

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: May 5, 2006

IBA Report Number: 06-22

City Council Agenda Date: May 8, 2006

Item Number: S402

Item: Additional Expenditures for Kroll and Related Entities

Overview

Definitions

- **Public Liability Fund:** Was established to provide funding for the City's self-insurance program for General Fund public liability claims, including claims for bodily injury, property damage, inverse condemnation, false arrest and errors and omissions. Recently, the Public Liability Fund has been used to fund other General Fund non-claim related expenses.

On Monday, May 8th, the City Council is being asked to authorize an additional payment to Kroll of \$4.1 million, bringing total Kroll payments for their investigation to \$17.65 million. In addition to the Kroll expenditures, the City Council is also being asked to authorize combined payments of \$1.5 million to NTI Breakwater for the completion of electronic data compilation, KPMG for auditing of the City's FY 2003 financial statements and Macias & Gini for auditing the City's FY 2004 and FY 2005 financial statements.

The chart on the next page presents the payments made to Kroll, date of Council authorization, and allocation for each payment:

Date	Amount	Allocation
February 2005	\$250,000	General Fund-60% Water/Sewer Funds-40%
May 2005	\$1.5 million	General Fund-60% Water/Sewer Funds-40%
June 2005	\$200,000	General Fund-60% Water/Sewer Funds-40%
June 2005	\$400,000	General Fund-60% Water/Sewer Funds-40%
August 2005	\$1.2 million; not to exceed \$3.55 million	General Fund-60% Water/Sewer Funds-40%
January 2006	\$10 million	General Fund-100%*
May 2006 (If approved)	\$4.1 million	General Fund-71% Other City Funds-29%
Total:	\$17.65 million	

* On May 8, 2006 the Mayor is requesting the reallocation of \$11.4 million in audit committee related expenditures charged to the Public Liability Fund (General Fund). See the Retroactive Reallocation of Previous Expenditures section of this report for more information.

The total approved expenditures for Kroll to date are \$13.55 million. If the City Council approves the most recent request of \$4.1 million, the total cost will be \$17.65 million. An additional \$2.65 million has been approved for Willkie Farr & Gallagher for legal expenses related to the investigation.

On January 17, 2006, the City Council raised questions regarding the proposed cost allocation during their consideration of the Kroll payment item. In response, a Cost Allocation Policy was developed by the Mayor's Chief Financial Officer (CFO) and approved by the City Council on March 17, 2006. This policy was supported by the City Auditor and the IBA. This policy recommends an allocation of 71% of all citywide expenses to the General Fund and an allocation of 29% to other City funds. This percentage allocation was determined by the CFO based on Full Time Equivalent (FTE) staffing- a generally accepted cost allocation methodology.

The City Attorney has stated on several occasions that he does not support this cost allocation for Kroll or for related attorneys' fees. The issue of cost allocation is typically considered a financial matter rather than a legal matter.

Retroactive Reallocation of Previous Expenditures

The Mayor is requesting the reallocation of \$11.4 million in audit committee related expenditures charged to the Public Liability Fund. If approved, the previously approved expenditures would be reallocated to all City Funds based on the approved allocation

method. Of the \$11.4 million, \$10 million was for the Audit Committee (Kroll), \$1.4 million for outside Attorney's fees, and \$50,000 payment to SDCERS.

If the payments of \$11.4 million were reallocated based on the approved allocation method, \$3.3 million that has been expensed to the Public Liability Fund would be spread to other City Funds. This would free up \$3.3 million in the Public Liability Fund to be used for additional legal expenses or other claims against the City. The IBA agrees with the Mayor's request to reallocate the \$11.4 million in audit committee related expenditures previously charged to the Public Liability Fund.

Docketing of this Item

The additional expenditures for Kroll and related entities have been docketed on Monday, May 8th as a supplemental item. The Request for Council Action and relevant backup material were submitted to the Council President's Docket Coordinator on Friday, May 5th. It is important to note that the docketing of supplemental items should only be used for emergencies. The IBA strongly advises that items of this significance should be docketed using the normal docket procedures to allow for adequate review of the item by the City Council and the IBA in the future.

[SIGNED]

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