EXECUTIVE SUMMARY

Process for Filing Audited FY 2010 CAFR on Electronic Municipal Market Access (EMMA) System

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: April 29, 2011 **IBA Report Number:** 11-26

Audit Committee Docket Date: May 2, 2011

Item Number: 2b

In response to a request from Councilmember DeMaio at the Audit Committee meeting on April 11, 2011, the IBA and the Office of the City Auditor have reviewed issues related to transmitting the FY 2010 CAFR to EMMA before additional internal review by the Audit Committee and City Council. We considered trade-offs between additional internal review (beyond the draft CAFR review options for the Audit Committee discussed in this report) and further delays in transmitting the audited CAFR to the financial markets.

Our offices recommend following the approach provided by the City's Disclosure Counsel and Independent Consultant in 2009 in order to immediately convey, rather than further delay, important City information to the financial markets. The language recommended by the City's Disclosure Counsel to accompany the EMMA filing informs and assures investors that any material changes to the CAFR attributable to additional Audit Committee or City Council review will be highlighted in a subsequent filing.

Given the challenges associated with public review/discussion of unaudited draft CAFRs by the Audit Committee or City Council, the IBA and City Auditor further recommend the Audit Committee consider existing Municipal Code provisions, management practices and the prior CAFR review suggestion presented in this report. In particular, we suggest 1) assigning a Committee member to attend DPWG meetings where the draft CAFR is reviewed and 2) taking time to review the substantially final draft CAFR before the audit opinion is issued. These opportunities will help the Audit Committee to better understand the City's CAFR development and review processes before an audit opinion is issued.

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: April 29, 2011 **IBA Report Number:** 11-26

Audit Committee Docket Date: May 2, 2011

Item Number: 2b

Process for Filing Audited FY 2010 CAFR on Electronic Municipal Market Access (EMMA) System

OVERVIEW

On April 11, 2011, the Audit Committee received an update regarding 1) correction of financial information in the data management SAP system and 2) the FY 2010 CAFR audit schedule. With respect to the updated audit schedule, the City's outside auditor Macias Gini & O'Connell (MGO) reported they believed they could issue an audit opinion for the FY 2010 CAFR by management's desired target date of August 31, 2011. MGO indicated this was an "aggressive timeline" that could only be achieved if they receive the draft CAFR by July 5, 2011, and if all other internally established milestones are met by the Office of the City Comptroller.

In reviewing the anticipated FY 2010 CAFR audit schedule, Councilmember DeMaio asked the CFO for her plans to notify rating agencies and investors of the revised timeframe for release of the audited CAFR. The CFO responded that, if necessary, she would continue to use the City's Investor Information Webpage to update the financial markets. She further requested the Audit Committee consider the policy decision of posting the audited CAFR to the Municipal Securities Rulemaking Board's (MSRB's) Electronic Municipal Market Access (EMMA) system before the Audit Committee and City Council conduct their internal review.

Recollecting Audit Committee concern over a similar situation related to review/release of the audited FY 2008 CAFR in March 2009, Councilmember DeMaio requested the IBA and Office of the City Auditor look into the issue and return with options for the Audit Committee to consider. This report provides options and recommendations from the IBA and Office of the City Auditor related to filing audited CAFRs with EMMA before or after internal review by the Audit Committee and City Council.

FISCAL/POLICY DISCUSSION

The question of releasing an audited CAFR before Audit Committee/Council review was previously addressed in March 2009. In that instance, the City released the audited FY 2008 CAFR before review by the Audit Committee and City Council in order to meet the City's Annual Report filing deadlines with EMMA. The Audit Committee received advice from outside Disclosure Counsel John McNally and Independent Consultant Stan Keller (Attachment 1).

Management currently anticipates receiving the audited FY 2010 CAFR on or before August 31st, approximately five months after the CAFR was to have been included in the City's Annual Report filings with EMMA. The City did notify EMMA that "The City expects to release the CAFR, including the audited financial statements, in August 2011 at which time the Annual Reports, including the CAFR, will be transmitted to EMMA."

In considering when to transmit the pending FY 2010 audited CAFR to EMMA, it is reasonable to ask whether another month of delay is advisable to allow for internal review. In 2009, Disclosure Counsel recommended, with concurrence from the Independent Consultant, the City file the audited CAFR when available provided that the following language accompany the submission to EMMA (modified below to reflect the FY 2010 audited CAFR):

> "We have attached the City's fiscal year 2010 Comprehensive Annual Financial Report ("CAFR"), which includes the City's fiscal year 2010 audited financial statements. Pursuant to disclosure controls and procedures adopted by the City, the CAFR is required to be approved by the City's Audit Committee and received and filed by the City's City Council. Those additional procedures of the Audit Committee and the City Council have not yet occurred, and were they to result in any material changes to the CAFR, such changes will be highlighted in a subsequent filing. In addition, the City will make a filing to advise when the Audit Committee and City Council processes have been completed."

The City's Disclosure Counsel has acknowledged the difference between the current circumstances and those in 2009. He believes this is a policy decision for the City with no single best approach and that the actions taken in 2009 remain as a reasonable approach for consideration again.

The IBA and the Office of the City Auditor have considered the trade-offs between additional internal review (beyond the draft CAFR review options for the Audit Committee as discussed below) and further delays in transmitting the audited CAFR to the financial markets. Reflecting on the trade-offs, our offices recommend following the approach suggested by the City's Disclosure Counsel and Independent Consultant in 2009 in order to immediately convey, rather than further delay, important City information to the financial markets.

Audit Committee Access to CAFR Information before Issuance of the Audit Opinion

It is difficult, if not impossible, for the Audit Committee or City Council to publicly review/discuss a draft CAFR before it is completed/audited. This is because the unaudited CAFR would be made public through the City's docketing process. Investors could mistakenly rely upon unaudited information in a draft CAFR (necessarily docketed for discussion) believing it was final or substantially complete. Understanding this limitation and the importance of internal review by the Audit Committee, a number of measures and practices have been developed to provide Audit Committee members with access to draft CAFR development and review processes before an audit opinion is issued.

In part, Section 26.1706 of the Municipal Code provides the Audit Committee:

- Shall review the calendar of milestones for the preparation of the annual audit;
- Shall ask questions about the outside auditor's objectivity and independence, and take appropriate action to oversee the independence of the outside auditor;
- May appoint up to two members of the Committee to meet with City management and the outside auditor, together or separately, to review and discuss the draft financial statements and the conduct of the audit;
- May appoint a Committee member to attend meeting of the Disclosure Practices Working Group (DPWG) at which the audited financial statements of the City are considered; and
- Shall review with the CFO and the outside auditor: significant accounting policies and practices applied in the preparation of the City's financial statements; any material financial or other arrangements of the City that do not appear in the City's financial statements; and any transactions or courses of dealing with third parties that are material in size or involve terms or other aspects that differ from those that would likely be negotiated with independent parties and which arrangements or transactions are relevant to an understanding of the City's financial statements.

Additionally, it has been the CFO's practice to make a substantially final draft of the CAFR available to Audit Committee members for review and comment before the outside auditor delivers their audit opinion. The IBA has confirmed the CFO will continue this practice; however, time for Audit Committee review & comment will be short and document confidentiality will be required.

Finally, we suggest that interested Audit Committee members review the layout and presentation of financial information in the prior year's audited CAFR as it is often the template or starting point for development of the CAFR for the following fiscal year. Questions or concerns related to the presentation of financial information can be discussed or conveyed to management in accordance with the above Municipal Code provisions.

CONCLUSION

In response to a request from Councilmember DeMaio at the Audit Committee meeting on April 11, 2011, the IBA and the Office of the City Auditor have reviewed issues related to transmitting the FY 2010 CAFR to EMMA before additional internal review by the Audit Committee and City Council. We considered trade-offs between additional internal review (beyond the draft CAFR review options for the Audit Committee discussed in this report) and further delays in transmitting the audited CAFR to the financial markets.

Our offices recommend following the approach provided by the City's Disclosure Counsel and Independent Consultant in 2009 in order to immediately convey, rather than further delay, important City information to the financial markets. The filing language recommended by the City's Disclosure Counsel informs and assures investors that any material changes to the CAFR attributable to additional Audit Committee or City Council review will be highlighted in a subsequent filing.

Given the challenges associated with public review/discussion of unaudited draft CAFRs by the Audit Committee or City Council, the IBA and City Auditor further recommend the Audit Committee consider Municipal Code provisions, management practices and the prior CAFR review suggestion presented in this report. In particular, we suggest 1) assigning a Committee member to attend DPWG meetings where the draft CAFR is reviewed and 2) taking time to review the substantially final draft CAFR before the audit opinion is issued. These opportunities will help the Audit Committee to better understand the City's CAFR development and review processes before an audit opinion is issued.

[SIGNED]

Jeff Kawar
Fiscal & Policy Analyst

[SIGNED]

APPROVED: Andrea Tevlin
Independent Budget Analyst

Attachment: 1. 2009 Memo from Hawkins Delafield & Wood dated March 21, 2009

Hawkins
DELAFIELD & WOOD LLP

MEMORANDUM

TO: Audit Committee
City Council

FROM: John M. McNally

DATE: March 21, 2009

RE: Filing/Posting of 2008 CAFR

The City is required, pursuant to continuing disclosure agreements entered into in accordance with SEC Rule 15c2-12, to file with national repositories certain financial information and operating data, including audited financial statements, on an annual basis. The first such deadline is March 26. It is expected that an executed audit letter will be issued by Macias regarding the fiscal year 2008 financial statements by March 25. As of that date, such financial statements will not have been reviewed by the Audit Committee or received and filed by the City Council.

The SEC staff has advised, in an interpretation of Rule 15c2-12 requirements, that "[i]f audited financial statements are not available by the time the annual financial information must be provided, unaudited financial statements must be provided as part of the annual financial information." In light of such advice, and most particularly because the City will have not simply unaudited financial statements but audited financial statements that are complete (subject to certain additional voluntarily-implemented control processes), it is our recommendation that the City file the audited financial information statements when available in order to meet the various continuing disclosure agreements filing dates. It is our further recommendation that any such filings be accompanied by language substantially along the following lines:

We have attached the City's fiscal year 2008 Comprehensive Annual Financial Report ("CAFR"), which includes the City's fiscal year 2008 audited financial statements. Pursuant to disclosure controls and procedures adopted by the City, the CAFR is required to be approved by the City's Audit Committee and received and filed by the City's City Council. Those additional procedures of the Audit Committee and the City Council have not yet occurred, and were they to result in any material changes to the CAFR, such changes will be highlighted in a subsequent filing. In addition, the City will make a filing to advise when the Audit Committee and City Council processes have been completed.

Stanley Keller, Independent Consultant, has reviewed and provided comments regarding this advice, and concurs in the conclusion.

cc: Brant C. Will