City of Santa Monica®

Information Item

Date: October 21, 2013

To: Mayor and City Council

From: Gigi Decavalles-Hughes, Director of Finance

Subject: Grand Jury Report

Introduction

On October 14, 2013, an editorial appeared in the Santa Monica Daily Press titled "County Grand Jury Gives Santa Monica a Fat 'D'". The editorial alluded to the June 2013 County of Los Angeles Civil Grand Jury (Grand Jury) report on Fiscal Health, Governance, Financial Management and Compensation. This information item serves to provide background on the City's involvement with the preparation of the Grand Jury report, and to clarify that the majority of the findings made in the report were erroneous.

During Fiscal Year 2011-12, in the wake of the City of Bell scandals, the Grand Jury conducted a review of the 25 charter cities in the County, including Santa Monica. The City received a questionnaire and request for information on financial management practices and submitted numerous documents and supplemental information to the Grand Jury and in return received a draft report of findings in June 2012 (Attachment A). The report contained 11 best practice recommendations for Santa Monica.

On August 30, 2012 and again on November 26, 2012 (Attachment B), Santa Monica responded to the recommendations as follows:

- 7 recommendations, predominantly related to financial planning and budgeting policies and practices, were already established as had been shown in previous documentation sent along with the questionnaire.
- 3 of the recommendations, related to the creation of an Audit Committee and the compilation of updated accounting policies and procedures, were opportunities for improvement and would be specifically addressed.

- 1 recommendation, related to the comprehensive review of salaries and benefits on an annual basis, was not perceived to be practical. However, although the City disagreed with the annual review provision, staff agreed that comprehensive review was necessary and provided information on the City's long-term strategy to manage employee compensation and provided links to the site where Santa Monica posts all salary and benefit information for the public to access. Santa Monica has consistently posted this information for the past several years.

In its response to the 2012 report, the City sought to correct inaccuracies regarding implementation of best financial management practices. Responding within the format, the City agreed that the majority of the Grand Jury's recommendations were indeed best practices and noted that, in almost all cases, the City already followed the recommended practices, and in other cases, was working to implement those practices. The City also referred the Grand Jury to documentation initially sent as proof that best practices were already being implemented.

In Spring 2013, the Grand Jury issued an additional report (Attachment C) on all 88 cities in Los Angeles County, reusing much of the information from the first report and updating funding amounts where relevant based on the City's financial statements. Upon receipt of the draft report, staff was appalled that the Grand Jury failed to recognize Santa Monica's previous attempts to correct inaccuracies. Staff sent a response to the Grand Jury on August 7, 2013, more strongly contesting the findings and providing additional, specific responses and evidence in support of the City's strong financial management (Attachment D).

Seven of the ten findings in the 2013 report are erroneous, as follows:

- That the City has not adopted financial planning revenue and expenditure policies to guide the development of balanced budgets. *Staff repeatedly supplied a number of policies, reviewed and adopted annually by Council, demonstrating that this was not the case.*
- That the City does not develop balanced budgets. *Staff supplied a summary form the Comprehensive Annual Financial Report (CAFR) demonstrating that the City does develop balanced budgets.*

- That the City uses one-time revenues to fund ongoing expenditures. *Staff supplied a summary form the Comprehensive Annual Financial Report (CAFR) demonstrating that the City does not use one-time revenue to fund on-going expenditures.*
- That the City has not adopted a method of saving into a reserve or rainy day fund. *Staff had noted repeatedly that the City amended its rainy day reserve policy to increase the reserve from 10% to 15% of the operating budget beginning in fiscal year 2011-12. In addition, the City maintains $9.7 million in economic uncertainty funds.*
- That the City does not have a policy requiring financial policies to be reviewed annually. *Staff had repeatedly noted that financial policies are reviewed by staff and Council as part of each year's budget adoption process.*
- That Santa Monica should complete a competitive process to select its independent auditor. *Staff provided documentation that demonstrated that the City completes a competitive process once every five years, as recommended, and most recently completed that process on May 10, 2011.*

Also included in the Spring 2013 report was a ranking of the City's responses to 32 questions regarding governance and financial management best practices. The City ranked 64th in terms of providing affirmative responses to 20 out of 32 questions related to the Civil Grand Jury's definition of best practices. For the most part, an affirmative response to a best practice required the City to have adopted formal processes, while the City has informally incorporated a number of these best practices in its operations and policies. The City would respond in the affirmative to an additional 8 questions if informal processes were considered, bringing the City's score from 20 affirmative answers (score of 63%) to 28 affirmative answers (score of 87%). The questions receiving adverse marks, with explanations of the City's current status on each of these issues, are shown in Attachment E.

Supported by these internal operating rules, Santa Monica has consistently held itself to a very high standard of ethics and internal controls, evident in the City's history of clean audits, most recently shown in the Independent Auditor's Reports, and in our Government Finance Officers' Association (GFOA) award-winning Comprehensive Annual Financial Reports and Budgets (Attachment F), its established internal audit

function, public presentations of the audit to the Council each year at a regular Council meeting, and management's and Council's participation in the Statement on Auditing Standards No. 99 (SAS99) Consideration of Fraud in a Financial Statement Audit process, in which the external auditor gathers information to identify risks of material misstatement due to fraud and assesses the risks after evaluating the city's programs and controls.

The City's sound financial management practices have been recognized by the GFOA for the past 29 years, most recently on October 10, 2013, when it presented Santa Monica with its Certificate of Achievement for Excellence in Financial Reporting for its Fiscal Year 2011-12 CAFR, and have played strongly in the City's AAA Bond rating held since 1995.

Coming on the heels of the 2012 report, the 2013 supplemental Grand Jury report contained misinformation and persisted in its failure to recognize the corrections that the City had made in response to the first review, thus providing an erroneous picture of the City's financial management practices. The Grand Jury report failed to recognize policies and procedures the City has in place, despite being provided copies and proof of such policies, procedures, and safeguards.

Prepared By: Donald Patterson, Assistant Director – Finance

Attachments:

A. 2011-2012 Los Angeles Grand Jury Final Report
B. Santa Monica's response to 2011-2012 Los Angeles Grand Jury Final Report
C. Cities of Los Angeles County Fiscal Health, Governance, Financial Management, and Compensation Final Report
D. Santa Monica's response to Attachment C.
E. Detailed explanation on status of questionnaire responses
F. Certificates recognizing Santa Monica's excellence in financial management