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March 31, 2009

Kevin L. Faulconer
Audit Committee Chairman
City of San Diego
202 C Street
San Diego, CA 92101

Dear Councilmember Faulconer:

You have asked me to address the process by which the Audit Committee reviews the City's CAFR, with particular focus on the sequence of completion of the audit and review by the Audit Committee prior to submission to the City Council.

The CAFR review process was considered in 2007 by the Council Audit Committee and a policy was adopted. A copy of that policy and covering memorandum dated May 11, 2007 are attached. The policy basically contemplates a procedure for preparation of the CAFR, including the annual financial statements, with Audit Committee ongoing involvement; review of a near final draft by the DPWG; completion of the audit of the financial statements; consideration by the Audit Committee; and acceptance and filing by the Council to complete the process.

Development of the policy presented a classic "chicken and egg" problem, compounded by the open meeting/public disclosure requirements of the Brown Act. It would theoretically be desirable to have Audit Committee review, and indeed Council action, before the CAFR is made public. However, this review and action could not take place without making the CAFR and related financial statements public, and the City does not want to be in the position to issue potentially incomplete or unreliable information. Moreover, there was concern over timelines in view of potential delays that could arise from Audit Committee and Council review and action, as well as problems from delaying completion of the audit since auditor review procedures need to correlate with their sign-off and issuance of their audit report.

Thus the process was put in place to provide the CAFR with audited financial statements to the Audit Committee for review in recognition that these are likely to be most reliable with the audit completed. This process also enabled timely completion of the audit. It is recognized that the CAFR, when it is presented to the Audit Committee, is management's document and is not an official document of the City until the process of Audit Committee review and Council action is completed and that it may be changed as a result. In fact, acknowledging this, the policy was adopted to legend the CAFR to reflect the foregoing and to refrain from posting it to the City's investor information page on its website until the review and approval process was completed. In addition, so that the Audit Committee would not be receiving the CAFR cold without earlier

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involvement in the process, the policy contemplates various steps during the audit process in which the Audit Committee is involved through reporting by the auditor and financial management.

Although revisions are not expected to occur as a result of Audit Committee review if the work is properly done, revisions are possible. Indeed, revision to the pension tax audit note took place in late 2007 after the CAFR with audited financial statements was released.

The most recent experience with the 2008 CAFR was unique in that the City ran up against its continuing disclosure agreement filing date before the Audit Committee review could take place. The issue surfaced just before the March 23 Audit Committee meeting and based upon legal advice, applying relevant SEC guidance, the decision was made, in order to be timely in the City's continuing reporting, to file the 2008 CAFR with audited financial statements, together with a legend that the review process was not yet completed and a further filing would be made. At my suggestion, this was reported to the Audit Committee at the March 23 meeting for information purposes. It is my recommendation that on a going forward basis the City have in place a schedule that contemplates completion of its CAFR and Audit Committee review and Council action before the continuing reporting filing is due so as to be in a position to avoid this problem.

The policy for review of the CAFR described above was carefully considered to balance the concerns for timely and reliable financial reporting along with an effective review process as part of the City's controls. In my judgment, it is a sound policy designed to accomplish these objectives. I recommend that it be updated to reflect the existing policy for posting the CAFR on the City's website and that it include a schedule for completing the entire CAFR review process before a continuing reporting filing is due.

I hope this is helpful. Let me know if there are any questions. I plan to be at the Audit Committee meeting on April 13 and will be happy to discuss this further at that meeting.

Very truly yours,



Stanley Keller
Independent Consultant

SK/kef

Enclosures

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CITY OF SAN DIEGO

INDEPENDENT CONSULTANT UNDER SEC ORDER

To: Audit Committee

Re: CAFR Process

Dated: May 11, 2007

Attached for your consideration are two documents relating to the process for dealing with the City's Comprehensive Annual Financial Report as follows:

1. *Process for Audit Committee Action on 2003 CAFR Review.* This is designed to assist the Audit Committee in completing the process regarding the 2003 CAFR, which previously has been issued so that it is in a position to make a recommendation to the City Council.
2. *Process for Review of CAFRs.* This outlines the Audit Committee process for dealing with CAFRs in the future.

These documents were prepared with input from Mark Blake, the Deputy City Attorney for Finance and Disclosure; John McNally of Hawkins Delafield & Wood LLP, the City's outside disclosure counsel; Andrea Tevlin and Jeff Kavar from the Independent Budget Analyst Office; and Jay Goldstone and Greg Levin from the City's financial management.

The processes outlined in these documents would be another significant step in the City's efforts to create effective controls and procedures designed to ensure the reliability of the City's financial reporting and disclosure and to establish a model for other municipal entities to follow. I recommend their adoption.

Stanley Keller
Independent Consultant

Process for Review of CAFRs

1. Prior to commencement of the audit for a fiscal year,* the outside auditor, with financial management present to comment as necessary, will review the audit plan with the Audit Committee.
2. Approximately mid-way through the audit, the outside auditor and financial management should report to the Audit Committee the status of the audit and any significant issues or problems encountered.
3. It is understood that the outside auditor and financial management also are expected and encouraged to bring to the attention of the Audit Committee in a timely manner, separate from the foregoing, any significant matters regarding the audit of which the Audit Committee should be aware as part of its oversight responsibility.
4. The near final draft of the CAFR shall be provided to the DPWG for its review and comments. Upon completion of such review, DPWG shall certify in writing to the Audit Committee and the City Council that the DPWG has reviewed the CAFR in accordance with Section 22.4107(a)(1) of the Municipal Code and that in the best judgment of the DPWG the CAFR is in substantially final form.
5. Upon completion of the audit and the related CAFR, including delivery of the outside auditor's opinion, and following review by the Disclosure Practices Working Group, the CAFR, with related certifications, shall be provided to the Audit Committee and City Council for review at least two weeks prior to their taking action on the CAFR.
6. At a meeting of the Audit Committee at least two weeks after being provided the CAFR, the CAFR will be discussed, with the Audit Committee asking questions of financial management and the outside auditor along the lines of those attached as Exhibit A. If the Audit Committee is satisfied, it will approve a motion recommending to the City Council acceptance and filing of the CAFR.
7. At a meeting of the City Council some time after the Audit Committee meeting, with financial management and the outside auditor available to answer questions, the City Council will be asked to approve a motion to accept and file the CAFR.

* This relates to commencement of future audits, and therefore is not directly applicable to audits now in progress (e.g., fiscal 2003 – completed; fiscal 2004 – near completion). If feasible and useful, the audit plan for fiscal 2005 and fiscal 2006 might be reviewed.