



JOHN CHIANG
California State Controller

April 2, 2012

Mr. Bob Deis
City Manager
City of Stockton
425 N. El Dorado Street
Stockton, CA 95202

Dear Mr. Deis:

This is to notify you that I have directed my Division of Audits to conduct an investigation of the financial practices and reporting of the City of Stockton (City) and the Stockton Community Redevelopment Agency (RDA) and its Successor Agency. The investigation will be conducted under Government Code (GC) sections 12464(a), 12468, 12410 and Health and Safety (H&S) Code section 34167.5. The basis for this investigation is as follows:

Annual Reporting Requirements: Neither the City nor the RDA has complied with state laws regarding the timely submittal of annual financial transaction reports as follows:

City of Stockton's Financial Transaction Report

- The City has not submitted the City of Stockton Financial Transaction Report for Fiscal Year 2010-11. The due date was on or before October 18, 2011.

Stockton Community Redevelopment Agency's Financial Transaction Report

- The RDA did not submit the RDA Financial Transaction Report for Fiscal Year 2010-11. The due date was on or before December 31, 2011.

City of Stockton's Annual Street Report

- The City has not submitted the Annual Street Report for Fiscal Year 2010-11. The due date was on or before October 1, 2011. Our office withheld the City's Highway Users Tax Account (HUTA) allocation of \$653,021 for February and we will continue to withhold all future monthly HUTA allocations until the report is submitted to and reviewed by my office.

While the City and the RDA timely submitted the above three reports for Fiscal Year 2009-10, several discrepancies raise questions regarding their reliability. Specifically, the City reported a net deficit between income and expenditures of approximately \$37 million and the RDA reported a net positive equity position of \$90 million. Yet, the Independent Audit Report for the City and RDA for the same year disclosed deficit equity balances in the following funds:

- The RDA Capital Projects Fund has a deficit fund balance of \$6.2 million as of June 30, 2010.
- The General Liability Insurance Fund has deficit net assets of \$3.5 million.
- The Worker's Compensation Insurance Fund has deficit net assets of \$32.5 million.
- The Employee Health Insurance Fund has deficit net assets of \$6.0 million.
- The Retiree Health Insurance Fund has deficit net assets of \$75.9 million.
- The Other Benefits and Insurance Fund have deficit net assets of \$3.5 million.

Moreover, the Independent Audit findings for Fiscal Year 2008-09 did not disclose any fund deficits. The emergence of such deficits in such a short time raises concerns about the reliability and accuracy of the information in the Fiscal Year 2009-10 reports. In addition, it also raises questions about the data that you will be using to compile the Fiscal Year 2010-11 reports, particularly given the Stockton City Council's recent action to enter a mediation process allowed under Assembly Bill 506 to address severe financial issues that threaten the City with bankruptcy. You have stated that Stockton's current financial issues are due, in part, to fiscal mismanagement in recent years. My investigations of other cities and RDAs have linked mismanagement to significant reporting errors by those local agencies.

Based on the above information, I have concluded that there is reason to believe that the City's ability to provide reliable and accurate financial information relating to the required financial reports is questionable. Therefore, under GC Section 12464(a), I have directed my Division of Audits to conduct an investigation to validate the FY 2009-10 financial transactions reports (City, Street, and RDA) and review the data that will be used to compile the FY 2010-11 reports. Under GC section 12464(b), the costs of this investigation, including preparing a report of the results and transmitting copies to the City Council of Stockton, will be borne by the City and the RDA.

State and Federal Funded Programs

In addition, I have directed my Division of Audits to review any programs with State general or special funding, and/or any federal funding passed through a State agency to the city or the RDA. These additional activities will be conducted under GC section 12468, which authorizes the State Controller to ". . . regularly audit the apportionment and allocation by counties of property tax revenue . . ." and under GC section 12410, which authorizes the Controller to ". . . superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment." These statutorily required review costs will be borne by the State Controller's Office.

Redevelopment Agency Transfer of Assets

Under H&S section 34167.5, my office is required to perform a review of all RDA assets transferred to any local public agency between January 1, 2011 and January 31, 2012 and where appropriate require that the assets be returned to the Successor Agency for use in the timely dissolution of the former RDA and its operations. The costs of this review will be borne by the Successor Agency under H&S section 34183 (d).

The Division of Audits will contact you about scheduling an entrance conference date and providing information regarding the specifics of the investigation, including a list of materials that will need to be available. We expect the entrance will be held in late April with the actual work to begin in May.

I am aware that the City is in sensitive negotiations under the provisions of Assembly Bill 506. As you know, interested organizations and individuals – including current and former elected officials representing the Stockton community - have requested that I audit the City's finances to ascertain reliable information that might inform decision-making during the AB 506 process. Because my auditors are completing their work on other audits and will not be available until early May, it is unlikely that my office will complete its audit of Stockton before the 60 to 90 day process afforded by AB 506 runs its course.

Many of these same audit requests have also urged my office to perform a review of the City's internal controls, cash management, accounting procedures, procurement/contracting policies, and overall fiscal management practices to identify the origins of Stockton's current fiscal distress. Review of these factors and any root cause analysis will be included in the investigation my auditors will perform and the final report will include detailed recommendations for how to remedy any identified management shortcomings. My belief is that this information will assist Stockton in implementing any reforms and recovery plan that the City will need to embrace to regain its fiscal footing.

If you have any questions about the investigation and the audits, please contact Jeffrey V. Brownfield, Chief, Division of Audits, at (916) 324-1696.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

Bob Deis
April 2, 2012
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cc: Ann Johnston
Mayor of the City of Stockton
Chairperson of the Successor Agency to the RDA
Elbert H. Holman Jr., Council Member
Stockton City Council
Katherine M, Miller, Council Member
Stockton City Council
Leslie Baranco Martin, Council Member
Stockton City Council
Diana Lowery, Council Member
Stockton City Council
Susan T. Eggman, Council Member
Stockton City Council
Dale Fritchen, Council Member
Stockton City Council