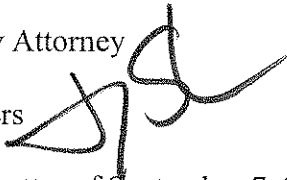




**MEMORANDUM**  
September 28, 2007

TO: Mike Aguirre, City Attorney

FROM: Mayor Jerry Sanders 

SUBJECT: Response to your Letter of September 7, 2007 regarding Pension Issues

Because I believe it is in the best interests of taxpayers to responsibly return to the public finance markets as soon as possible, my administration is focused on achieving this critical goal. I believe that the City should take all prudent steps to reduce its pension and retiree healthcare liability and as such, I will continue to support litigation to determine the legality of the various benefits in question. I will not support a tax increase to pay for these benefits nor do I support bankruptcy. Absent the legal authority to roll-back the alleged illegal benefits, the City of San Diego will continue to implement the aggressive reforms that I have introduced and live within our means as our taxpayers should expect. I will propose a new pension plan for future City employees.

This memo responds to your September 7, 2007 letter to me regarding fourteen issues you claim must be resolved before the City can return to the public securities market. I disagree with many of your assertions and will detail my positions on the issues below.

The pension and healthcare benefits conferred upon our employees by past City Councils jeopardize the City's long-term fiscal health. I will continue to support the various lawsuits, including appeals, aimed at determining the legality of the benefits conferred upon employees. That said, it is not prudent to recommend to the City Council that we summarily rescind pension benefits without the proper legal authority.

You have repeatedly failed to reduce the City's pension liability by rolling back the alleged illegal benefits and now you want the City Council to put San Diego taxpayers at great legal and financial risk by acting outside the law. I have said repeatedly and I will say again that I won't do this – only a judge can make such a decision. Pursuit of the reckless course you now demand in your letter would expose San Diego taxpayers to millions of dollars in liability and would set our city on a course that could very well lead to contempt of court. Until and unless a court of law grants the City authority to retroactively rescind these benefits, my plan is to propose a new pension plan for future

City employees beginning next fiscal year, and to seek collective bargaining agreements that are more advantageous to San Diego taxpayers.

I believe that with continued belt-tightening and fiscal discipline over a period of years, our long-term obligations can be managed, especially as the City's revenues naturally increase over time. I do not believe it is appropriate to ask the voters to tax themselves to pay for these benefits.

As a result of an entirely new set of financial controls and disclosure practices, I believe the City will soon be ready to re-access the public bond markets so that we can more efficiently fund our City's long-delayed and much-needed infrastructure improvements. As you know full well, the markets are interested in complete transparency and the full disclosure of all our debts and liabilities. Those will be the hallmarks of our return to the bond market. The rating agencies and the markets – not you – will determine our credit worthiness. I believe we will have a very good case to make.

Your assertion that I have made false or misleading statements regarding the City's financial situation is not accurate. I have made it clear on countless occasions that it will take significant discipline over years to correct the many mistakes that had been made in the past and get the City back to fiscal and managerial health – there is no silver bullet.

As the City's first strong mayor in over 70 years, my administration has worked hard to better the City's financial position including cutting the City's payroll and funding long-term obligations such as the pension and retiree health systems. I am proud of what we have accomplished to date, and I believe San Diegans have a right to know of this progress. Most of our accomplishments have been achieved in spite of the obstructionist tactics of the City Attorney's office and without the benefit of legal counsel.

Your public statements are often at odds with your actions behind closed doors. I include some pension-related examples because I think they call into question your credibility on the various issues you raise.

- Just a month ago, you gave 101 employees of the City Attorney's office discretionary pay increases totaling \$403,000 per year. These raises are all pensionable and will increase the City's pension liability. You gave these pay increases in spite of the fact that: 1) you publicly opposed raises for police officers and all other city employees on the basis that they would add to the pension liability; 2) the City Council specifically did not approve pay increases for the Deputy City Attorneys Association; and 3) you claimed that the cuts that were made to your budget would force you to lay off neighborhood prosecutors. Amazingly, some employees who had received raises just a few weeks before in July, were given pay reductions in August.<sup>1</sup>
- You supported a plan earlier this summer that would have continued the under-funding of our pension system and resulted in negative amortization. In a June 13, 2007 email to one of my staff members, your representative wrote that you were

---

<sup>1</sup> See Exhibit 1 for a chart detailing these pay increases.

recommending paying \$1.6 million in legal fees to attorney Michael Conger from our pension contribution. When asked if you had personally approved this scheme, the answer was “yes.”<sup>2</sup>

- You have claimed as late as August 21, 2007 that the San Diego City Employees’ Retirement System (hereafter referred as “SDCERS” or “Pension System” or “Retirement System”) is stable and that the City is doing everything necessary to fund it properly.

In a brief filed before Judge Barton on August 21, 2007, you represented that the Pension System is sufficiently stable and current and that there is no immediate need to resolve the pending litigation with SDCERS. You wrote: “As a result of those litigations, the City is obligated to make (and is making) payments to restore the San Diego City Employees’ Retirement System (‘SDCERS’ or ‘pension system’) funding to the actuarially–required level. Specifically, as a result of judgments in prior cases (Gleason and McGuigan), the City has provided SDCERS with real property security in the amount of \$475 million, has committed to making additional cash funding infusions to SDCERS of \$173 million (McGuigan), and is required to make contributions (ARC) to SDCERS annually from 2006 forward (Gleason). Indeed, the Mayor’s current budget provides for payments of “ARC-plus” infusing the Pension System with payments of over \$20 million above ARC in FY2008 alone.”<sup>3</sup>

Further, in the litigation brought against the City by the Police Officers Association, your agents have defended the City by asserting that the Pension System is actuarially sound and well-funded.

In his report filed as part of your case, your expert witness, actuary Joe Esuchanko, testified as follows: “...there is no material risk that SDCERS will be unable to pay the pension benefits which the City has agreed to pay its existing retirees, terminees entitled to future benefits and current employees.”<sup>4</sup> Amazingly, you claim otherwise in this letter.

Let me make clear three very important points. First, your position is adverse to the taxpayers’ best interest. You should be doing everything possible to get our City back into the bond market – not to try and keep us from it. While the City has been able to obtain very favorable rates to privately finance water and wastewater projects, the simple fact is that our taxpayers are paying a premium because of our inability to access public capital.

The very fact that you are obstructing our re-entry into the public markets means that taxpayers will pay a higher price for private financing and other projects, such as

---

<sup>2</sup> See Exhibit 2 for a copy of the email between Kristine Wilkes and Fred Sainz.

<sup>3</sup> See Exhibit 3 for a copy of the brief filed by the City Attorney on August 21, 2007

<sup>4</sup> See Exhibit 4 for a copy of Mr. Esuchanko’s Expert Report as well as a cover memo written to the Mayor by the SDCERS Administrator.

improvements to City facilities and roadways, will simply not get done. You are acting in a position completely contrary to the fiduciary position you have to taxpayers.

If we are unable to re-access the markets in a timely fashion for reasons having to do with your failure to perform your job as City Attorney, I will not hesitate to speak out publicly. At this very moment, we are waiting for you to provide the Attorney's Representation Letter for the FY05 Comprehensive Annual Financial Report (CAFR). It is long overdue and will preclude our issuance of the FY05 CAFR.

Second, I believe your memo and your actions are an indirect effort to drive our City into bankruptcy. Perhaps you believe that a bankruptcy proceeding would provide you with enhanced influence to policy decisions currently outside your authority. This will not happen while I am mayor. If bankruptcy is your goal, as many believe it is, then be honest about it and stop the game-playing that is wasting time and taxpayer money.

Third, you often take statements out of context and use them inappropriately to support your point of view. An example of this appears in the conclusion to your letter when you state that the Securities & Exchange Commission (SEC) "has noted that the only way to solve the problems created was by decreasing the debt, increasing the revenues, or cutting services." The paragraph is written in such a way that it would have you believe that the SEC is referring to the present day. That is not the case. It is a statement regarding the choices made by past City Councils. I will not endorse a tax increase and absent the legal authority, which you have so far been unable to obtain, we will have to live within our means. This is the responsible course of action.

In the very next paragraph, you assert that "rather than do the work needed to get rid of the illegal debt...the Mayor and certain members of the City Council have opted to continue the past practices of relying on the pension system's phony numbers and pushing the debt off to future generations." This is pure demagoguery.

After losing all of the pension roll-back lawsuits that you have brought, you are now demanding that the City Council take action that would be completely inappropriate and place our taxpayers in great jeopardy. As you know, SDCERS's numbers have been verified by the actuary that you recommended the City retain and have used as an expert witness. Finally, the 20-year amortization schedule, as I have structured it, eliminates any negative amortization.

I have served as Mayor now for almost twenty-two months. We have had scores of conversations and our staffs have met on just as many occasions. I find it telling that never once in all of those twenty-two months did you establish your fourteen remedial steps as pre-conditions to re-enter the public markets.

The City has not had access to public capital since 2003. All you have to do is drive down any one of our City streets to see that our public infrastructure is suffering as a result of this. I have made it my goal to re-access the public markets as soon as possible

in a manner consistent with full disclosure. I ask you to put aside your personal political agenda and work collaboratively with us to make this goal a reality.

**Alleged Remediation Items Detailed in Your Letter**

The majority of your claims lack merit, have been dismissed by courts of competent jurisdiction or are unnecessary impediments to the City's return to the bond markets. My response to each of them is set out below.

**Responses to Remediation Items 1-4 & 13:**

- #1: Rescind MP-1 and MP-2 Benefits
- #2: Actual Value of Purchase of Service Credits (PSC's)
- #3: Actual Value of Deferred Retirement Option Plan (DROP)
- #4: Purchase of Service Credits/10 and 20 year Vesting
- #13: Continue Litigation to Remove Illegal Pension Benefits

**None of these items are impediments to the City's return to the bond markets.**

As I have stated previously, I have supported all of your pension litigation. In spite of the fact that your arguments have been rejected repeatedly, I continue to believe that the legality of the benefits should be decided by the courts.

Your efforts have cost the taxpayers a minimum of \$6.6<sup>5</sup> million, as follows.

Contractor	Amounts Paid to Date
<b>City of San Diego Expenses:</b>	
Latham & Watkins	\$2,540,969.91
Heller Erhman	1,321,896.34
Wehner & Perlman	215,965.65
Actuarial Services Co.	183,624.65
Kramm & Associates	12,551.45
Legal Reprographics	15,018.55
Video Track	13,959.38
AJL Video	12,157.81
<b>SUB-TOTAL</b>	<b>\$4,316,143.74</b>
<b>SDCERS Expenses as of 8/31/07</b>	<b>\$2,327,166.82</b>
<b>TOTAL</b>	<b>\$6,643,310.56</b>

<sup>5</sup> See Exhibit 5 for a detailed summary of the expenses listed here.

I believe this amount to be on the low side as it only includes Latham & Watkins bills received through June 30, 2007 and SDCERS expenses through August 31, 2007. These figures also do not include our own staff's time or their related expenses. Naturally, all of these figures will climb with appeals.

Because I believe so strongly in the authority of the courts, I reject your arguments that the City Council and I can summarily rescind benefits that a court has been unwilling to roll back.

- Your first, second, third and fourth issues have been raised and rejected by the Superior Court in cases you tried and lost. The MP1 claims were ruled on by Judge Barton after a full trial in which you presented evidence by an actuary of the costs of alleged illegal benefits, including DROP, PSC's, 10/20 year vesting and the like. The Court held that these claims were merged in the Corbett settlement and also barred by the statute of limitations.

Thus, to advise the City that these benefits must be rescinded by the City Council before the City can return to the bond market places the City in potential contempt of court. Absent a successful appeal, issues demanding a roll back of alleged illegal benefits, including DROP, PSC's, and 10/20 year vesting schedules are closed.

- As for the proper valuation of DROP or PSC's, to the extent SDCERS allegedly improperly valued either, if the City has legal recourse, I will pursue it.
- With regard to MP2, you also lost that claim in Judge Barton's court. Moreover, while you claim the Judge did not reach the merits of the claim, his ruling that the statute of limitations barred further claims against newly named necessary parties is a direct result of your office's poor legal work. You refused to bring in the necessary parties earlier, despite repeated and early warnings that such an action was legally necessary. The Judge sustained the demurrer to your 6<sup>th</sup> attempt to plead a proper cross-complaint in that case, and again, absent a successful appeal, claims regarding MP2 are foreclosed.

**I plan to focus my efforts on a new pension system for new employees and more beneficial arrangements in collective bargaining agreements negotiated with employee bargaining units next year. When all five of the City's employee unions come to the bargaining table in January, I will make my case for an entirely new system for future employees. This system will help us to reduce future liabilities.**

I believe strongly that the DROP program and Purchase of Service Credits should be cost neutral.

In preparation for our negotiations with the POA, Local 145 and the City Attorneys Association going into FY08, I informed your office that I wanted to negotiate these two issues with the unions that were at the table; my goal was to achieve cost neutrality.

Your office advised my staff not to negotiate these issues as it was the prerogative of management alone to confer or alter these two benefits. We took your advice and began our negotiations on a separate list of issues. Just a few weeks later, your office then changed its previous advice and told us that DROP and PSC's were indeed subject to meet and confer. By that time, it was too late to introduce them as subjects of our bargaining since all economic issues must be introduced prior to the commencement of bargaining. I intend to deal with them as part of the upcoming round of labor negotiations.

On Monday, September 24<sup>th</sup>, we received a notice to docket from your office with a proposed ordinance amending the Municipal Code to make the DROP program cost-neutral. While I strongly support this concept, I am unsure, based on your previous legal advice, as to whether the City can unilaterally take this action. This is a good example of the continued inconsistency of your legal counsel.

#### **Response to Remediation Item 5: City Attorney Counsel for Pension System**

**This item is not an impediment to the City's return to the bond markets.**

As you know, I initially agreed with you on this point. However, your claim that you be declared counsel for the Pension System has nothing to do with the City's right and responsibility to return to the financial markets. Mixing the two issues is ridiculous and irresponsible. Further, Judge Barton addressed that claim and denied your demand to be SDCERS counsel under the circumstances presented, which were not limited to the duration of that litigation. Your writ before the Court of Appeal on this very issue was denied.

In his ruling, Judge Barton wrote: "The Office of the City Attorney has no right to fire SDCERS' independent counsel and appoint counsel of its choosing..."<sup>6</sup> This case continues to this day.

#### **Response to Remediation Item 6: Reform Management of Pension System**

**This item is not an impediment to the City's return to the bond markets.**

The Pension System has made significant changes to its managerial practices as well as its system of internal controls. There is undoubtedly more that can and should be done. Consistent with my agenda for City government, I will continue to encourage SDCERS to reform itself.

Effective April 1, 2005, Prop. H changed the composition of the Board from a majority of employee members to a majority of independent Trustees who must have extensive financial background and no personal financial interest in SDCERS.

---

<sup>6</sup> See Exhibit 6 for a copy of Judge Barton's ruling.

I think that you will agree that the Retirement System has made a number of significant reforms. There may very well be more but the future implementation of these reforms should not keep us from the public markets.

SDCERS reforms include:

- Since the Board's reconstitution, there have been numerous changes at the Retirement System, including: a new actuary; new fiduciary counsel; a new administrator; a new general counsel; a new financial officer; a new chief compliance officer (newly created position); a new internal auditor (newly created position); a new information systems director; and a new management structure.
- Commissioning the independent Navigant Consulting Report and addressing its findings;
- Filing with the Internal Revenue Service (IRS) for a Tax Determination Letter to confirm SDCERS's status as a tax qualified governmental retirement plan;
- Entering the IRS's Voluntary Correction Program (VCP) to work cooperatively to resolve past mistakes in administering the Trust Fund;
- Requesting IRS approval of SDCERS's change to a Group Trust, in which each of our three plan sponsors' assets are legally-protected from the other plans; and
- Creating an independent Audit Committee that has a majority of independent, non-board members.

SDCERS has completed an Actuarial Funding Study that included adopting more conservative and widely accepted actuarial methods and assumptions, including a new, shorter amortization period for the City's unfunded liability, recognition of contingent liabilities and moving to EAN from PUC.

It bears mentioning that Joe Esuchanko, the actuary you recommended we hire and your litigation expert, has confirmed that SDCERS is actuarially sound. In response to a question from a City Councilmember at a public meeting held on April 17, 2007, Mr. Esuchanko affirmed the actuarial soundness of the Retirement System, "There is quite a bit of concern as to whether SDCERS is actuarially sound. Yes it is [sound]."

The IRS has made no official demand on either SDCERS or the City to pay \$100 million into the pension fund liability to replace funds used to pay for health care. On February 13, 2007, the IRS commented that healthcare under-funding should be part of SDCERS' VCP proposal. However, at a meeting with the IRS on February 26, 2007, and in a letter to the IRS on March 14, 2007, SDCERS is working with the IRS to reconsider its position.



Nonetheless, the possibility of this liability has been disclosed in the FY03 and FY04 CAFR's and will continue to be disclosed in future CAFR's until resolved.

You state that "responsible trustees must be appointed before the City can represent to investors that it has in place proper internal controls." The pension system's trustees are vetted through your office and must meet pre-determined qualifications. They have adopted and implemented a new set of internal controls and they have demonstrated competence in managing the system's assets. Over the past fiscal year, they have had a 16% rate of return; over the past three fiscal years, they have experienced a 13.22% rate of return; and over the past five fiscal years, the rate of return has been 12.97%.

We continue looking for qualified candidates to serve as trustees. The irony of your observation is that most qualified candidates cite you as their reason for not wanting to serve. Your continued threats to sue the volunteer trustees and your repeated acts of intimidation are the reasons most prospects cite for not wanting to serve.

#### **Response to Remediation Items 7 & 9:**

Item #7: Remove Surplus Earnings

Item #9: Confirm DROP & Purchase Service Credits Ended as of FY05

#### **These items are not impediments to the City's return to the bond markets.**

We have no dispute with your seventh and ninth claims. However, the fact that these are still outstanding issues is a direct result of inaction, delay and poor legal work on the part of your office. Repeated requests were made to you to draft legislation to remove surplus earnings as an avenue for payments of contingent liabilities or retiree health care (the "Waterfall"). After long delays, your office finally presented an Ordinance to eliminate the Waterfall. Your draft Ordinance was criticized as legally inadequate by experts in this area of law. To date, you have refused to change one word in the pending Ordinance, and it remains in limbo awaiting a reintroduction before Council.

This same pattern of delay and inaction has also created legal uncertainty around the effective date of key pension reforms. As a result of the 2005 labor negotiations, the City eliminated certain pension benefits -- including retiree health care, DROP and PSC's -- for new employees hired after July 1, 2005. Despite repeated requests from both the Council President and me, your office refused to provide us with the legislation required to codify these changes. The changes were not codified until February 2007. Your inaction may cost the taxpayers millions of dollars.

You are correct in that there are competing legal opinions on this issue. As a result, I will ask the City Council for the authority to file a Declaratory Relief action so that the issue can be settled once and for all. I will also ask the City Council to hire outside legal counsel to represent the City on this issue.

**Response to Remediation Item 8: Misrepresentation in IRS 5300 Determination Letter**

**This item is not an impediment to the City's return to the bond markets.**

The letters you cite are part of ongoing discussions with the IRS that began in July 2005 and continue to this day.

**Response to Remediation Item 10: Reduce and fund pension deficit of \$1 billion within 15 year amortization**

**This item is not an impediment to the City's return to the bond markets.**

There will be no tax increase to pay for the pension benefits. You have failed to convince multiple courts to rescind them, so now you want the City Council to act outside the law. I cannot and will not recommend this course of action.

You claim there must be a 15-year amortization schedule. However, the Attorney General issued an opinion that held that voters couldn't bind pension boards in the determination of amortization schedules. SDCERS has decided on a 20-year amortization schedule. I wholeheartedly concur with their decision. The important part of such a schedule is that there is no negative amortization in the City's 20-year repayment plan. There is absolutely no reason for the financial markets to be concerned with a 20-year schedule if the City continues to pay its Annual Required Contribution.

**Response to Remediation Item 11: Reduce and Fund Retiree Health Care Deficit**

**This item is not an impediment to the City's return to the bond markets.**

While we must address this obligation, I strongly disagree with the rash actions you recommend. It is my plan to proceed deliberately and responsibly on two fronts. First, by creating a trust/investment vehicle to maximize our return on investment of retiree health care dollars.

Second, during the upcoming round of negotiations with our employee labor unions, I will negotiate in good faith to effect changes to the benefits for employees hired before July 1, 2005. I will negotiate in a manner that is consistent with the taxpayers' best interests.

**Response to Remediation Item 12: Retain City Actuary**

**This item is not an impediment to the City's return to the bond markets.**

The City does need to retain an actuary.

As with so many other issues raised by your September 7<sup>th</sup> letter, this issue has also suffered from the mismanagement of your office. One of the first actions I took upon assuming office was to hire the actuary that you recommended, Mr. Esuchanko. You used him in your various pension cases. While the amounts Mr. Esuchanko billed for City work remained well within the amount authorized by the City Council, your office's failure to pay close attention to his billing for the pension cases resulted in significant cost overruns well beyond the Council-approved contract limits. Because of the City Council's justified outrage at this mismanagement, the status of this contract remains uncertain.

**Response to Remediation Item 14: False or Misleading Statements About City Financial Conditions**

**This item is not an impediment to the City's return to the bond markets.**

You allege that certain Councilmembers and I have made false or misleading statements about the City's financial conditions. Nothing could be further from the truth. What concerns me is your repeated insistence that the City is near bankruptcy when our financials do not support this course of action.

The truth is that we have restored stability and discipline to City Hall. We have also meaningfully begun to fund obligations that have not been funded in the past. I inherited a government that was in serious need of repair. With the cooperation of our City Council, we have begun to make important changes.

It will take time to implement all of our reforms, but much has been accomplished, including:

- San Diego voters passed a "Strong Mayor" form of government, instilling operational responsibility in one chief executive officer accountable to the voters. Since January 2006, I have served in that position. I have brought an aggressive reform agenda to City Hall, including streamlining government operations to make them more efficient and effective. The City's fiscal health and the institution of a comprehensive set of financial controls have been my main priorities.
- As part of the "Strong Mayor" reform, voters also created the office of the Independent Budget Analyst (IBA) to advise the City Council on the financial implications of our various policy initiatives.
- I have proposed, and the City Council has passed, after exhaustive review, two balanced budgets that allow us to live within our means and begin paying down our obligations. The budgets were prepared under the direction of the City's first-ever Chief Financial Officer, a position which I created.

- My administration has completely overhauled the budgeting process to make the document more transparent, including the elimination of “phantom” or supplemental employees and the alignment of costs with their true cost centers.
- As part of the FY08 budget adopted by the City Council, City employment will drop from 11,416.35 FTE’s to 10,777.85 FTE’s as a result of the elimination of 639 FTE positions.
- My administration has launched a massive effort to examine and streamline every department, process or function of City government reporting to the Mayor. This process, known as “Business Process Re-engineering” (BPR) has already resulted in approximately \$32 million in savings. Further substantial savings from BPR’s are expected as more are completed.
- The City renegotiated the PETCO Park bonds, saving taxpayers nearly \$4 million in annual debt payments.
- My administration has ended the practice of using one-time revenues for on-going expenses.
- Last year, I introduced a Five Year Financial Outlook (FYFO) to guide the City’s budgetary priorities. The document was the basis for my FY08 budget proposal and will, by necessity, be updated routinely with new information. The FYFO established the funding of long-term obligations as our top budget priority.
- As a result of the FYFO, the City Council voted unanimously to dedicate an unprecedented \$104.3 million to 7 long-term obligations that have in the past been chronically under-funded, as follows:
  - Funding to the Pension System above and beyond the ARC to achieve no negative amortization: \$27.3 million
  - Funding for Retiree Health: \$25 million
  - Funding for Deferred Maintenance and Capital Improvements: \$15.7 million
  - ADA Compliance Funding: \$10 million
  - Funding for Reserves: \$3.3 million
  - Funding for stormwater pollution prevention system improvements: \$18 million
  - Funding for public liability fund: \$5 million.
- As part of the FYFO, I have proposed continued aggressive funding for these obligations – as well as a contribution to our Workers Comp Fund.
- Separately, due to the efforts of my administration, the City has contributed an additional \$108 million to the Pension System as a result of our leveraging of the tobacco revenue stream.

- I appointed a new Internal Auditor, Eduardo Luna, who will report out to the City Council's Audit Committee on his work.
- The City Council has created Budget and Audit Committees, independent from management.
  - In anticipation of the Council's consideration of my budget, the Budget Committee held months of public hearings on the proposal.
  - The Audit Committee, which is aided by an Ad Hoc Advisory Committee, has developed a legislative review process for the City's CAFR. The Audit Committee will also review all financial offerings under a pre-approved set of questions, which internal and external auditors must attest to.
  - The City Council will soon consider hiring the firm of Jefferson Wells to serve as the professional audit consultant for the Audit Committee.
  - There has also been systematic City Council financial training regarding disclosure and debt issuance. Management has also received training regarding these issues.
- The City established the Disclosure Practices Working Group to review all financial documents, including the City's CAFR, prior to their release.
- We have completed and received "clean" opinion letters for the City's long-outstanding FY03 and FY04 financial statements.
- We completed the Kroll investigation and negotiated a settlement with the Securities and Exchange Commission. Consistent with the Kroll report and the SEC settlement, the City has hired an independent consultant to help the City comply with the findings.
- An entirely new set of financial controls are being instituted to insure complete transparency in our financial reporting practices.<sup>7</sup>

In October, my staff will present the latest Kroll remediation update to the City Council. At that time, we will inform them that approximately 70 or 65% of the 121 remediation items have been completed or are substantially complete and more than 20 additional items are in process.

Separately, 106 internal control weaknesses were identified either by our Auditor & Comptroller or by our external auditors. To date, 47% of those have been remediated

---

<sup>7</sup> Exhibit 7 contains copies of all the progress reports the Sanders Administration has made to the City Council to date on the recommendations in the Kroll Report. The vast majority of those reforms involve changes to the City's financial controls.

and tested or remediated and not yet tested. 43% are in process and 9% have not yet been started. Clearly, the restructuring of our internal controls is something that we have taken very seriously and are attacking aggressively.

- A new ERP system will be implemented over the next two years to further aid our financial reporting systems.
- We crafted and shepherded to passage a comprehensive \$1.4 billion plan to repair the City's decrepit water and wastewater infrastructure. In spite of federal and state edicts, virtually no improvements had been made to either system in four years.

In order to ensure that these funds are used properly, financial and performance audits will be conducted every year on the water and wastewater budgets every year.

- We have launched a comprehensive review of various City Charter issues for consideration by the voters next year. The changes being considered include a permanent, independent Audit Committee and the establishment of a permanent independent Internal Auditor function separate from the City Controller.

I will continue taking all proper steps to bring the City back to financial stability. I will not put the City in legal jeopardy by recommending that the City Council act outside the law. There is no silver bullet to solve all of the City's fiscal and managerial problems. Our problems can only be solved over time and with a great deal of discipline.

At this important time in the City's history, it's important that we work cooperatively and constructively to solve our problems. I ask you to join that effort.

Thank you.

cc: Honorable Members, San Diego City Council  
Kelly Bowers, SEC  
Andrea Tevlin, San Diego Independent Budget Analyst  
Stan Keller, Independent Consultant