



CITY OF STOCKTON

OFFICE OF THE CITY MANAGER

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August 13, 2013

Presiding Judge
San Joaquin Superior Court
222 East Weber Avenue
Stockton, CA 95202

CITY OF STOCKTON RESPONSE 2012-13 CASE NO. 0112 – RECOVERING FROM STOCKTON'S FINANCIAL SINKHOLE – DON'T FALL BACK IN

Much attention has been paid to the City of Stockton's finances recently, and rightly so. The City declared an emergency based on fiscal circumstances in 2010 and began reducing expenses in order to balance the City's General Fund Budget. The City declared a second fiscal emergency in 2011 and the City Manager indicated in his message in the 2011-12 Proposed Budget that the City's General Fund was approaching insolvency. In February 2012, the City Council approved commencement of the AB506 Neutral Evaluation Process required of local governments before they may file for bankruptcy protection. After 90 days of mediation and with the City facing a \$26 million budget deficit for Fiscal Year 2012-13, the City filed for Chapter 9 bankruptcy protection.

With all due respect to the 2012-13 Grand Jury, there is important context to consider in the City's response to your investigation. We have long recognized that prior city management made a series of errors that when combined with the depth and length of the Great Recession, doomed Stockton to this situation. The City Council and management team have been completely dedicated over the past three years to understanding the financial condition of the City and undertaking the corrections and reforms necessary to get the City on solid financial footing again. The Grand Jury has reviewed the reports that describe the causes of our situation and the Council's priority goal: Get the City's Fiscal House in Order. In response to this goal, staff prepared an in-depth review of the City's fiscal condition, sought confirmation from an outside party by requesting a financial condition assessment and provided this detail to an independent external auditor. We also found poor practices in the accounting area, requiring us to restate previous financial statements. The independent auditor was requested to perform a complete and thorough audit that necessitated doubling the audit fees originally requested in the audit contract.



In addition, as part of the Council's Strategic Initiatives designed to address the Council goal to Get the City's Fiscal House in Order, at the request of the City Manager, Council approved a contract with a second independent auditor to perform an in-depth internal control audit (results should be available by August 2013). We believe this is the last piece, along with our other efforts, to truly getting our fiscal house in order. The City's former internal auditor opined on various aspects of the same issues e.g. arena. During all of the reviews staff has also been managing the very detailed review of our finances by City creditors, the financial community and local, national and international media.

The findings by staff, contained in the financial condition assessment, in the City's Comprehensive Annual Financial Report (CAFR), the preliminary findings of the independent auditor's internal control review, and the Grand Jury report are all very comparable. They speak to weak systems and controls and prior leadership that either were careless or incompetent. While we thank the Grand Jury for their thoughtful review of the City's fiscal situation, we fail to see the purpose of continually retracing old ground that has been reviewed by so many people. In light of the context outlined above, this letter provides summary responses to your findings and recommendations. For more detailed information, we point the Grand Jury to the numerous existing materials documenting our finances and the recommended improvements to our internal systems. In accordance with Sections 933 and 933.05 of the California Penal Code, the City Council of the City of Stockton offers responses to the Grand Jury Report on the above-referenced case as follows:

FINDINGS & RECOMMENDATIONS

1.0 Information Provided to the City Council

F 1.1 The agenda reports for the Events Center project for the December 14, 2004 council meeting, and other major projects were presented to Council Members with inadequate time to review the complex issues. The same finding was disclosed in the 2005-2006 Grand Jury report *City of Stockton Redevelopment*.

Response: *The respondent agrees with the finding. Council has hired three new City Managers since then, the current one has brought in a new management team. The new City Manager has created expectations for transparency and high performance, including improvements to the Council agenda process. Council holds the City Manager accountable for the information presented and the recommendations made. The City of Stockton has taken additional corrective action for complex and high profile issues as described in the response to R 1.1 below.*

F 1.2 Few Council Members asked questions of City staff about the City's financial condition or the financial impacts of major expenditures they were being asked to approve.

Response: *The respondent agrees with the finding. In the past, City Council members were not given the time to review or the detail needed to make informed decisions. In the last three years the Council has been provided extensive financial information and actively engaged with City staff regarding the City's financial condition. In fact, when compared to other jurisdictions, the Council agendas are extremely extensive and detailed. The City of Stockton has also taken corrective action as described in the response to R 1.2.*

F 1.3 The City Council's approval of loans between restricted funds without receiving any information or documents on the repayment requirements or impacts created an unclear picture of the actual fund balances in the various accounts.

Response: *The respondent agrees with the finding. The City of Stockton has already taken corrective actions as described in the response to R 1.3.*

R 1.1 Information regarding major new and/or complex projects or programs that have an adverse impact on the City's financial condition be provided to the City Council members and public not less than 10 calendar days before the date of proposed Council actions to allow for a thorough review of materials and an opportunity for the Council Members and public to ask questions.

Response: *The respondent partially agrees with this recommendation. The City Manager currently demands and the City Council expects that all major new and/or complex projects or programs are provided to Council well in advance of proposed Council action. The City Manager typically recommends complex projects and programs be considered at a study session or by Council Committee prior to Council taking any action. However, the respondent cannot guarantee that all information on complex projects will always be provided 10 days in advance, but will continue to strive for the provision of complete information for Council and the public with adequate time for review.*

R 1.2 The City Council hold a study session at least quarterly to receive and discuss complex financial issues to include, but not be limited to, the City's financial condition, long-term impacts of past, current and proposed financial obligations of the City, major capital outlays and employee contracts. An opportunity for all members of the City Council and the public to ask questions is to be incorporated into the study session.

Response: *The respondent partially agrees with this recommendation. Since 2010, staff has presented quarterly financial updates at City Council meetings including detailed information regarding General Fund budgeted revenues and expenditures. Staff will continue to conduct financial updates on a quarterly basis. However, the review of contracts, agreements and capital outlays are not well suited to quarterly reports. These items are better addressed at key milestones and decision points. For example, the Council reviews the Capital Improvement Program with adoption of the annual budget. In addition, as part of Council's goal to get our fiscal house in order and through the City's bankruptcy process, long-term financial forecasts have been prepared and reviewed with Council. Council has also received presentations prior to annual adoption of the City's health plan financing, municipal capital projects and utility financing along with 10 year proformas, and a review of the City's Comprehensive Annual Financial Report (CAFR). Staff will continue to bring these important issues forward to Council when appropriate.*

R 1.3 All proposals for the City Council to authorize inter-fund loans be accompanied with loan documents detailing obligations of the loan and any impacts on the City's General Fund.

Response: *The respondent agrees with this recommendation. The City Manager currently requires that any proposal for an inter-fund loan will be brought before Council and must be accompanied with loan documents detailing the obligation, its impacts on the General Fund, if any, and the plan for repayment including the term of the loan and source of repayment. In addition, no later than December 2013, staff will prepare for Council adoption an inter-fund loan policy specifying these requirements.*

2.0 Effectiveness of the City Auditor

F 2.1.1 While the City Auditor is accountable only to the City Council under the City Charter, city managers influenced the Auditor's day-to-day operations through recommendations on the City Auditor's budget, thus limiting the Auditor's direct interaction with department heads.

Response: *The respondent partially disagrees with this finding. The City Auditor has always been provided full access to City Council as an appointee. He received private performance reviews by the Council. In addition, the City Charter outlines the requirement to provide access to department heads, City personnel and City records in their role and responsibility. That level of authority was never circumvented by budgetary constraints imposed by the current City Manager. It is typical for the City Auditor, similar to other departments, to operate within budgetary constraints which require thoughtful planning to develop a risk*

based approach to their audit strategy. However, the City Auditor has an added benefit of conferring directly with his appointing authority, the City Council. This enables the office to deploy the City's finite resources to those areas that pose the highest risk to the organization. The respondent does agree that the City Internal Auditor function was not as robust as it should have been and has accordingly taken steps to improve the audit function including outsourcing it to a reputable CPA firm. This has provided the City with an independent third party auditor that is current on standards and audit procedures. The contract City Auditor is currently conducting a thorough risk assessment in order to develop an effective but cost efficient audit plan that targets strategic risks and opportunities.

F 2.1.2 The City Council showed little actual activity in fulfilling its obligations to oversee the City Auditors' Office.

Response: *The respondent partially disagrees with this finding. While not violating confidential personnel matters, we can say the former Council expressed opinions on performance and expectations with the former City Auditor.*

F 2.2.1 The City Auditor was instructed by a former city mayor and former city manager not to review the City's overall finances. The City Auditor did not at that time or since, conduct independent reviews of revenue or expenditure projections used for project and program funding.

Response: *The respondent is not in a position to agree or disagree with this finding. The current City Manager has no knowledge of this request and provided no such direction to the City Auditor. In fact, it was the current City Manager that specifically asked for an internal control audit by him. The City has been very transparent with the City's financial situation and requested that a third party financial condition assessment be conducted. The City has also brought in new external financial auditors that have conducted an in-depth review of the City's fiscal situation. Finally, the new internal auditors are conducting a robust risk assessment and internal control audit.*

F 2.2.2 Elected officials testified that the City Auditor was not assertive in conducting reviews and evaluations of city contracts, department programs, or the overall City financial condition, thus denying the City Council and public an independent review of financial implications of the city managers' recommendations.

Response: *The respondent agrees with this finding. This was an important factor in determining to revitalize and outsource the audit function as described in our response to F 2.1.1 and F 2.1.2. The City*

Council has directed the contract auditors to provide an independent review and perspective. The City Manager supports the independent and critical analysis of the contract auditors. Completion of the risk assessment and development of an annual audit plan are critical components of assuring an independent review of key risk areas for the City.

- F 2.2.3 The City Auditor did not conduct, nor did the City Council direct, a separate review of compliance with construction contracts related to the Events Center or the assumptions on which financial decisions for the project were made.

Response: *The respondent partially agrees with this finding. The City Auditor's office conducted an internal control evaluation of the Stockton Events Center (report dated March 2007). The Council hired an external auditor to conduct a Stockton Events Center fiscal evaluation (report dated February 2006). The results of these showed weaknesses in overall project management. No audit was conducted regarding the financial assumptions used regarding the project. This all occurred over 7 years ago. Since then we have extensively used independent firms to review or develop assumptions behind major financial decisions.*

- F 2.3 The recent practice of using a firm as the City Auditor gives the City Council more flexibility in directing what audits and studies are to be conducted since a wider field of expertise offered by the firm can be tapped to undertake the investigations.

Response: *The respondent agrees with this finding. An important factor in considering contracting out the audit function was the depth and breadth of experience that an external audit firm could provide.*

- R 2.1 The City Council adopt a concise policy by December 31, 2013 identifying the City Council's oversight obligations of the City Auditor, whether an individual or a firm, and the review process of the Auditor's findings and reports.

Response: *The respondent agrees with this recommendation. The Council has a unique opportunity with the pilot project of outsourcing the City's audit function to evaluate this relationship and clarify the roles and responsibilities of the Council and the City Auditor. In addition, the Council Audit Committee has determined to undertake a review of their role and establish a Charter outlining their scope of responsibilities. This will include a schedule of the types of reports and audits they expect to be provided by the City Auditor. Those elements of this review that are appropriate for inclusion will be adopted into a new version of City Council*

Policy 100-4, Mayor Appointments to Council Committees and Committee Structure/Function. The review of City Council Policy 100-4 is also related to the City's response to R 5.3 and R 6.1.2 discussed below. Council Policy 100-4 will be reviewed and updated by no later than December 31, 2013.

- R 2.2 The City Council adopt a policy by November 30, 2013 clarifying the types of audits and reports the City Auditor is to perform and when the audits are to be conducted and under whose direction they are to be undertaken.

Response: *The respondent agrees with the concept of this recommendation, but not the prescribed timing. As noted in the response to R 2.1 above, a review of City Council Policy 100-4 as it related to the Council Audit Committee will be undertaken. There may be elements of this review that clarify the types of audit and reports that the Council Audit Committee would like to receive. However, it is overly prescriptive to determine by ordinance specific audits and reports required of the City Auditor. The purpose of the risk assessment and annual audit plan is to provide direction from the Council Audit Committee to the City Auditor in conducting the appropriate audits and reports based upon the current needs of the City. We are also in test mode with the contractual auditor model and will not commit to a longer relationship at this time.*

- R 2.3 For the next two years, the City contract with an outside firm with multiple areas of expertise to serve as City Auditor. The use of a firm (versus an individual) to serve as City Auditor to be evaluated as a distinct action item annually as part of the budget review and adoption process.

Response: *The respondent agrees with this recommendation except it will not commit to the two year window until we review their work during this initial trial phase. On March 5, 2013, the City Council approved a contract with Moss Adams, LLP, who possesses extensive experience providing local government internal audit services and audit services. The contract provides the City with the option to either continue the contract after the first six month period or to terminate the contract upon completion of the risk assessment and internal control audit. Following completion of this initial 6 month project, staff will work with the Audit Committee and City Council in preparing an analysis of performance under this arrangement and recommend future direction of the internal audit function.*

3.0 Effectiveness of the City's External Auditors

F 3.1 The long-term nature of the contract with the former External Auditor firm may have been a major cause of complacency by both the auditors and City staff. The friendliness between the auditors and finance staff undermines the integrity and objectivity regarding the thoroughness of the audit process.

***Response:** The respondent agrees with this finding. It is worth noting that being long-term or friendly are not criteria that specifically impair independence, however long-term contracts and failure to rotate firms to obtain fresh perspective may impair independence. The City previously contracted with the same audit firm for ten years. This was too long. This is why city management encouraged the change. The term of the agreement expired in May 2011, and the City determined it was most appropriate to competitively bid the contract and seek out a new auditor to complete an in-depth review of the City's finances. Though the City is not required to rebid the contract every five years this will continue to be the City's practice.*

F 3.2 The City Auditor did not manage the external audit process in an effective manner to determine if a full independent review of the accounting processes was being conducted.

***Response:** The respondent agrees with this finding based on the magnitude of accounting errors that required the restatement of prior year financial statements as reported in the June 30, 2011 Comprehensive Annual Financial Report. These errors were found by City management and have been corrected and particular attention has been paid to closely managing recent and current external audit processes.*

F 3.3 The final audit for the fiscal year ending June 30, 2011 indicated there had been major deficiencies and material errors in the prior financial accounting records and procedures, which the prior external audit firm failed to identify and emphasize in their reports.

***Response:** The respondent agrees with this finding. These errors were discovered in large part by the efforts of City staff and communicated to the external financial auditors for review and documentation in the June 30, 2011 final audit.*

F 3.4 Concerns raised by the former External Auditors were repeated in subsequent Reports to Management indicating a lack of accountability before implementation of the City's action plan response by prior city management.

Response: *The respondent agrees with this finding. Many of the deficiencies identified by the previous external auditors have been addressed by new management, like cash reconciliation, accounts receivables, etc. The City of Stockton has taken corrective action as described in the response to R 3.3.2.*

R 3.1 The City Council adopt a policy no later than November 1, 2013 that stipulates all contracts for external audit services, including the preparation of the CAFR, be awarded for three year terms, with a maximum of two one-year extensions.

Response: *The respondent agrees with the concept but disagrees with the recommendation there must be a firm policy. The City supports awarding external financial contracts for terms that balance continuity with complacency. However, it is overly prescriptive to establish a policy stipulating that all contracts for external audit services have a particular term, three year terms with a maximum of two one-year extensions. There may be unique circumstances or audits that merit different terms. City management plans to award future external financial audit contracts according to the terms outlined in this recommendation, but does not intend to create a policy stipulating this term for all external audit services. We need to balance price, learning curve costs, performance and other emerging factors. At some future date we may want to contract for auditing for less than 5 years.*

R 3.2 Effective with the current external audit contract, the City require the audit firm to regularly rotate audit supervisors to provide fresh perspective on the City's financial accounts and operations, and to establish an arms-length professional relationship between the audits and City staff.

Response: *The respondent disagrees with this recommendation. A certain level of continuity is valuable in the financial audit process. Excessive turnover can in turn cause things to be missed. In order to balance continuity with fresh perspectives in the current external financial audit, the City has requested the audit firm to provide strong partner and manager involvement. This involvement of multiple senior auditors in a collaborative approach both builds institutional knowledge and provides a variety of perspectives for approaching this critical audit. In addition, it is a common practice to rotate audit firms every five years as opposed to requiring audit firms to rotate their managers or supervisors during the term of a contract. To enhance and preserve independence, the City's process will be to rebid the audit contract at a minimum of every five years. This will eliminate the need for partner or audit engagement personnel rotation.*

- R 3.3.1 No later than September 30, 2013 the City Council annually select a qualified individual or firm to provide an independent review of the external audit's Letter to Management and city management's response to include a report of findings to the City Council.

Response: *The respondent disagrees with this recommendation. This recommendation adds yet another layer of review that will actually slow improvements down and consume an extraordinary amount of staff time bringing another firm up to speed. It is not a wise use of tax payer dollars. The recommendation is not considered a standard practice within governmental agency audits nor other industry audits, including publicly traded companies. City Council Policy 100-4 establishes the responsibility of the Audit Committee to review the external audit and reports of the external auditor. The Chief Financial Officer, who reports to the City Manager, and the City Manager are charged with fixing any issues. The role of the audit committee in that policy is considered standard practice. The audit reports, Letter to Management on Internal Controls and responses have been and will continue to be provided to the Audit Committee in advance of the meeting with subsequent discussion at an open meeting of the audit committee. The City of Stockton recognizes the concerns caused by past audit errors. However, the City has demonstrated transparency, accountability, and professional expertise in recent years by finding and correcting these errors. City staff and the City Council, with assistance from new internal auditors and external auditors, are responsible for assuring that the financial audits are sufficient and that these be followed through.*

- R 3.3.2 Following the completion of the FY 2012-13 audit, the Chief Financial Officer and the City Manager provide the City Council with quarterly status reports describing actions that had been taken to address all recommendations, deficiencies and material weaknesses identified in the CAFR.

Response: *The respondent agrees with this recommendation. The Council Audit Committee holds regular meetings with the newly contracted City Auditor. Regular updates on the status of all audit findings will be provided to the Council Audit Committee by the Chief Financial Officer in coordination with City departments. After the FY 2012-13 audit, there will be an extensive review of all outstanding findings. Audit Committee minutes are provided to the City Council.*

4.0 City Finance Department's Operations

F 4.1.1 The Finance Department under the prior city government did not provide other City departments with timely or accurate information regarding financial status of expenditures versus budget appropriations.

Response: *The respondent disagrees with this finding. Financial reporting tools and systems for the City of Stockton could be improved. Due to antiquated accounting systems the departments have had difficulty understanding how to use the system to get the information they need. However, City departments have staff with access to the City's General Ledger and the ability to print various financial reports. The Finance Department has an advisory and oversight role, but it is the Departments' responsibility to manage their funds and programs and ensure compliance with City policies and procedures including budgetary compliance. The Finance Department has developed improved financial monitoring tools and is working with departments for roll out.*

F 4.1.2 Using the cumbersome and outdated financial software, few detailed financial reports have been prepared for the City Council because of the difficulty in extracting and arranging data in a meaningful manner.

Response: *The respondent agrees that existing financial software is cumbersome and outdated. However, we disagree on the assertion that the Council has received few reports. The software has been identified for replacement in the City's Technology Strategic Plan (CTSP). We will need voter approval of Measure A in November to find its replacement. In the last three years, the Finance Department and outside professional service providers have produced custom reports on a quarterly basis in order to communicate to Council the financial condition of the City. We have also produced 10 and 20 year financial forecasts as an aide in planning for the exit of bankruptcy. A modern software system will reduce the need to produce these custom reports.*

F 4.2 Recommendations have been provided to the Stockton Civil Service Commission to upgrade selected staffing classifications and qualifications in the Finance Department; a CPA has recently been hired to augment the finance department's management. Additional classification reviews are needed to improve the overall qualifications and accounting capabilities of the department's employees.

Response: *The respondent agrees with this finding. The City of Stockton has taken corrective action as described in the response to R 4.2.1.*

- F 4.3 The complexity of City funds and accounts permitted prior city governments to move money among accounts without adequate tracking or knowledge of actual balances in the funds.

Response: *The respondent agrees with this finding. City staff are aware of the complexities and challenges associated with numerous funds and account numbers. Given the size of the City and the services we provide, it is not uncommon to have a more complex budget. However, the City is pursuing those changes that are appropriate to simplify our financial structure as well as pursuing tools to better report our financial condition.*

- R 4.1 No later than December 31, 2013, the City Council approve a study for an approach to replace or upgrade the finance operation's computer and software to current technology standards, and to develop a plan under the Direction of the City Manager and Chief Financial Officer to implement such a change.

Response: *The respondent agrees with this recommendation. The City Technology Strategic Plan identified the City's financial system as critical for replacement. Staff is initiating plans to hire a consultant to perform a detailed requirements analysis as the first step toward system replacement. This analysis will identify technical and business needs, as well as the plan for conversion. It is estimated this activity will take 3 to 4 months and will be brought before the City Council when complete. The full implementation beyond this initial phase will take a long time and represents a significant financial investment for the City. Not all funds have been identified to complete the full implementation of a new financial system.*

- R 4.2.1 No later than December 30, 2013, the City's Chief Financial Officer conduct a comprehensive review of the education and experience requirements of all classifications within the Finance Department and submit recommendation to the Civil Services Commission for approval of the changes.

Response: *The respondent agrees with this recommendation. Management in the Administrative Services Department has already revised the Accountant/Accountant II/Sr. Accountant classifications, which now include preference for a CPA certification. The Civil Service Commission approved the updated job classifications in February 21, 2013. The Administrative Services Department management staff will further review and revise remaining job classifications to improve the qualifications and skills of the department's employees by no later than December 30, 2013.*

- R 4.2.2 No later than December 30, 2013, the City's Chief Financial Officer and City Manager prepare a training program with measurable outcomes for all Finance Department staff to improve their general finance and accounting skills and to provide for increased responsibility.

Response: *The respondent agrees with this recommendation, but reserves the discretion to implement this recommendation in consideration with competing priorities. The organization has a history of providing on the job training and offering some training sessions and events at the employee's request and supervisor approval. Moving forward the Finance Department will establish training goals for each of the employees within their annual evaluation. This will aid the department in beginning the process of increasing the knowledge and skill of staff. In recent years, the department has encouraged attendance at trainings and professional conferences and in general created an improved culture of continued learning. However, due to competing priorities, a full training program has not been developed. A more formalized training program will be established once the City has exited bankruptcy and funding for these programs resumes.*

- R 4.3 Prior to the Fiscal Year 2014-2015 budget preparation the Chief Financial Officer, with assistance from the City Auditor and External Auditors, review the City's Chart of Accounts and submit recommendations to the City Council on revisions to simplify the fund and account structure for more control and accountability.

Response: *The respondent agrees with this recommendation. The Administrative Services Department is in the process of reviewing the account structure and number of funds and will consolidate funds to simplify the account structure when appropriate. Several funds have already been consolidated that do not require a separate tracking for external purposes and create additional work. We anticipate that this work will have a better impact in the implementation of a new financial system rather than expending significant resources redesigning an old account code in an old financial system. Rather than migrating old data we will establish a new and modern chart of accounts that is scalable to the City.*

5.0 City Budget

F 5.1.1 A director's management of his/her department's budget relies on timely and accurate information on expenditures versus budgeted amounts. Failure to have the information available to the directors reduces their ability to be financially accountable.

Response: *The respondent agrees with this generic finding. Within the limitations of the antiquated Stockton financial system, departments do have the ability to manage their budgets, but more must be done. See response to R.5.1.*

F 5.1.2 A City Manager requires timely and accurate financial information to provide oversight and control of expenditures versus appropriations, which was not readily available in the past.

Response: *Again, despite the limitations of the antiquated financial systems, the City Manager does get quarterly reports on budget performance. However, the timelines for these could be improved. See response to R.5.1.*

F 5.2 An identification of key performance indicators had not been clearly presented by the City Council to the public.

Response: *The respondent agrees with this finding. A comprehensive report on Service Efforts and Accomplishments was prepared by the former City Auditor in 2008. Due to the reductions in staffing (43% non-safety) these efforts were curtailed. This finding does not recognize the current state of our bankruptcy and competing priorities.*

F 5.3 Past City Councils were not kept informed of the extent to which departments were or were not adhering to their budget appropriation limits, or about the City's overall financial health.

Response: *The respondent agrees with this finding in the past. However, recent City Councils have been kept informed on budgets and overall financial health more so than most cities in this state.*

R 5.1 Department heads be held accountable by the City Manager to stay within Council's budget appropriations, with quarterly public reports prepared identifying and explaining all significant deviations.

Response: *The respondent agrees with this recommendation. The City Manager does hold Department heads accountable to stay within their budgets. Detailed quarterly reports are prepared by operating*

departments and verified by budget staff and management. These reports are then presented at Council meetings for all General Fund departments and for those departments that have funding sources closely related to the General Fund.

Additionally, a financial management tool has been developed by finance staff that provides department heads with timely, high-level information regarding budget status. Department heads can use this tool to monitor their budgets and be quickly alerted to developing issues. Departments will also account for their budget status on a regular basis using this tool.

- R 5.2 A public discussion and subsequent development of key performance indicators by the City Council with assistance from the City Manager, Chief Financial Officer and City Auditor, be completed prior to February 2014.

Response: *The respondent agrees that key performance indicators would provide an excellent tool for monitoring budgets and financial and operating performance. Given the existing demands on a severely reduced workforce this recommendation will not be implemented as early as February 2014. As the top priority of getting our fiscal house in order is accomplished and the implementation of the Marshall Plan along with the other 37 Strategic Initiatives is addressed, we can take up performance measures. Again this recommendation is not based on the realities of our limited capacity and the competing priorities identified in this report.*

- R 5.3 Beginning with the Fiscal Year 2013-14 the City Manager and Chief Financial Officer provide the City Council a review of the budget expenditures at least quarterly, with a mid-year Council workshop to review the budget status in detail. When the key performance indicators have been established, they are to be included in the reviews. The requirement for these reports to be adopted as a City Council policy.

Response: *The respondent partially agrees with this recommendation. Council currently receives quarterly budget updates on the General Fund and related funds. In Fiscal Year 13-14 these quarterly updates will be expanded to include other major departments and funds. As performance measures are incorporated into future budgets, these will be included in the quarterly reviews. When a comprehensive performance management program is developed, the City will consider whether it is appropriate to prescribe how these measures are reported through Council Policy.*

6.0 City Council Budget and Audit Committee

F 6.1 Testimony from both elected and appointed City officials indicated the Audit Committee provided limited oversight of the City Auditor's function. Presentations on the annual financial audit were not detailed, and no witness recalled the Committee making inquiries into the External Auditor's results, findings or recommendations.

Response: *The respondent partially agrees with this finding. Additional oversight of the City Auditor was conducted in closed session performance evaluations. The City of Stockton has taken and will take corrective action as described below in the response to R 6.1.1 and R 6.1.2.*

F 6.2 Appointment to and removal from the Budget Committee by the prior city government had been based on political alliance rather than interest or knowledge of the City's fiscal activities, limiting the inquiries into the former management's activities.

Response: *The respondent is not in a position to agree or disagree with this finding. The current Council cannot ascribe the motives or account for the skills sets of previous Councils.*

R 6.1.1 No later than November 1, 2013 the City Council amend Council Policy No. 100-4 to create a single Finance Committee to replace the current budget and audit committees, to allow the new Committee's involvement with the FY 2012-13 CAFR review and the FY 2014-15 budget adoption. The purpose of the new Standing Committee would be to review in detail and make comprehensive recommendations to the whole City Council on financial matters including, but not limited to, those related to the City's budget; internal and external auditor reports; proposed bonds or loans; any proposed fee or tax increases or modifications; and modifications to the City's account and/or budget structures. The Committee should meet no less than quarterly.

Response: *The respondent disagrees with this recommendation. Currently, the Audit Committee has expressed interest in reviewing their scope and responsibilities. In addition, given the financial condition of the City, the full Council has expressed an interest in hearing all financial issues as a body. Given the entire Council is immersed in the City's finances as we work our way out of bankruptcy, adding a Finance Committee is redundant and hugely time consuming for a greatly reduced staff. Staff is already stretched given competing demands. Having a committee weigh in on the budget and then the full Council, is simply redundant. This added measure will slow down efforts in other areas. In*

addition, as the financial condition of the City stabilizes, the Council will have to determine the appropriate process for reviewing financial information in the future. As this determination is made, staff will provide for Council adoption an amended Council Policy 100-4.

- R 6.1.2 Prior to December 1, 2013 the City Council review and amend as necessary the stated purpose of all Standing Committees established in Council Policy 100-4 and provide clear specifications of the committees' scope of activity, in particular minimum effective oversight responsibilities.

Response: *The respondent is not prepared to agree or disagree with this recommendation. As previously noted, the Council Audit Committee will be reviewing their scope and responsibilities. The City of Stockton has a number of competing priorities. As a result, a review of Council Committee roles and responsibilities will be addressed as other priorities are addressed. Resulting updates will be incorporated into Council Policy 100-4, but the City is not prepared to commit to a specific outcome or timeline at this point.*

- R 6.2 By November 1, 2013 the City Council amend Council Policy 100-4 to set defined staggered and rotating two-year terms on the Finance Committee in order to bring fresh perspective to the committee's deliberations and to provide an opportunity for more council members to serve

Response: *The respondent disagrees with this recommendation. Respectfully, this recommendation seems counter to the implied suggestion in F 6.2. The City is not prepared to prescribe terms or qualifications for appointment to City Council Committees. Appointment to Council Committees is at the discretion of the Council and can be adjusted at any time by Council approval.*

7.0 Financial Training for City Council Members

F 7.1 The degree of training and knowledge about municipal finance varies among the current council members who responded to the Grand Jury's survey.

Response: *The respondent agrees with this finding.*

F 7.2 The current City Manager and CFO provide training on financial matters as they relate to issues being presented to the city council.

Response: *The respondent agrees with this finding.*

F 7.3 The lack of knowledge about municipal finance resulted in some council members not having the ability to ask questions or understand the financial information presented to them.

Response: *The respondent disagrees with this finding. The City recognizes that it can be difficult for some Council Members to become experts on municipal finance. All human beings have varying degrees of financial acumen. However, current management has taken great lengths to share transparent and complete information with the Council. The current Council has become well versed on the financial condition and the deficiencies of the financial condition of the City in a very short amount of time.*

R 7.1 The City Council submit a policy resolution for consideration during the League of California Cities (LCC) annual conference for the League to establish training programs for local elected officials to learn about the various aspects of municipal finance similar to the depth and content of the California State Association of Counties (CSAC) courses.

Response: *Staff disagrees with this recommendation. The deadline for submitting to the League of California Cities was July 20, 2013. The City is supportive of municipal finance training for elected officials. However, given the demanding workload of the City, there were not sufficient resources to develop a LCC resolution prior to the July 20 deadline. Our priority is ensuring our Council is up to speed on financial matters, and they are.*

R 7.2 The City Manager and CFO develop a workshop for elected officials on municipal finance operations, structure, responsibilities and oversight drawing upon best practices developed by other cities and professional organizations (with the assistance from local educational institutions). The workshop shall be available to all newly elected members of the City

Council during the period between when election results are known and the members assume office.

Response: *The respondent disagrees with this recommendation. The League of California Cities provides training for new Councils and it provides additional training options throughout the year. We have encouraged Council to utilize this source. The City is committed to providing extensive municipal finance training to elected officials. However, we question prescribing the precise format and venue. The current practice at the City includes the City Manager providing recently elected Council members with extensive information about the City's budget and finances and reviewing this information in personal meetings. In addition, there are continual efforts to ensure Council is comfortable with and understands the information presented to them. This occurs through weekly meetings with the City Manager, quarterly budget updates, study sessions on various topics and detailed staff and consultant reports that are issue specific. The extensive financial information in staff reports suggests the extent to which they are briefed on financial matters. One of the only benefits of our financial status, is that the City Council is conversant on financial matters of the City. Finally, financial acumen is like learning a foreign language. A class doesn't help, regular practice does. Our practice of informing Council on financial matters is in the top tier of the State.*

R 7.3 No later than January 2014 the City Manager and CFO present bi-monthly workshops to educate elected city officials about the various operations and responsibilities of Stockton's financial operations.

Response: *The respondent disagrees with this recommendation. The City does not have the staff, resources or time to offer bi-monthly meetings. The responses to R 7.1 and R 7.2 above will provide the Council with information related to local government finance. Should Council wish to have information presented on a specific topic or should management see a need to provide a workshop, this information will be incorporated into the quarterly financial updates or as a special study session on an as needed basis.*

8.0 Council and Manager Responsibilities and Oversight

- F 8.1 The behind the scenes actions and lack of complete and clear information from former city managers resulted in elected officials and the public having a false sense of confidence in the City's financial condition.

Response: *The respondent agrees with this finding. Additionally, a lack of proper auditing also led to a false sense of confidence in the City's financial condition. The Comprehensive Annual Finance Report for 2010-11 contained 37 findings. The City received an unqualified audit opinion but only after making multi-million dollar adjustments to prior years final records. The City's prior audit contained only 3 findings, indicating a poorly conducted audit. The City of Stockton has taken corrective action as described below in the response to R 8.1.*

- F 8.2 Failure of prior City Council Members to request information about or to question actions by city managers and mayors raises concerns of whether actions were taken for the City's benefit or for personal/political gain.

Response: *The respondent is not in a position to agree or disagree with this finding. The current City Council is not in a position to comment on the motives of former City Council Members. However, the City is prepared to recognize that it is staff's responsibility to properly inform Council of the City's financial situation. As evidenced in this Grand Jury report, past City Management provided limited or inaccurate information. For example, when the retiree health benefit was expanded to all employees, staff did not seek an actuarial study, did not ever properly fund the program and did not discuss the mounting liabilities with Council. When the City considered external retirement benefits, staff did not consider the interplay between the two new benefits and the City retirements of employees. The two left the City with a \$700 million unfunded liability for current management and Council to deal with. It is staff's professional responsibility to provide Council with complete and accurate information for decision-making purposes.*

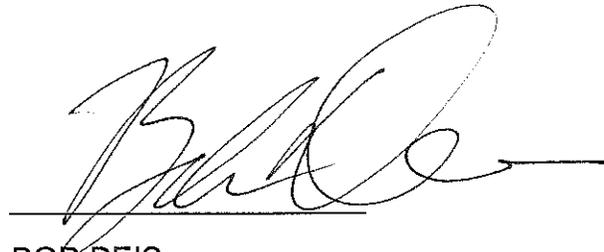
- R 8.1 The City Manager and his/her administrative staff provide detailed, timely, and accurate information supporting proposals with significant long-term financial implications for the City and that such documents be available to the public.

Response: *The respondent agrees with this recommendation. This has been the practice over the past three years. Staff has prepared extensive documentation for the City Council relative to the financial condition of the City in order to get the City's fiscal house in order. Council, staff and the community have a clearer picture of the long-term financial condition of*

the City than they have had in the past 20-30 years. This practice will continue into the future. The City Manager personally reviews all information presented to Council. City Management expects thorough and complete information be presented to Council so they may make a thoroughly informed decision. Long term impacts of proposals to Council are always considered and discussed.

R 8.2 Beginning immediately, ensure any proposals by the Council Members and the Mayor with long-term financial implications for the City be openly disclosed, explained and discussed for public review.

Response: *The respondent agrees with this recommendation. Proposals brought forward by the Mayor or a Council member are thoroughly reviewed by staff. Staff always prepares a report discussing the financial impacts of the proposal and provides a recommendation for Council consideration.*

A handwritten signature in black ink, appearing to read 'Bob Deis', is written over a horizontal line. The signature is fluid and cursive.

BOB DEIS
CITY MANAGER

BD:VB