

**OFFICE OF INDEPENDENT BUDGET ANALYST
CITY OF SAN DIEGO
M E M O R A N D U M**

No. 06-26

DATE: October 12, 2006

TO: Council President and Members of the City Council

FROM: Andrea Tevlin, Independent Budget Analyst

SUBJECT: Reviewing and Approving the Utilization of the City's Comprehensive Annual Financial Report

The Report of the Audit Committee (Kroll) of the City of San Diego presented to the City Council on August 8, 2006 recommended that the City Council review and approve the use of the City's Comprehensive Annual Financial Report (CAFR) – see attachment. Kroll further recommended that the City Council be provided at least two weeks to review substantially complete drafts of the City's CAFR (now referred to by the Mayor as the City's financial statements) before approving its use. On October 2, 2006, the Mayor indicated that he had transmitted substantially complete drafts of the City's FY 2003 CAFR to the City Council and asked that the documents be approved for use at the City Council meeting of October 16, 2006. This will mark the first time that the City Council has been asked to take a formal action with regard to the City's CAFR.

The IBA believes that it is important to clarify that Kroll's recommendation is for the City Council to review and approve the use of the City's CAFR. Kroll's rationale for their recommendation is that the City's CAFR is an integral component of the financial information provided as part of any City debt issuance. Kroll also states "the accuracy and completeness of the City's CAFR and offering documents, and the systems and controls necessary for them, are the responsibility of the Mayor and the CFO." The IBA agrees with Kroll's statement noting that the City's FY 2003 CAFR is an extremely technical document that has been years in the making. Other than the Mayor's financial staff, no City office possesses sufficient capacity, time or necessary historical accounting knowledge to comprehensively review the draft FY 2003 CAFR in two weeks.

On October 16, 2006, the City Council will be asked to approve a resolution and an ordinance related to the City's CAFR. The resolution indicates that the City Council "**has received the certification of the City's Chief Financial Officer** that the information contained in the draft Financial Year 2003 CAFR fairly presents, in all material respects, the financial condition of the City and results of the operations of the City, as of, and for, the period presented in the draft CAFR and that the draft CAFR does not make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading." Noting the City Council's disclosure oversight responsibilities and the importance of the CAFR, this resolution provides that the draft of the City's unaudited FY 2003 CAFR is approved for use by

Page 2

Council President and

Members of the City Council

October 12, 2006

KPMG, the City's outside auditor.

The ordinance before the City Council on October 16th also references the Kroll recommendation for the City Council to review and approve the release of the CAFR as part of their oversight and disclosure obligations. It further states that the San Diego Municipal Code does not require the input of the City Council in the production of the CAFR. In response to these statements, this ordinance provides City Council approval for the following changes:

- Beginning with the FY 2005 CAFR, specifies that the Auditor and Controller shall present to the City Council a draft copy of the CAFR once such draft is substantially complete and ready to be distributed for use by the Disclosure Practices Working Group and the outside auditor.
- Provides that the City Council shall review and, based on the representations of the City's Chief Financial Officer as to the accuracy and completeness of the financial information presented in the draft CAFR, approve the release of the draft CAFR to the City's outside auditor.
- Amend Chapter 2, Article 2, Division 7, Section 22.0710 of the San Diego Municipal Code to codify the following processes: 1) the City Auditor and Comptroller shall provide a substantially complete CAFR to the City Council who in turn will review the draft document and approve its release to the City's outside auditor; 2) the City Auditor and Comptroller shall request that the CAFR be placed on the City Council meeting agenda for presentation once the CAFR is final (when the City has received an opinion letter from its outside auditor); and 3) the City Auditor and Comptroller's Office shall be responsible for, either alone or in conjunction with appropriate City departments or related agencies, the preparation of all footnotes to the City's CAFR, and any stand-alone financial statement prepared by their Office.

In researching the requested actions, the IBA has learned that it is highly unusual for a legislative body (i.e., City Council) to review a draft CAFR and approve its use by an outside auditor. It is more common for the legislative body to accept an outside auditor's completed Audit Opinion Report in relation to a final CAFR. The IBA also understands that the City of San Diego is currently striving to restore its financial reputation and is generally desirous of following the expert recommendations provided by Kroll which may "raise the bar" for all financial activities.

The Mayor's Office has informed the IBA that the draft FY 2003 CAFR, and subsequent CAFRs, will be provided to the City Council for review with a certification signed by the Chief Financial Officer and City Auditor and Comptroller (which is compliant with applicable sections of the Municipal Code) as to the accuracy, completeness and comprehensive nature of the draft CAFR. The IBA recommends that

Page 3

Council President and

Members of the City Council

October 12, 2006

this certification mirror the language in the City resolution prepared for this item and that it be provided to the City Council before the October 16th meeting. Although the IBA has some concern about the City Council taking an unusual action to review and approve a highly technical draft document in two weeks time, we understand why the requested action has come before them and are comforted by the form of the promised certification and the resolution/ordinance language.

Due to the unusual nature of this request, it has been suggested to the IBA that other Kroll compliant options may exist which could be explored with Kroll and the City's outside auditor. For example, it has been suggested that the City Council could hold a public hearing to receive a CAFR presentation from the CFO and the Auditor and Comptroller. The City Council could then provide feedback before the draft CAFR is sent to the outside auditor. In this scenario, the CAFR could be completed and finalized by the City Council subsequently acting to accept the outside auditor's Audit Opinion Report, as is more customary for many organizations. This is a possible alternative, however it is unclear if it would comply with the intent of Kroll's recommendation. Again, due to the City's unique situation, it may be preferable to "raise the bar" regarding common practice in this area.

In summary, the City Council is being asked to take an unusual action with respect to technical and, arguably, complicated financial statements. Having reviewed the above referenced resolution and ordinance, and contingent upon City Council receipt of a certification (signed by the Chief Financial Officer and the City Auditor and Comptroller) in advance of the October 16th meeting, the IBA supports City Council approval of the draft CAFR.

The IBA also supports the City Council's desire to receive additional financial training to enhance their ability to fulfill financial oversight responsibilities. The IBA is currently reviewing relevant financial training opportunities and plans to return to the City Council with a recommended training program in early December.

[SIGNED]

Prepared by: Jeff Kavar
Fiscal & Policy Analyst

Attachment