
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA Report Number: 09-01

Recommended Changes for SEDC Operating Agreement

OVERVIEW

In September 2008 the City Auditor released a report on the Southeastern Economic Development Corporation (SEDC) Performance Audit of Operations conducted by Macias Consulting Group. Key findings from the Performance Audit included:

- SEDC lacks formal policies and procedures, including those needed to govern their budgeting process and provide guidelines on appropriate expenditures and reimbursements;
- Significant weaknesses were found on how SEDC presents budget information on employee compensation;
- SEDC was not reviewing and reconciling reimbursement payments from the City;
- No strategic plan exists;
- Multiple board meetings were cancelled due to a lack of quorum or upon the opinion of the SEDC President that they were unnecessary;
- Community feedback was lacking.

The Performance Audit concludes with 33 recommendations focusing on governance, organizational and operating changes. Attachment 1 includes a summary of the audit recommendations, the City Auditor's response, and response from the Board of Directors of SEDC.

The SEDC Performance Audit was presented at the September 15, 2008 Audit Committee. The Committee received the audit and directed the Independent Budget Analyst (IBA) "to review the findings and recommendations in the report and provide the Council with recommendations for amending the Operating Agreement as appropriate to ensure SEDC remains a separate and viable functioning entity with a stronger role for the mayor and Council as representatives to SEDC's Board and a stronger oversight role for the SEDC Board which includes Board training on their fiduciary responsibilities and that the IBA include analysis and recommendations on other processes including budgeting and how information is transmitted..."

On January 12, 2009 an update was provided to the Audit Committee, including the City Auditor's review of SEDC's response. The City Auditor noted general concurrence with SEDC's response with four exceptions to SEDC's response to Recommendations 14-17 on policies and procedures.

FISCAL/POLICY DISCUSSION

This report outlines our proposed recommendations to the SEDC Operating Agreement and other improvements that we believe will address issues identified in the audit. Our process for developing these recommendations included reviewing the operating agreements, bylaws, and articles of incorporation for all three entities that manage project areas for the Redevelopment Agency (SEDC, Centre City Development Corporation-CCDC, and the City's Redevelopment Division); meeting and discussing various ideas with multiple stakeholders including Board Members, Executive level management, the Mayor's Office, and Murray Kane, special counsel for the Agency; and performing research on other Agency's processes.

The goal we have strived towards, and continue to encourage, is consistent application of policies for all entities of the Agency. Although the specific recommendations suggested in this report are directed at SEDC, we anticipate similar efforts being applied to CCDC, upon the completion of their performance audit, and the City's Redevelopment Division, as part of their organizational review. An agreement to conduct a performance audit of CCDC was approved by the City Council on November 18 and is expected to be completed by April or May 2009.

Governance

The Performance Audit's first recommendation relates to governance structure:

“The City should revamp SEDC's governance structure. Options to consider include: (1) amend and update SEDC's operating agreement to include representatives of the City on the SEDC Board, limitations to the SEDC President's authority; specific requirements for holding Board of Director meetings, as well as establishing requirements for SEDC Board of Directors' training, budgeting practices, communication activities, project management, financial management, performance outcomes, and mandating leave utilization; or (2) integrate/merge SEDC under the direct control of the RDA or integrate SEDC with CCDC depending on the results of the anticipated CCDC study; or, (3) fully operate SEDC as a public agency within the City.”

The audit recommendation provides three options for the City to explore. Our report primarily addresses the first option (to amend and update the operating agreement) as this is the most expeditious manner for the City to institute change given the current governance.

We would also note that in IBA Report 06-31, our office provided a feasibility report to the Land Use and Housing Committee on various structures for the Redevelopment Agency. In addition, the City's Redevelopment Division had been given direction by the previous Council to proceed with steps to implement an Agency-Employee form of governance; wherein all existing Redevelopment Division employees would become employees of the Agency, instead of the City. The status of this proposal is uncertain.

In response to the governance Recommendation #1 in the Performance Audit, the Mayor's Office has proposed to expand the SEDC Board by two members to include one member representing the Mayor's Office and one representing the City Council. Issues with this proposal have been discussed in our meetings with Murray Kane, Special Counsel for the Agency and the City Attorney's Office. Primarily, the government code prohibits "incompatibility of office" in which a conflict may occur when two public offices are held by the same official. A conflict could occur when the goals of the individual offices differ and the same official must make decisions while simultaneously representing the interests of each of those offices. This conflict would impact the City Council from having a council representative on the SEDC Board. Also, the Redevelopment Division's current proposal for transitioning to an Agency-Employee Model includes a provision to expand the Redevelopment Agency by one member to include the Mayor. If this moves forward, the Mayor would have the same conflict.

Due to the conflicts cited above, the IBA offers the following as an alternative to the Mayor's proposal:

A. Consider the Redevelopment Agency's Executive Director (as a representative of both the Council and the Mayor) to sit as a voting member on the Board of Directors of SEDC in lieu of the proposal to add two new members, one representing the Mayor's Office and the other representing the City Council. This suggestion would be contingent upon the transition of the Redevelopment Division to the Agency-Employee model, the status of which is currently unclear. This proposal if approved would require an amendment to the Corporation's Bylaws.

Currently, the Mayor sits as the Agency's Executive Director, but if the Agency-Employee Model currently proposed is adopted, a new Executive Director would be appointed by both the Agency and the Mayor to represent the Agency's interests and overall strategy for the Agency. Similarly, if the Agency's Executive Director also sits on the CCDC Board, this person would be involved in all entities managing the Agency's project areas. Due to the workload, this role may have to be shared with a Deputy Executive Director of the Redevelopment Agency.

If the Mayor's proposal were to proceed, the IBA recommends that the City Attorney return with options on how to accomplish adding mayoral and council representatives to the SEDC given the incompatibility of office issue. This issue would also need to be addressed, if the Redevelopment reorganization to an Agency-Employee model does not occur.

Organizational Changes

Although not an audit recommendation, the IBA looked to further refine the qualifications of the SEDC Board of Directors to address areas of expertise. Upon our review of all the Agency's documents, the IBA noted that the Articles of Incorporation for CCDC include an expertise background, such that, four members of the Board of

Directors must have background or experience in finance; general business; real estate development; law or architecture.

The IBA offers the following to enhance Board expertise and ensure consistency:

B. Amend the bylaws for SEDC, to include a similar expertise requirement for SEDC Board members, with a grandfather clause.

In addition, the following discusses recommendations that would impact the officers of the Board of Directors. Currently, the Bylaws identify that the President/Chief Operating Officer and Chief Financial Officer are appointed officers of the corporation. The President/Chief Operating Officer is hired by the Board and directly supervised by the Chairman of the Board; the President/Chief Operating Officer has the sole power to appoint the Chief Financial Officer. Due to the shared accountability for SEDC matters, the IBA understands the desire of the Council/Agency to participate in the selection of the President/Chief Operating Officer.

The IBA offers the following as an alternative to the current process:

C. Amend the SEDC bylaws to require Agency confirmation of the SEDC Board's recommended selection of President/Chief Operating Officer. To facilitate this process, it is further recommended that the Agency elect a member to participate in the selection process with the Board.

The IBA is in agreement with Audit Recommendation No. 2 that requires the identification of a specific Chief Financial Officer classification that will report directly to the Board of Directors. This will ensure the Chief Financial Officer has the ability to report his/her findings directly to the Board without information being filtered. However, we also suggest that the President/Chief Operating Officer participate with the Board in hiring this position.

Policies and Procedures

The IBA is fully supportive of the multiple audit recommendations that direct SEDC to develop and obtain Board approval for all policies and procedures. The lack of cohesive, formal policies and procedures leads to ambiguity and the ability for the system to be manipulated. We believe a multitude of policies and procedures need to be developed, similar to any other corporation, including policies governing human resources and/or personnel matters, procurement, contracts, financial management, budgeting, real estate, public records access, etc.

The IBA recommends the following to address this deficiency:

D. Amend the Operating Agreement to include a covenant that requires the development and adherence of policies and procedures, subject to approval by the Board of Directors.

For example, the covenant could read as follows: *Development and Adherence to Board Policies and Procedures-Corporation will develop comprehensive policies and procedures that should, at a minimum, address the following:*

- *Human Resources and/or Personnel Manual, including the Corporation's compensation practices, merit pay, bonuses, benefits, performance reviews, performance evaluations, Equal Employment Opportunity (EEO)*
- *Contractual and Procurement, including methods to select consultants and the identification of thresholds for approval by the President, SEDC Board, and/or the Agency.*
- *Fiscal and Financial Management, including debt, investments, cash disbursements, segregation of duties, travel*
 - *Budget Process/Timelines based on City's Budget Policy and Process*
- *Real Estate Acquisition including the use of eminent domain.*
- *Records Retention including responding to Public Records Act requests.*
- *Except for those impacting the Agency's authority (further described below), policies and procedures of the Corporation shall be approved by the Board of Directors.*
 - *The Board of Directors shall identify a schedule to systematically review these policies and procedures.*
- *Policies impacting the Agency's authority (i.e. Contractual and Procurement Policies that identify the level of authority necessary to enter contracts) shall be approved by the Agency upon recommendation by the Board.*
- *A copy of these policies and procedures shall be transmitted to the Agency's Executive Director upon adoption by the Board.*
- *In the event that a specific policy and/or procedure does not exist, the City's policy would govern.*

The above proposal includes a requirement that those policies impacting the Agency's authority (i.e. establishing/identifying thresholds for contracts that must come before the Agency for approval) be approved by the Agency, upon review and approval of the Board. All other policies and procedures are to be approved by the Board of Directors. This is an area where the Board could take immediate steps to address the authority of the President as recommended by the Audit.

As part of the January 12, 2009 Audit Committee discussion on the City Auditor's review of SEDC's response, clarification on the following items was requested to return as part of the discussion(s) on changes to SEDC's operating agreement:

- Specifying in the operating agreement that wording be included in the employment contract between the Board and the CEO/President that requires the CEO/President to comply with all policies and procedures approved by the Board.
- Defining "material" vs "non-material" as it relates to Recommendation #14 in which SEDC responded that the Board of Directors 'reserves the right to delegate approval of all non-material policies and procedures to either the President or the CFO.'

- Developing protocol for deviation from policies and procedures. For instance, requiring Board approval, but in an instance that a decision must be made prior to a Board meeting, identifying the Chair of the Board as having the authority to grant the deviation..
- Clarifying that the threshold for Board approval of consultant contracts/ agreements is \$25,000 per fiscal year for each consultant is cumulative.
- Identifying specific timeframes for responses to recommendations that require periodic reviews (i.e. annually, bi-annually).

In Recommendation 17, the performance audit recommends that the Office of the CFO (City) review and approve SEDC's new policies and procedures. The IBA has discussed this with the Mayor's Office; however, our recommendations reflect the fact that the current governance structure identifies the Corporation as a separate, legal entity. If the current structure did not exist and SEDC was an agency (similar to the Housing Commission) then we would be in agreement that all policies and procedures be approved by the City.

The IBA offers the following suggestion:

E. The City's CFO should review and provide input on fiscal policies and procedures developed by SEDC prior to Board approval, but SEDC policies should not require approval by the City's CFO.

On January 12, 2009, Audit Committee Chair Faulconer requested the City Attorney to look into this legal issue and return with their findings at the next Audit Committee.

Budget Process

In previous IBA reports, our office had expressed concerns about the Agency's budget process as it pertained to consistency and completeness of information presented, particularly in the category of salaries. The Performance Audit similarly identified that "SEDC's budget presentation practices enabled executive management to hide the types and amounts of supplemental income that were provided." Although briefly addressed in the previous "Policies and Procedures" section, we further the discussion here.

As a separate legal entity, SEDC utilizes their own process and system to develop recommendations for their annual budget (both for the corporation and the project areas managed by them). The City Council, sitting as the Redevelopment Agency, is the ultimate authority that will approve SEDC's proposed budget. In their role as the City Council, the Agency has knowledge and experience in the City's budget process. SEDC needs to ensure their process is cohesive with the City's.

The IBA offers the following recommendation:

F. SEDC shall adhere to the City's budget process, including information requirements, guidelines, timelines and review processes. Prior to Agency approval, Financial Management will perform a technical review to ensure compliance with the City's process and budget parameters.

The City's Annual Budget includes performance measures. The City Management Program (CMP) is responsible for developing a Citywide strategic plan, establishing tactical plans with associated performance measures and implementing performance reporting to support data-driven decision making. Similar to the City Management Program, SEDC should develop and communicate how their goals and objectives are being achieved.

Throughout the year, an understanding of SEDC's financial status will need to be communicated. The IBA is supportive of Performance Audit Recommendation No. 19 that SEDC should communicate on a monthly basis, a financial position report to the Directors. This report would show current expenditures as they relate to each budget line item.

Furthermore, the IBA offers the following recommendation:

G. The Corporation's Chief Financial Officer shall submit requests for reimbursement of eligible expenses for Board approval prior to the request being made to the City Comptroller's Office.

Board Training

The City has instituted regular financial trainings to ensure applicable employees keep current and maintain competency levels and that elected officials understand their obligations. Similarly, the Performance Audit recommends (Recommendation No. 7) that the SEDC Board of Directors receive training to fully perform their fiduciary responsibilities. These trainings are especially important due to turnover on the Board and the complex subject of redevelopment.

The IBA offers the following recommendation:

H. On a frequent and routine basis, the Board receive training that shall, at a minimum, cover the Board's fiduciary responsibilities, general redevelopment, and redevelopment-related Finance.

City's Role and Responsibilities

In conjunction with changes to the Operating Agreement that are directed at SEDC, the IBA believes that it would also be beneficial to edit language in the Operating Agreement to ensure the roles and responsibilities of the City are clearly stated and defined.

The Performance Audit identified that approximately one-third of the Board of Directors meetings had been cancelled either because they lacked a quorum or the President requested the cancellation. The City plays a role in ensuring the Board has enough members to meet their quorum.

The IBA offers the following recommendation:

I. The City shall be responsible for promptly filling vacant and/or expired Board positions.

As discussed earlier in this report, the budget process requires significant improvement, especially in relation to how the development of SEDC's budget interacts with the City's.

The IBA offers the following recommendation:

J. The City shall be responsible for providing clear and timely direction on the format of the budget submitted by the Corporation, ensure guidelines are provided that communicate the City's needs and conduct technical budget reviews, for adherence to guidelines, prior to the budget being submitted to the Agency.

Also, the City's current budget process includes an initial review of department's budgets at Committee prior to Council's formal approval; however, the Agency reviews and approves the Corporations' and project areas' budgets in the same meeting.

The IBA offers the following recommendation:

K. The Budget and Finance Committee shall convene as a subcommittee of the Redevelopment Agency to review the proposed budget in advance of the Agency's review and adoption.

Throughout the fiscal year, the Chief Financial Officer is required to provide a financial status report to the City Council. Recent Budget and Finance Committee discussions of these reports have included a request to incorporate the Redevelopment Agency's status into these reports at least on a quarterly basis. This process began this fiscal year and will continue to be improved upon.

The IBA offers the following recommendation:

L. The Chief Financial Officer's (City) quarterly financial status report to the City Council shall include the Corporation's status and pertinent project area information. Format to be developed by the City in consultation with the Corporation's Chief Financial Officer.

Strategic Planning and Vision

The IBA is in agreement with the recommendation that a Strategic Plan be developed, which links to the vision of the City; however, the IBA would note that this vision should encompass both the Mayor and the City Council, rather than solely the Mayor as recommended in the audit. Once a strategic plan and vision is developed at the Agency level, each managing entity should develop their plan for accomplishing their component(s) of the goals established.

CONCLUSION

The goal of this report was to outline our proposed recommendations to the SEDC Operating Agreement and other improvements that we believe will address issues identified in the audit. Additionally, it is the intent of this report to provide a framework for discussion in order to move this issue forward. The IBA believes additional input and response to our recommendations is needed by the Mayor's Office, the City Attorney's

Office, the SEDC Interim Chief Administrator and Board of Directors, and the City Council.

[SIGNED]

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[SIGNED]

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Attachments:

1. Matrix of Performance Audit Recommendations and Responses by the Mayor and the SEDC Board of Directors
2. Matrix of IBA Recommended Changes