

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

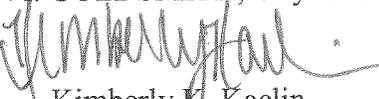
(619) 236-6220

DATE: September 15, 2011
TO: Audit Committee
FROM: City Attorney
SUBJECT: Memoranda of Law regarding City Auditor Authority

We received a copy of the City Auditor's e-mail to the Audit Committee dated September 12, 2011, regarding his request for advice from our Office on his authority to audit revenues, expenses, and other activities of various entities. As you may recall, our Office reviewed the Auditor's authority to conduct certain revenue audits in our Memorandum of Law (MOL) dated June 10, 2010 (City Att'y MOL-2010-12 (June 10, 2010)), a copy of which is attached as Attachment 1. A few months ago, the Auditor asked us to revisit our 2010 analysis and conclusions in that MOL. In response, we prepared a memorandum dated August 12, 2011, which concluded that our 2010 opinion remained the same. The Revenue Audit Division of the City Treasurer may not be transferred to the City Auditor. However, the memo further provided that the Auditor does have authority to audit the Revenue Audit Division of the Treasurer's Office.

The August 12, 2011, memorandum was not released after the Auditor advised us that he wanted our Office to answer a different set of questions. These questions were sent to us on September 1, 2011, and forwarded by the Auditor to the Audit Committee on September 12, 2011. We will be working with the Auditor to narrow the scope of such questions. To the extent that the Auditor's questions have not already been answered in the 2010 MOL or in the follow up memorandum dated August 12, 2011, we will provide additional legal analysis regarding the Auditor's authority to audit different entities. In the meantime, we are releasing our August 12, 2011, memorandum (City Att'y MS-2011-10 (Aug. 12, 2011)) as it provides additional legal analysis of some of these issues. A copy is attached hereto as Attachment 2.

JAN I. GOLDSMITH, City Attorney

By 
Kimberly K. Kaelin
Deputy City Attorney

KKK:jb
Attachments
cc: Eduardo Luna, City Auditor

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MEMORANDUM OF LAW

DATE: June 10, 2010

TO: City of San Diego Audit Committee

FROM: City Attorney

SUBJECT: Proposed Transfer of the Functions of the Revenue Audit Division of the Treasurer's Office to the City Auditor's Office.

INTRODUCTION

As part of the Fiscal Year 2011 budget considerations, Councilmember Anthony Young, as Chair of Council's Committee on Budget and Finance, suggested that the Mayor and City Auditor "review and take action on transferring the functions of the Revenue Audit and Appeals division of the City Treasurer's Office into the Office of the City Auditor" as a cost saving measure. Councilmember Young Memorandum at 1 (Apr. 30, 2009). The Audit Committee of the City of San Diego (Committee) considered this proposal at its May 10, 2010 meeting, reviewing a number of reports.¹

The proposed transfer of functions will affect the City Auditor's budget, which the Committee recommends to the City Council. The Committee requests the City Attorney provide it with a formal opinion assessing the legality of the proposed function transfer.

QUESTION PRESENTED

May the City Council transfer the functions of the Revenue Audit and Appeals Division (Revenue Audit Division) from the City Treasurer's Office to the City Auditor's Office?

¹ The Committee considered a Report from the Independent Budget Analyst (IBA) dated May, 7, 2010 (IBA Report No. 10-39); a Memorandum from the City Auditor dated May 7, 2010; a Memorandum from the City Treasurer dated May 10, 2010; and an outline from the City Attorney of potential legal issues involved in the transfer.

ATTACHMENT 1

SHORT ANSWER

No. The City Council may not legally transfer the functions of the Revenue Audit Division of the City Treasurer (Treasurer) to the City Auditor's Office. San Diego Charter section 45 places an express duty on the Treasurer to maintain a continuous inspection over special revenues she must collect from businesses, in order to effectuate collection of the revenue. The Treasurer meets this Charter duty through the Revenue Audit Division, which conducts periodic inspections of the records of businesses which remit the special revenues to the City, to ensure the revenues remitted are correct. The Treasurer is part of the City's financial management and reporting structure. The collection of revenue is a management function.

The independent City Auditor was established in 2008 by Charter section 39.2. The City Auditor is tasked with auditing City departments and offices to provide the public and City officials with objective, nonpartisan assessment of the stewardship, performance, or cost of the City's policies, programs, and operations. To ensure independence from management, the City Auditor reports to the Audit Committee. A transfer to the City Auditor of a management (collection-of-revenue) function, which the Auditor must audit, conflicts with the Charter and Government Auditing Standards' requirements for Auditor independence.

BACKGROUND

The City reformed its auditing and financial management systems in 2008 in the wake of a Securities and Exchange Commission (SEC) investigation of the City's debt financing disclosures occurring in the early 2000's. The 2008 reforms generally followed the remediation recommendations of the Kroll Report (Report),² issued in 2006 after an eighteen month review of the City's governance.³ The Report frankly assessed the City's failures "to adhere to principles of sound governance and financial reporting" leading to the investigation. Kroll Report at 1. The City lacked internal controls necessary to ensure accuracy in the City's accounting and financial reporting. Kroll Report at 240-42. The Report recommended reorganization of the financial reporting structure to ensure greater accountability.⁴

In January 2006, the trial Strong Mayor form of government placed the City's financial management system, including the City Auditor and Comptroller, directly under Mayoral control.⁵ This improved accountability in the reporting system. The City's accounting, financial reporting *and* internal auditing duties were still combined in the single office of Auditor and Comptroller. The Report found that retaining the internal audit function within the management

² "Report of the Audit Committee of the City of San Diego" (August 8, 2006).

³ The City Council retained Kroll Inc., a group led by Arthur Levitt, former Chairman of the SEC, to independently assess City governance and recommend solutions to the City Council to remediate problems leading to the SEC investigation.

⁴ The reorganization included creating a Chief Financial Officer (CFO), who reported to the Mayor, or CEO, of the City, and a City Treasurer reporting to the CFO. Kroll Report at 245-46.

⁵ Under the City Manager form of government, the City Auditor and Comptroller was the City's chief fiscal officer, appointed by the City Council. Former San Diego Charter § 39. In January 2006, former Charter section 265(b)(10) and (11) gave the Mayor sole authority to appoint and to dismiss the Auditor and Comptroller, subject to the officer's right to appeal to the City Council.

structure lacked “the requisite level of independence widely viewed as essential for a sound financial reporting system.” Kroll Report at 250; also 246, n. 1273. The Report expressly recommended the City create a “separate internal auditing function” distinct from the Mayor in a new officer called an Auditor General, who would report to an Audit Committee, and serve for a term of ten years. *Id.* at 250-51. This would leave the City Departments responsible for financial reporting and accounting, such as a CFO, Comptroller, and Treasurer, in management’s organizational structure, and the City’s internal auditing and independent oversight functions in a separate one. *Id.* at 245-46.

A Charter Review Committee recommended Charter changes to the City Council in 2007, to implement the financial reforms.⁶ At the June 3, 2008 Municipal Primary Election, voters approved Proposition C, amending the Charter to comprehensively change the City’s financial reporting and accounting structure. The Charter changes: 1) supplanted the previous title of Auditor and Comptroller with a new title of CFO; 2) created a CFO appointed by the Mayor and confirmed by City Council; and 3) formally transferred all “[t]he authority, power and responsibilities conferred upon the Auditor and Comptroller by this Charter . . . to . . . the Chief Financial Officer.” San Diego Charter § 39. The measure placed the Treasurer under CFO supervision, removing the requirement the Treasurer’s appointment be confirmed by the City Council. San Diego Charter §§ 39, 45. It created an Audit Committee, independent of management, to supervise the new Charter office of City Auditor, created to assume the City’s internal audit functions. San Diego Charter §§ 39.1, 39.2 and 111.⁷

ANALYSIS

I. THE CHARTER DUTIES OF THE CITY TREASURER AND CITY AUDITOR.

San Diego is a charter city. As such, the City charter creates and forms our municipal government, “distribut[ing] the powers and duties of the various departments, boards and officers, and provid[ing] the manner in which the . . . powers shall be exercised.” 2A McQuillin Mun. Corp. § 9:3 (3rd ed. 2010). This means that when a charter creates a public office or body, the charter is the source of the body’s or officer’s authority and responsibilities. For example, the San Diego Charter creates and establishes the City Council, the Treasurer, the City Auditor, the Audit Committee, the Mayor, and the CFO among other Charter officers or bodies. Each body or officer has designated responsibilities and authority given to them by the Charter. However, unless the Charter expressly permits it, one Charter officer or body may not limit or impede the performance of another. *See* City Att’y MOL-2006-2 (Jan. 23, 2006) [Mayor may not interfere with Auditor and Comptroller Charter duties.]

⁶ The Mayor’s Charter Review Committee provided most of the language for the Charter amendments in Proposition C. *See* 2007 San Diego Charter Review Committee, Final Report (October 4, 2007). The City Council incorporated its modifications during January and February 2008. *See* City Att’y Reports RC-2008-1 at 5-9 (Jan. 14, 2008), and RC-2008-3 at 4-6 (Jan. 29, 2008).

⁷ Proposition C also created the IBA as a new Charter officer, giving the City Auditor and IBA full control over the hiring and dismissal of their assistants and deputies. San Diego Charter §§ 39.3 and 117(a)(11).

Charter provisions are construed in the same manner by courts as are constitutional provisions. *Woo v. Superior Court*, 83 Cal. App. 4th 967, 975 (2000). The principal determination is what voters intended in approving the charter provisions. Courts look first to the actual words of the provisions, giving “the usual, ordinary, and commonsense meaning to them.” *Howard Jarvis Taxpayers Ass’n v. County of Orange*, 110 Cal. App. 4th 1375, 1381 (2003). If the language is clear and unambiguous, the courts will presume the voters intended the meaning apparent on the face of the measure and end their inquiry. *Woo*, 83 Cal. App. 4th at 975. If there is some ambiguity in the language, courts may look to extrinsic aids, such as the information and arguments contained in the official ballot pamphlet, to indicate the voters’ understanding of the measure and their intent in passing it. *Id.* at 976.

A. San Diego Charter Section 45 Requires the Treasurer to Continually Inspect Certain Revenues To Effectuate Collection.

The Treasurer is part of the financial management of the City under Mayoral control. The Treasurer performs management and administrative functions pursuant to the Charter, generally involved in collecting, holding, and disbursing City funds. The Treasurer must keep the usual “books and records as are necessary for the recording of all receipts and expenditures” connected with these general duties. San Diego Charter § 45.⁸

The Charter also contemplates the Treasurer will be assigned to collect other special types of revenues, such as “special assessments . . . , charges for permits for private use of public streets, and such other miscellaneous taxes, fees, assessments, licenses and privilege charges” San Diego Charter § 45. Once assigned to collect these revenues, the Charter places additional duties on the Treasurer to “maintain a *continuous inspection* of the records and accounts of such taxes, licenses and privilege charges *in order to effectuate their collection.*” *Id.* (emphasis added).

This particular and express duty to “maintain a continuous inspection” “to effectuate . . . collection” is undefined in the City Charter, and this precise language is rarely seen elsewhere.⁹ The Treasurer meets this duty using the Revenue Audit Division¹⁰ to periodically inspect the records of the tax-regulated businesses and those businesses remitting percentage-based franchise fees, and rents for City-leased lands. If deficiencies are found during these inspections, appropriate collection actions are initiated. “[F]inance/revenue related departments” of other California cities also perform these periodic inspections, which are often called revenue compliance audits. *See* IBA Report No. 10-39 at 4. The Treasurer’s process is also consistent

⁸ Since 2008, the Treasurer is directly responsible to the CFO, the City’s chief fiscal officer in the management structure. San Diego Charter §§ 39, 260(b) and 265(b). The CFO must report monthly to the Mayor/Manager and Council on the City’s “revenue and expenses” so as “to show the exact financial condition of the City,” its Departments and offices. San Diego Charter § 39. The CFO receives the City revenue information for these reports from those reporting to her, including the City Treasurer.

⁹ In a brief online search, we found the Tulsa, Oklahoma Municipal Code similarly directs its Director of Finance to “maintain a continuous inspection of all taxes, assessments, licenses, and fees and other revenues due the City in order to effectuate their collection.” Tulsa Mun. Code § 601.

¹⁰ The Division consists of five accountants employed in the City’s classified service and one manager in the unclassified service.

with periodic inspection processes of regulated businesses or their records at all levels of government to ensure compliance with applicable regulations.

In the tax or revenue context, these inspections are usually called tax examinations or tax audits.¹¹ The City's local business tax ordinances mirror this accepted process and give the Treasurer specific collection, inspection, and audit authority consistent with the Treasurer's Charter duties. For example, the Treasurer is required to collect the City's Transient Occupancy Tax (TOT) from City businesses. San Diego Municipal Code (SDMC) §§ 35.0101-35.0138.¹² The TOT is imposed on City visitors renting certain lodgings in San Diego, calculated as a percent of the rent charged by the operator business. Business operators must collect and remit the proper amount of TOT monthly to the City. The tax scheme permits the City to "inspect" and "audit" the business records to cross-check the payments they send to the City with the business records on which they are based. SDMC §§ 35.0116(c) and 35.0121. It gives the Treasurer sole access to these business entities to complete the inspections or audits. SDMC § 35.0121. If a deficiency is found after an audit, the business is invoiced by the Treasurer. SDMC § 35.0116(c). The businesses can either pay the deficiency or appeal the determination. SDMC §§ 35.0117, 35.0118.

The plain language of Charter section 45 is not ambiguous. When the Treasurer is assigned to collect fees, assessments, taxes, or other like matters from outside entities, the Charter requires the Treasurer to continuously inspect the records of those entities to ensure the City collects the proper amount. The Treasurer fulfills this specific charter duty by using the accountants in the Revenue Audit Division to periodically inspect the records of the businesses remitting these fees and taxes, to effectuate collection of the appropriate amounts. *See* Treasurer Memorandum to Chief Financial Officer at 4 (May 15, 2009).

Accordingly, the Treasurer has a legal duty under the Charter to continuously inspect the records of businesses from whom she is assigned to collect special revenues in order to effectuate that collection. She appropriately meets that legal duty by these periodic inspections (revenue compliance audits) of those records to ensure the correct amounts are remitted to the City. These periodic inspections are an integral part of the Treasurer's special revenue collection duties, expressly imposed upon her by the Charter. In addition, these inspections serve management and administrative functions under the Charter as reformed in 2008, providing management with accurate revenue information for required reporting purposes under the Charter.

¹¹ The Internal Revenue Service (IRS) indicates: "There is no statutory or common law definition of the term 'examination.' However, an examination, or audit, may be described as the systematic inspection of the books and records of a taxpayer for the purpose of making a determination of the correct tax liability." http://www.irs.gov/govt/foia/article/0,,id=159772_00.html. Similarly, Black's Law Dictionary indicates a tax audit is "[a]n examination of books, vouchers and records, or other transactions possessing tax consequences, of a taxpayer" *Black's Law Dictionary* at 131 (6th ed. 1990).

¹² The Treasurer is also required to collect business taxes, and has the same rights of access to those business records. *See* SDMC §§ 31.0301, 31.0128, and 31.0140.

B. Charter Section 39.2 Requires the City Auditor to Be the City's Independent Auditor.

Charter section 39.2 governs the responsibilities and duties of the City's Auditor. In combination with Charter section 39.1, the sections were intended to create a "separate internal auditing function" apart from management control. Kroll Report at 250. Internal audits in general are "performed by personnel of a company to assure that internal procedures, operations, and accounting practices are in proper order." *Black's Law Dictionary* at 131 (6th ed. 1990).

Charter section 39.1 requires the Audit Committee to be "an independent body," whose composition and appointment process "ensure[s] its independence." The Committee has "oversight responsibility regarding the City's auditing, internal controls and any other financial or business practices required of [it] by this Charter." San Diego Charter § 39.1.¹³ It is "responsible for directing and reviewing the work of the City Auditor and the City Auditor shall report directly to the Audit Committee." *Id.*

Charter section 39.2 requires the City Auditor to either "be a certified public accountant or certified internal auditor" and to follow "Government Auditing Standards" (GAGAS). GAGAS, as the name suggests, provides legislators, government officials, and the public with "an independent, objective, nonpartisan assessment of the stewardship, performance, or cost of government policies, programs, or operations . . ." GAGAS § 1.01. Independent auditors use GAGAS to assess whether "(1) government manages public resources and uses its authority properly and in compliance with laws and regulations; (2) government programs are achieving their objectives and desired outcomes; (3) government services are provided effectively, efficiently, economically, ethically, and equitably; and (4) government managers are held accountable for their use of public resources." GAGAS § 1.02.

Charter section 39.2 gives the Auditor access to City officials and records, requiring City officials and employees to cooperate and disclose pertinent information.¹⁴ It permits the Auditor to "investigate any material claim of financial fraud, waste or impropriety within any City Department" and authority to "summon any officer, agent or employee of the City, any claimant or other person, and examine him or her upon oath or affirmation" for that investigation. San Diego Charter § 39.2. It contemplates the City Auditor to have access to the records of some outside entities who voluntarily contract with the City, in order to verify compliance with contract terms. Those are particular City contracts with "consultants, vendors or agencies," and appear generally to involve the spending or use of City revenue, not the receipt of revenue owed the City. *Id.* Charter section 39.2 does not authorize the City Auditor independent access to the

¹³ We have previously interpreted the meaning of the Committee's oversight responsibility. See City Att'y Report RC-2009-14 (June 11, 2009).

¹⁴ Charter section 39.2 provides in pertinent part: "The City Auditor shall have access to, and authority to examine any and all records, documents, systems and files of the City and/or other property of any City department, office or agency, whether created by the Charter or otherwise. It is the duty of any officer, employee or agent of the City having control of such records to permit access to, and examination thereof, upon the request of the City Auditor or his or her authorized representative. It is also the duty of any such officer, employee or agent to fully cooperate with the City Auditor, and to make full disclosure of all pertinent information."

records of business entities subject to the City's regulatory or taxation scheme, nor access to the records of franchisees, or entities leasing City property who owe money to the City.¹⁵

That voters intended the City Auditor to assess City processes and certain businesses contracting with the City is also consistent with information presented to them. The ballot materials specifically stated that "[t]he Mayor's supervision of the Auditor and Comptroller's duty to audit fiscal departments under Mayoral control raised concerns about the independence of internal audits." Ballot Pamp., Municipal Prim. Elect. (June 3, 2008), City Att'y Impart. Anal. Prop. C. Voters also understood that Proposition C would "more clearly separate the City's internal auditing function from supervision of the Manager (Mayor) by creating the new office of the City Auditor, which would be supervised by a restructured Audit Committee [T]he Auditor would perform the City's internal audits and investigations" *Id.*

Accordingly, we conclude Charter section 39.2 requires the City Auditor to audit City Departments and processes and to do so independent of City management. The independence of the City Auditor's Office is assured by requiring the Auditor report, not to management, but to the independent Audit Committee. This independent City audit system meets necessary GAGAS independence standards because "the audit function is organizationally placed outside the reporting line of the entity under audit and the auditor is not responsible for entity operations." GAGAS § 3.13. It permits the City Auditor to fulfill an *essential* City role: to provide "objective, nonpartisan assessment of the stewardship, performance, or cost of [the City's] policies, programs, or operations." GAGAS § 1.01. This permits the public, City Council, and other City Officials to know how well or poorly the City manages public resources and provides public services, and holds accountable those City Officials who perform poorly.

II. THE CITY COUNCIL MAY NOT TRANSFER THE TREASURER'S REVENUE AUDIT FUNCTION TO THE CITY AUDITOR.

Charter section 39.2 permits the City Auditor to "perform such other duties as may be required by ordinance" It is also well-established that a legislative body, like the City Council, has wide discretion, especially in the exercise of its budgetary authority. *Scott v. Common Council*, 44 Cal. App. 4th 684, 693 (1996), citing *Hicks v. Orange County Board of Supervisors*, 69 Cal. App. 3d 228, 235 (1977). This might prompt the belief that if the City Council ordains something, it must occur. But a city council's authority to act in budgetary capacity or by ordinance is not unlimited. A city council's authority in a charter city is limited by the city charter. "[I]t is well settled that a charter city may not act in conflict with its charter Any act that is violative of or not in compliance with the charter is void." *Domar Electric, Inc. v. City of Los Angeles*, 9 Cal. 4th 161, 171 (1994) (citations omitted). Several cases limit a legislative body's authority when it takes actions affecting the functions and duties of charter or statutory officers.

In *Hubbard v. City of San Diego*, 55 Cal. App. 3d 380 (1976), the City Council attempted to create by ordinance a department of legislative analyst with certain specified duties, which the

¹⁵ Whether or not any particular City agreement, lease, or franchise permits the City Auditor independent access to a business' records must be determined on a case by case basis.

court found to be administrative in nature. *Some* of the duties and responsibilities given to the new department duplicated or overlapped those required by the Charter of the City Manager. However, the ordinance removed the new department from managerial or administrative supervision. The court found the ordinance invalid. *Hubbard*, 55 Cal. App. 3d at 384. The legal rule we derive from this case is straightforward. The City Council cannot do something by ordinance, “which *duplicates* or *infringes upon* the specific powers or duties assigned by the charter to another department or, generally, to the manager.” *Id.* at 388 (emphasis added).

Similarly, in *Dadmun v. City of San Diego*, 9 Cal. App. 549 (1908), the City Council created by ordinance an Office of Special Prosecutor to handle certain criminal cases, and appointed Mr. Dadmun to fill the position. He prosecuted certain criminal cases, and sued the City for payment when it declined. The Charter then required the City Attorney to prosecute all criminal cases arising from violations of city ordinances. The Court found the actions of the City Council in appointing a special prosecutor to be “unauthorized and void.” *Dadmun*, 9 Cal. App. at 551. The rule distilled from this case: “[T]he city council cannot relieve a charter officer of the city from the duties devolving upon him by the charter and designate another to perform such duties.” *Id.*

Hicks is a case analogous to the current situation. A county board of supervisors tried to transfer about one third of a district attorney’s investigators to the sheriff’s office, in an effort to reorganize investigatory activities. The California Constitution and state laws governed the derivation of authority of the various governmental bodies and officers in the *Hicks* case, as the City Charter does in our case. The laws did not give the board of supervisors control over the district attorney. The laws did give control to the district attorney over the institution of criminal proceedings. The investigation and gathering of evidence was inseparable to that function. The question was whether the board could lawfully require the district attorney to perform some of its investigatory function through the sheriff’s office. The answer was no. The court held that the county legislative body had no power to control the district attorney, a statutory officer, in the performance of a required function “by requiring that he perform his essential duties through investigators who are subject to the control of another county officer.” *Hicks*, 69 Cal. App. 3d at 241. It did not have “authority to transfer control of one officer’s statutory function to another officer.” *Id.* at 244.

In *Scott v. Common Council*, 44 Cal. App. 4th 684 (1996), the Common Council of the City of San Bernardino by budgetary action eliminated the only two investigators in the City Attorney’s Office. The City Attorney sued, claiming the Council had a legal duty to provide the attorney with a sufficient number of investigators to perform his charter-mandated duties. The Court found the Council had acted beyond its budgetary jurisdiction. By eliminating the investigators in the attorney’s office, it had eliminated the attorney’s ability to carry out a mandatory charter duty. *Scott*, 44 Cal. App. 4th at 698. The court found that legislative bodies may not allocate their dwindling supply of funds during hard time funds among competing government needs “by first eliminating mandatory government functions.” *Scott*, 44 Cal. App. 4th at 697.

The question before us is whether the City Council may transfer the functions of the Treasurer's Revenue Audit Division to the City Auditor. We have concluded these functions (consisting of periodic revenue compliance audits or inspections) appropriately meet the Treasurer's express legal duty under the Charter to continuously inspect the records of the businesses remitting the special revenues she must collect, to effectuate that collection. The functions are an integral part of the Treasurer's special revenue collection duties, expressly imposed upon her by the Charter. Under these circumstances, the City Council may not transfer these Charter-required functions from the Treasurer to the City Auditor by ordinance or otherwise.¹⁶

The Revenue Audit Division's functions are also plainly part of City management's functions under the Charter as reformed in 2008. The City Auditor has the particular duty under our Charter to audit such management functions and processes, assessing how well or poorly they are performed. The City Auditor must follow GAGAS, which place great emphasis on auditor independence. Two overarching independence principles are that "(1) audit organizations must not provide . . . services that involve *performing management functions* or making management decisions and (2) audit organizations *must not audit their own work . . .*" GAGAS § 3.22 (emphasis added). Services that "directly support the entity's operations" and impair independence of the auditor *cannot be overcome* by compliance with supplemental safeguards. GAGAS § 3.29. They include services that involve "taking responsibility for basic financial or other records that the audit organization will audit." GAGAS § 3.29(a).

Transferring the functions of the Treasurer's Revenue Audit Division to the City Auditor conflicts with the GAGAS independence principles the Auditor must follow under our City Charter. It risks permanent impairment to the Auditor's independence, which voters just approved by adding sections 39.1 and 39.2 to the Charter. The 2008 restructuring of the Charter separated the City's financial accounting and reporting functions under Mayoral control from the independent Auditor function. This proposed transfer of a management function to an officer who may not perform such function under the San Diego Charter conflicts with the Charter. Accordingly, we conclude that a court would likely determine such action by the City Council to be void. *See Domar Electric*, 9 Cal. 4th at 171.

CONCLUSION

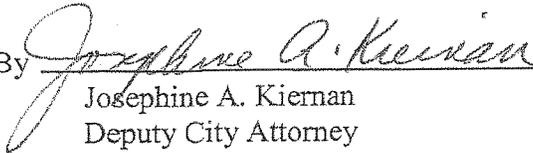
The Audit Committee is tasked with recommending potential budgetary changes to the City Auditor's Office to the City Council for action. The proposal to transfer functions of the Revenue Audit Division from the Treasurer's to the City Auditor's Office would impact the budget of the City Auditor and so the Committee has correctly asked for advice on the legal propriety of the proposal.

Under the requirements of the recently-amended Charter and the facts presented to us, the City Council is legally precluded from transferring the functions of the Revenue Audit Division to the City Auditor. The Charter places an express duty on the Treasurer to maintain a

¹⁶ These cases also tell us that the City Council may not duplicate the Treasurer's revenue audit function in the City Auditor's Department; or require the City Treasurer to exercise this function through the City Auditor's Office.

continuous inspection over special revenues she must collect, in order to effectuate their collection, a traditional management function. Maintaining the authority and independence of the City Auditor is critically important to the public and public officials, and is now required of the City Auditor by the Charter. Attempting a transfer to the City Auditor of a management (collection-of-revenue) function also conflicts with Charter requirements for that office and would likely be found legally invalid.

JAN I. GOLDSMITH, City Attorney

By 
Josephine A. Kiernan
Deputy City Attorney

JAK:jdf:sc

cc: Gail Granewich, City Treasurer
Eduardo Luna, City Auditor
Honorable Mayor Jerry Sanders
City Councilmembers
Andrea Tevlin, Independent Budget Analyst
ML-2010-12

Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

(619) 236-6220

DATE: August 12, 2011
TO: Eduardo Luna, City Auditor
FROM: City Attorney
SUBJECT: Review of Opinion Regarding Transfer of Revenue Audit Function

You requested that our Office review the City Attorney Memorandum of Law No. 2010-12 (MOL) dated June 10, 2010, which opined that the City Treasurer Revenue Audit Function cannot legally be transferred to the Independent City Auditor. You have requested further review of the MOL, with the specific inquiry of where the audit authority lies for the revenue recovery, since the function may not be transferred to the Auditor.

I have reviewed the MOL; the Independent Budget Analyst (IBA) Report dated May 7, 2010; the City Auditor memoranda dated June 10, 2010, and May 7, 2010; and the City Treasurer memorandum dated May 10, 2010; along with the pertinent San Diego Charter and Municipal Code sections, and San Diego Administrative Regulations. I conducted a further review of recommendations for, and the role of auditing in public sector governance from the Generally Accepted Government Auditing Standards (GAGAS) and well-known government auditing publications, including the Association of Local Government Auditors and The Institute of Internal Auditors.

After a thorough review of these sources, I have come to the same conclusion. The functions of the Revenue Audit Division of the City Treasurer cannot legally be transferred to the City Auditor's Office.¹ The analysis further supports the current organizational structure wherein the City Treasurer (Treasurer) is responsible for management and collection of City revenue and the Independent City Auditor (Auditor) is responsible for auditing such revenue collections.

¹ For an in-depth analysis on the reasons why City Council may not legally transfer the Revenue Audit Division of the City Treasurer to the City Auditors, please see City Att'y MOL No. 2010-12 (June 10, 2010), entitled "Proposed Transfer of the Functions of the Revenue Audit Division of the Treasurer's Office to the City Auditor's Office."

It is widely-known in the government auditing industry that auditors are required to have organizational independence from the departments they audit. Specifically,

[A]udit organizations must be free from organizational impairments to independence with respect to the entities they audit. Impairments to organizational independence result when the audit function is organizationally located within the reporting line of the areas under audit or when the auditor is assigned or takes on responsibilities that affect operations of the area under audit.

Government Accounting Standards, The United States Government Accountability Office (GAGAS), July 2007, § 3.12. This basic tenet is commonly discussed in heavily relied on government auditing publications.

For example, the Institute of Internal Auditors also emphasizes that the auditor needs to have organizational independence from departments it audits. Specifically, “[a]uditors should have sufficient independence from those they are required to audit so that they can both conduct their work without interference and be seen as able to do so” *Everyday Ethics for Local Officials, The Agency Auditing Function*, Institute for Local Government, December 2009, (quoting *The Institute of Internal Auditors, “The Role of Auditing in Public Section Governance”*). In fact, The Institute of Internal Auditors recommends that: “[t]o preserve their independence, government auditors’ advisory/assistance services should never assume a management role” (“The Role of Auditing in Public Sector Governance,” The Institute of Internal Auditors, Nov. 2006, p.5). Proper governance “requires regular financial and performance reporting *that is validated for accuracy by an independent auditor.*” *Id.* at 7 (emphasis added). Also, the San Diego City Auditor’s (Auditor) May 7, 2010, memorandum recognizes: “Standards specifically state that impairments result when an audit function is organizationally located within the reporting line of the areas under audit or when the auditor is assigned or takes on responsibilities that affect operations of the area under audit.”

Here, the Treasurer’s Office performs a management function in the oversight and collection of revenue for the City. The Treasurer’s Office has the managerial duty, not only to collect revenues on a daily basis, but to establish effective controls and assess risks in its collection efforts. The San Diego Municipal Code (SDMC) requires the Treasurer to collect taxes and also gives the Treasurer audit authority in certain scenarios. For instance, with respect to the Transient Occupancy Tax (TOT), the Municipal Code requires the Treasurer to collect the TOT revenue, to inspect all business records of operators², and “to apply auditing procedures” to determine the amount of such tax for which hotel operators are liable. SDMC § 35.0121. The Municipal Code further provides that “it shall be unlawful to refuse to allow or to permit such audit to be conducted after a lawful demand therefor by the City Treasurer, or the City Auditor *when so requested by the City Treasurer.*” *Id.* (emphasis added). Therefore, the revenue compliance audit performed by the Treasurer’s Office is a management function; required to

² “Operator” means the person who is the proprietor of the Hotel, Recreational Vehicle Park, or Campground assessed the TOT tax. SDMC § 35.0102.

ensure proper collections. The Auditor, on the other hand, is not given such access to independent, revenue-producing entities, unless requested to do so by the Treasurer.

The auditor's role is to provide the oversight, insight and foresight to the managing department. "The Role of Auditing in Public Sector Governance," The Institute of Internal Auditors, Nov. 2006, pp 12-13. The government auditor has the duty to assess and report on the success of these collection efforts conducted by the treasurer. The auditor's job is to provide insight by further assisting management in assessing which programs are working and which programs are not. The auditor should also have the foresight to help departments identify trends and challenges before they become crises. *Id.*

Here, the City Charter only gives the Auditor access to an entity's records for all City contracts with "consultants, vendors, or agencies." San Diego Charter § 39.2. These are entities which voluntarily contract with the City, and generally involve spending City revenue. The Charter, however, does not provide the Auditor with the same access to entities which are required to provide revenue to the City, such as the hotel operators (TOT assessments), franchisees, and lessees.

The City of San Diego currently operates with the same organizational structure recommended by GAGAS and government publications for public sector auditing. The Treasurer has the responsibility to manage the collection of revenue. The Auditor has the authority to audit such collections, just as the Auditor conducts audits on other City departments, to objectively determine whether the departmental reports establish a proper basis for the collection of, accounting for, and depositing of revenues and other resources. *The Agency Auditing Function*, quoting The Association of Local Government Auditors. The Auditor, however, may not perform the management function and may not take on responsibilities that affect the operations of the Treasurer's department. The City's current organizational structure with respect to revenue collection also ensures compliance with the Auditor and Treasurer functions as described in the Municipal Code, and the San Diego Charter at sections 39.1, 39.2, and 45³. Further support for the current structure of the revenue audit function can be found when compared to other jurisdictions. The IBA reported that most cities operate in the same manner as the City of San Diego with respect to revenue compliance audits, or collections, i.e., that a finance or revenue related department performs this function – not the auditor.⁴

To summarize, in addition to the requirements found in state and local laws, Government Auditing Publications recommend that the Auditor should be determining whether programs are effective, not actually managing the collection of revenue.

³ For an in-depth analysis on the functions of the Auditor and Treasurer in accordance with the City Charter, please see the City Attorney MOL No. 2010-12 (June 10, 2010), which remains good law.

⁴ See Independent Budget Analyst Report No. 10-39, dated May 7, 2010, entitled, "Analysis Related to a Proposal to Transfer the City Treasurer's Revenue Audit Program to the Office of the City Auditor."

Therefore, the City Auditor is permitted to perform such revenue audits to determine whether the revenue has been properly collected, in addition to assessing the efficiency and controls of the Treasurer's department, just like the Auditor does for any other City Department(s).

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cc: Honorable Mayor
City Councilmembers
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Gail Granewich, City Treasurer

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