

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: August 29, 2007

IBA Report Number: 07-80

City Council Docket Date: September 4, 2007

Item Numbers: 332 and 333

Item: Background Information for Item 332 - Report from the Independent Consultant (Stanley Keller) and Item 333 - Response to the SEC

RECAP OF INDEPENDENT CONSULTANT/MONITOR CONTRACT

The purpose of this report is to provide background information for Council and the public with respect to two items on next week's docket that relate to the status of the City's financial reforms. The first item, Item 332, is an information report from Stanley Keller in his capacity as the City's **Independent Consultant** as required by the Securities and Exchange Commission (SEC) in their Order of November 14, 2006. The SEC required that the City retain an Independent Consultant for a period of three years to review and make recommendations regarding the City's policies and internal controls with respect to its financial disclosure functions. A three year contract with Mr. Keller was recommended by the Mayor and approved by Council on January 16, 2007.

This contract also provided for Mr. Keller to serve in the capacity of "**Monitor**" as recommended by the Kroll report that was issued on August 8, 2006. In his role as Monitor, Mr. Keller is to assist with review and implementation of remediation measures as recommended by Kroll. While there is natural overlap between Independent Consultant and Monitor duties, it is important that they be distinct in their execution. Given the crossover of issues, the intent of Mr. Keller serving in both roles was to take advantage of knowledge he has acquired about San Diego's reform efforts in order to achieve efficiencies.

INITIAL REPORT OF INDEPENDENT CONSULTANT TO THE CITY OF SAN DIEGO (Item 332)

The SEC Order calls for the designated Independent Consultant to issue three reports to the SEC as follows: "issue its first report within 120 days after the date of the engagement and the following two reports within 60 days following each subsequent one-year period from the date of engagement." With Mr. Keller's contract with the City

being executed on or about January 27, 2007, his first report, using that date, was due to the SEC on May 28, 2007. However, Mr. Keller requested of the SEC, and the SEC approved, an extension to June 8, 2007. Mr. Keller indicated he requested an extension in order to allow for items that were underway to be finalized and reflected in the report. Future requests for extension should first be approved by the Mayor and City Council.

Mr. Keller issued his report to the City Council, the Mayor's Office and the City Attorney as well as to the SEC on June 7, 2007. As Mr. Keller did not present his report to the City Council upon its release, this item is docketed so that he can discuss his report in a public forum and respond to questions.

LETTER FROM SEC IN RESPONSE TO THE INDEPENDENT CONSULTANT'S INITIAL REPORT (Item 333)

On Monday, July 23, 2007 Stanley Keller, Independent Consultant, and John Hartigan, the City's outside legal counsel on this matter, received a letter from Kelly C. Bowers, SEC Senior Assistant Regional Director, in response to the Independent Consultant's June 7th Initial Report. Mr. Keller provided the letter to the CFO and the City Attorney's Office the same day he received it, and he suggested that it be provided to the Chair of the Audit Committee. The correspondence was not similarly distributed to the Council President, members of the City Council or the IBA on the 23rd. It was provided to the Chair of the Audit Committee at the end of the week and to the City Council on Monday, July 30th. Timely distribution of important SEC communications is critical to both branches of government, and responsibilities for this should be clarified for the future.

The letter from the SEC requested that additional information be provided on the steps taken by the City to adopt the following items discussed in Mr. Keller's report:

- Finalizing the internal audit function and hiring a qualified internal auditor
- Completing the organization of the Audit Committee and selecting citizen advisors and professional consultants to advise them
- Upgrading to a new financial accounting system
- Reevaluating the roles and accountability of the CFO and the Auditor and Comptroller
- Evaluating the disclosure process and consider moving to a shelf-like disclosure system

The letter stated: "please advise us as soon as possible as to the steps taken by the City to adopt the above recommendations or other alternative methods designed to achieve the same objectives...We are also interested in knowing the estimated timeframe for implementing these recommendations."

Since the letter was addressed to Messrs. Keller and Hartigan, I asked Mr. Keller to clarify whether the response should come from him or directly from the City. Mr. Keller noted that the City should be responding directly “since it is the City’s response to my (Mr. Keller’s) recommendations.” At a special Audit Committee meeting of August 6th, the CFO discussed several points that he suggested be included in a City response. It was also noted at this meeting that this item would be scheduled for full Council discussion on September 4th, 2007 - the first Council meeting following legislative recess. In a letter sent on August 7th, the CFO notified the SEC regarding this schedule. This item has been docketed in order to discuss and coordinate a City response.

The IBA believes that a coordinated response regarding steps taken and planned actions will best convey the City’s commitment to be responsive to the items noted in the SEC letter of July 23rd, 2007.

This report is provided for information only.

[SIGNED]

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