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**OFFICE OF MAYOR JERRY SANDERS  
CITY OF SAN DIEGO**

**MEMORANDUM**

Date: October 30, 2006  
To: Honorable Members of the City Council  
From: Mayor Jerry Sanders   
Subject: Kroll Remediation Status for November 13, 2006, Council Meeting

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In my memorandum dated August 24, 2006, I reported my staff had identified 121 items for remediation from the Kroll Report. These items were grouped by remedial category and were described in detail along with anticipated due dates. In my memorandum dated October 5, 2006, I updated you on the status of items due in September 2006. On November 13, 2006, my staff will meet with you to discuss the following:

- Status of remedial items completed as of November 13, 2006.
- Status of remedial items in-process but not complete as of November 13, 2006

Attachment A – Mayor’s memorandum dated October 5, 2006, Kroll Remediation Status for October 16, 2006, Council Meeting

Attachment B – City Employee Waste, Fraud, Abuse and Ethics Hotline Policy and Procedures Manual (Draft)

Attachment C – Anonymous Submission of Suspected Wrongdoing (Whistleblowers) – Issues for Government Audit Committees to Consider (source: AICPA)

Attachment D – Interest Allocation Remedial Documentation

Cc: City Attorney  
Chief Operating Officer  
Chief Financial Officer  
Independent Budget Analyst  
SDCERS  
John Dyer

## I. Remedial Items Completed

### A. Items Previously Reported Complete

Kroll Items 7-12, 46-47, 48(i), 57.1, 107.1 – see my memorandum dated October 5, 2006 (refer to Attachment A)

### B. Items Completed During this Reporting Period

#### Remedial Category – Audit Committee – Formation and Duties

24. The Audit Committee should have responsibility for the establishment and monitoring of effective policies and procedures for dealing with "whistleblower" complaints, including an internal hotline. (Pages 252 & M-6)

**Status:** Mayoral Office of Ethics and Integrity (OEI) task complete; awaiting meet and confer process results and formation of Audit Committee, see section II.B. The OEI has drafted a policy and procedures for the City's hotline process. Refer to Attachment B. In drafting the policy and procedures, the OEI used the American Institute of Certified Public Accountants (AICPA) tool kit for "Anonymous Submission of Suspected Wrongdoing (Whistleblowers) - Issues for Government Audit Committees to Consider." Refer to Attachment C.

The policy and procedures include protection for whistleblowers and meets the recommendations of Kroll Report item 24. The OEI is in the process of "meet and confer" with the City's unions regarding the policy and procedures manual. Once the Audit Committee is in place, the policy and procedures will be reviewed by the Committee and changed if necessary (after "meet and confer" with the unions).

#### Remedial Category – Budget Policies and Practices

45. The City should publish, along with the annual budget, the significant assumptions that can materially affect the budget, and a comparison of these assumptions against actual experience in recent years. (Pages 261 & M-12)

**Status:** Complete. The City's Fiscal Year (FY) 2007 budget is complete and will be distributed in November. Included in this document is a section that describes the assumptions used to develop the budget. As the City develops its first five-year financial plan, the projections for the current fiscal year will be frequently updated. This will provide a working tool for the City Council to compare budgeted assumptions to actual data.

The City of San Diego does not have actual data for FYs 2003-2005 to illustrate actual experience against the budget. In preparation of the FY 2008 budget and subsequent FY budgets, significant assumptions will be compared against actual experience for prior years.

## I. Remedial Items Completed

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### \* Remedial Category – Financial Reporting

54. The City budget should be presented by month, by department. (Pages 261 & M-13)
55. At least quarterly, a report should be prepared reflecting budget-to-actual comparisons by department in aggregate, with an explanation of significant variances, to be disseminated to the public. (Pages 261 & M-13)
56. The City budget should present budget-to-actual comparisons by department, fiscal year-to-date, along with variances on a monthly basis. (Pages 261 & M-13)
57. At year-end, a budget should be presented to the City Council containing a final budget-to-actual comparison, along with an explanation of variances by department. (Pages 262 & M-13)

**Status:** Complete. The City budget by month, by department for the first two accounting periods was provided to the City Council and presented to the Budget and Finance Committee on October 18, 2006. This report also contains budget to actual comparisons and an explanation of significant variances. The report was made public on the City's website. A similar report will be published on a quarterly basis. Additionally, on September 13, 2006, The Fiscal Year 2006 Summary Report was presented to the City Council. This report contains a final budget-to-actual comparison, along with explanations of variances by department.

### Remedial Category – Interest Allocation

74. The City must develop an improved cash reconciliation process, which is more automated, documented, and complete. The revised process must support accuracy, timely completion, and improved ease of review. (Page M-16)

**Status:** Complete (internal control operating effectiveness to be tested by March 31, 2007). A formal documented process has been completed. Documentation includes an internal control matrix, process flow, process narrative and identification of significant control activities. Additionally, remediation documentation contains a background discussion, actions taken for remediation, design effectiveness assessment, operating effectiveness assessment and process improvement recommendations. Refer to Attachment D. The CFO briefed Macias Ginni & O'Connell on the remediation documentation and received positive feedback.

### Remedial Category – Reconciliation of Accounts

84. The City must develop an improved cash reconciliation process, which is more automated, documented, and complete. The revised process must support accuracy, timely completion, and improved ease of review. (Page M-16)

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## I. Remedial Items Completed

85. The City should develop and implement a timely and less cumbersome bank reconciliation process to clearly reconcile bank and the general ledger balances. The improved process should facilitate timely completion, ease of review, correction of errors, and enhance communication between the Comptroller's and Treasurer's staff. (Page M-16)

**Status:** Complete (internal control operating effectiveness to be tested by March 31, 2007). A formal documented process has been completed. Documentation includes an internal control matrix, process flow, process narrative and identification of significant control activities.

Additionally, remediation documentation contains a background discussion, actions taken for remediation, design effectiveness assessment, operating effectiveness assessment and process improvement recommendations.

## II. Remedial Items In-Process

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### A. Items In-Process Previously Reported

Kroll Items 1-6 and 86 – see my memorandum dated October 5, 2006 (refer to Attachment A).

There is no update to the status of Kroll item 86. Updated status for Kroll Items 1-6 is presented below.

#### **Remedial Category - Oversight Monitor**

1. Appoint a Monitor to oversee the implementation of and compliance with the Remediation Plan. (Pages 263 & M-14)
2. The Monitor should be selected by the Mayor in consultation with the City Council and subject to the approval of the SEC and should be an independent person of suitable standing, independence and experience for the assignment. (Pages 263 & M-14)
3. The Monitor should have complete and unfettered access to all City and SDCERS personnel and records. (Pages 263 & M-14)
4. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)
5. The Monitor should serve a term of no less than three years and should be provided adequate resources to carry the duties of his office. (Pages 263 & M-14)
6. The SEC should have the right, upon request, to expand the scope of the Monitor's duties following consultation with the City. (Pages 263 & M-14)

**Updated Status:** In process. Meetings are being scheduled with the Council and the City Attorney to discuss the Kroll recommended monitor. The Mayor will bring forward a monitor recommendation(s) as soon as possible but no later than January 31, 2007. The scope of duties, term of retention and qualifications will be consistent with the Kroll Report and any subsequent SEC order, if applicable. The Council will have the final approval over the term of retention, scope of duties and qualifications through approval of the contract entered into between the City and the monitor.

### B. Items In-Process During this Reporting Period

#### **Remedial Category – Audit Committee, Formation and Duties**

18. The City should establish a three member Audit Committee comprised of two members from the public and one City Council Member. The public members would be nominated by the Mayor and confirmed by the City Council. (Pages 251 & M-6)

## II. Remedial Items In-Process

19. The City's Financial Reporting Oversight Board should be eliminated as redundant to the Audit Committee. (Page M-6)
20. The Audit Committee should establish a written charter. (Pages 251 & M-6)
21. The Audit Committee should meet quarterly, or more often if necessary, with the City's independent auditors, the City's Auditor General and the CFO. (Page 252)
22. The Mayor, CFO, City Attorney, *Independent Budget Analyst (added)* and City Council should have the authority to make requests of the Audit Committee and Auditor General to perform internal audits of material matters they reasonably believe to be warranted. (Page 252)
23. With the assistance of the CFO and Auditor General, the City's independent auditors would be retained by, report to and take direction from the Audit Committee. (Page 252)
24. The Audit Committee should have responsibility for the establishment and monitoring of effective policies and procedures for dealing with "whistleblower" complaints, including an internal hotline. (Pages 252 & M-6)

**Status:**      Long Term Plan – A City Charter change is required to fully meet all the Kroll Report Audit Committee recommendations identified above. The Mayor requests the City Council direct the City Attorney to prepare a proposed Charter change that will meet the Kroll Report recommendations. The proposed Charter change should be included in the June 2008 general election.

Short Term Plan – Until the above Charter change can be effectuated, the Mayor requests the City Council direct the City Attorney to amend the Municipal Code<sup>1</sup>, using the Kroll Report language as modified below, to convert the Financial Reporting Oversight Board into the Advisory Audit Committee which will serve as an advisory board to the Mayor and City Council.

18. The City should establish a three member Audit Committee comprised of two members from the public and one City Council Member. The public members would be nominated by the Mayor and confirmed by the City Council. (Pages 251 & M-6) No change.
19. The City's Financial Reporting Oversight Board should be eliminated as redundant to the Audit Committee. (Page M-6) No change.
20. The Audit Committee should establish a written charter consistent with its role as an advisor to the Mayor and City Council. (Pages 251 & M-6)

<sup>1</sup> San Diego Municipal Code, Chapter 2: Government, Article 6: Board and Commissions, Division 17: Financial Reporting Oversight Board

## II. Remedial Items In-Process

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21. The Audit Committee, in conjunction with the Mayor and City Attorney, should meet quarterly, or more often if necessary, with the City's independent auditors, the City's Auditor General and the CFO. (Page 252)
22. The Mayor, CFO, City Attorney, *Independent Budget Analyst (added)* and City Council should have the authority to make requests of the Audit Committee and Auditor General to perform internal audits of material matters they reasonably believe to be warranted. (Page 252) No change.
23. With the assistance of the CFO and Auditor General, the City's independent auditors would be retained by, report to and take direction from the Mayor and City Council. The Audit Committee will provide input on an advisory basis. (Page 252)
24. The Audit Committee, in an advisory capacity to the Mayor and City Council, should have responsibility for the establishment and monitoring of effective policies and procedures for dealing with "whistleblower" complaints, including an internal hotline. (Pages 252 & M-6)

### Remedial Category – Ethics

42. To discourage any improper influence of the professionals who serve as "gatekeepers" to the public financial reporting process of the City, the Municipal Code should be amended to add criminal penalties for such conduct. It should be unlawful for any elected official, or employee of the City, or anyone acting under their direction, to take any action to corruptly influence, coerce, manipulate or mislead any independent certified public accountant engaged in the performance of an audit of the financial statements of the City or its component units, or outside legal counsel performing services for the City in connection with an offering statement of the City, or any actuary performing an actuarial valuation in connection with the preparation of the City's or SDCERS's CAFRs, or employees of a bond rating agency performing a credit rating of the City's bonds. (Page M-6)

**Status:** Waiting promised Ordinance from City Attorney's office.

### Remedial Category – Budget Policies and Practices

43. In order to maintain current service levels and address issues such as deferred maintenance, the City must reduce expenditures by improving efficiency, increasing the current revenue base, and seeking alternative revenue sources. (Page M-14)

**Status:** As the City develops its first five-year financial plan, it will address current service levels and other budgetary demands.

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## II. Remedial Items In-Process

44. Ongoing expenditures should be supported by ongoing revenues; capital projects should identify all future cost considerations and financial impacts, including direct and indirect costs for each Enterprise Fund; activities supported by user fees should be fully cost recoverable; discretionary General Fund revenues should not be earmarked; increase the General Fund reserve to the range of 7-10%; budget development should be guided by a long term or strategic plan proposed by the Mayor and adopted by the City Council; and after adoption, annual budgets should be amended only for urgent needs. Specific funding sources should be identified to pay for these needs. (Pages M-14 & M-15)

**Status:** A General Fund reserve policy will be presented to the Budget and Finance Committee at its November 29th Committee meeting and to the full Council for action at a subsequent meeting in December. The policy will identify a reserve account, separate from the "deep" reserves, which will serve as a contingency for unanticipated expenses approved by City Council during a given fiscal year.

### Remedial Category – Retirement Benefits

87. The City Council and employees should develop realistic retirement plan parameters for future City hires. This includes positioning the City to attract and retain the talent needed to meet the citizens' expectations for services, not be viewed as providing excessive benefit levels, and creating a plan the City can afford. (Page M-25)

**Status:** A benchmark study of health and retirement benefits for all employees is in process. Additionally, benchmark studies of police and fire compensation are in process.

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