



To: Mr. Kurt Wilson, City Manager

From: Cathy Standiford, Partner

Subject: Review of Proposed Charter Amendments Related to City Auditor

Date: August 10, 2015

The City of Stockton charter is being reviewed to identify potential amendments for consideration by voters in November 2016. A Charter Review Advisory Commission of 15 residents has been established to review the current charter in detail and make recommendations for improvement. Commission members have been discussing each section of the charter in sequence and making recommendations to an Ad-Hoc Charter Committee consisting of the Mayor and two City Council members.

On July 22, 2015 the Charter Review Advisory Commission recommended significant modifications to Article XV of the charter pertaining to the city auditor. Management Partners was asked to conduct a high-level, independent review of the proposed language recommended by the Commission to determine consistency with best practices for modern municipal management and identify any issues or concerns. The purpose of this memorandum is to transmit the results of this review. It is organized into four sections: 1) Background, 2) Methodology, 3) Analysis and Observations, and 4) Conclusion.

Background

The California State Constitution gives municipalities the power to become charter cities (Article XI, § 3(a)). This allows cities to adopt a charter and ordinances that replace state laws in areas related to “municipal affairs,” subject to the limitations within the charter. At all times, the city, whether a charter or general law city, is subject to the United States Constitution, federal laws, the California Constitution, and state laws regarding matters of statewide concern. The primary difference between a charter city and a general law city is who gets to make decisions regarding “municipal affairs,” i.e., the state legislature or the city council. Of the 482 cities in California, 121 are charter cities.

Key Principles of Charters

Modern, effective charters seek to follow four key principles: 1) be a document of limitation, 2) be flexible, 3) stand the test of time, and 4) reserve all powers possible to allow home rule by the local municipality. Ensuring a charter or charter amendment reflects these principles is a best practice for modern municipal governance. Each principle is discussed below.

Document of Limitation

A charter serves as a limitation by the voters on city council action. It should include only those elements necessary to achieve identified goals and objectives. The charter may, intentionally or unintentionally, expand or contract a city's ability to function. Therefore, it is important to protect and define local municipal authority in the charter when appropriate. Many issues are better addressed outside of the charter, such as through the city's municipal code, or policies and procedures adopted by the city council and/or city manager.

Flexibility

A charter should be proactive and flexible, and not unreasonably restrict future government action. It should allow for change, progress and reform. Controls that seem appropriate today may become less appropriate in the future. Therefore, a charter should not impede timely governmental response to changing conditions.

Test of Time

A charter should stand the test of time. The nature of government is that missions, goals and responsibilities will change over time as community needs and conditions change. A charter should also address these changes and be as sound today as 20 years from now. Charter development must involve forward thinking and an element of forecasting the future.

Reserve All Powers of Municipal Affairs

A charter must reserve all powers possible to the municipality. The more broad the granting of authority, the less likely individual charter elements will be challenged as conflicting with state law. A charter brings a degree of independence, and that independence should be protected and preserved in the charter language. The charter must ensure accountability and preserve authority over all municipal affairs.

Methodology

Management Partners reviewed Stockton's current charter provisions concerning the city auditor function as well as the revisions recommended by the Charter Review Advisory Commission. The proposed revisions were analyzed based on the context of the key principles described above.

There are eight charter cities with populations between 200,000 and 400,000 in California. Charters from each of these agencies were reviewed to identify common practices for the city auditor function and provide additional context to the analysis. The comparable peer agencies, their populations and incorporation dates are shown in Table 1. It shows four of the peer agencies are smaller in population than Stockton and four are larger.



Table 1. Peer Charter Cities, Populations and Incorporation Dates

City	Population*	Incorporation Date
Stockton	300,800	1850
Anaheim	348,306	1876
Bakersfield	367,315	1873
Chula Vista	256,139	1911
Irvine	242,651	1971
Modesto	206,785	1884
Riverside	314,034	1883
San Bernardino	212,721	1854
Santa Ana	331,953	1886

Source: California Department of Finance

*Populations as of January 1, 2014

Table 1 also shows all but two of the peer agencies were incorporated prior to 1900. The most recently incorporated city is Irvine (1971). Irvine also has the shortest charter at 11 pages. This is reflective of the modern practice for charters to be documents of limitation and include only those matters over which the voters have ultimate control. In other words, newer charters tend to be shorter, simpler and less complex than those created a century ago.

Analysis and Observations

This section summarizes the results of our analysis and observations related to city auditor provisions proposed by the Charter Review Commission.

Current Charter and Municipal Code Provisions

Article XV of the Stockton City Charter currently contains three sections. Section 1500 vests authority in the City Council to appoint the city auditor, and specifies the auditor be, “certified according to standards comparable to a Certified Public Accountant or a Certified Internal Auditor at time of appointment.” The auditor serves at the pleasure of the City Council.

Section 1501 defines the powers and duties of the city auditor. Three types of duties are identified in this section. The first is responsibility for conducting the annual audit of financial transactions and preparing the Comprehensive Annual Financial Report (CAFR), consistent with generally accepted auditing standards. A second duty is to conduct “performance audits” as assigned by the City Council. As defined, performance audits are assessments of individual departments or programs to ensure the effective use of public resources; identify opportunities to improve efficiency, effectiveness and/or customer service; and ensure the City Council’s goals and objectives are being met.

Section 1501 also authorizes the city auditor to conduct “special audits and investigations, as assigned by the City Council.” These special audits are limited in scope to confirm the accuracy



of information provided to the City Council, the financial implications of recommendations being made to the Council or, “other information concerning the performance of City Departments, Offices or Agencies as request by the Council.”

Section 1502 gives the city auditor the authority to appoint and remove employees of the Office of the City Auditor, prohibits nepotism in hiring appointments (unless waived by a two-thirds vote of the City Council) and designates employees in the Office of the City Auditor as unclassified employees.

Chapter 2.16 of the Stockton Municipal Code provides additional information about the role and responsibilities of the city auditor. Section 2.16.010 reiterates charter language that the auditor be, “appointed by, report to, and serve at the pleasure of the Stockton City Council,” while Section 2.16.030 reiterates the city auditor’s authority to appoint staff employees. Section 2.16.020 contains a list of duties to be performed, “at such times and in such manner as may be prescribed by the City Council.” All of these duties describe financial auditing and review of appropriate internal controls. Duties related to performance audits or special investigations are not specified in the Municipal Code.

Proposed Charter Provisions for City Auditor

Our review of the proposed revisions recommended by the Charter Review Advisory Committee identified three primary areas of concern. Each is described below.

Requiring the City Auditor to Be an Employee

The recommended revisions to Section 1500 maintain the City Council’s authority to appoint the city auditor. However, new subsections are added to specify that the city auditor be an employee of the city, with an employment term of not less than four years. The revision also includes conditions for removal from office for cause and a process for removal. It prohibits the City Council from appointing a qualified independent auditor (i.e., an outside firm) unless there is a vacancy, and then for only one year.

Based on our review, it is highly unusual to mandate that the auditor be an employee. In fact, Stockton is already somewhat unique in having its charter and municipal code identify a city auditor at all. Peer agency data regarding city auditor positions and functions are summarized in Table 2, which shows that only Modesto has a city auditor defined by city charter. Even then, the function is combined with the city clerk and is limited to conducting performance audits and special investigations.



Table 2. Summary of Peer Agency Provisions for Internal Audit Position and Functions

City	City Auditor Established by Charter or Municipal Code	City Auditor an Employee?	Comments
Anaheim	No	No	Financial audits performed by independent certified public accountant appointed by City Council.
Bakersfield	No	No	Charter requires financial audits to be performed by independent certified public accountant. City Council policy is to rotate auditors through a competitive bidding process every five years.
Chula Vista	No	No	Financial audits performed by independent certified public accountant appointed by City Council.
Irvine	No	No	Financial audits performed by independent certified public accountant appointed by City Council.
Modesto	Yes	Yes	City Clerk and City Auditor are combined under one appointed position. Functions include performance audits and special investigations as well as typical city clerk functions. The charter requires financial audits to be performed by independent certified public accountant appointed by City Council.
Riverside	No	No	Financial audits performed by independent certified public accountant appointed by City Council. Charter specifies the City Council must employ a different qualified public accountant at least every five years.
Santa Ana	No	No	No language in charter regarding either city auditor or independent audit functions.
San Bernardino	No	No	Arranging for the preparation of an annual financial audit is delegated to the finance director by the City's municipal code.

Table 2 also shows the common practice is for a city council is to hire an independent certified public accountant to conduct an independent audit of the city's financial transactions and financial position. Such accountants are not employees of the City, but are essentially consultants retained to conduct the audit and prepare the Comprehensive Annual Financial Report.

It is also more common for department or program performance audits (sometimes referred to as organization assessments) to be conducted either by an independent, professional consulting firm or internally by the city manager, assistant city manager, or other high-level designee. Other than Modesto, there are no references to performance audits in any of the peer agency charters.

Requiring the city auditor to be a city employee is inconsistent with the charter principle of flexibility because it limits the City Council's ability to determine the most efficient manner for financial and performance audits to be conducted. It is also unusual to specify an employment



term and conditions for removal in a charter or a municipal code. Such terms are more commonly found in either an individual employment agreement, memorandum of understanding, or civil service rules, if applicable.

Establishing a Specific Minimum Budget within the Charter

Proposed Section 1500 (d) instructs the city auditor to submit a proposed budget to the City Council no later than three months before the commencement of the fiscal year. It instructs the City Council to adopt a final budget for the city auditor as part of the annual budget process. The proposed language also specifies that the budgeted funds be at least 0.15% of the City's total budget.

A charter provision that defines a minimum budget for a city office or department is highly unusual. None of the peer agency charters have such language, nor is such language contained in their respective municipal codes. Establishing minimum budget allocations in governance documents such as charters or codes is not a best practice, primarily because doing so violates the principle of flexibility.

Instead, the best practice is for budget resource allocations to be made based on the specific goals, programs, services and/or activities to be accomplished during the year, while taking into account the needs of the organization as a whole. This gives the governing body flexibility to ensure the budget responds to the established needs and priorities of the community.

There is no apparent nexus between the size of a municipality's budget and the workload demands of a city auditor. Consequently, the designation of 0.15% is somewhat arbitrary. The Stockton Citywide budget for FY 2016-17 is \$610,449,861. The language proposed by the Charter Review Advisory Committee would result in a City Auditor budget of \$915,675, an increase of approximately \$199,400. Currently city auditor services are provided by a private contractor for less cost. Assuming the services are satisfactory, the proposed language would result in decreased efficiency by mandating a higher budget allocation.

Redundancy of "Objectives," "Oversight," and "Powers and Duties"

The Charter Advisory Commission has proposed a number of modifications to the powers and duties of the city auditor as currently provided by charter. New Section 1501, entitled "Objectives of the City Auditor," requires the city auditor to "seek to ensure" the city:

- Produces timely and accurate finance reports;
- Completes, "required financial, compliance and specialized audits on a timely basis" using, "qualified independent outside auditors";
- "Provides timely and proper responses to findings made as a result of outside or internal financial, compliance and program audits"; and
- "Maintains effective internal controls."

The revisions also require the city auditor to ensure, "the City's operations are economical, effective and efficient and conducted without fraud, waste or abuse."



New Section 1502, “Oversight,” specifies that the city auditor shall advise and report to the City Council, submit an annual audit plan to the City Council, perform other functions assigned by the City Council, and undertake independent examinations, reviews, investigations and other procedures consistent with the Charter.

New Section 1503, “Duties and Powers” contains a list of eight duties for the city auditor.

1. Cause annual post audits of fiscal transactions and accounts to be conducted.
2. Review annual and quarterly financial statements and prepare a written report to the City Council, including comments on “the timeliness and accuracy of annual and interim financial statements, the nature and changes in City assets, liabilities, net position, fund balances, revenues, expenditures, actual results vs. budget and other appropriate matters.”
3. Review and provide advice to the City Council about financial statements, audit reports and other financial reports before any are filed with regulatory agencies.
4. Receive copies of all communications related to internal and external audit requests, audit responses, program reviews and monitoring visits and report the status of compliance activities to the City Council.
5. Provide independent analysis of the potential financial impacts of “any proposed or amended contract, memorandum of understanding, retirement plan agreement, loan, bond, or similar agreement that entails a potential new or continuing obligation of \$1,000,000 or more”, along with recommendations on their “fiscal advisability.”
6. Access and examine any documents, records and property consistent with audit provisions specified in City contracts.
7. Conduct any financial, attestation or performance audit in accordance with generally accepted government auditing standards.
8. Prepare and submit quarterly reports of activities to the City Council, with recommendations to improve the administration of the City.

Embedded in the sixth duty (access and examine documents) are provisions that City managers and staff cooperate with reasonable requests made by the city auditor, and that the city auditor may meet in private with a variety of individuals and stakeholders subject to the provisions of open meeting laws. These provisions seem out of place and would be more appropriate in a different section.

Several components in these three sections appear to be redundant and would benefit from consolidation. The title of the “Oversight” section is confusing, since the contents of the section do not describe the city auditor’s oversight authority; that authority is implied by the duties described in proposed Section 1501 and to some extent, proposed Section 1503.

It is helpful to define the roles and responsibilities of city officials, and we understand the desire to do so. However, these proposed sections contain a greater level of specificity than is recommended for charters and would be better suited to either the City’s municipal code or adopted administrative policies. Their proposed inclusion in the charter is inconsistent with the



charter principles of flexibility and limitation, and may require the city auditor to perform duties that may not stand the test of time.

Conclusion

The language for the city auditor as proposed by the Charter Review Advisory Commission is overly detailed and in some cases redundant. It also is inconsistent with key principles for modern charters, primarily the principles of limitation and flexibility. The language recommended by the Commission should be streamlined to reflect best practices for effective, efficient governance. If specific descriptions for city auditor duties are desired, it would be more appropriate to add them to either the City's municipal code or established administrative policies.

