risks or legislative changes impacting the organization.
- Details of meetings, including the number of meetings held during the relevant period and the number of meetings each member attended.

Other Incidental Reporting

Draft audit committee minutes should be distributed to the board shortly after each meeting. Additionally, the audit committee chair should meet with the board periodically throughout the year and more frequently if significant issues arise that require prompt escalation. In some jurisdictions, reports prepared by the audit committee may be provided to a political oversight committee. For example, in some local governments, audit committee reports are presented at a full council meeting.

Principles Guiding Audit Committee Reporting Relationships

As previously stated, public sector organizations worldwide employ a variety of governance structures with the underlying principles of accountability and transparency. This guidance for establishing and maintaining effective audit committees should be adapted to the organization's unique circumstances while respecting the principles of accountability and transparency.

In conclusion, regardless of the governance structure, there are two basic principles that govern the duties and responsibilities of audit committees:

- As an oversight mechanism, the audit committee is responsible for enhancing accountability for the use of public resources by the public sector organization.
- An audit committee exists to add value and assist a public sector organization in achieving its objectives. It can be best positioned to do so if it is made up of independent and objective members and its decisions receive the attention of the highest level of the organization.

Appendices

Appendix 1: Model Public Sector Audit Committee Charter

Introduction (Optional)

The audit committee plays an important role in providing oversight of the organization's governance, risk management, and internal control practices. This oversight mechanism also serves to provide confidence in the integrity of these practices. The audit committee performs its role by providing independent advisory and assurance services to the board.

Background (Optional)

The audit committee was established on <date>. At that time, the charter for the committee was established. The charter, which governs the work of the committee, was reviewed and updated on <date>.

Purpose

The purpose of the audit committee is to provide structured systematic oversight of the organization's governance, risk management, and internal control practices. The committee assists the board by providing advice and guidance on the adequacy of the organization's initiatives for:

- Governance structure.
- Risk management.
- Values and ethics.
- Internal control framework.
- Oversight of internal and external audit.
- Financial statements and public accountability reporting.

In broad terms, the audit committee reviews each of the items noted above and provides the board with independent advice on the adequacy and effectiveness of management's practices. This advice and guidance also may include suggestions and recommendations to strengthen these arrangements.

Mandate

The mandate for the establishment of the audit committee was derived from <insert item: The exact source of the mandate will vary among jurisdictions and depend on the location, government structure, type of public sector services, and relationship to other government entities>.

<The mandate may come in the form of laws, regulations, policies and procedures, or bylaws. Best practice recommends that governments adopt a clear policy requirement and clear expectations for the audit committee.>

Authority

The authority of the audit committee to perform its work is established within the scope of its charter. In discharging its responsibilities, the audit committee shall have unrestricted access to members of management, employees, and relevant information it considers necessary to discharge its duties. The committee also shall have unrestricted access to records, data, and reports.

The committee is entitled to receive explanations from management and staff of the organization that it deems necessary to discharge its responsibilities.

The audit committee may engage independent counsel and/or other advisers as it deems necessary to carry out its duties.

Composition of the Audit Committee

The audit committee shall consist of <number (typically three to five)> members, the majority of whom shall be independent of the organization. The members should collectively possess sufficient knowledge of audit, finance, IT, the law, risk, and control. As the responsibilities of the audit committee evolve in response to regulatory, economic, and reporting developments, it is important that members' competencies and the overall balance of skills on the committee be periodically evaluated to respond to emerging needs.

The Chair of the Audit Committee

The board shall designate the chair of the audit committee.

Terms of Office

The term of office for an audit committee member is a term of <number (typically three to four)> years. Independent members of the committee should not serve more than two terms. Continuance of audit committee members will be reviewed annually.

To ensure continuity within the audit committee, the appointment of members should be staggered.

Quorum

The quorum for the audit committee shall be a majority of the members.

Operational Principles of the Audit Committee

Audit committee values. The audit committee will conduct itself in accordance with the code of values and ethics of the organization and <add reference to additional legislation/regulations/policies pertinent>. The audit committee expects that management and staff of the organization will adhere to these requirements.

Communications. The audit committee expects that all communication with management and staff of the organization as well as with any external assurance providers will be direct, open, and complete.

Work plan. The audit committee chair, in concert with senior management and the chief audit executive (CAE), will establish a work plan to ensure that the responsibilities of the audit committee are scheduled and will be carried out.

Meeting agenda. The chair shall establish meeting agendas in consultation with audit committee members, senior management, and the CAE.

Information requirements. The audit committee shall establish and communicate its information requirements. This shall include the nature, extent, and timing of such information requirements. Information shall be provided to the audit committee at least one week prior to the meeting.

In camera or executive sessions. At least annually, the audit committee shall hold a private session with the chief executive officer (CEO), the chief financial officer (CFO), the CAE, external assurance providers, and with any other officials that the audit committee may deem appropriate.

Preparation and attendance. Audit committee members have an obligation to prepare for and participate in committee meetings.

Conflict(s) of interest. It is the responsibility of an audit committee member to disclose a conflict of interest or the appearance of a conflict of interest to the committee. If there is any question as to whether audit committee member(s) should recuse themselves from a vote, the committee should vote to determine whether the member should recuse himself or herself.

Orientation and training. Audit committee members shall receive formal orientation training on the purpose and mandate of the committee and on the organization's objectives. A process of continuing education shall be established.

Operational Procedures

Meetings. The audit committee shall meet at least <insert number> times annually or more frequently as the committee deems necessary. Leading practice recommends meeting at least four times a year.

Minutes. Minutes shall be prepared in accordance with applicable law, regulation, policy or procedure, bylaw, or whatever is applicable.

Access to officials. The audit committee shall have unrestricted access to officials of the organization as may be required to discharge their duties.

Required attendance. The CFO and the CAE are required to attend all committee meetings.

Secretariat services. The CAE (or another appropriate designee) shall facilitate and coordinate meetings as well as provide ancillary support to the committee, as time and resources permit.

Remuneration of Committee Members (If Applicable)

Committee members may be reimbursed for travel and committee-related expenses. *[This should be established and outlined in the legal basis and/or a formal travel policy that applies to all committee members.]*

Payment rates and allowances for committee members' time or services are established formally in laws, regulations, or in written policy and procedures by the governing body.

Professional indemnity insurance arrangements are to be established that are suitable to both the member and the organization.

Responsibilities

It is the responsibility of the audit committee to provide the board with independent, objective advice on the adequacy of management's arrangements with respect to the following aspects of the management of the organization:

Values and ethics. To obtain reasonable assurance with respect to the organization's values and ethics practices, the audit committee shall:

- Review and assess the policies, procedures, and practices established by the governing body to monitor conformance with its code of conduct and ethical policies by all managers and staff of the organization.
- Provide oversight of the mechanisms established by management to establish and maintain high ethical standards for all of the managers and staff of the organization.
- Review and provide advice on the systems and practices established by management to monitor compliance with laws, regulations, policies, and standards of ethical conduct and identify and deal with any legal or ethical violations.

Governance of the public sector organization. To obtain reasonable assurance with respect to the organization's governance arrangements, the audit committee shall review and provide advice on the governance arrangements established and maintained within the organization and the procedures in place to ensure that they are operating as intended.

Risk management. To obtain reasonable assurance with respect to the organization's risk management arrangements, the audit committee shall:

- Provide oversight on significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.
- Review and provide advice on the risk management arrangements established and maintained by management and the procedures in place to ensure that they are operating as intended.
- Annually review the organization's corporate risk profile.
- Obtain from the CAE an annual report on management's implementation and maintenance of an appropriate integrated risk management process.

Fraud. To obtain reasonable assurance with respect to the organization's procedures for the prevention and detection of fraud, the audit committee shall:

- Take an active role in the prevention and deterrence of fraud.
- Challenge management and the auditors to ensure that the entity has appropriate antifraud programs and controls in place to identify potential fraud and ensure that investigations are undertaken if fraud is detected.
- Ensure that appropriate action is taken against known perpetrators of fraud.

Management control framework. To obtain reasonable assurance with respect to the organization's management control framework, the audit committee shall:

- Review and provide advice on the organization's overall and management units' internal control arrangements.
- Receive reports on all matters of significance arising from work performed by others who provide financial and internal control assurance to senior management and the board.

Oversight of Internal and External Audit and Other Assurance Providers

Internal audit. To obtain reasonable assurance with respect to work of the audit activity, the audit committee shall:

- Review and approve the internal audit charter at least annually. The charter should be reviewed to ensure that it is consistent with changes in the financial, risk management, and governance arrangements of the organization and reflects developments in internal audit professional practices.
- Review and approve proposed risk-based internal annual audit work plans and make recommendations concerning internal audit projects.
- Advise the board regarding the qualifications and recruitment, retention, and release of the CAE.
- Provide input to management on the annual performance evaluation of the CAE.
- Recommend to management or the governing body the appropriate compensation of the CAE.
- Review the budget, expertise, and staffing levels of the internal audit program.
- Advise the board about increases and decreases to the requested budget for the internal audit program and any additional expertise needed. Evaluate whether additional expertise is in the form of permanent staff or contracting for outside consulting services.
- Review internal audit reports and other communications to management.
- Review and advise management on the results of any special investigations.

- Inquire of the CAE whether any evidence of fraud has been identified during internal audits and further action to be taken.
- Review and track management's action plans to address internal audit recommendations.
- Inquire of the CAE whether any internal audit engagements or tasks have been carried out that did not result in a report to the committee. If there have been, inquire as to the matters of significance, if any, arising from such work.
- Review and provide input on internal audit's strategic plan, program goals, performance measures, and outcomes.
- Inquire of the CAE about steps taken to ensure that the audit activity is consistent with The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)*.
- Ensure that the internal audit function has an external quality assurance review every five years.
- Review the results of the independent external quality assurance review and monitor the implementation of the action plans to address recommendations raised.
- Advise the board of any recommendations concerning the continuous improvement of the audit activity.

External audit. To obtain reasonable assurance with respect to work of the external assurance providers, the audit committee shall meet with the external assurance providers during planning of the audit, the presentation of the audited financial statements, and the discussion of the letter to management on recommendations.

Follow up on management action plans. To obtain reasonable assurance that management has acted on the observations and recommendations from internal and external audit, the audit committee shall review regular reports on the progress of implementing approved management action plans and audit recommendations resulting from completed audits.

Financial statements and public accountability reporting. The audit committee is responsible for oversight of the independent audit of the government entity's financial statements, including but not limited to overseeing the resolution of audit findings in areas such as internal control, legal, regulatory compliance, and ethics.

Other responsibilities. In addition, the audit committee shall:

- Perform other activities related to this charter as requested by the governing body.
- Institute and oversee special investigations as needed.
- Regularly evaluate the performance of the committee and individual members *[leading practice recommends annual assessments]*.

Reporting on audit committee performance. The audit committee shall:

- Make an annual report to the board summarizing the committee's activities and recommendations. The report may be delivered at an audit committee meeting attended by the board or may be scheduled for a regularly scheduled meeting of the board.
- The report should include:
  - A summary of the work the committee performed to fully discharge its responsibilities during the preceding year.
  - A summary of management units' progress in addressing corrective actions on the findings and recommendations made in internal and external audit reports.
  - An overall assessment of the management units' risk, control, and compliance framework, including details of any significant emerging risks or legislative changes impacting the governing organization.
  - Details of meetings, including the number of meetings held during the relevant period and the number of meetings each member attended.
  - The committee may, at any time, report to the governing body any other matter it deems of sufficient importance.

Approval/Signatures

Chief Executive Officer (CEO) _____

Date _____

Audit Committee Chair _____

Date _____

Chairman of the Board _____

Date _____

Appendix 2: Values and Ethics Oversight Tool

Values and Ethics Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
1. The committee has reviewed the initiatives established by management to implement and maintain a values and ethics framework for the organization.	❐	❐	❐	❐	❐
2. The organization's values and ethics expectations have been communicated to staff.	❐	❐	❐	❐	❐
3. A member of senior management is responsible for championing the values and ethics program.	❐	❐	❐	❐	❐
4. The program is periodically reviewed and the results of this review are provided to the audit committee.	❐	❐	❐	❐	❐
5. Management measures and monitors compliance with the value and ethics framework.	❐	❐	❐	❐	❐
6. Management and staff are required to sign off on: • Receipt of a copy of the values and ethics expectations of the organization. • Understanding of these expectations. • Commitment to adherence to the requirements.	❐	❐	❐	❐	❐
7. The values and ethics program is consistent with compensation and rewards of the organization.	❐	❐	❐	❐	❐
8. The organization has established procedures for communicating any breach of the organization's values and ethics policies to the audit committee.	❐	❐	❐	❐	❐
9. The audit committee has inquired of management and the organization's legal counsel whether they are aware of any breaches of the organization's values and ethics policy.	❐	❐	❐	❐	❐

Appendix 3: Governance Oversight Tool

Governance Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
1. The legal structures and authorities that govern the operation of the public sector organization are clearly stated.	❐	❐	❐	❐	❐
2. The purpose and mandate of the organization are clearly stated.	❐	❐	❐	❐	❐
3. The strategic priorities are set out and supported by a strategic plan.	❐	❐	❐	❐	❐
4. The values and ethics policy of the organization is clearly established and communicated and adherence to it is monitored.	❐	❐	❐	❐	❐
5. The key stakeholders of the public sector organization and their expectations are well known. There are mechanisms in place to monitor whether these expectations are being met.	❐	❐	❐	❐	❐
6. The risks that the organization faces have been identified. There are established mechanisms to assess, manage, and mitigate these risks to a level established by the board.	❐	❐	❐	❐	❐
7. The mandates of committees with governance responsibilities are known, understood, and consistent with each other.	❐	❐	❐	❐	❐
8. There are established mechanisms for the appointment of committee members.	❐	❐	❐	❐	❐
9. There are mechanisms within the public sector organization to assess the performance of the board.	❐	❐	❐	❐	❐
10. There are mechanisms to assess the performance of individual committee members.	❐	❐	❐	❐	❐
11. There is effective interaction among the organization's board and committees of the board with management and staff.	❐	❐	❐	❐	❐
12. Methods of compensating senior management are consistent with the values and ethics of the organization.	❐	❐	❐	❐	❐
13. The organization is appropriately resourced to achieve its strategic priorities and fulfill its mandate.	❐	❐	❐	❐	❐
14. The organization has mechanisms to measure, monitor, and report on its performance.	❐	❐	❐	❐	❐
15. The organization has mechanisms to account for its use of the resources entrusted to it.	❐	❐	❐	❐	❐

Appendix 4: Risk Management Oversight Tool

Risk Management Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
1. There is a formal coordinated risk management framework that aligns with the organization's vision and strategies.	❐	❐	❐	❐	❐
2. The risk management framework includes a suitable risk management policy with clarity over key features including the risk appetite, risk profiling, responsibility and accountability for risk management, critical service and operational changes, and periodic formal risk review and reporting arrangements.	❐	❐	❐	❐	❐
3. The organization's risk management framework is consistent with internationally accepted risk management standards (e.g., ISO 31000:2009 and COSO's *Enterprise Risk Management–Integrated Framework*).	❐	❐	❐	❐	❐
4. The organization has an appropriate attitude toward risk management and it communicates the importance of risk management and internal controls.	❐	❐	❐	❐	❐
5. Management uses appropriate processes to identify, assess, and respond to risks in a manner that is aligned with the organization's risk appetite.	❐	❐	❐	❐	❐
6. Management obtains assurance that the organization's material business risks — including operational, financial, legal, and compliance — are appropriately captured in the risk profile/risk register and reported to the board at least annually.	❐	❐	❐	❐	❐
7. The committee had periodic in camera meetings with the chief risk officer to obtain his or her insights.	❐	❐	❐	❐	❐
8. Responsibility and accountability for risk is clearly assigned to the organization's managers.	❐	❐	❐	❐	❐
9. There are complementary risk planning arrangements in place that cover areas such as business continuity, disaster recovery, legal compliance, and fraud control.	❐	❐	❐	❐	❐
10. Appropriate arrangements have been established with management to receive briefings on emerging risk areas, such as those associated with technological changes and cybercrime.	❐	❐	❐	❐	❐

11. The organization has adequate internal controls in place and is operating effectively over its major risks.	❒	❒	❒	❒	❒
• Steps are taken to evaluate the overall effectiveness of the risk management and internal control framework, including actions undertaken by the audit activity and external assurance providers.	❒	❒	❒	❒	❒
• Practices are in place to ensure that management maintains rigorous control systems over the approval, recording, and processing of financial data so as to deliver financial statements that comply with relevant standards and government requirements.	❒	❒	❒	❒	❒
• Appropriate reporting and briefings are received from senior management on the controls over computer systems and applications, including change management, security, and business continuity management, and arrangements that provide protection against computer fraud, misuse, and cyberattacks.	❒	❒	❒	❒	❒
• Steps have been taken to establish the reasonableness of management's processes for managing insurable risks, including the adequacy of insurance coverage (and self-insurance, if applicable).	❒	❒	❒	❒	❒
• Assurance has been given that risk management practices adequately cover critical third-party arrangements such as cross-agency governance and significant third-party service providers and suppliers.	❒	❒	❒	❒	❒

Appendix 5: Internal Audit Oversight Tool

Best practices indicate that the audit committee should define in its charter the scope of its relationship with the internal auditors and should work to enhance its oversight ability — thereby strengthening the audit activity.

To provide adequate oversight of internal audit, an audit committee must ensure:

- The audit committee engages in an open, transparent relationship with the CAE.
- The audit committee annually reviews and approves the internal audit charter.
- As a result of discussions with the CAE, the audit committee has a clear understanding of the strengths and weaknesses of the organization's governance, internal control, and risk management systems.
- The audit activity is sufficiently resourced with competent, objective internal audit professionals to carry out the internal audit plan, which the audit committee has reviewed and approved.
- The audit activity is empowered to be independent by its appropriate reporting relationships to executive management and the audit committee.

- The audit committee addresses with the CAE all issues related to internal audit independence and objectivity.
- The audit activity is quality-oriented and has in place a quality assurance and improvement program.
- The audit committee regularly communicates with the CAE about the performance and improvement of the position and the audit activity.
- Internal audit reports are actionable, and management implements audit recommendations and other improvements.
- The audit committee meets periodically with the CAE without the presence of management

Internal Audit Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
Considerations for the Chief Audit Executive					
1. Governance and Communication • Management considers internal audit's views. • The senior management team supports the internal audit function. • Internal audit is sufficiently independent from management. • Internal audit and the audit committee support each other. • Matters that warrant audit committee attention are brought forth on a timely basis.	☐ ☐ ☐ ☐ ☐	☐ ☐ ☐ ☐ ☐	☐ ☐ ☐ ☐ ☐	☐ ☐ ☐ ☐ ☐	☐ ☐ ☐ ☐ ☐
2. Proficiency • Internal audit has the expertise it needs to conduct its assignments. • Existing skill sets are appropriate. • Team members have acquired professional designations that demonstrate their competence.	☐ ☐ ☐	☐ ☐ ☐	☐ ☐ ☐	☐ ☐ ☐	☐ ☐ ☐
3. Continuing Professional Education • Internal audit staff stays current with changes in audit and accounting standards and best practices. • Team members participate in professional development training.	☐ ☐	☐ ☐	☐ ☐	☐ ☐	☐ ☐

4. Quality Assurance and Improvement Plan					
• The audit activity has a quality assurance and improvement program.	❒	❒	❒	❒	❒
• The audit activity has performed its work in accordance with its charter.	❒	❒	❒	❒	❒
• The internal auditors adhere to The IIA's Code of Ethics.	❒	❒	❒	❒	❒
• Internal audits are conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing (Standards).*	❒	❒	❒	❒	❒
• The audit activity engages in ongoing internal review and analysis of supervision, documentation, policies, and procedures.	❒	❒	❒	❒	❒
• The audit activity engages in periodic reviews that include customer surveys, risk assessments, work paper reviews, review and analysis of performance metrics, and best practice benchmarking.	❒	❒	❒	❒	❒
• The audit activity has obtained an independent external quality assessment within the past five years.	❒	❒	❒	❒	❒
5. Planning, Risk Assessment, and Internal Controls					
• Internal audit has a clearly articulated strategy.	❒	❒	❒	❒	❒
• The internal audit plan has been developed.	❒	❒	❒	❒	❒
• Internal audit plan is aligned to key risks of the organization and other assurance activities.	❒	❒	❒	❒	❒
• Risks are identified.	❒	❒	❒	❒	❒
• The organization has adequate internal controls over its major risks.	❒	❒	❒	❒	❒
• The information systems control environment, including key business information systems, is assessed, and security over these systems is maintained.	❒	❒	❒	❒	❒
• Procedures are in place to prevent/address the risk of management override of controls.	❒	❒	❒	❒	❒
6. Fraud, Waste, and Abuse					
• The organization's policies and procedures are monitored to prevent improprieties.	❒	❒	❒	❒	❒
• Internal audit considers issues related to the potential for fraud, waste and abuse.	❒	❒	❒	❒	❒
7. Resources					
• Staff size is adequate.	❒	❒	❒	❒	❒
• There are areas of concern that were not reviewed due to budget or other limitations.	❒	❒	❒	❒	❒
• The activity has the tools and other resources it needs.	❒	❒	❒	❒	❒
8. Coordination					
• There is an effective working relationship between internal and external audit.	❒	❒	❒	❒	❒
• Internal audit activities are coordinated with those of external audit.	❒	❒	❒	❒	❒

9. Reporting and Results					
• Audits have identified areas of concern to the overall environment. Specific locations or areas have been identified.	❒	❒	❒	❒	❒
• Internal audit has a clear set of performance expectations that are aligned with the success measures of the audit committee.	❒	❒	❒	❒	❒
• Internal audit has met expectations of the audit committee.	❒	❒	❒	❒	❒
• Internal audit has accomplished its audit plan.	❒	❒	❒	❒	❒
• Internal audit contributes to the improvement of organizational operations and is perceived by stakeholders to add value.	❒	❒	❒	❒	❒
10. Monitoring Progress					
• Management required to respond to internal audit findings and recommendations.	❒	❒	❒	❒	❒
• Management has been responsive to internal audit's previous findings and recommendations.	❒	❒	❒	❒	❒
• Recommendations made in previous years with respect to internal controls have all been adopted.	❒	❒	❒	❒	❒
11. Standards checklist items. This tool provides a checklist of responsibilities related to the board that the CAE is required to perform under The IIA's International Professional Practices Framework.					
• The CAE reviewed the internal audit charter and presented it to senior management and the board for approval.	❒	❒	❒	❒	❒
• The CAE discussed The IIA's Definition of Internal Auditing, Code of Ethics, and *Standards* with senior management and the board.	❒	❒	❒	❒	❒
• The CAE has direct and unrestricted access to senior management and the board.	❒	❒	❒	❒	❒
• The CAE confirms to the board, at least annually, the organizational independence of the audit activity.	❒	❒	❒	❒	❒
• The CAE reports functionally to the board.	❒	❒	❒	❒	❒
• The CAE communicates and interacts directly with the board.	❒	❒	❒	❒	❒
• The CAE discusses with the board the form and frequency of external assessment and the qualifications and independence of the external assessor or assessment team, including any potential conflicts of interest.	❒	❒	❒	❒	❒
• The CAE communicates the results of the quality assurance and improvement program to senior management and the board.	❒	❒	❒	❒	❒

• When non-conformance with the Definition of Internal Auditing, the Code of Ethics, or the *Standards* affects the overall scope or operation of the audit activity, the CAE discloses the non-conformance and the effect to senior management and the board.	❒	❒	❒	❒	❒
• Input from senior management and the board has been incorporated into the audit plan.	❒	❒	❒	❒	❒
• The CAE has communicated the audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval.	❒	❒	❒	❒	❒
• The CAE reports periodically to senior management and the board on the audit activity's purpose, authority, responsibility, and performance relative to its plan.	❒	❒	❒	❒	❒

Appendix 6: External Assurance Provider Oversight Tool

External Assurance Provider Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
1. The audit committee considers and understands the external audit plan.	❒	❒	❒	❒	❒
2. The committee reviews external audit reports and management letters and considers management responses to findings and recommendations.	❒	❒	❒	❒	❒
3. The committee provides input and feedback on external audit coverage and performance.	❒	❒	❒	❒	❒
4. The audit committee considers the relationship between planned internal and external audit coverage.	❒	❒	❒	❒	❒
5. The activities of internal audit are coordinated with those of external audit.	❒	❒	❒	❒	❒
6. The external assurance provider had complete and timely access to the organization's books, records, information, and staff.	❒	❒	❒	❒	❒
7. Business risks that may affect the conduct of the work of the external assurance provider have been communicated to him or her.	❒	❒	❒	❒	❒
8. The external assurance provider has adequate independence of the public sector organization.	❒	❒	❒	❒	❒
9. There are adequate safeguards over the threat of familiarity.	❒	❒	❒	❒	❒

Appendix 7: Management Action Plans Oversight Tool

Management Action Plans Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
1. The audit committee reviews the results of completed audit work.	❐	❐	❐	❐	❐
2. The committee evaluates the findings and related risk exposures in terms of the impact on achievement of the organization's mandate.	❐	❐	❐	❐	❐
3. The committee reviews and assesses management's response to audit recommendations and considers their completeness and adequacy.	❐	❐	❐	❐	❐
4. The audit committee reviews the action plan established by management to address the observations raised.	❐	❐	❐	❐	❐
5. The audit committee receives periodic reports on the progress that management is making in correcting the identified weaknesses.	❐	❐	❐	❐	❐
6. The audit committee is provided with periodic reports on the recommendations fully addressed and those that remain outstanding.	❐	❐	❐	❐	❐

Appendix 8: Financial Statements and Public Accountability Reports Oversight Tool

Financial Statements and Public Accountability Reports Oversight Tool	1	2	3	4	5
Rating scale 1 = Strongly disagree 2 3 4 5 = Strongly agree					
1. The audit committee work plan provides time to review financial statements and public accountability reports.	❒	❒	❒	❒	❒
2. The audit committee has reviewed the appropriateness of the organization's accounting policies and financial statement note disclosures.	❒	❒	❒	❒	❒
3. The key estimates and judgments that management has made in preparing the financial statements are appropriate.	❒	❒	❒	❒	❒
4. The audit committee has obtained reasonable assurance that the financial statements are presented fairly in accordance with GAAP or the organization's stated accounting policies.	❒	❒	❒	❒	❒
5. The audit committee has reviewed the financial statements and note disclosures with the external assurance providers.	❒	❒	❒	❒	❒
6. The audit committee has reviewed public accountability reports.	❒	❒	❒	❒	❒

Glossary of Terms

Accountability. An obligation to give an account (explain) of one's actions and accept responsibility and/or consequences arising thereof.

Add value. Provides objective and relevant assurance and contribution to the effectiveness and efficiency of governance, risk management, and control processes. *(Source: Standards Glossary)*

Agencies. Public organizations that are clearly a part of the government and deliver public programs, goods, or services, but that exist as separate organizations in their own right — possibly as legal entities — and operate with a partial degree of operational independence.

Board. The highest level of governing body charged with the responsibility to direct and/or oversee the activities and management of the organization. Typically, this includes an independent group of directors (e.g., a board of directors, a supervisory board, or a board of governors or trustees). If such a group does not exist, the "board" may refer to the head of the organization. "Board" may refer to an audit committee to which the governing body has delegated certain functions. *(Source: Standards Glossary)*

Chief audit executive (CAE). A person in a senior position responsible for effectively managing the audit activity in accordance with the internal audit charter and the Definition of Internal Auditing, the Code of Ethics, and the *Standards*. The CAE or others reporting to him or her will have appropriate professional certifications and qualifications. The specific job title of the CAE may vary across organizations. *(Source: Standards Glossary)*

Core government. All departments, ministries, or branches of the government that are integral parts of the structure and are accountable to and report directly to the central authority — the legislature, council, cabinet, or executive head. The core government includes both central/federal governments and local governments.

Independence. The freedom from conditions that threaten the ability to carry out responsibilities in an unbiased manner. *(Source: adapted from the Standards Glossary)*

International Professional Practices Framework (IPPF). The conceptual framework that organizes the authoritative guidance promulgated by The IIA, the global guidance-setting body. The IIA provides internal audit professionals worldwide with authoritative guidance organized in the IPPF as mandatory guidance and strongly recommended guidance. *(Source: Standards Glossary)*

Members of the public. Citizens of a locale who are primary beneficiaries of the goods and services provided by public sector.

Objectivity. An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. *(Source: Standards Glossary)*

Public enterprises. Agencies that deliver public programs, goods, or services but operate independently of government and often have their own sources of revenue in addition to direct public funding. They also may compete in private markets and may make profits.

Public sector. Governments and all publicly controlled or publicly funded agencies, enterprises, and other entities that deliver public programs, goods, or services as elaborated in The IIA guidance titled *Public Sector Definition*.

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Elizabeth MacRae, CGAP

ATTACHMENT 6

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: February 6, 2020

TO: Honorable Members of the Audit Committee

FROM: City Attorney

SUBJECT: Preliminary Response to Interim Auditor's Request for Independent Legal Counsel

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INTRODUCTION

On January 24, 2020, the Interim City Auditor (ICA) issued a memorandum requesting support for a ballot measure that would amend the San Diego City Charter (Charter) to authorize the City Auditor to obtain independent legal counsel. The ICA alleges that such an amendment would protect the City Auditor's independence. This memorandum provides a preliminary response to the request which the Office of the City Attorney understands will be agendized and discussed at the Audit Committee meeting on February 19, 2020. This memorandum is not intended to be a full analysis of the issues raised.

First and foremost, this Office notes that the electorate will determine during the March 2020 primary whether to amend the Charter to change the manner in which the City Auditor is appointed. This Office understands that a recruitment to fill this position with a permanent City Auditor will begin immediately thereafter. The enactment of such a fundamental, permanent change in the Charter to provide independent counsel to the City Auditor is uncharted territory for the City of San Diego and will necessarily affect the City Auditor's department and the way that the new City Auditor conducts his or her operations. Furthermore, the new City Auditor may have additional proposed amendments to the Charter relating to the Office of the City Auditor that he or she would like addressed. It may be advantageous to postpone this discussion until after the new City Auditor is hired so that she or he may have an opportunity to provide input as to which proposals, if any, should be considered for inclusion on an upcoming ballot.

PRELIMINARY ANALYSIS

Irrespective of its timing, a number of issues related to the ICA's request require more research, analysis, and discussion before a final determination is made as to whether a measure should be placed on the ballot to provide the City Auditor with authority to retain independent counsel. Preliminarily, the issues are as follows:

I. WHETHER THERE IS AN ACTUAL NEED FOR A CHARTER REVISION TO PROVIDE THE CITY AUDITOR WITH INDEPENDENT COUNSEL

There are five points this Office would like to highlight relating to this issue, which are as follows:

First, it is not a conflict of interest for this Office to represent different City departments because City departments are "component parts of an indivisible municipal corporation." 2010 City Att'y MOL 392 (2010-21; Oct. 5, 2010). This Office represents the City of San Diego, and not a particular individual or department. *Id.* It is common for departments to have differing views on policy matters requiring legal advice, or competing perspectives. "That relationship does not make these City Officers the City Attorney's separate clients. Accordingly, rules prohibiting an attorney from representing clients with adverse interests do not apply." *Id.*, citing Op. Cal. State Bar 2001-167. This Office addresses this common issue by assigning an attorney to advise each department specific to its particular needs and establishing ethical walls between these attorneys. For instance, this Office advises the City's Civil Service Commission (the decision-maker) and the department imposing employee discipline (an advocate appearing before the decision-maker). The courts have held that a single public law agency like the City Attorney's Office may advise both so long as the Office establishes appropriate ethical screening walls between advising attorneys. *Howitt v. Superior Court*, 3 Cal. App. 4th 1575, 1586 and n.4 (1992); *see also In re Charlisse C.*, 45 Cal. 4th 145, 162-66 (2008).

Second, the Charter already authorizes the use of outside counsel when the Office has a conflict of interest, lacks expertise, or does not have sufficient resources available to handle a particular matter. San Diego Charter § 40. For example, this Office recently retained outside counsel with specialized expertise to assist the ICA in investigating and analyzing a Fraud Hotline complaint. The need to retain outside legal counsel rarely materializes. Accordingly, it is worth exploring whether a Charter revision is necessary when the need for outside counsel is rare.

Third, the ICA equates his need for independent counsel to that of the Ethics Commission, although the Auditor and Ethics Commission have fundamentally different roles and legal needs. The Ethics Commission is a regulatory enforcement entity with the power to enforce the City's governmental ethics laws and to issue legally binding administrative enforcement orders regarding violations of these laws. *See* San Diego Municipal Code (SDMC) §§ 26.0414(e) and 26.0439. Furthermore, the Ethics Commission has the authority to levy fines of up to $5,000 per violation. SDMC § 26.0440. Their enforcement role necessitates the need for subpoena power[1] and independent counsel. San Diego Charter § 41(d).

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[1] In the past, the City Auditor has erroneously asserted that he had subpoena power, which was addressed by this Office in a memo dated August 4, 2014. 2014 City Att'y MOL 304 (2014-16; Aug. 4, 2014). It is also important to note that the creation of the independent Auditor position has its origins in the Kroll Report, yet there is no mention in that report of the need for independent counsel to allow the City Auditor to fulfill his or her role or to protect the City Auditor's independence.

The Auditor, on the other hand, provides recommendations on how to improve the efficiency and effectiveness of City departments and programs, and on how City management should address substantiated findings of fraud, waste, or abuse. *See* San Diego Charter § 39.2.

Fourth, the ICA's request mentions only one city, which is outside of California, that has taken this approach of providing its auditor with independent counsel. This Office suggests including the Independent Budget Analyst (IBA) in this discussion, as she may have input on how prevalent this approach is and whether California cities, particularly major California cities, have taken this approach and the reasons for and against doing so.

Fifth, even assuming there is a need for independent counsel, the question is whether outside counsel could deliver services comparable to the services provided by this Office. Attorneys advising the City Auditor must be familiar with and knowledgeable about the regulations affecting all City departments and programs as well as the rules regarding City governance, policies, and procedures. This Office has attorneys with a wide range of subject matter expertise involving every City department and program. Without comprehensive expertise, outside counsel would have to acquire such knowledge at a significant cost to the City. In addition, competent outside counsel will need to communicate with and involve the City Attorney's Office to some degree, as the Office remains the City's Chief Legal Advisor under section 40 of the Charter.

II. THE NEED FOR AN ACCURATE CALCULATION OF THE COST OF PROVIDING INDEPENDENT COUNSEL TO THE CITY AUDITOR

The ICA's request asserts an estimated annual budget for independent counsel of $180,000 per year based solely on the budget for outside counsel by the Ethics Commission. No additional research or analysis has been performed. Based on the comprehensive services that are provided by this Office to the City Auditor, this figure may significantly underestimate the cost of providing independent counsel, unless the level of legal services is drastically reduced. This Office recommends that the IBA analyze the full cost of the ICA's request, which should include the cost of the independent counsel services per fiscal year based on at least five years of data.

III. THE NEED TO MEET-AND-CONFER WITH AFFECTED CITY LABOR UNION(S)

Because the ICA's request directly impacts the work of attorneys and support staff in the Office, represented by the Deputy City Attorneys' Association (DCAA) and the San Diego Municipal Employees Association (SDMEA) respectively, there is a legal requirement to notify the DCAA and the SDMEA, and to meet-and-confer on the ICA's request, before any proposal may appear on the ballot.

CONCLUSION

While this Office stands ready to further discuss these issues and any others that may be raised related to the ICA's request for independent counsel, this Office believes that such discussions should include input from the new City Auditor whose department and operations will be most affected by such a change. Furthermore, this Office believes that there should be appropriate research and analysis conducted on the issues raised in this memorandum to better inform any further discussions.

MARA W. ELLIOTT, CITY ATTORNEY

By */s/ Mara W. Elliott*

Mara W. Elliott
City Attorney

MWE:KRS:soc:ccm
MS-2020-3
Doc. No. 2307213_3
cc: Honorable Mayor Kevin Faulconer
Honorable Members of the City Council
Aimee Faucett, Chief of Staff, Mayor
Kris Michell, Chief Operating Officer
Ron Villa, Assistant Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst
Kyle Elser, Interim City Auditor

Attachment D

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: December 9, 2009

TO: Lisa Gordon, Director of Appointments

FROM: City Attorney

SUBJECT: [redacted] Appointee for Commission for Arts and Culture

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You have asked that our Office help you identify any potential conflicts of interest if [redacted] is appointed as a member of the Commission for Arts and Culture. In that regard, you have provided our Office with [redacted] application and background check materials gathered by the San Diego Police Department.

The laws governing conflict of interest include provisions of the Political Reform Act, case law and other statutory laws, the San Diego Municipal Code, and Council Policy 000-04. These laws are designed to protect against the appearance of conflict and self-benefit by public officials, and may be violated if certain appointees participate in certain business or votes before that board or commission. To determine whether a potential conflict exists, we would need to know all the facts in a given situation, and absent those facts, our Office cannot provide a "blanket" opinion as to whether an appointee will be unable to participate in future governmental decisions.

This pre-appointment review should not be used as a substitute for an ongoing review of potential conflicts. These potential financial interests include investments in business entities, interests in real property, income, positions in business entities, and gifts. These interests should be disclosed on the appointee's Statement of Economic Interests (Form 700) after the appointment is confirmed and will help identify future conflicts of interest. In addition to those interests, there are other general common law and California Government Code section 1090 requirements precluding self-dealing and conflicts of interest.

Notwithstanding the above, we have conducted a cursory review of the application and background materials for general concerns or issues that may create a potential conflict of interest. In that regard, we make the following observations:

Application and Background Materials:

We note that [redacted] indicates in his answers to questions 25 and 26 of the application that he does not have any potential conflicts of interest arising out of his business positions or financial interests.

[redacted] application states that he is the co-owner of [redacted] located in [redacted] and has co-owned this [redacted] since November 2007. [redacted] has a financial interest in his business endeavor that raises potential conflict of interest issues. If a conflict exists, [redacted] may be precluded from participating in a decision as a member of the Commission for Arts and Culture if it is reasonably foreseeable that the decision will have a material financial effect distinguishable from its effect on the public generally, on him, or on a member of his immediate family. A further analysis would be required depending on the nature of the interest and the facts of the proposed decision.

The results of the background materials indicate there may be a match with [redacted] name under the investigative categories described as criminal background search, Superior Court research, and Internet research. Nevertheless, based on the summary of information provided, we cannot determine whether this information would reveal a potential conflict of interest. We will conduct further review if more detailed information is provided.

As discussed above, conflict of interest analysis is dependent upon specific factual circumstances presented. Thus, our Office cannot opine in general as to whether [redacted] may have a potential conflict of interest in dealing with matters that may be before the Commission for Arts and Culture. However, based on the information provided, we do not see any major concerns regarding his appointment except as noted above.