

~~April~~ ~~March~~ xx, 2010

Mr. Kelly C. Bowers  
Senior Assistant Regional Director  
Securities and Exchange Commission  
Los Angeles Regional Office – 11<sup>th</sup> Floor  
5670 Wilshire Boulevard  
Los Angeles, California 90036-3648

Dear Mr. Bowers:

This is in response to the recommendations contained in the Third Annual Report of the Independent Consultant to the City of San Diego dated February 24, 2010 (Report). The City is pleased to report that the recommendations provided by the Independent Consultant over the past three years have been implemented or are in process of being completed. Progress has been demonstrated of the remediation of Internal Controls Over Financial Reporting, the remaining significant recommendation as described in this letter.

### **Financial Control Structure**

#### **Audit Committee**

##### Recommendation 1:

*The City Council should complete the formation of the new Audit Committee by adopting the ordinance recommended by the Audit Committee to confirm that the Audit Committee has the full scope of authority of its predecessor Council Audit Committee.*

##### Response 1:

The City concurs with this recommendation.

The City Council introduced the ordinance recommended by the Audit Committee on March 9, 2010 and unanimously adopted the ordinance on March 23, 2010.~~[The Audit Committee Ordinance will be considered by the City Council on March 9, 2010.]~~ As noted in our response to the previous Report, the powers of the Audit Committee will vary somewhat from those of the Council Audit Committee in order to comply with the requirements of City Charter section 39.1.

### **Internal Audit Function**

##### Recommendation 2:

*The City should continue the effort to increase the staffing of the internal audit function in order to permit effective internal auditing to be accomplished, and the City Auditor should periodically report on progress to the Audit Committee.*

Response 2:

Since the creation of the Office of the City Auditor in July 2008, the City has committed increasing resources to grow the office. In FY 2008-09, the City provided funding to hire five auditors, which doubled the size of the office to ten positions. In January 2009, the City Auditor's Office entered into a service level agreement with the Public Utility Department to fund an additional auditor position. In FY 2009-10, the City provided funding to hire six additional auditors. The City Auditor has hired experienced auditors, who possess advanced degrees and professional certifications. The City Auditor periodically keeps the Audit Committee apprised of staffing needs and provides updates on audit progress.

**Whistleblower and Hotline Complaint System**

Recommendation 3:

*The Audit Committee should continue to monitor the operation of the hotline to ensure that it is operating effectively as intended with respect to complaints and concerns regarding the financial control or financial and auditing matters, and that matters reported to the hotline, especially those that are fraud related, are being appropriately referred and handled.*

Response 3:

The City Auditor issues quarterly reports to the Audit Committee regarding the number and type of fraud complaints and the disposition to the calls. In addition, the City has provided a Fraud Hotline Administration Plan to the Audit Committee for their review and approval. Between January 2009 and December 2009, the City Auditor issued eight reports that substantiated fraud, waste, and or abuse concerning the misuse of public funds or issues of integrity. Copies of the reports are publically distributed and posted on the City Auditor's website.

**Internal Controls Remediation**

Recommendation 4:

*The City must have a dedicated and sustained effort to complete its ICOFR remediation. In this connection, it must have the full commitment of senior management to the process and should fully staff the ICD and increase that staffing if necessary.*

Response 4:

The City concurs with this recommendation and is fully committed to the ICOFR remediation. The City has established and staffed an Internal Controls ~~Section~~Division (ICDS) within the Office of the City Comptroller. The recently hired (July 2009) City Comptroller, who has private sector experience in implementing internal controls, leads the Internal Controls ~~Section~~Division. The ICDS is solely dedicated to the development, implementation and ongoing monitoring of the City's internal controls relating to financial reporting and operations. There are currently four budgeted positions in the Internal Controls Section with three positions filled and recruitment is underway for the fourth position.

The ICDS established and published a detailed implementation plan that senior management fully supports and that has been presented to and accepted by the Audit Committee. Senior management will monitor resource requirements to ensure plan milestones are met and provide additional staffing requests as appropriate and necessary. A dedicated Internal Controls ~~Section~~ Division is now a permanent budgeted unit within the City Comptroller's department and integrated operationally within the Chief Financial Officer's financial organization.

Recommendation 5:

*The target should remain for now completion of the ICOFR remediation to permit an independent integrated audit in connection with the fiscal 2011 CAFR audit.*

Response 5:

ICOFR remediation efforts continue and the City anticipates the new internal control structure will be substantially operational during fiscal year 2011. ICOFR related processes are receiving priority attention and the City is committed to having an independent integrated audit in connection with its annual CAFR audit.

The Independent Consultant has suggested the City follow the private industry standard for a publically traded corporation under the Sarbanes Oxley Act. It should be noted that the City, as a municipal government, is not required by any regulation to engage in an independent integrated audit of their internal control environment. As noted in his Third and Final Report, the Independent Consultant states "that an external assessment of ICOFR is not the norm in the municipal sector and that San Diego would be a pacesetter in making an external assessment of its ICOFR a part of its financial control procedure." Since the City is not subject to the Sarbanes-Oxley Act, the City proposes an assessment audit of internal controls be customized for municipal government operations and focused on the risk of making material misstatements.

In order to prudently minimize audit expense in a challenging budgetary environment, the City believes it is important for the new internal control structure to be operational for a sufficient period of time to allow for internal testing/adjustments, thereby putting the City in position for a successful internal controls audit. The City's ability to complete an independent integrated audit in connection with its fiscal year 2011 CAFR audit will be dependent on the readiness of the new internal control structure, the scope of the audit, and the time required by the independent external auditor to complete the audit. As has been noted by the Independent Consultant, it may be premature for the City to commit to meeting this goal until ICOFR implementation is further along and an independent external auditor has been selected/consulted.

The City believes it should make the decision as to the timing of the audit when all parties (Audit Committee, City Council and the Mayor) agree that we are fully prepared and have the highest probability of an effective, successful internal controls audit.

~~While management is committed to have an independent integrated audit of its internal controls, the timing of this audit is dependent upon the readiness of the internal control structure that the City is currently developing. While recommendation #36 of the Kroll Report indicated that the City should~~

~~follow the private industry standard for a publically traded corporation under the Sarbanes Oxley Act, it should be noted that the City, as a municipal government, is not required by any regulation to engage in an independent integrated audit of their internal control environment. The external audit of ICOFR would be unique for a municipal government to undertake and has a potential cost of several million dollars; however the City has been and continues to be fully committed to engage in an external audit of ICOFR remediations at the appropriate time.~~

~~Should our governing leadership decide to dedicate taxpayer dollars for a voluntary independent audit of our internal controls environment, the City believes that we should make the decision as to the timing of that audit when all parties agree that we are fully prepared and have the highest probability of success. Given the timing of the implementation of the City's new ERP System and the development of new internal controls, spending funds for this audit prior to fiscal year 2012 would be premature and a waste of public funds.~~

~~Despite the SEC Monitor's conclusion that a fiscal year ending 2011 independent integrated internal controls environment audit target should remain to "keep the pressure on management" to complete the ICOFR efforts, management is fully committed to the ICOFR implementation plan. Hard decisions on the timing of an independent integrated internal controls environment audit are premature at this time.~~

Recommendation 6:

*The City should update and reissue its ICOFR Document, which should describe the overall ICOFR process at a summary level, reflecting the strategic and process considerations that are the basis for the City's ICOFR remediation effort.*

Response 6:

The City concurs with this recommendation. The document that this recommendation refers to is called our "Internal Controls Scoping Document". A considerable amount of time has been spent working in tandem with the SEC Monitor's Accounting Consultants, McGladrey & Pullen, on the sufficiency of this document. Essentially the Scoping Document provides a roadmap from our CAFR material accounts to the key process and access controls built into our IT and operating processes. In order to prepare for an independent integrated internal controls environment audit, we concur that the Scoping Document needs to be finalized and reissued. Management will complete the Scoping Document by ~~December 2010XXXX~~ and present it to the City's Audit Committee for review and comment.

Recommendation 7:

*The City should utilize external expertise to assist it in its ICOFR implementation to an extent at least consistent with the assistance it has received from McGladrey & Pullen.*

Response 7:

The City agrees with this recommendation. The City has appreciated the consultative advice from the SEC Monitor's accounting consultants, McGladrey & Pullen, and City management is confident that the current ICOFR implementation plan is sufficient to meet our long term objectives for the development

and operation of a robust internal controls environment. This implementation plan has been reviewed in detail over the past eight months by McGladrey & Pullen and our Internal Controls management and staff. In addition, the employees now working on this project have extensive internal controls experience. However, it may be useful for management to solicit the advice of an external internal controls expert such as McGladrey & Pullen on an as needed basis as technical issues may arise from time-to-time. In addition, the Audit Committee may choose to engage a firm to assist in their review of management's progress in completing the ICOFR remediations.

Recommendation 8:

*The Audit Committee should provide active and regular oversight of the City's efforts to implement its ICOFR process. In doing so, it should utilize external expertise similar to my use of McGladrey & Pullen to assist me in my monitoring efforts. In the same way that my use of McGladrey & Pullen also permitted expertise to be provided to the City, consistent with the role of independent oversight, the same firm could both assist the Audit Committee and, as part of that assistance and similarly consistent with its independent oversight role, provide expertise in implementing an ICOFR process to the City. Because of the efficiencies it would bring, the City, with the approval of the SEC, could consider continuing to use McGladrey & Pullen in that role.*

Response 8:

The Audit Committee has been and is currently performing its duties in legislative oversight of the City's efforts to implement its ICOFR process. As part of that oversight, the Audit Committee receives monthly internal control project update reports from the City Comptroller, which include verifiable progress statistics. As part of the revised audit committee ordinance, three outside (non-council) committee members, who are required to be financial experts, were added to the five member audit committee. In addition, the Independent City Auditor reports directly to the Audit Committee and aids in investigation activities as requested by the Audit Committee.

The Audit Committee Ordinance adopted by the City Council on March 23, 2010 (incorporated into the City's Municipal Code) allows the Audit Committee to retain professional consultants it considers necessary to carry out its responsibilities. The firm of Jefferson Wells (a professional service firm with expertise in internal controls) is currently under contract on an as-needed basis to provide professional audit consultant services to the Audit Committee. McGladrey and Pullen have been assisting management in reviewing the design/implementation of ICOFR. Given that Jefferson Wells has expertise in internal control review/implementation and is already under contract to serve the Audit Committee, the City believes Jefferson Wells is appropriately suited to assist the Audit Committee, as needed, in its independent oversight responsibility related to ICOFR effectiveness.

~~The Audit Committee may employ the use of outside experts, from time to time, as it sees fit and necessary depending upon the circumstances of any particular issue. Should the City decide to engage McGladrey & Pullen in the future, the SEC will be contacted for exemptive approval prior to any engagement.~~

**Financial Reporting Enhancements**

## Review of CAFRs

### Recommendation 9:

*The Audit Committee should oversee the procedures for review of the City's CAFR to ensure that they are operating effectively and efficiently.*

### Response 9:

The City agrees with this recommendation. As the Report points out, the Audit Committee has an important role to play in the review of the City's CAFR and currently ~~follows the~~ Audit Committee ~~follows~~ procedures ~~that were~~ developed by the Council Audit Committee. While the preparation of the CAFR is the exclusive responsibility of management, the CAFR is ultimately reviewed by DPWG, the Audit Committee and the City Council.

The Audit Committee Ordinance adopted by the City Council on March 23, 2010 incorporates language into the City's Municipal Code specifying certain annual oversight responsibilities for the Audit Committee related to the CAFR and the annual audit. These responsibilities include but are not limited to: meetings with City management and the outside auditor to discuss key elements of the CAFR/audit; the ability for an Audit Committee member to attend DPWG meetings when the annual CAFR is under review; annual reviews of significant accounting policies and internal controls over financial reporting; and reviewing/resolving any disputes that may arise between the outside auditor and City management with regard to the CAFR. It is expected that the Audit Committee will continue to evaluate CAFR review procedures to ensure that they are operating effectively and efficiently.

~~This review is clearly related but not completely integrated. In the Second Annual Report, management provided a calendar of milestones for the preparation and review of the CAFR. This calendar has been built into the Audit Committee Ordinance [recently approved by the City Council] and is a useful point of departure for developing specific deliverables during the review process and integrating the DPWG and Audit Committee review procedures. This would allow the City to avoid future circumstances where changes, material or otherwise, are suggested by the Audit Committee after the outside auditor has completed its work. The Audit Committee Ordinance also requires the Audit Committee to review management's calendar of milestones for the preparation and review of the CAFR. The review processes of the Disclosure Practices Working Group, the Audit Committee and the City Council could be incorporated into this calendar which would allow the Audit Committee to monitor the CAFR development and audit process from beginning to end, better plan for the Audit Committee's review process and enhance the Audit Committee's oversight capabilities. This potentially avoids future circumstances where changes, material or otherwise, are suggested by the Audit Committee after the outside auditor has completed its work.~~

## Improved Discussion and Analysis

### Recommendation 10:

*The City, on an ongoing basis, should continue to improve the quality of its financial disclosure by providing analysis that facilitates an understanding of the City's financial statements and its financial*

*condition, financial results, liquidity and capital needs, including the risks faced by the City. It should consistently review this disclosure with a fresh eye to determine if revisions are necessary to reflect changed circumstances.*

Response 10:

The City concurs with the recommendation. Management will continue to take a fresh look at the Letter of Transmittal each fiscal year to address issues of importance to the citizens of San Diego and financial investors. This will continue to include analysis and some forward looking statements, with proper disclosures and qualification, which frame the financial impact of current and near term events or trends. The City has in place a CAFR financial team that is responsible for reviewing and updating the Management Discussion and Analysis section and the disclosure notes to the CAFR. This editing takes place throughout the year as new information becomes available and relevant to our financial statements. It is a priority of the City to prepare a timelythe CAFR each fiscal year that is revised with new and updated disclosure information, ~~and that is issued in a timely manner.~~

Recommendation 11:

*In connection with forward-looking statements, such as forecasts, projections and statements of future intent, the City should evaluate the adequacy of its inclusion of appropriate cautionary statements that would put those forward-looking statements in proper context.*

Response 11:

The City concurs with the recommendation. As the discussed above, the City continues to expand the scope and sophistication of the forward looking statements provided to investors. Aware that offering forward looking statements creates certain risks with respect to securities law liability, the City has also significantly increased the use and scope of cautionary language regarding the use of such forwarding looking statements by investors.

## **Loss Contingencies and Risk Assessments**

Recommendation 12:

*The City, through the City Attorney's Office and the Risk Management Department, should continue to improve its systems for dealing with loss contingencies for financial reporting purposes in order to remedy any deficiencies noted by the City's independent auditors.*

Response 12:

The City concurs with this recommendation. Deficiencies with respect to the City's process for identifying and assessing loss contingencies, particularly regarding litigation, were noted in the Kroll report. In response to the Kroll report and in order to mitigate those deficiencies, the City implemented a procedure requiring quarterly meetings between the Risk Management Department and the City Attorney's Office to ensure that both responsible offices are fully apprised of all outstanding claims against the City and are aware of the progress of those claims to date. The City Attorney's office has also developed a comprehensive process for the preparation of the City's FAS 5 letter which has greatly

enhanced the quality of the information provided to the City's independent auditors and which is disclosed in the City's audited financial statements. Since implementing new procedures for reporting loss contingencies as identified in the Kroll report, the City is not aware of any particular issue raised by the independent auditors.

Recommendation 13:

*The effectiveness of these systems should periodically be monitored, including the reporting at least annually by the Risk Management Department to the Chief Financial Officer regarding the effectiveness of these systems.*

Response 13:

The Risk Management Director reports directly to and meets at least monthly with the CFO. Any discrepancies or concerns regarding the reporting of liabilities or discrepancies with the City Attorney's Office are addressed and an action plan developed in the course of the meeting. Since implementing new procedures for reporting loss contingencies as identified in the Kroll report, the City is not aware of any discrepancies. *See comment above.*

**Disclosure Practices Working Group (DPWG)**

**Shelf-like Disclosure**

Recommendation 14:

*The City Council should approve the updated Disclosure Ordinance forwarded to it by the Audit Committee.*

Response 14:

~~†The City agrees with the recommendation. The City Council introduced the Disclosure Ordinance forwarded from the Audit Committee on March 9, 2010 and unanimously adopted the ordinance on March 23, 2010. Amendments to the Disclosure Ordinance will be considered by the City Council on March 9, 2010.†~~

Recommendation 15:

*The DPWG should update the City's Disclosure Controls and Procedures to reflect changes that have occurred in the City's disclosure process since the Disclosure Controls and Procedures were adopted.*

Response 15:

The City agrees with the recommendation. DPWG is currently reviewing the Disclosure Controls and Procedures to ensure they accurately reflect the City's current disclosure process. Revisions are expected to be adopted by DPWG before the end of the fiscal year.



Recommendation 16:

*The DPWG should continue periodically to evaluate its processes and procedures to ensure that it has the correct composition to fulfill its role and to streamline its operations so that it operates efficiently and effectively without sacrificing the thoroughness of its review of the City's disclosures.*

Response 16:

The City agrees with the recommendation. Along with recommendations made by the Independent Consultant, many of the proposed changes to the City's Disclosure Ordinance were brought forward to the City Council at the suggestion of DPWG. Further, as noted above, DPWG is currently reviewing the Disclosure Controls and Procedures. In addition to ensuring the Controls and Procedures accurately reflect the City's disclosure practices, DPWG will be critically evaluating the Controls and Procedures in an effort to make them more streamlined and efficient without sacrificing the integrity of the process.

Recommendation 17:

*The Audit Committee and the DPWG should consider on an ongoing basis whether the revised procedures permitting an Audit Committee member and Councilmember or staff to attend DPWG meeting is serving its intended purpose without diminishing the effectiveness of the DPWG.*

Response 17:

The City agrees with the recommendation. With the adoption of the Audit Committee Ordinance and the amendments to the Disclosure Ordinance, the DPWG process ~~has will~~ become far more open to the City Council and the Audit Committee. While this is a welcome change from the perspective of the reliance of the individual members of those bodies on DPWG, it does create potential challenges for DPWG. All interests within the City recognize that the quality and integrity of the City's disclosures are paramount and we expect that DPWG's high level of quality and integrity will be maintained. However, if issues do arise, DPWG will work with the Audit Committee to ensure that such issues are discussed and addressed in an appropriate manner.

Recommendation 18:

*An SDCERS official should participate as necessary in a session of the DPWG at which pension-related disclosures are addressed.*

Response 18:

The City agrees with the recommendation. DPWG continues to have a good working relationship with SDCERS and all pension related disclosures are reviewed by SDCERS in coordination with DPWG. Moreover, DPWG receives appropriate certification from SDCERS regarding pension-related disclosures contained in all City offering documents.

See the Attached response from SDCERS in the letter dated March 3, 2010 from Mark Hovey, the Acting Administrator of SDCERS.

Recommendation 19:

*The City, with the assistance of the DPWG, should continue to evaluate steps toward a shelf-life disclosure system, including expanded use of the City's website, to improve the quality and timeliness of its reporting to the financial markets on an ongoing basis and to permit the efficient access to the capital markets for needed financing.*

Response 19:

As previously reported, the City is evaluating the costs and benefits associated with the potential implementation of a shelf-like disclosure regime. The City is examining ways to use the City's investor information webpage to actively reach out to investors. For example, recently the Mayor posted a letter to investors stating his position on municipal bankruptcy. This statement was reviewed by DPWG prior to posting. We consider this to be a positive step in terms of communicating useful and timely information to the investing public. In addition, periodic cash flow statement updates are being posted on the investor webpage to provide for ongoing updates to investors on the general fund cash position. The investor webpage is a comprehensive database for the investor community to access all of the City's mandatory and voluntary disclosures, continuing disclosure agreements, and the current ratings and rating reports. As continuing disclosures are filed with MSRB, the City makes those filings available to investors on the City's investor webpage. The City also uses the investor webpage to do outreach for public offerings, including posting of the bond offering statements, ratings releases, and notices of bond sales with appropriate disclaimers. Financial advisors, buy side analysts, and financial media have noted the City's growing use of its investor page to make information available in a user friendly and timely manner.

**San Diego City Employees' Retirement System (SDCERS)**

Recommendation 20:

*The SDCERS Board should consider again steps for the selection of SDCERS' actuary that ensure the independence and objectivity of the actuary as part of best practices for actuary retention.*

Response 20:

See the Attached response from SDCERS in the letter dated March 3, 2010 from Mark Hovey, the Acting Administrator of SDCERS.

Recommendation 21:

*The City, working with SDCERS and with the assistance of an experienced pension consultant, should continue to explore the range of alternatives for funding the City's pension and retiree health care benefits commitments, but it should do so based only on sound actuarial principles, consistent with prevailing practices in similar entities, with total transparency and without impairing the integrity of the pension system.*

Response 21:

Under separate contracts, the City has engaged the actuarial firm of Buck Consultants to perform independent actuarial analyses on the City's pension and retiree health benefits. The City continues to work with its labor organizations to reform pension and retiree health benefits. City management and

three of the City's labor unions agreed to study the retiree health care benefit this fiscal year leading to a negotiation in fiscal year 2011 on the retiree health benefit. Following the conclusions of these negotiations, the City will establish an actuarially sound funding approach to its retiree health care benefits.

See the Attached response from SDCERS in the letter dated March 3, 2010 from Mark Hovey, the Acting Administrator of SDCERS.

## **Fiscal Integrity**

### Recommendation 22:

*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 22:

~~The City's Five-Year Financial Outlook continues to be an extremely valuable planning tool which serves as a guide for long-range fiscal planning and provides the framework for the development of the annual budget and for decision-making. Since 2007, the City's Five-Year Financial Outlook has served as a valuable tool for guiding the City's long-range fiscal planning and has provided City leaders with a framework for development and adoption of the annual budget.~~ The Outlook incorporates a variety of economic assumptions and new expenditure requirements influencing revenues and expenditures over a five-year forecast period. This long-term forecast identifies structural challenges facing the City. The Outlook projects funding requirements for the City's priority areas including the City's pension obligation, General Fund reserves, deferred maintenance and capital improvement needs, retiree health benefits, storm water permit obligations, obligations under the Americans with Disabilities Act, City's workers' compensation fund reserves, and City's public liability fund reserves. The Outlook is updated, revised and issued annually to reflect the most current revenue and expenditure projections and programmatic budget issues.

~~The Five-Year Financial Outlook projects funding requirements for the City's priority areas, such as the pension obligation and funding of retiree health care, and identifies them as a priority for the City's annual budget process. Those areas include City's pension plan, General Fund reserves, deferred maintenance and capital improvement needs, retiree health benefits, storm water permit obligations, obligations under the Americans with Disabilities Act, City's workers' compensation fund reserves, and City's public liability fund reserves.~~

In addition to being updated annually, the Outlook is independently reviewed and analyzed each year for its completeness and accuracy by the Office of the Independent Budget Analyst (IBA). The IBA's reports on the Outlook, which are issued and presented to the City Council Budget and Finance Committee, include analyses of the following: underlying assumptions for all categories; consistency with goals set in the previous year's Outlook; accuracy of data provided; completeness and reliability of information; and consideration of "risks" or changing events.

The City Council recently amended the City's Budget Policy as it relates to the development of the Outlook to require alternative funding scenarios for retiree health care in order to better facilitate their decision making. The City Council also recently adopted eleven Budget Principles to guide future budget decisions and adherence to sound budgetary practices. One of the eleven principles specifically addresses the Outlook and information needs of the City Council, including alternative budget balancing scenarios, should the Outlook suggest multi-year budget deficits. These Principles will also guide the development of a City plan to eliminate the City's structural budget deficit which will be issued in September 2010.

The City will continue to evaluate the usefulness of the Five-Year Outlook while also looking for additional tools to enhance fiscal performance and decision making.

The Government Finance Officers Association (GFOA) recommends that local governments follow a financial planning process that combines the forecasts of revenues and expenditures into a single financial model over a three to five year period to be used as a tool to assess the long-term financial implications of current and proposed policies, programs, and assumptions in developing appropriate strategies to achieve established goals. The Financial Outlook is consistent with the GFOA best practices recommendations.

The City adopted City-wide Budget Principles that established guidelines for budgetary decision making and set standards for sound budgetary practices and fiscal performance.

### **Fulfillment of the City's Obligations Under the SEC Order**

In summary, the City believes it has substantially complied with the requirements in the Cease-and-Desist Order of the SEC dated November 14, 2006 (Order) to comply with the undertakings in the Order at Section III.F. at paragraph 5. The Order contained two principal requirements. First, to comply with the undertakings in Section III. F. at paragraph 5 of the Order. Second, to comply with Section 17(a) of the Securities Act of 1933 (Section 17(a)) and Section 10(b) of the Securities Exchange Act of 1934 (Section 10(b)) on an ongoing basis in the future.

The basis for the City's belief it has substantially complied with the undertakings in Section III.F. of the Order is more further described in this reply to the Final Report. These undertakings relate to the hiring and reporting requirements of the Independent Consultant. In addition, these undertakings include that the City take all necessary and appropriate steps to adopt, implement and employ the Independent Consultant's recommendations or the City's alternative method designed to achieve the same objective or purpose as that of the Independent Consultant's recommendations.

The City also believes it is complying with Section 17(a) and Section 10(b). Moreover, the City is committed to complying with Section 17(a) and Section 10(b) in the future. Further, the City believes that its disclosure controls, procedures and practices, its governance oversight structure and its ongoing commitment to adopt, implement and employ the recommendations of the Independent Consultant or the City's alternative method designed to achieve the same objective or purpose as the Independent

Consultant's recommendations will help to ensure that it continues to comply with Section 17(a) and Section 10(b) in the future.

This letter confirms the City's commitment to respond to each of the recommendations of the Final Report. The Final Report was presented to the City Council on March 8, 2010.

Sincerely,

Mayor Jerry Sanders

Ben Hueso, Chair, City Council

Attachment: SDCERS letter from Mark Hovey to City Comptroller dated March 3, 2010

DRAFT