
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Comments on the Comptroller's Internal Controls Status Report

On June 23, 2008, the Office of the Comptroller presented their Internal Control Project Status Report (Report) dated June 1, 2008. The IBA and the City Auditor were asked to provide any comments they had related to the Report at the next meeting of the Audit Committee. This report provides IBA comments on the Comptroller's Report.

Budget Policy

On page 5 of their Report, the Internal Controls Manager recommends that the Department of Finance work with the IBA to develop a budget policy to address specific issues contained in Kroll recommendation #44. As discussed in the IBA's review of the FY 2007 Proposed Budget, the City has lacked comprehensive financial policies. In some cases, the City has written or informal policies on some topics, but the IBA has recommended on several occasions that financial policies be developed and formalized, in accordance with best practices and recommendations by respected professional organizations, including the Government Finance Officers Association (GFOA).

The City has made progress on several fronts, but it remains a critical priority that policies be institutionalized, in order to ensure long-term financial goals and strategies are in place, and provide a road map for decision makers to assist in improving and maintaining the City's fiscal health. Adherence to well-developed financial policies also provides credibility with the public, financial institutions, and credit rating agencies. Over the past year, the City has developed and adopted new financial policies related to debt issuance and reserves.

The IBA continues to research and review best practices and recommended budget policies for possible development of a comprehensive budget policy, in order to formalize budget-related principles. A comprehensive policy could address several

aspects of budget development, including: use of one-time revenues; ensuring a balanced budget; contingency planning; and revenue diversification, among other topics.

Cost Recovery

Included in the Report related to the recommendation for a new budget policy is the issue of user fees and the goal to achieve full cost recovery. While we acknowledge its relationship to the budget, the IBA believes cost recovery warrants its own policy. On February 28, 2008, the IBA issued Report No. 08-20, entitled "Need for Comprehensive Annual User Fee Review Process as Part of the Annual Budget." The report described how the IBA has discussed, over the last two years, the need for the City to identify the full cost of service for activities that charge user fees; to determine current cost recovery rates for these activities; to develop "target" cost recovery policies and to propose recommendations to Council for achieving these targets.

This item was discussed at the March 5, 2008 Budget and Finance Committee meeting. The Committee requested that the Mayor include a list of current user fees as part of the Proposed FY 2009 Budget, and requested that the City Auditor provide an analysis of what resources would be needed in order for his office to perform an audit of existing user fees prior to the Mayor's planned review of the issue this coming summer.

Since that time, the Financial Management Department has convened a task force of various departments that has begun to compile a comprehensive database of all City fees and charges. In addition, current and recommended levels of cost recovery for departmental fees will be developed, along with a plan for annual or periodic adjustments. It is anticipated that a cost recovery policy will be an outcome of this process. The IBA is participating in task force meetings, and will provide ongoing input and suggestions on the work being done by the task force, including the development of the cost recovery policy.

Independent Outside Auditor Selection

In accordance with the Audit Committee Charter and the Municipal Code (Article 2, Division 43), the Audit Committee is in the process of fulfilling its responsibility to select an independent outside auditor to perform the financial statement audit for FY 08. Based on Audit Committee discussions with management and an opinion from the City Attorney, the decision was been made to pursue a sole source agreement with Macias Gini & O'Connell for the FY 08 audit.

As noted on page 6 of the Report, the Kroll recommendation that the Audit Committee select an independent outside auditor will be considered remediated once a competitive selection process has been completed to hire an independent outside auditor for the next five years beginning with FY 09. The IBA recommends that the City Auditor be directed to coordinate this competitive selection process, with the assistance of the IBA if necessary, in order to take advantage of their auditing expertise in developing RFP selection criteria and evaluating bidder responses. We further recommend that the City

Auditor be asked to assist the Audit Committee in administering the agreement with the independent outside auditor. The City Auditor concurs with this recommendation.

Testing and Validating Responses to the Kroll Recommendations

The IBA and the City Auditor have periodically evaluated and/or tested management’s responses to Kroll recommendations. Many of the items presented in the Master List within the Report are assigned a status of “remediated” or “tested”. The IBA and the City Auditor may utilize different approaches or evaluate different criteria to ascertain whether a particular recommendation has been remediated. In order to benefit from the perspectives of both offices and consolidate status findings, we recommend that the City Auditor coordinate their review of management’s responses to Kroll recommendations with the IBA. The City Auditor concurs with this recommendation.

Employee Training

On page 34 of the Report, the Master List provides a status of “tested” for Kroll recommendations #90 and #93. These recommendations call for adequate and effective training programs to be developed for City finance employees and employees involved with grants and/or loans. In the City Council’s letter to the SEC in response to First Annual Report of the Independent Consultant, the Council informed the SEC that the DPWG will review current employee training programs and make recommendations to ensure that a comprehensive and coordinated training program is maintained. Although the DPWG has discussed current City training programs for both elected officials and City employees, a formalized employee training program has yet to be presented for consideration or review. The IBA recommends that the Audit Committee request an update on the status of systematic employee training, as recommended by Kroll and the Independent Consultant, at an upcoming meeting of the Audit Committee.

The IBA will continue to review the Comptroller’s Internal Control Project Status Reports and coordinate responses with the City Auditor. Additionally, the IBA will continue its efforts to work with the Department of Finance to develop comprehensive budget and cost recovery policies.

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