May 20, 2008

Mr. Kelly C. Bowers
Senior Assistant Regional Director
Securities and Exchange Commission
Los Angeles Regional Office
11th Floor
5670 Wilshire Boulevard
Los Angeles, CA 90036-3648

Dear Mr. Bowers:

On behalf of the San Diego City Council, this response is intended to present recent actions taken by the City Council in response to several of the 36 recommendations contained in the First Annual Report of the Independent Consultant to the City of San Diego dated March 25, 2008 (Report). These actions are in addition to or compliment actions taken by the Mayor in response to the Report. Each of the following Council actions follows the corresponding recommendation within the Report.

Financial Control Structure - Audit Committee

Recommendation 1:
The City should submit to the voters for approval in June 2008, and timely take all action to meet that schedule, the establishment of an Audit Committee that meets the following criteria:

- *Has the requisite independence from financial management.*
- *Has the requisite expertise to perform its oversight functions.*
- *Has a sufficient relationship with the City Council to engender its confidence in view of the Council's role in the City's financial reporting.*

Response 1:
The City Council concurs with this recommendation. On March 3, 2008, the Council adopted an ordinance (O-19718) to place Proposition C before the voters on June 3, 2008. Proposition C would do the following:

- Establishes an independent five member Audit Committee comprised of two members of the City Council and three members of the public appointed by the City Council.
- Provides that public members of the Audit Committee shall possess the independence, experience and technical expertise necessary to carry out the duties of the Audit Committee. The minimum professional standards for public members shall include at least 10 years of experience as a certified public accountant or as a certified internal auditor, or 10 years of other professional financial or legal experience in audit management.
- Specifies that one of the two City Council members shall serve as the Chair of the Audit Committee. Additionally, the Audit Committee shall recommend to the City Council: annual compensation for the City Auditor; an annual budget for the Office of the City Auditor; retention of the City's outside audit firm and, when

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appropriate, the removal of such firm. The City Council may specify additional responsibilities and duties of the Audit Committee by ordinance as necessary to carry into effect the provisions of proposed new Charter language for the Audit Committee.

Internal Audit Function

Recommendation 2:
The City should submit to the voters for approval in June 2008, and timely take all action to meet that schedule, the creation of an office of City Auditor that is separate from the current office of Auditor and Comptroller and with direct reporting responsibility to the Audit Committee.

Response 2:
The City Council concurs with this recommendation. The current Office of the City Auditor was established by the Mayor and City Council in calendar year 2007 by separating the internal audit functions from the comptroller duties. The reporting structure was also changed so that the City Auditor no longer reports to the Auditor & Comptroller (currently the Chief Financial Officer) but rather to the Chief Operating Officer.

In addition, the Mayor and the Audit Committee worked together to develop a Statement of Operating Principles (SOP) that provides for the City Auditor to communicate directly with and be responsive to requests of the Audit Committee. The City Council formally approved the SOP signed by the Mayor and appended it to Audit Committee Charter. Until the City's Charter is amended, this is the most effective segregation of duties permitted.

On March 3, 2008, the Council adopted an ordinance (O-19718) to place Proposition C before the voters on June 3, 2008. Proposition C would do the following:

- Provides that the City Auditor shall report to and be accountable to the Audit Committee.
- Specifies that the City Auditor may be removed for cause by a vote of two-thirds of the members of the City Council.
- Establishes that the City Auditor may investigate any material claim of financial fraud, waste or impropriety within any City department and for that purpose may summon any officer, agent or employee of the City, any claimant or other person, and examine him or her upon oath or affirmation relative thereto.

Proposition C provides that the City Auditor would be appointed by the Mayor, in consultation with the Audit Committee, and confirmed by the City Council. Three members of the City Council preferred that the Mayor not have any involvement with appointment of the City Auditor. The other five City Council members believed there are sufficient City Auditor independence safeguards in place with 1) the City Council confirming the appointment, 2) the Auditor reporting directly to an independent Audit Committee and 3) the City Council's ability to remove the City Auditor for cause. Proposition C was placed on the ballot by a 5-3 vote of the City Council.

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Recommendation 3:
The City should begin the process of significantly increasing the staffing of the internal audit function in order to permit effective internal auditing to be accomplished, including an assessment by the internal auditor of staffing needs, and should periodically report its progress to the Audit Committee.

Response 3:
The City Council concurs with this recommendation. In September 2007, the Audit Committee authorized the hiring of the firm of Jefferson Wells to serve as professional audit consultant to the Committee. The City Council had appropriated funds for this purpose in their adoption of the annual budget for fiscal year 2009. The hiring of Jefferson Wells was intended to provide independent, expert counsel to the Audit Committee (and City Council) related to their legislative fiscal oversight responsibilities and technical audit issues encountered.

The Audit Committee requested that Jefferson Wells examine the City's risk assessment, discuss elements of an effective annual audit work plan and recommend appropriate staffing levels for the City's audit organization. Jefferson Wells presented their report to the Audit Committee on March 24, 2008 recommending approximately 24 auditors for the City. In response, the City Auditor presented the Audit Committee with a three-year plan for increasing his staff to the levels recommended by Jefferson Wells. The Audit Committee expressed interest in supporting this proposal and plans to address it in the FY 2009 budget deliberations that are currently underway.

In January 2008, the City Council adopted a budget priorities resolution to convey their budget priorities to the Mayor before the FY 2009 Proposed Budget was developed. One of the Council's expressed priorities was to increase staffing for the audit function, and to ensure that personnel are qualified and have appropriate tools and training. The Mayor submitted his FY 2009 Proposed Budget on April 15, 2009 and proposed increasing City Auditor staff from five to eleven positions. It is expected that the City Council will be supportive of this initial proposal to more than double current City Auditor staff in FY 2009 in an effort to achieve the recommended levels within three years. Once the FY 2009 Budget has been approved, the City Auditor will provide monthly status reports to the Audit Committee covering his efforts to expeditiously hire additional staff.

Whistleblower and Hotline Complaint System

Recommendation 4:
The City should implement within 45 days, consistent with the advice of Jefferson Wells for steps prior to Charter revision, the procedure contemplated by the Audit Committee charter for a confidential and anonymous hotline involving the Audit Committee independent of City management for complaints and concerns regarding financial control or financial and auditing matters.

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Response 4:
The City Council concurs with this recommendation. The Audit Committee requested that Jefferson Wells prepare a report that 1) analyzed successful hotlines used by other public agencies, 2) evaluated the City's current Employee Hotline, 3) described critical processes and attributes for an effective employee hotline, and 4) made recommendations for how to begin transitioning Employee Hotline oversight from the Mayor to the Audit Committee prior to possible City Charter reform in accordance with a recommendation from the Kroll Report. The Audit Committee received and discussed the Jefferson Wells Employee Hotline report on February 25th and March 24th, 2008. The Audit Committee unanimously adopted motions recommending that recommendations from the Jefferson Wells report be forwarded to the City Council for consideration.

Jefferson Wells presented their Employee Hotline Report to the City Council on April 28, 2008. The City Council unanimously adopted a resolution accepting the Jefferson Wells report and directing that the report's recommendations be implemented. The City Council's resolution requested that employee confidentiality and anti-retaliation policies be developed for inclusion into the City's Municipal Code. Additionally, the resolution specifies that e-mail notification of complaints involving Senior City Management, allegations of improper financial activity and fraud, waste and/or abuse received by the hotline be sent to the Audit Committee Chair, or other designated members of the Audit Committee.

Improper Influence Ordinance

Recommendation 5:
The City should address any remaining issues expeditiously so that an improper influence ordinance can be adopted as promptly as practicable.

Response 5:
The City concurs with this recommendation. A draft ordinance was presented to the Council and the Rules Subcommittee in December 2007; however, the Mayor's Chief Operating Officer raised a few issues to be addressed and requested that it be continued. The outstanding issues dealt with what entity should enforce the ordinance, the type of enforcement, and the definition of certain terms. The City Council stands ready to docket this item for action once the Mayor has addressed the issues raised.

Focused Financial Management Responsibility and Accountability

Recommendation 6:
The City should submit to the voters for approval by June 2008, and timely take all action to meet that schedule, the separation of the Auditor and Comptroller position into two and the creation of the position of Chief Financial Officer in order to focus responsibility and related accountability for the City's financial reporting.

DRAFT

Response 6:

The City Council concurs with this recommendation. The current Office of the City Auditor was established by the Mayor and City Council in calendar year 2007 by separating the internal audit functions from the comptroller duties. The reporting structure was also changed so that the City Auditor no longer reports to the Auditor & Comptroller (currently the Chief Financial Officer) but rather to the Chief Operating Officer. The Audit Committee's Charter indicates that the City Auditor is to communicate directly with and be responsive to requests of the Audit Committee.

On March 3, 2008, the City Council adopted an ordinance (O-19718) to place Proposition C before the voters on June 3, 2008. In addition to creating the Office of the City Auditor, Proposition C would substitute Chief Financial Officer for Auditor and Comptroller in the City Charter. It further provides that the Chief Financial Officer shall be appointed by the Mayor and confirmed by the City Council for an indefinite term and shall serve until his or her successor is appointed and qualified.

Financial Reporting Enhancements - Review of CAFRS

Recommendation 13:
The Audit Committee, with the assistance of its ad hoc advisory group and its professional consultant, should review within 45 days and improve as necessary its procedures for review of the City's CAFR to determine if any improvements should be made to those procedures.

Response 13:
The City Council concurs with this recommendation. The City has now completed four CAFRs (for fiscal years 2003 through 2006) and all of them have been presented to the Audit Committee and City Council for discussion. In 2007, the City Attorney's Office worked with the City's Disclosure Counsel and the Independent Consultant to develop an extensive list of CAFR review questions for Audit Committee members to utilize in their review of the City's CAFRs and the related outside audits.

In an effort to improve their current procedures for reviewing City CAFRs, the Audit Committee appointed a citizen Ad-Hoc Advisory Committee to provide recommendations for enhancing the quality of the CAFR review process. Additionally, the Audit Committee requested that Jefferson Wells review and report on best legislative practices for CAFR review and the CAFR review approaches of comparable governmental agencies.

On April 28, 2008, the Audit Committee received the above referenced reports from both the Ad-Hoc Advisory Committee and Jefferson Wells. After discussing the respective reports, the Audit Committee directed the IBA to work with the City Attorney's Office to incorporate recommendations from both reports into the current list of CAFR review questions and to also comment on additional CAFR review training that would be useful to the Audit Committee. This feedback is planned for the Audit Committee meeting scheduled for June 9, 2008.

DRAFT

It should be noted that Jefferson Wells conducted an extensive review of comparably-sized municipalities and their processes for accepting, reviewing and approving their annual CAFR. This section of their report concluded with the following statement:

"Over the course of the information gathering process, it became apparent that the City of San Diego's CAFR review process is indeed on the cutting edge of fulfilling the requirements of both GAGAS and GAAS standards."

Disclosure Practices Working Group (DPWG)

Recommendation 25:
The DPWG, in conjunction with City financial management and the IBA, should assess the current training program for City officials and staff and recommend and implement changes, if any, within 45 days.

Response 25:

The City Council concurs with this recommendation. A panel including representatives from the DPWG, the CFO, and the Office of the Independent Budget Analyst ("IBA") will review the current training programs and make recommendations to improve the programs for city officials and staff. If needed, the panel will make recommendations and implement changes within 45 days.

In December 2006, the City Council adopted a comprehensive financial training program developed by the IBA at their request. Trainings to date covering disclosure and financial reporting have logically been coordinated with certain members of the DPWG and City fiscal/legal consultants. The City Council training program is: comprehensive for elected official needs/purposes; systematic in requiring that certain important financial topics be covered once every two years, and available to City staff/public live and via 7/24 replay on the City's website.

Role of Counsel in Legal Compliance

Recommendation 26:
The City should consider whether any steps are necessary to ensure the availability of legal counsel that will foster the ability of City officials to consult with and obtain legal advice based upon a relationship of trust and confidence designed to promote legal compliance.

Response 26:
The City Council concurs with this recommendation. There is some disagreement among City officials on the role of the City Attorney. The City Attorney as a city-wide elected official, currently views his client as the public rather than the City and its officials. The City Attorney on occasion pursues policy and/or legal positions that are contrary to the legal/policy positions adopted by the City Council and/or the Mayor. The City Attorney also believes that he can initiate civil proceedings without authorization by the City Council.

DRAFT

As noted by the Independent Consultant, that "because of the potential for tension between separately elected officials there may be a need for legal counsel who is in a position to serve as advisor to other elected officials and thus able to advise on legal compliance as matters are being considered." The City Council has from time-to-time hired outside counsel to advise it and the Mayor on particular issues and has even retained outside legal counsel to represent the City on matters where it has been determined that the City Attorney has taken a position contrary to the best interest of the City.

In addition, a committee that reviewed the City Charter recommended that changes be made to the Charter to better clarify that the role of the City Attorney, whether elected or not, is to represent the City and its officials and that litigation can only be initiated with Council approval. Those recommendations were not included in ballot measures coming before the citizens in June 2008. Nonetheless, City officials work to promote procedures that foster compliance with disclosure and all other legal requirements, including work on the DPWG, the completion of four CAFRs, cooperation with the SEC Independent Consultant, and the implementation of Kroll recommendations. The issues of authorization and identity of the client may require judicial resolution.

San Diego City Employees Retirement System (SDCERS)

Recommendation 27:
The City Council should address within 30 days the "technical corrections ordinances and the "waterfall" ordinance. It also should act on the matters required by the compliance statement with the IRS within the time specified therein.

Response 27:

The City Council concurs with this recommendation. On April 15, 2008, the City Council unanimously adopted an ordinance (O-17940) to implement the Settlement Agreement between SDCERS, the City of San Diego and the Internal Revenue Service.

In addition, SDCERS and City Management have been attempting to modify the Municipal Code to "officially" eliminate the concept of "surplus earnings" to pay for certain retirement benefits. The actual use of "surplus earnings" ended with the City's June 30, 2006 actuarial valuation. At that time, SDCERS directed its actuary to include the payment of the 13th check and Corbett Benefits in its valuation liabilities and as a result these two benefits are now being paid for by the City as part of its Annual Required Contribution. As such, no benefits are being paid from "surplus earnings." The City Council had docketed the "waterfall" ordinance for action on April 29th; however, the item was continued at the request of the City Attorney to make necessary amendments. This item was continued to the City Council meeting on May 27, 2008.

For additional information, please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 2**).

DRAFT

Recommendation 33:
The City, working with SDCERS and with the assistance of an experienced pension consultant, should explore the range of alternatives for funding the City's pension and post-retirement benefits commitments. Alternatives might include, for example, funding alternatives, reduction or freezing of benefits, or establishing, as some private entities have done, a separate employee/union controlled plan that relieves the employer of further obligations. While all such alternatives are subject to legal, contractual and employee relation considerations, a comprehensive report should be issued by December 31, 2008.

Response 33:
The City Council concurs in this recommendation. The City has taken significant steps to reduce its pension obligations and its post-retirement benefits commitments. The City is funding not only its full pension yearly obligations but also paying in excess of its obligations. Based upon court decisions, reduction of obligations for existing employees has not been possible. The City has also reduced post-retirement commitments. By agreement effective July 2005, the City eliminated retiree health benefits. The City has also taken steps to fund its current health benefits by establishing a trust with CalPERS and has deposited approximately $30 million into this account during fiscal year 2008. For additional information, please refer to SDCERS' response to the First Annual Report of Independent Consultant to the City of San Diego dated March 27, 2008 (**Attachment 1**).

On March 4, 2008, the Mayor briefed the City Council on a pension system proposal for new employees that reduces City obligations significantly. Noting the significance of a possible policy decision to modify the pension plan for future City employees, the IBA worked with the City's contracted actuary to develop other retirement plan options for consideration. The plan options were developed to demonstrate how different plan designs could achieve similar goals to those in the Mayor's proposal. The IBA presented five different plan designs and added a sixth CalPERS design for valuation in IBA Report # 08-32. The City Council's Budget Review Committee discussed these options at a three-hour budget hearing on May 9, 2008. The City Council will continue to evaluate different pension plan options going forward with a goal of reducing/controlling pension costs and also providing a competitive retirement plan that will enable the City to retain a talented workforce.

Training

Recommendation 35:
The City, with the involvement of the DPWG and the IBA, as applicable, should develop within 90 days a comprehensive and coordinated training program for City officials and personnel on disclosure and financial reporting and then should report quarterly on the implementation and effectiveness of that program and any changes made to it.

Response 35:
The City Council concurs with this recommendation. As noted in the response to recommendation 25 above, In December 2006, the City Council adopted a comprehensive financial training program for the City Council in December 2006. Trainings to date covering disclosure (March 2007) and financial reporting (April 2007)

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have effectively been coordinated with certain members of the DPWG and City fiscal/legal consultants. The City Council training program is: comprehensive for elected official needs/purposes; systematic in requiring that certain important financial topics be covered once every two years; and available to City staff/public live and via 7/24 replay on the City's website.

A panel including representatives from the DPWG, the IBA, and the CFO will review the current training programs and make recommendations to improve both the program for elected city officials (i.e., the City Council) and a program for City personnel reporting to the Mayor. It is possible that elements of the Council's training program may be useful to City personnel reporting to the Mayor. The panel will make recommendations and implement useful changes, if any, within 45 days. Once these training programs have been developed or enhanced, the City will report quarterly on the implementation and effectiveness of the programs.

Fiscal Integrity

Recommendation 36:
The City should assess the value of its current Five-Year Financial Outlook as a planning tool, and consider use of additional planning tools, for ensuring that the City is able to meet its goals for providing services to the citizens of San Diego at a cost they are willing to bear.

Response 36:
The City's Five Year Financial Outlook (Outlook) provides the framework for informed budgetary planning and the adoption of the City's annual budget. The Mayor issued his first Outlook for fiscal years 2008 through 2012 in November 2006 and issued an updated Outlook for fiscal years 2009 through 2013 in January 2008. The City Council has welcomed this financial planning document which provided a valuable roadmap for the future and laid an early foundation for development of the fiscal year 2008 and 2009 budgets.

Each year, upon release of the Mayor's Outlook, the IBA has conducted a full review and assessment of the Mayor's Outlook for the City Council and the public (see IBA Report #08-9 - **Attachment 2**). The IBA review includes an analysis of the following:

- Underlying assumptions for all categories
- Consistency with goals depicted in previous year's Outlook
- Accuracy of data provided
- Completeness and reliability of information
- Consideration of "risks" or changing events
- Accurate portrayal of proposals.

DRAFT

The IBA Report noted items that were not considered in the Outlook that are likely to impact the City's General Fund. The IBA Report also compared the City's Outlook to other municipal forecasts and suggested common features that could add value in future updates (i.e., a discussion of risks). City management has reviewed the IBA's recommendations and indicated that they will incorporate them into the next Outlook.

The City will continue to work with the Independent Consultant to not only implement these recommendations but also to go beyond in order to ensure that the City continues to establish best practices in its financial reporting and ultimate disclosure.

Sincerely,

_____
SCOTT PETERS
City Council President

Attachments

Cc: Honorable Members of City Council/Audit Committee Members
Michael Aguirre, City Attorney
Stanley Keller, Independent Consultant
Jay M. Goldstone, Chief Operating Officer
Andrea Tevlin, Independent Budget Analyst

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