




THE CITY OF SAN DIEGO

DATE: September 15, 2008

TO: Honorable Mayor and Members of the City Council

FROM: Eduardo Luna, City Auditor 

SUBJECT: **Macias Consulting Group's Response to SEDC's Comments to the SEDC Performance Audit Report**

Attached is Macias Consulting Group's response to SEDC President Carolyn Y. Smith's written response, dated September 5, 2008, to the SEDC Performance Audit Report. Macias Consulting has reproduced the SEDC President's comments made in her memo, and responded to each point accordingly.

Please contact me if you need any additional information.

cc: Carolyn Y. Smith, SEDC President
Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Greg Levin, City Comptroller
Michael Aguirre, City Attorney
Andrea Tevlin, Independent Budget Analyst
Stanley Keller, SEC Consultant





To: Eduardo Luna, City Auditor

Date: September 12, 2008

Re: Addendum: SEDC comments to the SEDC Performance Audit report

SEDC Response: The failure of this document to include information that SEDC staff has provided, coupled with "the apparent 180 degree change in position from the original (and previous) audits prepared by Macias Consulting Group and its affiliates creates an impression that this "expanded" audit was created primarily to satisfy those who commissioned the report, and is not a fair and impartial analysis of SEDC's performance.

- **Macias Response: Disagree.** The draft report issued on August 28, 2008 was the only report issued by Macias Consulting Group on SEDC and no other reports had been previously issued by us, thus no 180 degree change has occurred. Reports that had been previously issued by Macias Gini and O'Connell, LLP were on SEDC's financial statements and in no way constitute a performance audit.

Our report fairly and objectively presents the original documentation and information that was provided by SEDC.

SEDC Response: The issue of additional compensation was discussed in a memorandum sent to MCG September 2, 2008. (MCG Note: SEDC disagreed with our findings that the one page compensation data submitted to the Board was insufficient and that SEDC did not disclose its compensation structure. They also disagreed with our performance audit finding of fraud and provided budget information as supporting information.)

The Audit states that there is not a great level of detail on specific expenditures and compensation information and goes on to say that the Board received a one page hand-out showing key types of revenues and expenditures. As a point of clarification, the one page report distributed to the Board of Directors during its meetings was prepared to provide additional detail for SEDC's expenses incurred during the proposed Fiscal Year.

In addition, all Board members were provided specific responses to the specific questions asked during the meeting and were invited to review the extensive back up data that was utilized to prepare the budget. At least one Board member did review this back up data made available to the entire Board.

- **Macias Response: Disagree.** The "detailed" description of the compensation that SEDC has provided as documentation to the City was for FY 2007-08 only. During our review for FY 2004-05 thru FY 2006-07 we found no evidence that this "detailed" information was submitted to the City. Moreover, this "detailed" description that was provided for FY 2007-08 to the City continued to be

insufficient because the information was in a summary format, and does not provide the actual compensation as budgeted per employee. It is this continued lack of complete disclosure that is the basis for our finding of fraud, from a performance and internal audit perspective. Within Attachment 1, we are providing the actual detailed summary budget information prepared by SEDC for FY 07-08 and maintained in their budget books. It is this information that should have been presented to the Board for discussion and review.

In an effort to explain how salary savings and saving from other accounts were used, we have provided a comparison of the budget information contained in the “detailed” budget documents provided by SEDC to that of the actual compensation provided in FY 2007-08.

TABLE 1.0 Budget to Actual Comparison for FY 2007-08

	Budget (As Presented by SEDC)	Actuals (As determined by MCG)	Difference
Sub-Total Salary Base	\$995,360.00	\$878,728.94	\$116,631.06
Payments in Lieu	\$64,500.00	\$25,892.05	\$38,607.95
Accrued Vacation Contingency	\$45,000.00	\$0.00	\$45,000.00
4% COLA	\$40,100.00	\$28,950.00	\$11,150.00
Merit Increases/Longevity	\$48,040.00	\$236,328.00*	(\$188,288.00)
Sub-Total	\$197,640.00	\$291,170.05	(\$93,530.05)
TOTAL	\$1,193,000.00	\$1,169,898.99	\$23,101.01

* Inclusive of actual merit and longevity is also the holiday bonus. To pay for this compensation, salary savings within the total personnel budget had to have been used.

Moreover, the explanation that SEDC provides to the City in a footnote in a one page summary document for Merit/Longevity states “provided to the employees as a lump sum based on their responsibilities and length of employment”. SEDC further provides a description of merit/longevity pay by stating that a Project Coordinator who has been with the corporation for five years may receive a lump sum of approximately \$2,000, while a receptionist who has been with the corporation for two years or less may receive \$500. SEDC further states the following: “Please note that this is established to recognize the value of employees who has chosen to remain with the Corporation; and thus, as his/her value to the corporation increases the lump sum amount increases.” Based on these footnotes, a reasonable person would not conclude or know that the Project Coordinator would actually receive over \$20,000 in bonuses, and the President in excess of \$70,000.

Moreover, individual Board members cited concerns that specific information was not provided to them concerning the budget. We note in our report that the direct and specific questions would have to be asked before information would be provided by SEDC. SEDC in our review obviously did not provide disclosure on

individual compensation or types of compensation that would be provided to staff because no specific question was posed to them about these areas, but questions were asked about obtaining additional information about salary compensation that would have, for an effective leader, prompted an open discussion and provision of further detailed information.

Finally, if SEDC were transparent in their compensation practices, the one page spreadsheet, (see attached) should have been presented to the Board

SEDC Response: The Audit cites examples of "problem" expenditures. These references are vague and often omit a reference to supporting documentation. Take for example the discussions on expenditures related to SEDC's 25th Anniversary, in this particular instance, the expenditure is referenced as "an event". Section 6 of SEDC's Special Events Policy states the following:

Inherent in the Corporation's mission statement is the responsibility to reverse the effects of many years of neglect which have resulted in physical and economical blight being visited upon the residents and business owners of the southeastern community of San Diego. To that end, the Corporation will solely, or in conjunction with other interested parties propose, plan and produce special events for the following purposes which include but are not limited to: attracting new businesses to the area; acknowledging significant accomplishments by the community and/or the Corporation; encouraging participation in the redevelopment process and commemorating significant steps in the redevelopment process. The conception, planning and production of these events will be the responsibility of the President of the Corporation.

Any funds identified for Special Events shall be governed by the available fund approved by the Board of Directors for Special Events.

SEDC's 25th Anniversary expenditures were approved as required in the FY 06/07 budget: in the line item for Special Events SEDC held two community celebrations.

In addition, SEDC produced marketing material which included: (1) Production and distribution of monthly post cards depicting the SEDC redevelopment activities/areas; (2) A 25th Anniversary Book documenting the Corporation's history of accomplishments -and are not classified as Special Events but were funded through the Marketing, Advertising, Postage Categories which are the appropriate line items.

- Macias Response: Disagree. While a budget line time for promotions/special events was approved, the budget approval for this line item was \$30,000. The total cost of the 25th Anniversary celebration was \$156,000. Our issue is that Board was not informed or approved of the total estimated expenditures for the

25th Anniversary celebration. In direct contrast to SEDC's response, there is not a budget line item for marketing in the FY 2006-07 budget. Advertising was approved for \$9,900 and postage received approval for \$63,600, which is much lower than the total cost that was incurred for the celebration. Given the lack of specific Board approval for the event and the spreading of the anticipated expenditures among various line items which are for other uses, there is no sufficient evidence for SEDC to claim that the amounts reported within these line items was approved for the specific use of the 25th Anniversary celebration. Finally, expenditures for the celebration started in FY 2005-06, approved budget amount included Special Events totaling \$12,300, and advertising \$26,100. All of the anticipated costs for the 25th Anniversary celebration should have been captured in the Special Events budget.

Without the detailed information to support the budget request the Board would not be able to conclude that expenditures for this 25th Anniversary celebration would exceed \$150,000, which included \$80,652 in FY 2005-06 and another \$76,028 in FY 2006-07.

It is this continued lack of transparency in the budget information presented to the Board that has raised our concerns over the financial management operations of SEDC.

SEDC Response: The Audit notations for "questionable" expenditures were not explained and were often simply noted as a "conflict of interest". Take for example SEDC's office lease with Pacific Development Partners (PDP). The PDP identifies the office lease as a conflict of interest simply because it is a lease between the Developer and the Corporation. What it does not explain is that SEDC's corporate lease was approved by the SEDC Board of Directors three years after the original Disposition and Development Agreement (BDA) was negotiated and approved and the lease is a market rate lease.

The current lease with PDP in an office building is located in the Central Imperial Redevelopment Project Area where SEDC's presence continues to be of great assistance in convincing potential businesses that their investment into the southeastern community is a good business decision despite the antiquated image of the community held by many not familiar with the tremendous redevelopment of the area.

Historically, the only office space available *to* those seeking an office within southeastern San Diego has been space developed as part of a specific redevelopment project. Until the early 90's, office space in southeastern San Diego was limited to a few medical buildings or converted industrial space. It has been SEDC's strategy to assist the redevelopment of specific areas with its presence hence the corporation had previously executed two leases in the Gateway Center East Business (Mount Hope) with the development entities developing in the business park. This practice is similar to the leases for the Downtown Police Headquarters, Barrio Logan and City Heights Police Station which were built by local developers and leased by the city.

- **Macias Response:** Our report took issue with the lease agreement because of the conflict of interest that exists as a result of the fact that PDP, who leases its building to SEDC, has also been awarded the Valencia Business Park development project, and there appeared to be no disclosure about the lease arrangement to the Board or to the City upon approving subsequent contracts to this developer.

SEDC Response: As noted previously in the 2007 Redevelopment Review prepared by Keyser Marston & Associates, SEDC has achieved significant accomplishments while employing the smallest staff and fewest management positions when compared to the other redevelopment divisions. It is particularly challenging to obtain and retain qualified staff to work in the southeastern area of San Diego (particularly management level positions), and the compensation and benefits staff received over the years covered by the Audit was within the reasonable parameters, discretion, and authority as set forth in the SEDC Operating Agreement, bylaws, and other applicable contracts, policies and procedures. This compensation including variable compensation over and above base salary remained below-market based upon an independent compensation study prepared for SEDC in July 2007.

Moreover, the compensation that the SEDC sought to pay its staff, is it through base salary or other incentive and retention benefits, was disclosed and authorized by the City. Specifics related to additional compensation have been addressed under separate cover in the letter provided to Macias and previously noted as Attachment No. 1.

- **Macias Response:** It is important to note that the scope of work performed by Keyser Marston did not include an internal audit of payroll records. The Keyser Marston report, instead, prepared a comparison of personnel budgets and determined the average compensation per position. This analysis was based on the total personnel budget and the number of budgeted positions for the Agency. The Keyser Marston report, based on our review, does not make mention that the compensation and benefits staff received over the years covered by the Audit was within the reasonable parameters, discretion, and authority as set forth in the SEDC Operating Agreement, bylaws, and other applicable contracts, policies and procedures. As a result, we do not know the basis for SEDC's assertion in their response to our report.

SEDC Response: The Audit notes record keeping problems and references a document that has been altered. The document in question was a Personnel Action that noted the President's Auto Allowance. The Director of Finance corrected the document, initialed the change and re-issued a revised document which was subsequently re-executed with the approval of the Board Chairman. There was **no** concealment. If that had been the case, SEDC would not have attached the original document with the final executed copy. (See Attachment No. 3) This is yet another example of how the Audit misstated the facts by omitting information in an attempt to reach a foregone conclusion. The Audit also implies that these personnel records are easily accessible. All personnel and/or confidential documents are contained in locked file cabinets in an office which can also

be locked.

- **Macias Response:** Our report does not state that SEDC concealed the improper approval of the President's auto allowance. Our report states that the increase in auto allowance was improperly approved by the SEDC Director of Finance. We presented supporting documentation in our report as an attachment to the Appendix which provides evidence that there was re-execution of the personnel action form in this instance. All personal action forms related to payroll and employee benefits were properly maintained in the Finance Unit, which we were provided full access. If the personnel action form was re-executed, we question why this the new form was not maintained in the file and why the Finance Director appeared to be unaware of this based on his email, as documented in our attachment to the report.

SEDC response: The Audit indicated that the Redevelopment Plans are simply a reflection of existing land uses. SEDC notes that adopted Redevelopment Plans must be consistent with the corresponding Community Plan and zoning. Since SEDC was intricately involved in the 1986 update of the Southeastern San Diego Community Plan we were able to recommend the general land use designations that were necessary to implement activities in existing and future Redevelopment Project Areas.

Subsequent amendments have been and will continue to be made to the plan as necessary to implement the various redevelopment plans.

- **Macias Response:** Our report primarily discussed the need to establish specific and measurable goals for redevelopment area. An existing or planned land use designation is one component of establishing an appropriate goal for the project area. These goals need to be linked to the activities stated in the Implementation Plan. Providing this information allows an adequate assessment of whether implementation activities will fully accomplish the stated goals.

SEDC Response: The Implementation Plan includes the stated redevelopment goals for each adopted project area but do not include the land use map contained in the redevelopment plans. If a map were included it would clearly display the correlation between a specific goal of the Redevelopment Plan and the implementing activity. Take for instance, the goal of developing mixed use projects (Commercial/Residential Development). Currently, this is a land use that is not designated within the Southeastern San Diego Community Plan or the Southeastern San Diego Planned District Ordinance and consequently cannot be built. SEDC has initiated an amendment process known as the 5th Amendment to the Central imperial Redevelopment Plan which will amend all necessary documents allowing this type of development to be built.

It should be noted that most of the future proposed projects in the various project areas are proposed as mixed used in conformance with the City of Villages and would there fore require an amendment.

- Macias Response: Our report states that goals within redevelopment plans are based on the pre-existing land uses with each project area. Examples of goals that would provide a correlation between a goal and an activity stated in an Implementation Plan would include rehabilitation and clean up of certain properties and eliminating blight. A map would not document this type of information.

SEDC Response: SEDC should continue to improve operational goals contained in annual work plans and should be measurable and have specific timeframes. While project management techniques can always be improved, it should be noted that approximately 90% of the proposed projects occurring during the review period have been completed in the timeframes noted in the respective Schedules of Performance and the system of managed projects has ultimately yielded the desired results. SEDC's project management tools are sound. In addition to the 30/60/90 Work Plans and the Project Status Report, the measurable time frames are also contained in the following documents:

- Specific Development, Loan, or Sales Agreements – Schedule of Performance (See Attachment No. 4)
 - Project specific timelines established for planning documents
- Macias Response: Our review of SEDC's schedule of performance provides no time periods for completion of activities. Instead, the schedule of performance outlines general provisions outlining the approval process of anticipated activities. For example, "submission of basic concept/schematic draws need to be submitted to the Agency for approval.... not later than the execution and submission of the RLA ... to Agency. SEDC provided no supporting documentation to verify that project specific timelines were established for planning documents. Our review pointed out that while the President used the Project Status Report to monitor the current status of its activities on a weekly basis, we could not determine the extent to which milestones were adjusted throughout the project and thus could not determine whether projects were completed based on their original completion date.

SEDC response: The Audit notes that an RFP was not issued to obtain a developer for the project proposal. This is correct. The project began as part of the Owner Participation Agreement (OPA) process for the development of affordable housing. Once the developer requested additional assistance in assembling the land necessary, SEDC made a decision to become the property owner which allowed SEDC (one behalf of the Agency) the opportunity to retain the asset. Ultimately, a Request for Proposal was distributed but is not always required.

- Macias Response: MCG appreciates the added information. The information further validates our statement that the acquisition processes are general, open to interpretation, and do not provide sufficient criteria that shows under what circumstances when to issue a request for proposal.

SEDC response: The process for consultant selection is outlined in the SEDC Policies and Procedures. In those instances of hiring an individual or firm considered a “Sole Source” SEDC is governed by Section 22.3212 (e) and Section 22.3037 of the City of San Diego Municipal Code which requires specific findings prior to the issuance of a Sole Source Contract. Attachment No. 5 is a copy of the Memorandum to the City for the Consultant referenced in the report. It should be noted that subsequently SEDC distributed an RFP for the subject consulting contract.

Finally, all contracts that are funded through Project Direct Costs require the approval of the Executive Director or the Agency/City Council depending on the monetary amount of the contract. With this additional review being required, approximately 95% of all contracts and/or Letter Agreements are reviewed and approved by the appropriate city department.

- **Macias Response:** SEDC responds to their approval process, but our report does not raise issue with specific contract approvals. The primary findings our report discusses the disclosure of contracts to the SEDC Board and the maintenance of documentation to provide transparency of the consultant selection and review process.

SEDC response: Although the Audit states that staff did not provide staff evaluations thus implying it was deliberately withheld the information, SEDC was advised of its obligation to uphold its employee’s privacy rights and other state and federal laws.

- **Macias Response:** MCG and the City’s Auditor requested the use of employee evaluations on two separate occasions. On one request, MCG agreed to SEDC’s request to ask for employee permission to release the evaluations. On the second request that was issued by the City Auditor, it was requested that SEDC request employee permission to waive confidentiality. In our report, we state only that SEDC did not provide us with the employee’s evaluation and attached SEDC official response to the City Auditor’s request as an Appendix to the report. We provided this information to point out only that we made an effort to assess whether employee evaluations could be linked to supplemental compensation.

SEDC response: There is always room for improvement with respect to the operations and procedures at SEDC, and by this response, I do not mean to suggest that certain circumstances made in the Audit would not be helpful. Rather, they are welcomed. But simply because SEDC as an organization has room for improvement does not mean that the organization has not acted within the letter and the spirit of its by-laws and Operating Agreement with the City. To the contrary, the Audit makes clear that SEDC has, despite its small staff been able to “make notable accomplishments in increasing tax increment, employment, and bond issuances” for one of the most neglected areas of our City.

These comments are not intended to address each and every area in which I believe that the Audit presents and unfair and unwarranted picture of SEDC and its past experiences. But in the limited amount of time provided to respond to a document that was over a year

in the making, I hope that this will at least raise for those willing to listen the possibility that the Audit is hardly an impartial and balanced view. In that regard, I appreciate the opportunity to respond to the Performance Audit.

- **Macias Response:** Abiding by an outdated operating agreement is no excuse for poor management practices of SEDC. SEDC has a duty and obligation to ensure that public funds are properly spent and safeguarded, and an effective leader would not take advantage of weaknesses in its governance structure. The performance audit that we performed required 8 months of work and provided a full and objective assessment of SEDC's operating and redevelopment activities that was conducted in accordance with generally accepted government auditing standards for performance audits.

SOUTHEASTERN ECONOMIC DEVELOPMENT CORPORATION

Complete Salary Schedule	FY 2006/2007	FY 2007/2008										Total Personnel Budget						
	Budgeted Base Salary	Positions & Salaries Forecast				Benefit Forecast							Total Benefit					
		Base Salary	Payments In Lieu	4% Cost of Living	Totals	Pension	Health Insurance			Life Insurance				Work Comp	Employer Taxes			
Position							Medical	Dental	Vision	Life	ACC / D&D	LT Disability		Medicare	Fed Unemp	State Unemp	State TrainT	
President	165,000	172,000	16,538	6,880	195,418	29,313	5,875	556	93	180	21	414	1,141	-	7	343	7	37,950
Director of Finance	100,000	105,000	6,058	4,200	115,258	17,289	15,581	1,103	216	180	21	414	1,054	1,671	7	343	7	37,886
Manager of Projects/Development	0	100,000	5,769	4,000	109,769	13,172	15,581	1,103	216	180	21	414	1,438	1,592	7	343	7	34,074
Community Relations Manager (a.d.)	75,920	76,000	4,385	3,040	83,425	10,011	5,875	556	93	180	21	350	1,093	1,210	7	343	7	19,745
Sr. Planner	75,000	77,000	4,442	3,080	84,522	10,143	15,581	1,103	216	180	21	414	1,107	1,226	7	343	7	30,347
Senior Accountant	66,040	69,000	3,981	2,760	75,741	9,089	5,875	556	93	180	21	317	816	1,098	7	343	7	18,503
Project Coordinator (s.b.)	52,000	55,120	3,180	2,205	60,505	7,261	3,568	1,015	216	180	21	254	793	877	7	343	7	19,542
Executive Assistant	58,448	61,000	3,519	2,440	66,969	8,035	4,507	556	93	180	21	281	810	-	7	343	7	14,840
Staff Accountant	46,800	49,000	2,827	1,960	53,787	6,454	13,680	1,562	216	180	21	225	651	780	7	343	7	24,127
Administrative Support Coordinator	43,680	47,840	2,760	1,914	52,514	6,302	4,507	556	216	180	21	220	635	761	7	343	7	13,756
Asst. Proj. Coordinator (reclass to Proj. Coordinator)	40,000	53,748	3,101	2,150	68,999	7,080	15,581	1,103	216	180	21	414	773	855	7	343	7	26,580
Asst. Community Dev. Coordinator	35,000	38,500	2,221	1,540	42,261	5,071	8,568	1,015	216	180	21	177	554	613	7	343	7	16,773
Corporate Receptionist (p.a)	31,720	35,152	2,028	1,406	38,586	4,630	15,264	1,562	216	180	21	162	467	559	7	343	7	23,419
Communications Coordinator (half-time)	20,800	28,000	1,615	1,120	30,735	3,688	4,507	556	216	180	21	96	372	446	7	343	7	10,439
Messenger Clerk	22,620	28,000	1,615	1,120	30,795	3,688	12,298	1,562	216	180	21	120	403	446	7	343	7	19,290
Rounding Amount			450	286	746		203											203
Grand Totals	833,028	885,350	84,500	40,100	1,099,950	141,226	152,051	14,463	2,754	2,700	315	4,271	12,206	12,134	105	5,145	105	368,000
Merit / Longevity Pay					48,040	5,765												5,765
Accrued Vacation Contingency / Separation Payments					45,000	5,400												5,400
Sub Total Positions & Salaries					1,193,000													
Overtime/Temporary/Bonus/Misc.					114,000	9,360												9,360
Total Positions & Salaries					1,307,000	161,751	152,051	14,463	2,754	2,700	315	4,271	12,206	12,134	105	5,145	105	368,000
						161,751	169,268			7,286		12,206			17,489			368,000

Assumptions:

- Base Salary** - 4% increase from the prior year budget base salary
- Payment in Lieu** - Proposed Base Rate x Number of Eligible Hours
- Cost of Living** - 4% of Base Salary
- Pension** - 12% of eligible salary (Base Salary + Overtime + Payments in Lieu + Cost of Living + Merit Increase + Year End Acknowledgment)
- 15% of eligible salary (Base Salary + Payments in Lieu + Cost of Living + Merit Increase + Year End Acknowledgment) for Senior Management
- Health & Life Insurance** - Base on individual employee history & estimate 10% increase in premium every year
- Worker Comp Insurance** - Base on individual employee rate & salary
- Employer Taxes** - Base on individual employee rate & salary