



THE CITY OF SAN DIEGO

DATE: March 5, 2010

TO: **Honorable Mayor, City Council, and Audit Committee Members**

FROM: Eduardo Luna, City Auditor

SUBJECT: **Southeastern Economic Development Corporation**

In a memorandum dated January 22, 2010, the Independent Budget Analyst (IBA) requested the City Auditor's Office review material submitted to Councilmember Tony Young by Acting CEO, Brian Trotier of the Southeastern Economic Development Corporation (SEDC). The purpose centered on assessing the deficit operating position of SEDC in light of suspect accounting practices.

We met with the IBA, members of her staff, the Chief Financial Officer, Office of the City Comptroller staff, and the Deputy Executive Director of the Redevelopment Agency. Additionally, we conducted a cursory review of 2010 Revenue and Expenditure Projections, and City Redevelopment Agency Budget Summaries, and we discussed the FY 2009 SEDC financial audit with Leaf & Cole, LLP, SEDC's external financial auditor.

The external financial auditor is required to communicate matters which are significant and relevant to the governing body regarding the financial reporting process. Applicable auditing standards provide guidance regarding some of these areas. They include, but are not limited to:

- Significant accounting practices which do not appear appropriate, and when considered necessary, auditor requested changes;
- Significant difficulties encountered in dealing with management;
- Effect of uncorrected misstatements on the financial statements as a whole;
- Disagreements with management, whether or not satisfactorily resolved, significant to the financial statements; and
- Significant issues discussed or provided in correspondence with management.

After further analysis, City staff and the IBA indicated that SEDC presented materials to Councilmember Young's office which appear to reflect a "stress test" analysis based on County of San Diego revised tax increment projections. This analysis compared the lower projected tax increment revenues with corporation administrative expenses, including anticipated Educational Revenue Augmentation Fund and Community Development Block Grant payments for FY 2010, to determine whether operations could be funded solely with tax increment revenue and not depend on carryover funds.

OFFICE OF THE CITY AUDITOR
1010 SECOND AVENUE, SUITE 1400 • SAN DIEGO, CA 92101
PHONE 619 533-3165, FAX 619 533-3036

The projected deficits resulting from this analysis may have prompted Councilmember Young's office's concerns regarding SEDC's financial condition. The IBA plans to address the budgetary and policy implications of SEDC's financial situation in a subsequent report.

According to the FY 2009 audit, the external auditor did not note any irregular accounting practices, difficulty with management, significant uncorrected misstatements, or disagreements with management which would indicate a material financial statement misstatement. The financial audit does not make an assessment of how changing market conditions or alternative budget policies would impact future SEDC operations. Therefore, these unforeseen conditions may have a future impact on SEDC's operations.

We should note that a separate audit of SEDC's Section 403(b) Plan, not conducted by Leaf & Cole, identified issues related to violations of the Internal Revenue Code. According to FY 2008 audit of the SEDC's Section 403(b) Plan, significant and pervasive issues impacted the external auditor, Levitzacks, from being able to express an opinion on the financial statements.

Specifically, the auditors noted the plan:

- Held certain investments that did not meet the requirements of the Internal Revenue Code;
- Offered loan repayment terms to participants that did not meet the requirements of the Internal Revenue Code; and
- Paid hardship distributions to participants that did not meet the requirements of the Internal Revenue Code.

The FY 2009 audit of the Section 403(b) Plan noted that SEDC submitted a corrective plan through the Internal Revenue Service's (IRS's) Voluntary Correction Program. The corrective plan included actions to address the issues discussed in the FY 2008 audit. The IRS issued a compliance statement (dated January 4, 2010) accepting SEDC's corrective action methods and revisions to administrative procedures and indicated the IRS may require SEDC to verify timely implementation of the corrective actions.

We note that we compiled this technical information from current available sources and did not audit the information or conduct a performance audit of SEDC, its Section 403(b) Plan or the City's overall Redevelopment Agency.

If you have any questions regarding this memorandum, feel free to contact me at (619) 533-3026.

Respectfully Submitted,



Eduardo Luna
City Auditor

cc: Honorable Mayor Jerry Sanders
Honorable City Council Members
Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Jan Goldsmith, City Attorney
Andrea Tevlin, Independent Budget Analyst