Annual Report on Internal Financial Control

17th Edition

Calendar Year 2022

Department of Finance

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Contents

Executive Summary

This Annual Report on Internal Financial Control is issued pursuant to City of San Diego Municipal Code (SDMC) §22.0706, adopted by the City Council in October 2004 via Ordinance O-19320 to achieve a high standard of quality in and efficacy of the City of San Diego's (City's) financial reporting and disclosure practices. SDMC §22.0706 requires that management:

1. Perform an annual evaluation of the City's internal financial controls;
2. Submit a written Annual Report to the Audit Committee and the City Council on management's annual evaluation of the City's internal financial controls;
3. Submit a Certification by City Management regarding the design, maintenance, and effectiveness of the City's internal financial controls.

The objective of a system of internal controls over financial reporting is to provide reasonable assurance that the financial information produced is reliable and that it reflects the City's transactions and events for the reporting period. It is not intended to eliminate all risk as factors such as collusion, human error, inconsistencies in judgement, impacts of external events outside management's control, and cost effectiveness can have an influence on an organization's control policies and procedures. Rather, the controls are intended to mitigate the risk of financial reporting errors to a level that is acceptable based on considerations of materiality. Materiality represents the magnitude of an omission or misstatement of an item in a financial report that in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.

Internal control is influenced by a board of directors, management, and other personnel. The City must consider the efficacy of the organization's governance structure and culture to produce accurate and reliable reporting. Management must continuously assess risk, as financial reporting standards or requirements change, and new software or technology is implemented. Risk can also increase as accounting and reporting processes change and as there is turnover in management and staff. As new risks are identified, management responds by implementing or enhancing controls to mitigate such risks.

Within the last 120 days, management evaluated the City's internal financial controls over financial reporting. Based on this evaluation, management concludes that the internal financial controls are effective and has certified the result (Attachment 1).

The Department of Finance (DoF) includes an assessment template to illustrate the approach used for management's evaluation of internal financial controls. The template is intended to help the reader understand management's criteria in its evaluation and offer more visibility into the process. The template and its results are included as an attachment (Attachment 2) for reference and described in more detail later in the report.

This report summarizes management's approach to maintaining an internal control system that provides reasonable assurance that financial reporting objectives are met. Significant enhancements during calendar year 2022 and potential risks that were identified, either by management or through the audits performed by external auditors and the Office of the City

Auditor (City Auditor), are included. For this reporting period, management did not identify any significant deficiencies in the design or operation of internal controls that could adversely affect the City's ability to record, process, summarize and report financial data.

Financial Reporting Achievements and Internal Control Improvements

The list below identifies the most significant financial reporting achievements and internal control improvements implemented during the assessment period.

- Received an unmodified (clean) audit opinion on the City's Fiscal Year 2022 Annual Comprehensive Financial Report (ACFR). No material adjustments, material weaknesses, or significant deficiencies in internal controls over financial reporting were identified through the independent audit.
- Received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA) for the Fiscal Year 2021 ACFR. The certificate is awarded for publishing an ACFR that satisfies both generally accepted accounting principles (GAAP) and applicable GFOA program requirements, including transparency and full disclosure.
- Received a Distinguished Budget Presentation Award from GFOA for the Fiscal Year 2022 Adopted Budget. Recipients are awarded this honor for meeting guidelines set by the National Advisory Council on State and Local Budgeting (NACSLB) and GFOA's best practices on budgeting.
- Finalized and implemented "telework" and flexible schedule policies via a new Administrative Regulation (A.R.), A.R. 95.95–*Telework Program*. The new A.R. defines guidelines, requirements, and procedures for employees seeking a telework option and allows the City to maintain competitiveness in attracting and retaining employees.
- Added two supplemental Finance Analyst positions in the Grants section in DoF as a result of receiving increased grant fund awards to support City programs and activities.
- Implemented several system enhancements including placing limitations on posting activity to closed purchase orders, validating commodity codes, improving outsourcing service tracking, streamlining inventory management, making improvements to centralize the accounts payable process, replacing an obsolete investment accounting system, implementing Governmental Accounting Standards Board Statement No. 87, *Leases* (GASB 87) compliant lease accounting software, and implementing a Short–Term Residential Occupancy IT system.
- Upgraded several software applications to new versions or patched with service packs to add new features, fix known bugs, and improve data security. These include updates to the City's Enterprise Resource Planning (ERP) system, Vendor Invoice Management (VIM) for automated invoice processing, Budgeting and Planning for development of the City's annual budget, and Governance Risk and Compliance (GRC) for risk identification and role provisioning.

- Created or updated several financial reports including the Vendor Bank Account Change Report, the FMBB (Budget Adjustment) Audit Report, and the Open Invoice Report. Additionally, Ariba contracts were made more accessible and historical financial data in legacy systems was converted to ensure future access. Approximately 38 additional financial reports were created or modified for Citywide, departmental, or program use.

Background

The City of San Diego (City) is accountable to San Diego residents and outside stakeholders for the management of the City's financial and economic resources. It meets this responsibility in large part by preparing multiple financial reports made available to the public throughout each fiscal year.

External Financial Reports

The Annual Comprehensive Financial Report (ACFR) is the most significant financial report produced by the City for external users. It is available on the City's website and can be accessed by anyone including residents, investors, rating agencies and other interested parties. The ACFR is a comprehensive financial document that includes the balances and activity of all funds and component units of the City and related disclosures. The report typically takes five months to prepare and involves the collaboration of Department of Finance (DoF) staff, as well as key outside department staff who provide necessary information for required disclosures. The ACFR is prepared in accordance with generally accepted accounting principles (GAAP), which are established by the Governmental Accounting Standards Board (GASB). The ACFR is audited annually by an external, independent auditing firm who expresses an opinion on whether or not the basic financial statements are fairly presented in all material respects in accordance with GAAP. The City received an unmodified (clean) audit opinion on the Fiscal Year 2022 ACFR.

The City also produces other financial reports for external use such as the Schedule of Expenditures of Federal Awards, which summarizes all expenditures of federal awards for the fiscal year and is subject to a single audit by an external independent auditor (Single Audit). The City received an unmodified (clean) audit opinion on the Fiscal Year 2021 Single Audit. The Fiscal Year 2022 Single Audit is expected to be completed by March 31, 2023. The City's external auditor also conducts an audit of the schedule of costs for the fiscal year related to the Metropolitan Wastewater System and the City's allocation of such costs to the last audit period.

The Debt Management division of DoF develops financing plans, conducts planning, structuring, and issuance activities for all bonds, notes, and loans to finance the City's capital projects, essential equipment, and vehicles.

Bond financings are conducted for capital projects secured by the General Fund and the City enterprises, as well as projects supported by dedicated revenue sources such as the San Diego Redevelopment Successor Agency (Successor Agency) and special districts. The Debt Management division evaluates and applies for various State and Federal loans to help finance infrastructure projects including those for water, wastewater and storm water. Loan

agreements are executed to fund approved infrastructure projects. The division also administers certain short and medium-term financing mechanisms, including capital leases and commercial paper programs.

The division coordinates and monitors Citywide post-issuance administrative functions related to bond offerings, commercial paper programs, Federal and State loans, and capital leases. The division regularly reviews outstanding obligations for refunding opportunities and timely refinances to lower interest costs. The division manages credit and investor outreach functions for the City, special districts, and the Successor Agency providing information to current bondholders, prospective investors, and rating agencies that monitor credit.

The issuance of bonds and notes, and the execution of loans require development of reports that communicate critical financial information to investors and Federal and State agencies that provide loans to the City. The City has strong controls to ensure that all material financial information is properly disclosed, free of errors and omissions.

Internal Financial Reports

Reports for internal use are published and presented to the City's legislative body, the City Council, and available to the public. These reports are mandated as part of City Charter and the City of San Diego Municipal Code (SDMC). They promote transparency and oversight of management's financial spending and plans. The City's annual budget is, in many respects, the most important internal financial report because it informs readers of the Mayor and Council's priorities in terms of financial characteristics and serves as a key tool for financial management and compliance. Proper planning through the budget also facilitates compliance with rules and regulations, and ensures restricted funding sources are spent appropriately.

The City also publishes a long-range forecasting report for the General Fund known as the Five-Year Financial Outlook, which serves as a framework for the development of the annual budget, and provides anticipated funding needs over a medium to long-term horizon. In addition, the Public Utilities Department also issues a Five-Year Financial Outlook annually that allows for financial planning and serves as the foundation for development of water and sewer rates. Departments responsible for each of the remaining enterprise funds also produce annual five-year financial outlooks that are used internally to monitor the funds and provide a framework for development of user fees and budgetary adjustments.

The City publishes Capital Improvement Program (CIP) reports to provide information and transparency on CIP to stakeholders. The Five-Year Capital Infrastructure Planning Outlook is an overview of the City's capital infrastructure needs, revenue projections, and funding to assist in budget decisions and allocation of resources in order to meet the City's strategic goals. The State of the CIP and Construction Mid-Year and Year-End reports are semi-annual status updates on City CIP and highlight major programs, emergency projects, process improvements, and accomplishments. These reports are defined by Council Policy 000-31, which was amended by Resolution R-314352 in September 2022. The City also publishes the CIP Mid-Year and Year-End Budget Monitoring reports, which provide a semi-annual review and overview of the City's CIP available allocations and key funding source activity. The CIP Mid-Year and Year-End Budget Monitoring reports also include requests for City Council to approve budget adjustments that supplement the City's capital budgeting.

The Office of the City Treasurer distributes Monthly Investment Reports (MIRs) to the Mayor, City Council, Chief Operating Officer, and Chief Financial Officer and reports are made available to the public on City Treasurer's website. The MIRs summarize the City's pooled investments that are in conformance with the City Treasurer's Investment Policy.

Lastly, the Chief Financial Officer publishes monthly expenditure and revenue reports known as Charter 39 Financial Performance Reports, and quarterly year-end projection reports known as Quarterly Budget Monitoring Reports. These reports assist management and City Council with managing budgets and explaining variances in spending or revenue collection.

Management's Approach Using an Internal Controls Framework

Internal control over financial reporting is defined as a process established by an entity's governing body, management and other personnel, which has been designed and implemented to provide reasonable assurance regarding the achievement of financial reporting objectives. The main internal control objective in preparing financial reports is that the information included in the report is reliable and that it reflects the City's transactions and events for the reporting period in accordance with GAAP or other reporting requirements.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Controls Framework is an integrated framework commonly used by organizations. This Framework is a basis for the City's internal control program and provides guidance on internal controls over financial reporting. The framework put forth by COSO is comprised of five fundamental components which, when present and functioning together, work towards the goals of reducing risk to an acceptable level and achieving objectives for reliable financial reporting. The assessment of internal control over financial reporting focused on an evaluation of each of the five components.

The five fundamental components include:

1. Control Environment
2. Risk Assessment
3. Control Activities
4. Information and Communication
5. Monitoring Activities

DoF has incorporated a management assessment template (Attachment 2) to help assess the effectiveness of the City's system of internal financial controls and ensure that it meets the following requirements:

- Each of the five components and relative principles are present and functioning.
    - **Component:** A component of internal control supports an organization's efforts in achieving its financial reporting objectives. It describes what is required for the organization to meet its objectives and is relevant to an entire entity or at any entity level, division, operating unit, or function of the organization.
    - **Principle:** A principle is a fundamental concept associated with one of the five components of internal control. There are seventeen principles in the Framework.

- The five components are operating together in an integrated manner (Attachment 3).

The management assessment template contains the following three sections:

1. **Overall Assessment:** Summarizes management's determination of whether each of the components and relevant principles is present and functioning and components are operating together in an integrated manner.
2. **Components and Principles:** Summarizes management's determination of whether components and principles are present and functioning. A template for each of the five components with its associated principles is included. The framework also includes points of focus to describe important characteristics of each principle. However, the framework does not require management to evaluate whether all points of focus are in place.
3. **Deficiencies:** A log of all identified internal control deficiencies that can be leveraged in the evaluation of components and principles and can enable the internal control deficiencies to be aggregated.

The template provides a logical structure for management to analyze and document the organization's assessment of effectiveness of internal controls and assist management in developing a process for identifying and evaluating internal control deficiencies. The template is not an integral part of the internal control framework but serves as an illustrative aide.

Based on the evaluation outlined in the template, management has concluded that the City has established a comprehensive internal controls program and believes the internal controls over financial reporting are effective. All five COSO components are present and functioning. Although there are two internal control deficiencies that were identified in a prior year, they do not represent major deficiencies that affect the City's system of internal financial controls. The deficiencies and City's remediation progress are discussed further in this report and template.

1. Control Environment

The Control Environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The Control Environment sets the tone of the organization and represents what is commonly referred to in the private sector as an entity's "corporate culture." It encompasses the City of San Diego's (City's) integrity and ethical values; the City Council and Mayor's oversight, responsibilities, and delegation of authority; the process for attracting, developing and retaining employees; and the measures, incentives and rewards used to manage accountability and performance. The City has established policies and practices that provide for a strong control environment through the City Charter, City of San Diego Municipal Code (SDMC), management policies and practices, and a comprehensive financial training program.

City Charter

The City is organized as a strong-mayor form of government where the Mayor acts as the executive branch of government carrying out the operating functions of the City, while the City Council acts as the legislative body. In addition, the City Attorney, who is elected to a

four-year term, is independent from City Management and Council serving as the chief legal adviser and attorney for the City and most departments. This model of government provides checks and balances through separation of powers and is codified in the San Diego City Charter. The mayor appoints the Chief Financial Officer of the City and the City Council confirms the appointment. City Charter Section 39 gives supervision and oversight responsibility over all financial accounts of the City to the Chief Financial Officer. It requires that all financial transactions of the City be performed based upon forms prescribed by the Chief Financial Officer.

Charter Section 39.1 establishes an independent audit committee to oversee the City's auditing function. The Audit Committee is composed of two members from the City Council facilitating independence from management and three members from the public who possess the appropriate technical expertise to carry out this responsibility.

Charter Sections 39.2 and 39.3 also establish independent positions to assist the City Council in maintaining checks and balances over the executive branch, including the Independent Budget Analyst and City Auditor. The Independent Budget Analyst provides budgetary and policy analysis for the City Council. The City Auditor is responsible for the internal audit function of the City, with authority to investigate any material claim of financial fraud, waste, or impropriety within any City department. The City Auditor reports to the Audit Committee to prevent any conflicts of interest from reporting to the executive branch.

The City, like most large governments and corporations, also retains an independent audit firm to independently audit its financial statements. The City's current external independent auditor, Macias Gini & O'Connell LLP, reviews the City's financial statements and accompanying notes and reports on any findings during their audit process. The contract for the City's external audit firm is administered by the City Auditor and is evaluated every five years.

San Diego Municipal Code (SDMC)

The SDMC incorporates all ordinances passed by the City Council and approved by the Mayor. On October 11, 2004, Ordinance O-19320 incorporated Division 41: Securities Disclosure, which establishes the Disclosures Practices Working Group (DPWG), a group of senior City officials and disclosure counsel responsible for ensuring compliance by the City with federal and state securities laws, and for promoting the highest standards of accuracy in disclosures relating to securities issued by the City or by its related entities. As required by the SDMC, DPWG has developed the Disclosure Controls and Procedures to effectuate its responsibilities under the SDMC.

The Disclosure Controls and Procedures establishes process requirements over the development of documents that have disclosure obligations under applicable federal and state securities laws, including bond documents and the City's Annual Comprehensive Financial Report (ACFR). It establishes responsibilities for development and review of the financial documents and requires certification by those department heads that contribute information for development of such documents.

In addition, the SDMC establishes the Ethics Commission, which contributes toward a strong control environment for the City. As an independent department, the Ethics Commission monitors, administers and enforces the City's governmental ethics laws, conducts investigations, refers violations to appropriate enforcement agencies, reviews disclosure statements, and advises and educates City officials, candidates, political committees, and lobbyists about governmental ethics laws. All City management is required to participate in training provided by the Ethics Commission once every two years.

The City Council approved via Ordinance O-21565, an update to the SDMC replacing the Debt Management Director as a required member of DPWG with the Department of Finance Director. The Debt Management Director position was reduced due to the consolidation of the Debt Management Department and the Department of Finance (DoF), described later in this report. The Department of Finance Director, with assistance from staff, has assumed the responsibilities of the Debt Management Director and has reviewed relevant disclosures in accordance with the City's Disclosure Controls and Procedures.

Chief Compliance Officer

The position of Chief Compliance Officer was created in early 2020 and facilitates the City's response to internal and external audits; and coordinates compliance with local, State, and federal regulations related to labor, wages, health and safety, and the environment. The Chief Compliance Officer has played a key oversight role in reviewing department expenditures for eligibility of federal funding related to the COVID-19 pandemic. Another key responsibility of the position is improving the coordination of Citywide responses to audit findings and recommendations, especially when multiple departments are involved. The Chief Compliance Officer participates in Audit Committee meetings and serves as a representative for City management. In early 2022, the Compliance Department was established and added to the SDMC, via Ordinance O-21402, with the Chief Compliance Officer as the administrative head of the department.

Debt Management Reorganization

Effective in calendar year 2022, the Debt Management Department was consolidated with DoF to increase coordination between debt management, accounting, and financial planning functions. The City uses debt financing when financially prudent to procure long-term assets such as vehicles, land, and buildings, with the cost to acquire these assets spread over the useful life of the construction project or equipment, rather than paying for these assets upfront with cash. The City's most pressing need for debt financing is to fund the City's infrastructure in the Capital Improvement Program. Deciding to use debt financing for the City's infrastructure, and preparation of disclosure documents for debt financing was oftentimes a collaborative process performed by the Debt Management Department, DoF, and the Chief Financial Officer. This reorganization is expected to enhance communication and information sharing under a single responsible department, streamline the debt financing process, and overall strengthen the City's approach to funding infrastructure.

As a result of the reorganization, the position of Debt Management Director has been eliminated and replaced with an Assistant Director position reporting to the Department of Finance Director and City Comptroller. The position is required to oversee the functions of the former Debt Management Department and is currently filled by an Assistant Director with strong technical background and knowledge of debt financing vehicles, municipal bond disclosure practices, and post issuance responsibilities.

The reorganization is codified in the SDMC and was revised via Ordinance O-21565, approved on November 3, 2022. The updated SDMC establishes the new responsibilities of DoF for debt financing, special district formation, and coordinating enrollment and payment of assessments and special taxes.

Management Policies and Practices

The Chief Operating Officer issues Administrative Regulations (A.R.s) to establish policies, roles, and procedures of a continuing nature, and to direct operations within the City. Departments involved in complicated, lengthy, or detailed operations are required to work with the Internal Controls Section in DoF to develop and issue process documentation to detail the performance of these operations. Also, Citywide policy memorandums are sent out as necessary to clarify or establish policies and procedures for the City's mayoral departments. The City's policies and procedures are communicated to employees via Citywide email or by posting on the City's intranet and internet.

In 2017, A.R. 95.39–*Management Responsibilities for Internal Financial Controls* was established to provide a strong enhancement over the City's control environment. The A.R. establishes responsibility for developing Citywide financial policies and procedures within the finance branch, including Citywide dissemination of such policies and training as appropriate. It also emphasizes the role of the executive management team in creating an organizational culture that supports the internal control environment.

Financial Training

The City has implemented a comprehensive financial training program. As part of Citywide financial training, all levels of the organization are provided training to aid employees in submitting or reviewing financial data and reports. This includes City employees, City management, and elected officials. Under SDMC §22.4110, the City has established biennial mandatory Federal Securities Law training for members of management, relevant City staff, and elected officials to ensure material information in financial documents is disclosed in accordance with state and federal security laws.

Continuing education for professional staff who have financial responsibilities is critical for delivering comprehensive and accurate financial information to the City's stakeholders. The City's Chief Financial Officer requires financial professionals to grow and maintain their professional competencies in all areas of accounting, reporting, compliance, internal controls, grant analysis, debt management, ethics, and other finance related fields. This is accomplished through training policies tailored to promote competencies in each department's respective area. DoF maintains a training policy that requires staff engaged in accounting, financial

reporting, budget, and payroll functions participate in a minimum of 40 hours of formal subject matter training per year.

DoF staff members are also encouraged to attain professional designations such as a Certified Public Accountant (CPA) to maintain professional expertise on the latest accounting standards and practices. As of the end of calendar year 2022, eight DoF staff members held the CPA designation, and are required by the California Board of Accountancy to enroll in continuing education courses to maintain an active status.

Other Practices and Policies

Other practices and policies contributing to a strong control environment for the City include the adoption of an Employee Code of Conduct, the Fraud, Waste, and Abuse Hotline, Annual Report of the City of San Diego DPWG, Ethics Commission Annual Report, Department Conflict of Interest Codes, and the Annual Report on Internal Financial Control.

2. Risk Assessment

A continuous and effective assessment of risk is a critical component of the internal control framework because it allows management to form a basis for determining how risk should be managed and mitigated. It allows management to identify the need for control and monitoring activities, improvements to the flow of information and communication, or the need for changes to the control environment.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines risk as the possibility that an event will occur and adversely affect the achievement of objectives. As noted earlier, the main objective in preparing the Annual Comprehensive Financial Report (ACFR) is that the information included in the report is reliable and that it reflects the City of San Diego's (City's) transactions and events for the reporting period in accordance with generally accepted accounting principles (GAAP) or other reporting requirements. The policies and procedures established for financial reporting include controls that have resulted from management's risk assessment and its efforts to mitigate such risks.

Management's Risk Assessment on the ACFR

At the beginning of each ACFR preparation cycle, management communicates areas of potential risk to the City's external auditor based on management's risk assessment and ongoing monitoring activities, including management's response to such risks through the development and implementation of additional controls. For the Fiscal Year 2022 ACFR, management identified the following risks to the City's external auditor: Government Accounting Standards Board Statement No. 87, *Leases* (GASB 87) implementation, the Debt Management department merging with the Department of Finance (DoF), and ongoing significant events. Each of these risks will be described in detail in this report.

Changes in Accounting Standards

Management has the responsibility to select and use appropriate accounting policies. To mitigate the risk associated with changes in accounting standards, DoF staff with primary ACFR preparation responsibilities are provided training throughout the year, including an

annual Government Finance Officers Association (GFOA) training introducing new accounting pronouncements, and disseminate this information through cross-training within the department. Staff actively reviews all new standards to determine the applicability and requirements to properly implement in the effective reporting period. Staff also works closely with the City's external auditors to ensure full compliance with reporting standards.

Each fiscal year, DoF evaluates new accounting standards promulgated by GASB for potential financial impact. Research is assigned to the appropriate section in the department for in-depth analysis and implementation. A listing of the significant accounting policies adopted by the City each fiscal year is included in Note 1 of the City's ACFR.

During calendar year 2022, the City successfully implemented the accounting and reporting requirements GASB 87 in the Fiscal Year 2022 ACFR. The GASB 87 model is based on the foundational principle that leases are a financing mechanism for the right to use an underlying asset. The objective of GASB 87 is to increase the usefulness of governmental financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows or outflows of resources based on the payment provisions of the contract. Due to the scope of the standard and the volume of lease agreements the City is a party to, the expertise and resources needed to implement the accounting and reporting requirements of the standard were substantial. To mitigate risks related to the implementation of this standard, DoF developed and implemented a comprehensive multi-year plan for GASB 87. This plan included staff dedicated to a Citywide effort to identify, obtain, and review lease contracts, and the acquisition of lease accounting software described under Changes in Technology.

The City implemented four additional governmental accounting standards for the Fiscal Year 2022 ACFR; however, the implementation of these standards did not have a material impact on the financial statements. DoF is currently in the process of researching or implementing standards applicable through Fiscal Year 2025. No risks related to the implementation of these standards are anticipated at this time.

Considering Entity Activities

Financial reporting should capture an entity's transactions and events. Large entities such as the City can face several non-routine events on an annual basis where management needs to make assertions regarding the recognition, measurement, presentation, and disclosure on financial statements.

Events should be represented in financial statements in accordance with applicable governmental accounting standards. Management does this by making implicit or explicit assertions that consider the following:

- **Occurrence:** Transactions and events that have been recorded in the City's financial records have occurred and pertain to the City.
- **Completeness:** Transactions and events that occurred during a specific period, and that should have been recognized in that period, have in fact been recorded.

- **Accuracy:** Amounts and other data related to the transactions and events have been recorded appropriately, and their valuation is disclosed fairly with appropriate amounts.
- **Presentation and Disclosure:** Items in the statements are properly described, sorted, and classified.
- **Rights and Obligations:** The City holds or controls the rights to assets, and liabilities are the obligations of the City.

Management also meets with external auditors and the City's Disclosures Practices Working Group (DPWG) to explain assertions before the preparation and release of financial statements. This opportunity allows management to present any risk of material misstatements from their assertions, and to discuss the review of any supporting documentation.

From a financial reporting standpoint, management identified three events requiring additional risk assessment. They are summarized here and described in additional detail in the Fiscal Year 2022 ACFR:

- **Unwinding of Proposition B:** City voters passed Proposition B in June 2012 which prevented City employees hired on or after July 20, 2012, from entering a defined benefit retirement plan. The Proposition was invalidated through a series of legal challenges, and the City was directed to negotiate impacts with the City's Recognized Employee Organizations (REOs). On June 22, 2021, the City Council approved amendments to both the San Diego Municipal Code (SDMC) and SPSP-H Plan so that most employees hired after July 9, 2021, now enter the San Diego City Employees' Retirement System (SDCERS). Subsequently, the City entered into labor agreements with all its REOs except for the San Diego Police Officers Association.
- **Storm Water Regulation Compliance:** The City is currently operating under a Municipal Permit issued in May 2013 by the state agency regulating storm drain runoff. The Municipal Permit imposes numerous obligations and requirements on the City, including requirements to ensure that the City's various water bodies, and the storm drains discharging into them, do not contain pollutants in excess of Federal and State-mandated numeric limits. To comply with the water requirements of the permit, significant additional funding is required to address these water quality needs.
- **Senate Bill (SB) 1383 Regulation Compliance:** California SB 1383 was signed into law in 2016 and established targets to achieve a 50 percent reduction in the level of the statewide disposal of organic waste from the 2014 level by 2020 and a 75 percent reduction by 2025. The City has a preliminary estimate for fiscal years 2023 through 2026, of $120 million in General Fund expenditures for regulatory compliance, as well as anticipated operational costs of approximately $20 million per year starting in fiscal year 2027. The Fiscal Year 2023 Adopted Budgeted includes a total of $17.4 million across various funds to support the implementation of SB 1383. This funding will be used to implement the regulation by increasing staffing, accruing collection vehicles, and procuring additional containers. The consequence for non-compliance is up to $10,000 per violation, per day starting in 2022.

Changes in Technology

The City continues to modify and add modules to the core Enterprise Resource Planning (ERP) system in order to maximize the efficiency and span of control over business operations and reporting. Each of these changes introduces the risk of system generated errors, which are mitigated through configuration and development testing. Business process owning departments such as DoF, the Department of Information Technology (DoIT), Purchasing and Contracting (P&C), Personnel, Human Resources (HR), Risk Management, and the Office of the City Treasurer all work closely to ensure that any changes or improvements to the system are fully tested for operational needs and for the impact to financial reporting. At the completion of testing, signoffs are required by the Business Process Coordinators (BPC) involved.

During calendar year 2022, many key enhancements were made to further tighten controls over financial systems data integrity including the following:

- DoF, HR, and P&C implemented several changes to the procurement process. End users will no longer be allowed to post a document in the system acknowledging receipt of goods (goods receipts) against closed purchase orders. This will help minimize accidental postings of new goods receipt postings that reopen purchase orders and result in unintended encumbrances. Mandatory training in Governance, Risk, and Compliance (GRC) was instituted before users can obtain access to post goods receipts. Additionally, a system workflow and approval process for contracting out services was enhanced with validation checks and reporting capability. This new enhancement gives the City more assurance that purchase requisitions or purchase orders are better tracked to more accurately identify how much the City spends in HR approved outsourcing services. This is essential because HR must report how much was spent in outsourcing services to the REOs and City Management.
- DoIT's Enterprise Resource Planning (ERP) Division, along with P&C's Central Stores Division, implemented the Warehouse Management module of SAP. The Warehouse Management module allows Central Stores to track its inventory at the bin level. This provides the department with the ability to track its materials at the staging location, before the materials are issued to an individual or department, as well as providing additional master data, i.e. warehouses, and transactions in the system. These enhancements provide improved visibility of an item's physical location, a more streamlined process of moving inventory in and out of the warehouse, and a more comprehensive warehouse management tool. The addition of the Warehouse Management module is a prerequisite of the planned implementation of handheld scanners and barcoding technology.
- During calendar year 2022 a pilot program to explore the centralization of the accounts payable process was under way. The intent of the program is to streamline, centralize, and automate the process through SAP Vendor Invoice Management (VIM), the Business Capture Center (BCC), and Business Center (BC). These improvements will leverage automated workflow for exception handling, approvals, and auditability, digitize and transform invoice ingestion, achieve long-term user and stakeholder adoption by driving change management, training, and communication activities, as well as help to set up data archiving for VIM objects by using SAP standard procedure. To fully centralize this function, additional personnel resources are needed. The City is

- currently evaluating budgetary additions for DoF to permanently centralize the accounts payable process.
- The City Treasurer's Office implemented a new application, Sympro, to replace the previous investments accounting software, SunGard, which is no longer supported. The transition to Sympro occurred in calendar year 2022 and was run in parallel with SunGard for a short period to ensure it was working as expected.
- DoF worked with IGM Technology Corporation and completed the implementation of Gravity, GASB 87 compliant cloud-based lease accounting software. During the implementation period, GASB 87 relevant lease data was entered into the system; amortization schedules, journals, and reports were created and validated; and the information was utilized to account and report on GASB 87 leases in the Fiscal Year 2022 ACFR.
- City Treasurer's Office implemented Accela for the application and renewal of Short-Term Rental licenses. The Accela system has been updated to automatically post required transactions to City's general ledger for fees associated with the Short-Term Rental program. Daily and monthly reconciliations are performed to ensure any discrepancies between Accela, general ledger, and the City's bank accounts are identified and resolved in a timely manner. In addition, the Short-Term Residential Occupancy module within Accela is accessed only by designated City Treasurer's staff that work directly in the program. Access to the module is only available upon request to the Development Services Department, who oversees the Accela system.

Along with system enhancements, it is important for the City to stay current with the versions of the software that are used on a day-to-day basis. These updates add new features, improve security, fix known issues, help protect integrity and confidentiality of data, and ensure the systems continue to be supported by the manufacturers.

Each year a review of the SAP landscape is conducted by DoIT's ERP Division. The review includes databases, SAP applications, supporting solutions, and the Linux and Windows infrastructure. This is done to ensure end-of-support deadlines are not breached and that the latest vendor provided fixes/patches and security controls are reviewed. This provides continued stability and ensures security and vendor support. During 2022, various modules of ERP were updated or upgraded to more current versions including the following: VIM for automated invoice processing, Budgeting and Planning for development of the City's annual budget, and GRC for risk identification and role provisioning. Scenarios based on test scripts intended to mimic real world situations were performed in the test environment in order to confirm the ERP system was working appropriately following the upgrade before implemented in the production system.

DoF staff did not find any significant deficiencies over ERP system related internal financial controls that could impact the financial statements. However, due to the interrelationship between SAP modules and third-party systems, there is a potential risk that changes to a module could impact others. There is also a potential risk that system errors are not identified through testing. To address these risks, the production changes are reviewed by a change control board before deployment and by affected BPCs after deployment. Any newly identified system errors are communicated for correction. Management identifies the significant financial risks that require additional monitoring.

Risks associated with system changes and SAP enhancements are also mitigated with training, feedback and question and answer workshops provided to end users before and after implementation. Additionally, users can access training videos which are readily available online via SuccessFactors, the City's learning management module. These training videos in SuccessFactors are also used in conjunction with the GRC Access Request Provisioning tool to automatically verify users have completed the appropriate training prior to being provisioned the related roles. Process documentation is also developed or updated as needed.

Information Technology Disaster Recovery Plans

The City contracted with a vendor to perform a Business Impact Analysis/Risk Assessment (BIA/RA) and to create a Disaster Recovery Plan (DRP) in order to identify risks to the organization, the impact to business operations and impact of the threats, as well as to offer recommendations for remediation to building organizational resilience with the capability of an effective response that safeguards the interests of the City's key stakeholders, reputation, brand, and value-creating activities.

The objectives of the BIA were to identify all business functions, including applications with a financial reporting relationship, assign each function a recovery time objective, identify applications supporting those functions, assign application criticality based on the functions, present findings and recommendations for areas of risk, and to identify upstream and downstream dependencies.

The DRPs provide guidance for re-establishing information technology services within the established recovery time and recovery point objectives to ensure minimal downtime and data loss. The plans are reviewed annually and designed to address how the City will prepare for and subsequently recover from any unplanned interruption to the production operating environment at each of the City's data centers.

Cybersecurity and Incident Response Plans

The City continues to have a very robust set of standards, guidelines, policies, and procedures for providing security, confidentiality, integrity, and accountability related to its information systems and/or assets. These include Administrative Regulations (A.R.s), end user training, Data Loss Prevention Guidelines and Standards, and Information Security Standards and Guidelines that are updated annually at a minimum.

The City also has an Incident Response Plan in order to respond quickly and in accordance with an agreed set of standards focusing on minimizing business impact, securing protected information, optimizing processes and procedures, building and retaining a detailed knowledge base, keeping responses to incidents inconspicuous, and ensuring best practices are being followed. As part of this plan, the City has established a Cybersecurity Incident Response Team (CIRT) consisting of individuals with the requisite skills to address security incidents.

During calendar year 2022, the City implemented the cloud-based data management tool, Rubrik, for cloud-based storage and disaster recovery, employed a Security Operations Center (SOC) to ensure after hours cybersecurity monitoring of the City's environment, performed simulated cyber security incident table-top exercises, conducted a vulnerability assessment as well as deployed additional tools and cyber awareness training to bolster protection from ransomware and malware.

During calendar year 2022, DoIT's ERP Division deployed several SAP provided patches across the SAP landscapes to correct the LOG4J Security Vulnerability within SAP Applications. The Log4j issue is a remote code execution vulnerability that allows attackers to drop malware or ransomware on a target system. This can lead to the compromise of a network and the theft of sensitive information, as well as the possibility of sabotage.

Risks Identified through Internal Audit Function

The City Auditor conducts an annual Citywide risk assessment in order to plan for audits based on the level of risk to the City. This is accomplished by identifying a scope of auditable units surveying management and analyzing management's response to formulate risk scores. From this risk assessment, an audit work plan is created outlining planned performance audits for a fiscal year.

Every three years, Generally Accepted Government Auditing Standards (GAGAS) require that audit organizations undergo an external audit called a "peer review." For the period of July 1, 2019 to June 30, 2022, the Association of Local Government Auditors completed the peer review for the City Auditor and recognized them for conducting exceptional and thorough Citywide risk assessments during the review period. The City Auditor received the highest passing rate with their work in full compliance with GAGAS.

In each performance audit, a variety of actions are taken by the City Auditor such as gaining an understanding of the process by obtaining and reviewing relevant background documents, identifying major threats, and understanding the mitigating controls that are in place to mitigate the threats. At the conclusion of an audit, the City Auditor will report the audit results which include findings and recommendations as it relates to the audit, and address this information to department management. While most audits focus on operations and performance, issues that may have an impact on accounting and financial reporting are sometimes identified. This may include risks to financial reporting, safeguarding of City assets, recommendations to enhance transparency, and issues affecting the internal control environment. DoF management participates in City Auditor audit entrance and exit meetings with City departments.

DoF also participates in the remediation of performance and hotline audits if the City Auditor directs departments to work with DoF's Internal Controls Section to document processes or strengthen internal controls.

The City Auditor conducts an annual performance audit of the Mission Bay and San Diego Regional Parks Improvement Fund to ensure compliance with the requirements of Charter Section 55.2. In calendar year 2022, while the City Auditor found that the Mission Bay and San Diego Regional Parks Improvement Funds' revenues, expenses, and improvements remained in substantial compliance, recommendations were made to help better manage the oversight of the lease properties on Mission Bay. The City Auditor found that Improvement Funds were significantly reduced due to the impact of lost revenue from the pandemic, which caused inadequate funding for capital improvements in Mission Bay and San Diego Regional Parks. The City Auditor also found that there was no invoice reconciliation support documentation attached to invoices for project expenditures in SAP and were not able to determine if charges were properly made to each project.

To replenish the Improvement Funds, the City Auditor recommended DoF present an option to compensate for lost revenue to the Mayor for consideration as part of the mid-year budget update. DoF discussed the option to replenish the Improvements Funds with the Chief Financial Officer and presented the option to the Chief Operating Officer and the Mayor for consideration of a fiscal year 2023 budget amendment. However, due to the current structural deficit projected for the General Fund in fiscal year 2024, American Rescue Plan Act of 2021 (ARPA) funds will continue to be used to replenish revenue lost in the General Fund and will not be used to replenish the Improvement Funds.

In calendar year 2022, DoF updated process narrative, PN-0010, *Purchase Order Invoices and Credit Memos,* to have all departments responsible for attaching supporting documentation to substantiate an invoice charge in SAP. DoF also updated process narrative, PN-0026, *Process Purchase Order Invoices and Credit Memos,* with the same requirement. The Internal Controls section reviewed the process narrative updates to ensure proper controls are in place and satisfy the City Auditor's recommendation.

In calendar year 2020, the City Auditor completed a series of performance audits of the City's Human Capital Management (HCM), evaluating how the City monitors and communicates core metrics of its workforce, and monitors and addresses employee performance issues. The City Auditor provided recommendations and improvements in the areas of compensation, employee performance reviews, and the City's rewards and recognition program to help the City better attract, develop, and retain competent employees to ensure high-quality services are provided to the public. To address the findings in the report, City management agreed to implement the recommendations which included creating a total compensation strategy or philosophy, improving the special salary adjustment process, and reviewing and monitoring the employee performance review process and the Rewards and Recognition Program. Management reviewed these reports and identified these as internal control deficiencies to the Control Environment component in the COSO management assessment template; however, management does not believe these are major deficiencies that would affect the City's system of internal controls.

In calendar year 2021, the City created the first Compensation Philosophy, approved, and signed by City Council in February 2022. The Compensation Philosophy aims to provide competitive, equitable and sustainable employee compensation in order to attract and retain highly qualified and high-performing employees. The Compensation Philosophy serves as a

guidance on how the City intends to approach compensation for City employees and is intended to be updated periodically, as needed, to remain consistent with the City's strategic objectives.

In addition to general salary increases provided in calendar year 2022, the City implemented special salary adjustments for several job classifications to address market competitiveness, and recruitment and retention issues. In calendar year 2021, the City, through agreements with the impacted REOs, restored the defined benefit pension plan for over 3,000 employees by allowing them to join the SDCERS due to the unwinding of Proposition B. This is further anticipated to improve employee recruitment and retention. The City Council amended the SDMC to allow new Officers and employees (except Police Recruits) hired after July 9, 2021 to participate in SDCERS. In calendar year 2022, the City Council approved the agreements reached with the impacted REOs to restore current eligible employees to SDCERS. The City is currently meeting and conferring with the impacted REOs to address the unwinding of Proposition B regarding former employees. In addition, the Human Resources Department updated A.R. 95.91– *Employee Rewards and Recognition Program.*

In calendar year 2022, HR published the first Workforce Report providing critical workforce data and analysis to City staff with actionable items based on data gathered from HR Performance dashboards and City Employee Sentiment surveys. HR continues to improve the employee experience by modernizing HR services, improving and increasing access to professional development opportunities, and streamlining rewards and recognition processes.

Lastly, the City is conducting a total compensation study for all City positions to determine competitiveness of City job compensation in relationship to public or private sector job positions.

COVID-19 Pandemic Risk

The COVID-19 pandemic changed the landscape of the work environment. Staff have adapted to working remotely or in a hybrid setting and have been able to produce financial reports for a third consecutive year. As employees have become more comfortable in a remote, or hybrid work environment where they split time between the office and home on a regular schedule, management faces a different set of risks with remote work. The same set of controls provided in an office setting such as physical supervisor oversight, private offices, and secured IT equipment may not be present at a home setting. This may lead to increased risk of financial data theft, time theft, cybercrime, or fraud. In a home environment, financial or confidential data may be more susceptible to theft from members living in the same household or from cyberattacks targeting unsecured networks or computer equipment without the latest security patches. The potential for increased employee isolation and lack of a physical supervisor may also open an opportunity for fraud or spending work hours on personal tasks, or even a second job, if employees perceive less oversight.

The City experienced a significant increase in turnover of positions during calendar year 2021 which continued into calendar year 2022. The City saw a budgeted vacancy rate of 17.3 percent as of December 1, 2022 compared to an average of 12.1 percent in the previous five years. Contributing to the high vacancy rate are the significant number of new positions added in the Fiscal Year 2023 Budget. The Fiscal Year 2023 Adopted Budget added over 800 positions,

representing an increase of about 6.5 percent compared to fiscal year 2022. It typically takes four to seven months to fill new positions. To the extent the City fills some of the new supervisory level positions with internal candidates by promoting from within the organization, vacancy levels are maintained even longer as vacancies at more junior levels in the organization are generated.

DoF, which is responsible for much of the City's financial statements, experienced vacancies similar to Citywide levels starting in calendar year 2021 but has since improved. As of December 1, 2022, DoF had 8.6 percent of budgeted positions vacant, a 37 percent drop from the prior year. The vacancies from last year were due to a combination of factors including key departures from management staff due to promotional opportunities inside and outside of the City, the addition of middle management positions that created vacancies in entry level positions after the promotional process was completed, and regular attrition. DoF has moved to quickly fill those positions and reduce the number of vacancies. However, the risk associated with onboarding and training a significant number of new staff remains.

The trend of employees resigning since the start of the pandemic has also been referred to as the "Great Resignation" or "Big Quit". According to the Bureau of Labor Statistics, quit levels reached a low of 2.1 million across the nation in April 2020, shortly after the start of the pandemic, when employees probably sought job stability. Figures returned to pre-pandemic levels in July 2020. Since that time, total resignations have surpassed 4.0 million in July 2021 and have remained above the 4.0 million level through October 2022.

The resignations may be due to the effects of the pandemic, inadequate pay or benefits, new opportunities elsewhere, or a mix. Nonetheless, employees are seeking opportunities elsewhere. The loss of trained and experienced staff can cause disruption through insufficient resources to enter, compile, analyze, review, and report on financial data until those vacancies are filled. During the hiring process, workload tends to be redistributed to remaining staff which adds even further strain from absorbing duties. If employees continue to leave, the length of time to fill all vacancies is extended. Current employees then must manage greater workloads for an extended time which could induce even more turnover. Even after a position is filled, additional time is needed to train employees on the City's financial processes and systems.

Management has assessed the risk of material misstatements from a remote or hybrid work environment, as well as protracted turnover and newly hired staff, and has implemented the controls later explained in the Control Activities section to mitigate the effects.

On March 27, 2020, the City received $248 million in federal direct payment from the Department of Treasury's Coronavirus Relief Fund (CRF), under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to use for COVID-19 related expenditures. Subsequently, the federal government passed the American Rescue Plan Act of 2021 (ARPA) in March 2021. This provided emergency funding for State, local, territorial, and Tribal governments in the form of Coronavirus State and Local Fiscal Recovery Funds (SLFRF). The City received two distributions of $149.9 million on June 1, 2021 and June 6, 2022. These programs are subject to the Single Audit Act regarding audit requirements that apply to any non-federal entity.

DoF and the Chief Compliance Officer have been tasked with working with departments to track, identify, review and approve eligible expenses to be reimbursed from the CRF and ARPA. Appointing Authorities from each department must certify that all expenses are allowable under the CARES Act and ARPA and maintain all applicable documentation. Agencies receiving federal funding also must meet reporting requirements. Without adequate controls to track and verify spending eligibility, the City could risk not complying with federal requirements. This may lead to the inability to use federal funding, and audit findings of inappropriate reporting. Management has implemented measures to mitigate these effects as discussed further in the Control Activities.

Grant Funding Risk

The City receives significant grants from other governments and organizations to support City programs and activities. Accepting grants come with specific requirements such as compliance, monitoring, and reporting. Starting in fiscal year 2019, the City experienced an increase in the number of grant applications submitted and the number of awards received.

In fiscal year 2022, the City submitted 100 grant applications at a combined value of $259.5 million, compared with 62 applications valued at $133.8 million in fiscal year 2019. In fiscal year 2022, the City received 59 grant awards with a combined value of $229.2 million, compared with 20 grant awards valued at $83.9 million in fiscal year 2019.

The acceptance of grants or the increase in grant awards introduces financial internal control risks. For example, responsibilities for grant oversight, monitoring, and awarding need to be defined, and strong communication among departments and the grantee and grantor should exist. Additionally, the risk increases if those responsible for grant oversight, monitoring and awarding are not productive, or misunderstand the relevant compliance requirements, and where to find them. An ineffective grant team causes increases in delayed or inaccurate financial reporting, non-compliance with audit regulations, fines, grant funds not being used for their intended purposes, and/or return of funds to the granting agency.

3. Control Activities

Control activities are the next step in response to risks identified through management's risk assessment. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines control activities as the actions established through policies and procedures that help ensure that management's directives to mitigate risks are carried out. In the preparation of financial reports for external use, these are the policies and procedures, with embedded controls, that management develops and implements to mitigate risks of errors and omissions that could affect the reliability of the information presented in the reports. It also includes controls embedded within the City's Enterprise Resource Planning (ERP) system.

Budgetary Control

The City of San Diego (City) adopts an annual budget authorizing the expenditure of funds based on current financial resources. Budgetary control and monitoring are fundamental elements of a government's system of internal controls.

In accordance with budgeting best practices, the City maintains a Budget Policy, Council Policy 000-02, to guide the development and monitoring of the City's annual operating and capital budget, as recommended by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB).

Through the budget preparation process, management estimates annual revenues, providing a basis for evaluating actual revenue as it is recorded during the fiscal year. Similarly, expenditures are monitored against those expenditure levels authorized in the budget. For the City, budgetary control is exercised at the department level for the General Fund and at the fund level for all other budgeted funds. In addition, the budget authorized for personnel expenditures (salaries, wages, and fringe benefits) for a fund or department may not be used for non-personnel expenditures. The City's financial system incorporates embedded controls in which non-personnel expenditures cannot be incurred if a budget appropriation is not available. The City also uses an encumbrance system of accounting as a mechanism to accomplish effective budgetary control. The budget and accounting structure that SAP maintains for expenditure control has the added benefit of ensuring that expenditures are properly categorized in the Annual Comprehensive Financial Report (ACFR) by function.

Transaction Control Activities

The implementation of SAP provides the foundation for a well-designed internal control framework. SAP allows internal controls to be embedded in the system through restricted access, segregation of duties, and authorization workflows. These controls allow for review, validation, and approval of transactions, not only mitigating the risk of fraud but also preventing transaction errors or instances of non-compliance with laws and regulations.

The majority of user interactions within SAP occur in various departments as they perform their core responsibilities. Often transaction workflows are processed across multiple departments in order to properly segregate duties and mitigate the risk of fraud. For example, the Department of Finance (DoF) processes employee payroll, but only the Personnel department can change an employee's hourly compensation rate in SAP. Other transactions include vendor payments, generation of City invoices, cash deposits, payroll transactions, and journal entries, most of which segregate the creator of the transaction from the approver. These interactions make their way into the financial system either through direct input or through some type of interface application. The City's financial activity is consolidated with similar types of activities and is eventually presented in the ACFR and other financial reports.

Over the years, the City has implemented a variety of control activities over financial transactions. Where automated controls are not available, manual controls are used. These control activities ensure that the financial information is complete, accurate and valid. Below are some of the control activities embedded in the City's multiple accounting and financial reporting processes:

- **Authorizations and Approvals:** Affirming that a transaction is valid, such as the approval of a journal entry or an invoice payment.
- **Verifications:** Comparing two or more items with each other, such as comparing goods received against a purchase order.

- **Physical Controls:** Controls that prevent or detect unauthorized access to physical assets, such as storing cash or fixed assets in a secure environment.
- **Reconciliations:** Comparing two data elements and taking action when differences are identified to bring the data into agreement, such as reconciling bank accounts to the general ledger.
- **Supervisory Controls:** Assessing whether other transaction control activities are being performed completely, accurately and in accordance with policy.
- **Application Controls:** Controls related to procedures to check the accuracy of the output data, including follow-up on exceptions. The functional analysts in the Department of Information Technology (DoIT) and the Business Process Coordinators (BPCs) in City departments validate and approve any functional changes in the SAP system. Security related changes are also reviewed by DoF's Internal Controls Section. DoIT's Control Change Board reviews documentation, testing, and approvals before implementing changes in production.

Internal Controls Section

The Internal Controls Section of DoF provides dedicated staff focused on maintaining and enhancing the City's control environment. The Internal Controls Section is involved with the implementation or monitoring of new software and reviews the system implementation for process gaps, control weaknesses, segregation of duties, system access, data transfer to SAP, and the development of process narrative documentation. The Internal Controls Section also manages and oversees post-monitoring reviews that are designed to enhance a process' internal financial control and ensures that reviews are performed in a timely manner as described in the Monitoring Activities section. Some of these monitoring programs are results of audit findings and recommendations management agreed to perform to prevent occurrences of fraud, misuse, or abuse.

Control Activities Deployed through Policies and Procedures

Management incorporates controls into financial reporting activities by establishing clear accounting policies and developing and implementing accounting procedures. Policies reflect management's statements of what should be done, guiding the actions of staff. Procedures consist of actions that implement a policy. Having policies, procedures and controls is key to preventing and detecting material errors and fraud. It is essential that policies are current, formally documented, and easily accessible to all employees. The following list highlights core policies that drive prudent fiscal planning and actions.

- **Accounting Policies**: The City's ACFR Note 1, *Summary of Significant Accounting Policies (SOSAP)*, summarizes the City's accounting policies that conform to generally accepted accounting principles. Note 1 summarizes significant accounting policies in the areas of financial reporting including Government-wide and Fund Financial Statements, Cash and Investments, Capital Assets, Long-Term Liabilities, Reserves, and more. Note 1 also lists the new governmental accounting standards implemented during year-end and upcoming governmental accounting standards. In fiscal year 2022, Note 1 was updated with a detailed disclosure of the lease policies adopted as a result of the Governmental Accounting Standards Board Statement No. 87, *Leases* (GASB 87) implementation, including a description of the measurement and reporting of lease assets and liabilities and key estimates and judgments.

- **Materiality Policy:** DoF maintains a formally documented materiality policy that establishes materiality guidelines for the preparation and review of financial transactions included in the City's ACFR. The policy establishes quantitative materiality thresholds and requires additional levels of review and approval for complex high-risk accounting transactions or other qualitative factors.
- **Investment Policy:** The investment activities for the City Treasurer's Pooled Investment fund are governed by the City Treasurer's Investment Policy, which is based on California Government Code §53601 with additional constraints added by staff. The Investment Policy is reviewed by the Investments team, the City Treasurer, the City Treasurer's Investment Advisory Committee, and then presented annually to the City Council for approval. The Investment Policy for calendar year 2023 was adopted by City Council in November 2022 and is posted on the City Treasurer's website.
- **Debt Policy:** The City adopted a Debt Policy in November 2007. The Policy documents the procedures and goals for the use of various debt instruments to finance City needs and the sound management of existing debt obligations. A biennial review of the Debt Policy is performed, and changes are forwarded to City Council for consideration and approval. A revised policy was adopted by City Council in June 2021 and is posted on the City's Debt Management website.
- **Reserve Policy:** The City adopted a Reserve Policy, Council Policy 100-20, in October 2002, which was last amended by City Council in December 2022. The Policy documents the City's approach to establishing and maintaining strong reserves across the spectrum of City operations, including General Fund, risk management and enterprise operations. These reserves help provide for strong fiscal management and mitigate financial risk.
- **User Fees Policy**: User fees are charged for services provided to residents and businesses in the City as a result of public need. Abiding by the standards and best practice guidelines established by GFOA and NACSLB, the City has formed a User Fees Policy, Council Policy 100-05, to identify factors to be considered in calculating the full cost of services in order to appropriately set fees. In calendar year 2022, DoF completed the Fiscal Year 2023 Comprehensive User Fee Study. The City Council approved updates to Council Policy 100-05 in December 2022, and DoF is in the process of making corresponding updates to the Administrative Regulation (A.R.) 95.25 to incorporate the City Auditor recommendations from the internal audit of the City's General Fund User Fees.

These policies, in combination with the Budget Policy, Council Policy 000-02, lower the financial risk and help the City maintain compliance with laws and regulations which could materially affect reporting of liabilities.

In 2016, the Human Resources department initiated Citywide efforts to update existing A.R.s and Department Instructions (D.I.s) as an additional method to strengthen the control environment. The City's effort to update all A.R.s began with the revision of A.R. 1.00– *Administrative Regulation and Department Instruction Preparation Procedures,* which added the involvement of the Internal Controls Section to all future revisions of A.R.s or D.I.s. This effort continued in 2019, with the responsibility transferred to the Deputy Chief Operating Officers for their respective departments for greater oversight. The A.R.s and D.I.s direct administrative

policies and procedures of a continuing nature, as it is important that policies as documented reflect the actual processes.

The City currently has over 100 documented A.R.s. The majority of these have been created or revised since the Citywide effort was initiated in 2016. During calendar year 2022, three A.R.s were created or revised, including A.R. 95.95–*Telework Program*, A.R. 30.20–*Motive Equipment Replacement Policy,* and A.R. 95.21–*Responding to California Public Records Act Requests.* A further discussion of the Telework Program is included in the COVID-19 Pandemic Response section below.

The Internal Controls Section reviews and approves policies and procedures included in the A.R.s to ensure internal finance controls exist to mitigate risks and improve efficiency. Published A.R.s are utilized as a guide and standard in ensuring that City processes comply to the stated requirements. Though it is an ongoing effort, the Internal Controls Section ensures that if policies and procedures have been added or revised, control activities are also modified to enhance the current process and continued compliance.

DoF continues to focus on formally documenting policies and procedures, such as process narratives and work instructions, related to accounting and financial reporting. Most of these policies and procedures have been long-standing practice and are consistently applied each fiscal year. Formal documentation allows the City to have an inventory of procedures and related controls that can be systematically monitored for effectiveness and continued relevance. DoF has formally documented 795 processes and continuously assesses the need for further documentation. In calendar year 2022, DoF documented 28 processes and will continue efforts in the current year.

The Office of the City Treasurer annually reviews their Investment Division's Internal Controls Manual, which outlines the specific operational procedures the Investment Division staff use in implementing the City's Investment Policy. The Investment Division Internal Controls Manual highlights the key control points implemented in their processes.

COVID-19 Pandemic Response

During the COVID-19 pandemic, management maintained adequate controls to recruit, manage, and retain competent employees that are responsible for financial reporting. Elevated resignation and vacancy levels Citywide, if unaddressed, may result in incomplete or inaccurate review of financial transactions for financial statements. The City has controls in place to address employee turnover. Normally, attrition exists with any organization and procedures are established to quickly hire and onboard employees. The City also has established hiring and short-term staffing procedures to deal with standard attrition. For example, the City maintains hiring lists of qualified candidates for classified positions, which are the majority of City positions, that can be requested at any time for interviews. While hiring is performed, the duties of the vacant positions can be temporarily completed by another employee. This process is also known as an Out-of-Class assignment and detailed in the City's Personnel Manual. Other activities such as reclassification of jobs or special pay adjustments for jobs that show constant turnover are some mechanisms management uses to address turnover. However, to mitigate the risk of financial reporting misstatements especially during

periods of persistent turnover such as one the City faces from the pandemic, management must maintain additional controls to complete objectives.

One such example is to review documentation on business processes and procedures. Documentation can include work instructions, standard operating procedures, or process narratives. It serves a number of different functions, such as acting as a repository of information, especially from staff with decades of experience and institutional knowledge. It can be used as a training tool for new staff or existing staff that transition responsibilities and provides uniform standards on how to perform a task, such as recording expenditures with a journal entry. Documentation can even prevent or resolve differences between employees who have developed different procedures to perform a certain task.

Retaining current employees is also a critical focus to alleviate the strain on existing staff. In 2022, the City finalized and implemented "telework" and flexible schedule policies via a new Administrative Regulation, A.R. 95.95–*Telework Program*. The new A.R. defines guidelines, requirements, and procedures for employees seeking this option. Controls include the following: obtaining department approval for continued telework, complying with all City policies and regulations including information security requirements, sharing contact information, responding to requests within a timely manner, continuing to meet performance expectations, and maintaining an adequate remote worksite. Management recognizes the benefits to employee productivity and job satisfaction by allowing this option, especially as other employers start adopting this benefit. The City can maintain competitiveness in attracting and retaining employees as this trend becomes more widespread.

Telework must be subject to management approval which also allows management to reduce the risk of unproductive remote employees, abuse of the program, or interference with operations. In addition to the policy, employees and their supervisor must have the work schedule, work duties and objectives, identification of confidential data, and telework equipment identified and discussed prior to beginning telework. This facilitates a smooth transition into a remote work environment by setting expectations and goals and determining readiness. The relaxed physical supervisor oversight can be mitigated by the employee meeting key performance indicators or goals that are discussed and monitored by the employee and supervisor.

Management has expanded the City's internship program through State funding. The goal is to provide 1,000 local youth with paid internships and work for training opportunities. Interns not only provide additional resources for departments with vacancies, but also create a pipeline for a future workforce. Furthermore, management has expanded the City's mentorship program in 2022, providing more opportunities to employees for training, development, and recognition.

With the influx of federal stimulus money for COVID-19 relief efforts, implementing adequate controls provides management assurance that expenditures comply with eligible spending requirements, and reporting requirements meet regulatory and financial accounting standards. Starting with the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) eligible expenses, management developed procedures to collect, review, and report on the data. The major control activities implemented were the following:

- Creating a tracking mechanism for departments to associate all CARES Act spending.
- Setting up a dedicated fund to separate expenditures and revenues from other funds.
- Understanding the federal and regulatory guidance for spending eligibility and reporting.
- Communicating information to departments via a memorandum and instructions posted on the City's intranet.
- Establishing roles and responsibility to manage the process and ensure compliance.
- Creating a process to collect expenditure data with a standardized template.
- Reviewing expenditures for compliance with eligibility requirements using a formal approval process.
- Maintaining appropriate backup documentation.

The City's external independent auditor, Macias Gini & O'Connell LLP, audited CARES Act spending under the Single Audit for fiscal year 2021 and did not have any findings. The Single Audit is an annual audit encompassing both financial and compliance components and is required of the City as a condition of receiving federal funds.

Based on the assurances achieved from the controls in CARES Act spending, and a clean audit opinion from the most recent Single Audit, management has implemented the same set of controls for the American Rescue Plan Act of 2021 (ARPA) spending.

Grant Funding Control Activities

The City has established A.R. 1.80–*Grant Application Approval,* Management Procedures, and the Grants Manual for all City staff. The Grant Review Team consists of the Chief Operating Officer, Deputy Chief Operating Officers, and DoF, who reviews and approves all grant applications. Once approval is granted, the administering departments can proceed with submitting the grant application.

The DoF Grant Finance Analyst monitors grant operating budgets for each grant on a regular basis to ensure compliance with grant agreements and identified errors are addressed promptly. Per A.R. 1.80, all financial documents (reimbursement claims, invoices, federal financial reports, etc.) must be reviewed and approved by DoF prior to submission to the granting agency.

Administering Departments are responsible for expenditure monitoring to ensure all expenditures are allowable and adequately documented; cost sharing or match requirement is identified and performed; compliance requirements are followed; and all reporting requirements–programmatic and financial are met.

DoF provides grant accounting and management training semiannually at the Finance Academy and conducts as-needed training to administering departments and grant administrators. To properly address the significant increase in grant funding, DoF added two supplemental grant Finance Analyst positions and will request funding for these positions in the Fiscal Year 2024 Proposed Budget. Additionally, the Compliance department will also request additional staff to provide administrative support to some of the smaller City departments that do not currently have the background and expertise to successfully administer new grants.

4. Information and Communication

The Information and Communication component of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework supports the functioning of all components of internal control. COSO defines communication as the continual iterative process of providing, sharing and obtaining necessary information. In an organization as large as the City of San Diego (City), it is critical that management establishes effective communication procedures to meet accounting and disclosure requirements under governmental accounting standards and under state and federal securities laws.

Formal Communication Processes

The City has formal communication processes to ensure relevant information is communicated effectively to those responsible for preparing the Annual Comprehensive Financial Report (ACFR). The Disclosure Practices Working Group (DPWG) includes individuals in key City positions within the City and external counsel that can review disclosures, communicate known facts and other relevant information, and ensure consistency throughout the City's financial disclosure documents. DPWG has formal disclosure controls and procedures that define roles and responsibilities over the development and review of financial disclosures. These controls and procedures require that the City's Chief Financial Officer certify to the City Council that the City's financial statements included in ACFR are fairly presented and that disclosures are true and complete. Similarly, department directors are required to also certify that contributions made by their staff are accurate and complete.

While DPWG is responsible for ensuring that disclosures comply with federal and state securities laws, Department of Finance (DoF) is responsible for ensuring financial statements and related disclosures are prepared in accordance with generally accepted accounting principles (GAAP). DoF relies on a formal distribution of work document that clearly communicates specific responsibilities for development of the ACFR, including who is responsible for preparing and reviewing the relevant sections of the report. During the preparation of the Fiscal Year 2022 ACFR, DPWG participated in the review of the report drafts. DPWG reviewed and signed off on the disclosures included in the ACFR, including the Letter of Transmittal, Management's Discussion and Analysis, and Notes to the Basic Financial Statements.

DPWG ensures the City's financial disclosures related to the public offering and sale of securities is accurate. The City prepares a Preliminary Official Statement (POS) that contains all material information provided to investors to help determine whether to purchase securities offered by the City. It is later referred to as an Official Statement once the security is sold. DPWG reviews the statements before City Council approval of a public debt issuance and its related disclosure document. The City also conducts presentations with ratings agencies prior to marketing new securities. DPWG is required to review all materials that the City presents to credit rating agencies and investors.

Pursuant to §22.4107 of the City of San Diego Municipal Code (SDMC), DPWG is required to provide an annual report of the City's disclosure controls and procedures and activities of DPWG in the past calendar year. The results of DPWG's work and findings are to be presented to the City Council by January 31 of each year formally communicating any deficiencies. DPWG

reviews and revises its Disclosure Controls and Procedures (Controls) periodically to ensure DPWG meets the legal and operational requirements of the City. The Controls were last revised in May 2021 and significant revisions were made to ensure that they accurately reflect actual practice. DPWG will review and update the Controls in 2023, as necessary.

During the audits of the ACFR and other financial reports, the external audit firm requests a broad range of supporting documents. The multiple items requested are managed through a master pending list. This allows for effective communication with the external auditor, as items are clearly assigned to relevant staff and tracked by management throughout the audit process. DoF uses a financial statement checklist to assist in the preparation and review of the fund level financial statements. This helps to communicate expectations and ensures that statements are complete and accurate, and allows supervisors to review the work of staff against a standard set of expectations. In addition, DoF relies on a comprehensive accounting and disclosure checklist developed by the Government Finance Officers Association (GFOA). Each question in the checklist is assigned to a staff member within DoF based on area of responsibility. This allows for a clear and objective way to ensure compliance with existing governmental accounting standards.

Financial Reporting Tools

DoF continues to work with the Department of Information Technology (DoIT) to develop and implement new financial reporting tools through business intelligence (BI) reporting software that allows users to perform ad-hoc queries and efficiently access financial data stored in SAP. Information is useful when it is timely, accurate, and appropriate to the user. The following reporting tools were developed and published or modified by DoIT and finance branch departments in calendar year 2022:

- The Vendor Bank Account Change Report was created to monitor changes to vendor's electronic banking information in SAP. The report provides various details regarding the initiator, approver, and change dates. The report is used in the Vendor Automated Clearing House (ACH) Verification monitoring test to ensure appropriate controls are followed and segregation of duties is observed.
- The FMBB (Budget Adjustment) Audit Report was created to monitor budget adjustments posted in the system for segregation of duties violations, backdated transactions, and outstanding pre-posted budget documents. The report provides the document number, owner, and current status for an analyst to follow up on and remediate.
- The Open Invoice Report was modified to allow staff to easily filter accounts receivables invoices based on account status, aging bucket, and account determination.
- DoIT transitioned to new IT services contracts and centralized metrics for IT services into a single system. The new dashboard contains key metrics consolidated from over 250 contract service-level agreements the department monitors for CGI and Zensar, the City's Application Development and Maintenance Services contractors. The metrics reflect contract performance and will be used alongside Citywide IT service surveys that will be released in early 2023 to assess IT services and drive continuous service improvements.

- Purchasing and Contracting implemented an enhancement to make contracts more accessible to all departments including contract administrators. All City staff with Ariba access can now view vendor contracts to refer to the contract duration, amount, terms, and supporting documentation. Though all City staff with Ariba access can now view contracts, staff will only be able to edit the contracts with the necessary additional access, ensuring proper controls. This enhancement allows for better monitoring of contract spending and satisfies an audit recommendation from the Performance Audit on Citywide Contract Oversight.
- DoF worked with CGI to ensure historical data is available from its legacy systems by converting them to more current infrastructure. These changes included converting applications from an Oracle database, as well as updating from SQL Server 2012 to SQL Server 2019. These systems include the CAPPs Web Database, SSRS ePay Reports, and Simpler Financials. Each of these contain historical financial information that must be retained per the department's retention policy. Without these efforts it is possible this data could be lost, breached, or made unavailable due to unsupported applications or outdated technology.

In addition to the aforementioned reports, multiple reporting tools were developed for specific departments or programs within the City during calendar year 2022. These reporting tools are developed to meet the needs of the individual department or program rather than the City as a whole. Approximately 38 different reports were either created or modified during this time for various purposes including infrastructure asset management, supply chain management, human capital management, and finance.

Many SAP related initiatives were completed by DoIT in calendar year 2022, including 13 SAP training videos and approximately 8,354 SAP training instances including classroom and online classes.

Financial Training

DoF coordinates two Citywide financial training classes, a one-day class designed for newer City employees called Finance Orientation, and a multi-day class designed for experienced employees called Finance Academy. Beginning 2020, the two classes transitioned to a virtual training allowing employees to continue attending while minimizing exposure to COVID-19 in the workplace. Subject matter experts representing various departments collaborated on these accelerated learning programs to strengthen core financial competencies of key individuals through a variety of lessons. Each topic focused on the latest government practices and processes in place to strengthen internal controls and improve financial reporting for the City. Additionally, DoF provides other annual financial training, on topics such as disbursements and budgeting, to other City departments to keep staff current on the latest procedures.

5. Monitoring Activities

An effective internal control program requires continuous evaluation of each of the five Committee of Sponsoring Organizations of the Treadway Commission (COSO) components to ensure that they are functioning effectively. This includes assessing whether risks are identified timely, and control activities address identified risks. Management should evaluate whether controls are performed completely, accurately and in accordance with policy. It also

includes assessing whether information is communicated effectively to ensure disclosures are accurate and complete and that accounting policies and procedures are clearly understood by relevant staff.

Review of Independent Audits

As part of its monitoring activities, the Department of Finance (DoF) reviews the results of independent audits to identify potential areas of risk or areas for which controls need to be strengthened. External auditors are required by Governmental Auditing Standards to communicate to the appropriate governing body any material adjustments identified through the audit of the City of San Diego's (City's) financial statements. For the audit of the Fiscal Year 2022 Annual Comprehensive Financial Report (ACFR), no material adjustments were identified by the external auditors. In addition, no material weaknesses or significant deficiencies in internal control over financial reporting were identified in the *Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards* dated December 28, 2022 (see Attachment 4). The audit of the financial statements is not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. However, the audit process does require significant interaction between the audit team and management with a sustained communication effort throughout the process that allows for effective monitoring of controls over accounting and financial reporting.

DoF also conducts an internal review of the preparation and completion of the ACFR to identify entries that occurred after the draft was submitted to the external auditor. This allows DoF to identify potential areas of risk and implement controls to continuously improve the ACFR preparation process.

DoF's Internal Controls Section reviews and monitors the results of audits performed by the City Auditor that directly or indirectly impact the financial reporting functionality and IT role access of the City. The Internal Controls Section monitors recommendations that impact internal controls and works closely with departments, as needed, to document or modify business processes, establish new controls, and strengthen existing controls. The audits are tracked to ensure that new or existing processes are documented and updated, respectively, and for timely remediation of internal control deficiencies.

Monitoring through Government Finance Officers Association (GFOA) Certificate Process

During calendar year 2022, the City received the Certificate of Achievement for Excellence in Financial Reporting awarded by the GFOA for the Fiscal Year 2021 ACFR. To receive this award, the City must comply with a comprehensive checklist that incorporates accounting and disclosure requirements in accordance with generally accepted accounting principles (GAAP). Comments received from GFOA on the submittal of the ACFR also serve as a monitoring tool to ensure controls are effective. If GFOA identifies significant deficiencies in the report, they disqualify it from the Certificate of Achievement for Excellence in Financial Reporting award. The review of the Fiscal Year 2021 ACFR resulted in ten comments and suggestions for improvements on presentation. The City responded to all comments and suggestions and

incorporated the changes in the Fiscal Year 2022 ACFR. The City anticipates receiving the award for the Fiscal Year 2022 ACFR.

The City was awarded certificates for its budget document: the Distinguished Budget Presentation Award (Budget Award) for exemplary budgeting practices by GFOA for the City's Fiscal Year 2022 Adopted Budget and the California Society of Municipal Finance Officer's Operating and Capital Budget Excellence Awards. The Distinguished Budget Presentation Award program was established in 1984 to assist state and local governments in preparing budget documents of the highest quality that reflect both the guidelines established by the National Advisory Council on State and Local Budgeting (NACSLB) and GFOA's best practices on budgeting, and to individually recognize governmental entities that succeed in achieving that goal. Reviews are conducted by selected members of GFOA professional staff and by outside reviewers with experience in public-sector budgeting, and feedback and comments received by the City are used to improve future year budgets.

Segregation of Duties Monitoring

DoF continues to monitor for segregation of duties to ensure that no one individual has control over an entire process or multiple components of a process, which if abused, could cause harm to the City or result in misstatements in the financial statements. Due to the importance of maintaining controls around segregation of duties, continuous monitoring is performed. To assist users in selecting the proper roles and avoiding possible segregation of duty violations, DoF and the Department of Information Technology (DoIT) have continued the annual review and update of a Role Definition Guide. The Role Definition Guide identifies and defines all available SAP roles and lists possible segregation of duty violations. DoF works with the appropriate business process coordinators in departments to ensure the information is correct and updated. The City also performs an annual user access review of all roles provisioned to City staff to ensure they are still appropriate. The review is meant to remove roles that should no longer be assigned to users that transferred departments or changed positions.

In calendar year 2022, the Public Utilities Department (PUD) merged supply chain and Environmental Monitoring & Technical Services (EMTS) roles into a single set of composite roles. These changes incorporated additional segregation of duties such as limiting Store Keepers from both creating and approving their own physical inventory documents. Also, a new Store Keeper III role was created that can process goods movements and approve physical inventory documents; however, this role is not able to initiate or count those documents. Additionally, a new Supply Chain Manager composite role has been created that can process physical inventory differences, approve purchase requisitions, and approve master data governance change requests while the new Material Requirements Planning (MRP) Controller composite role can manage MRP processes and initiate purchase requisitions. Finally, all single roles are specific to the employee's department that will limit their access to PUD related data.

The Internal Controls Section reviews and assesses existing and new risks that are introduced to the City's processes, along with the mitigating controls that are in place, and updates the information in Governance. Risk, and Compliance (GRC) when deemed appropriate.

DoIT also continues to deploy the Business Role Management concept to a majority of the business processes within the GRC Access Request Provisioning tool. This approach allows users to request the necessary roles based on the specific business processes that they are responsible for and requires multiple approvals from the user's manager, Internal Controls, and the security team. The Internal Controls Section also provides independent monitoring of privileged user activities to assess whether these accounts are sufficiently controlled and comply with DoIT's policies and procedures. In these cases, Internal Controls must first approve the request from the security team, and then conduct a review of the privileged user activity log to confirm usage was limited to approved tasks.

Assessment of Documented Processes and Controls

A key part of maintaining a strong internal control system is the periodic evaluation and monitoring of processes and their embedded controls. Process and control design assessments have been developed in the GRC module with the objective of testing the validity, accuracy, and performance of the process as documented and to test the presence and performance of controls identified in the process.

The Internal Controls Section uses a risk-based approach to prioritize and select process documentations for the periodic assessments. Under this approach, the risk of a material misstatement occurring in the financial statement within a documented process is assessed by measuring its inherent and control risk. Inherent risk refers to the susceptibility of an account balance or class of transactions to material misstatement before consideration of any related controls. Control risk refers to the risk that the system of internal controls will fail to prevent or detect material misstatements on a timely basis by the controls described in the process documentation.

In calendar year 2022, the Internal Controls Section delivered the selected process and control design assessments within GRC to respective process owners of significant processes with financial reporting impacts. The Internal Controls Section reviewed responses provided in the completed assessments to identify process documentation in need of updates and notified process owners of the responsibility to perform the necessary revisions in a timely manner. As processes may pertain to more than one department or personnel, it is critical that process documents are timely updated and re-uploaded to the City's intranet, CityNet, for all City employees to access.

In addition to the assessments, notification is sent annually to all process owners and their supervisors, Appointing Authorities, and Directors reminding them of each department's responsibility for reviewing their process narrative(s) on a regular basis to ensure the validity and accuracy of the processes and controls documented. As a result of the assessments and process owner-initiated changes, over 41 process narratives received major revisions to the documented process and related controls and 104 had minor updates, such as a change to the listed process owner or minor updates to the process, attachments, or formatting.

The processes and procedures related to Governmental Accounting Standards Board Statement No. 87, *Leases* (GASB 87) require detailed documentation. DoF is currently working on writing those procedures. Once the documentation is completed, the Internal Controls Section will evaluate for completeness and control risk.

Ongoing Monitoring

DoF periodically evaluates the effectiveness of controls of transactional activities that are deemed significant by management. Monitoring of controls also includes considering whether the controls are operating as intended and that they are revised as appropriate for changes in the organization. Numerous post-processing transactional monitoring activities have been established over the past few years. The following summarizes each monitoring activity:

Procurement Card Program (P-Card): The Internal Controls Section developed a formal methodology for selecting departments, P- Card holders and transactions to review. At the beginning of each fiscal year, a review test cycle is created based on established criteria to ensure that all departments are reviewed at least once per fiscal year. The Internal Controls Section also primarily focuses on capturing the new P-Card holders who have not been tested, if applicable. On a monthly basis, the Internal Controls Section selects transactions to review and schedules a manual test in GRC. Areas that are considered high-risk are reviewed more than once in a year. Under the supervision of the P-Card Administrator, the Assistant P-Card Administrator reviews these transactions for proper authorization, completeness, accuracy, validity, and compliance to ensure that the P-Card holders adhere to the City's policies and procedures. The Internal Controls Section monitors for timely completion of the review. Findings are recorded in a summary log and provided to the P-Card Administrator monthly. Corrective actions are taken by the P-Card Administrator when findings are identified.

Aging Goods Receipts: DoF developed and updated procedures for departments to review aging Goods Receipts (GR) without a corresponding invoice, or the GR and Invoice Receipts quantities do not match. If left unaddressed, this can result in expenses that are overstated or understated leading to inaccurate financial reporting in the City's financial statements. Beginning in June 2020, DoF started conducting monthly reviews of outstanding GRs and communications are sent to the departments to review and reverse any GRs that are no longer needed. A count of outstanding GRs is also sent to department managers on a monthly basis to provide better visibility and oversight.

Grant Accounts Receivable Invoices: The Internal Controls Section developed a monitoring test to review grant related accounts receivable (AR) invoices for segregation of duties violations. DoF identified a segregation of duties issue that allows certain users to both create and post grant AR invoices. As grant administrators are in multiple departments, removing the roles would negatively impact these administrators and prevent them from continuing their job responsibilities. This detective test is performed on a monthly basis to determine if users who posted AR grant customer invoices and customer credit memos have committed a segregation of duties violation. The monitoring review provides reasonable assurance that invoices posted in SAP are in compliance with City's policies and procedures.

Journal Entries: The Internal Controls Section developed a monitoring test to review journal entries for segregation of duties violations. DoF finance analysts are given access to submit and post journal entries to record financial transactions in the system. Finance analysts assist in reviewing and posting submitted journal entries made by departments Citywide. Finance analysts may need to submit journal entries for a department, but reviewing and posting journal entries should be delegated to another department finance analyst. Submitting and posting by one City employee is a violation of segregation of duties and creates a potential for financial misstatements and/or fraud. The monitoring test is designed so that a supervising finance analyst reviews the finance analyst's journal entries to ensure that the City has proper internal controls over the submission and posting of journal entries. Another separate supervising monitoring test is designed to review the supervising finance analyst's journal entries to ensure proper internal controls over submission and posting of journal entries.

Travel and Tuition Reimbursements: The Internal Controls Section developed a monitoring test for travel and tuition reimbursements. A random selection of travel and tuition reimbursements are chosen to maintain impartiality. The sampling methodology also considers testing the majority of departments at least once within the calendar year. A tracking log is created each calendar year and accompanies the monitoring test to help the Internal Controls Section achieve this objective. Every two pay periods, the test is performed to review for accuracy, completeness, proper authorization, validity, and cutoff (reimbursements were made in the pay periods being reviewed). The monitoring review provides assurance that reimbursements comply and adhere to City's policies and procedures.

Jury Duty Leave: The Internal Controls Section developed a monitoring test with the objective of strengthening monitoring over paid time off for jury duty and ensuring compliance with the City's policies and procedures. The test is scheduled and performed every two pay periods and City employees are randomly selected. DoF performs a review for accuracy, completeness, proper authorization, validity, and compliance with the Personnel Manual. The Internal Controls Section schedules a manual test in the SAP GRC module and monitors for timely completion of the review. Corrective actions by the Payroll Section of DoF are taken when findings are identified.

Accounts Payable Vendor Invoice Management (VIM): The Internal Controls Section developed a daily monitoring review of invoices passing through the VIM system to ensure accuracy and compliance with the City's Accounts Payable procedures. The Internal Controls Section is responsible for obtaining a list of purchase order invoices that were posted daily in VIM and selecting invoices for review using a risk-based sampling methodology. The selections are forwarded to the Disbursement Section in DoF to conduct the review prior to the daily payment run.

Vendor Automated Clearing House (ACH) Verification: The Internal Controls Section developed a quarterly monitoring review of changes to vendor's electronic banking information in SAP due to the increased fraud attempts involving electronic banking changes as a result of the pandemic. The Internal Controls Section randomly selects a sample of vendors that have either been created or had their banking information changed and reviews the supporting documentation for accuracy, completeness, proper authorization, validity, and compliance with the documented process. Issues identified are reported to the Disbursement Section in DoF to conduct a follow-up review when necessary.

Purchasing & Contracting (P&C): The Internal Controls Section developed manual and semi-automated monitoring tests in GRC with the objective of improving monitoring, compliance, and contract surveillance of Citywide contracts with the assistance of P&C. On a monthly and quarterly basis, the Internal Controls Section is responsible for scheduling monitoring for P&C to conduct the review, based on a formal methodology and control focus. The purpose of these monitoring reviews is to ensure threshold limits are not bypassed by the splitting of purchase orders and that engaged vendors are licensed to perform business within the City. SAP is utilized to pull data, and if applicable, deficiencies are flagged for review.

Accounts Receivable Customer Credits: The Accounts Receivable section of the City Treasurer's Office performs a post process review for the open credits on customer contract accounts. These credits represent liabilities to the City until they are associated with an invoice/receivable and recorded as revenue. These amounts may also be refunded to the customer if they cannot be associated with a given invoice/receivable or are the result of an overpayment. The supervising accountant creates the report in SAP on a monthly basis and then reviews the outstanding credit list items. They further work with the appropriate departments to identify the applicable invoice/receivable and revenue account. The report is distributed to the Accounting Program Manager and Deputy Director to provide management with a monthly status of open credit items. This monitoring is to help ensure these credit amounts are recorded as revenue against invoices/receivables or are refunded to the customer on a timely basis.

Conclusion

The City of San Diego (City) has established a high bar for the development of a comprehensive internal control program for a municipal government. Based on management's evaluation, the internal controls over financial reporting are effective. The City's internal controls over financial reporting are adequate with the system-embedded preventative and detective controls, combined with the numerous documented processes and controls currently in place, which allow for the production of reliable financial information.

Now in its third year since the COVID-19 pandemic began, the City has adapted to a hybrid remote environment with controls to mitigate risk of turnover, fraud, and inadequate in-person oversight. In response, the City continues to assess these risks, as they relate to financial reporting, providing additional resources as needed and implementing additional systems to ensure continued effectiveness. In addition, the City's management maintains strong and active communication with employees during the pandemic.

Establishing effective internal controls is an ongoing process. Effective internal controls reduce exposure to error, fraud, and theft. It is management's responsibility to design, implement, and maintain internal controls and consider the areas of risk. The Department of Finance continues to develop written policies to document and confirm existing internal financial controls and works with City departments to document processes and new system implementations. As with any effective system of internal controls over financial reporting, management actively assesses risk as the organization changes and as new reporting requirements are issued, including those that have been identified in this report.

Sources

1. Gauthier, Stephen J. *Evaluating Internal Controls*. Chicago IL: Government Finance Officers Association of the United States and Canada, 2013. Print
2. Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework, Framework and Appendices,2013*
3. Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework, Internal Control over External Financial Reporting: A compendium of Approaches and Examples, 2013*
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5. Bureau of Labor Statistics, *Job Openings and Labor Turnover Survey (JOLTS)*, *https://www.bls.gov/jlt/#data*. Accessed December 22, 2022.
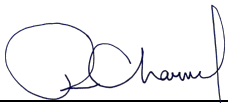
Attachments

1. Certification by the Mayor and Chief Financial Officer
2. Management Evaluation Assessment Template
3. COSO Internal Control- Integrated Framework Principles
4. Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Matthew Vespi, Chief Financial Officer

Rolando Charvel, Director and City Comptroller, Department of Finance

CERTIFICATION BY MAYOR AND CHIEF FINANCIAL OFFICER

In accordance with the requirements of §22.0706 of the San Diego Municipal Code, the Mayor's designee, the Chief Operating Officer and the Chief Financial Officer hereby certify that they:

1. are responsible for establishing and maintaining the City's internal financial controls;
2. have identified the need to design such internal financial controls to ensure that material information relating to the City and its departments, offices, agencies, and affiliated "related entities" as defined in San Diego Municipal Code section 22.4102, is made known to the Mayor and/or the Chief Financial Officer by others within the City and its departments, offices, agencies, and affiliated "related entities," particularly during the period in which the Annual Report required by this section is being prepared;
3. have evaluated the effectiveness of the City's internal financial controls as of a date within 120 days prior to the Annual Report;
4. have presented in the Annual Report their conclusions about the effectiveness of their internal controls based on such evaluation as of that date;
5. have disclosed to the City's independent auditors and the Audit Committee all significant deficiencies in the design or operation of internal controls that could adversely affect the City's ability to record, process, summarize, and report financial data;
6. have identified for the City's independent auditors any material weaknesses in internal controls and any fraud, whether or not material, that involves management or other employees who have a significant role in the City's internal controls; and
7. have indicated in the Annual Report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Signed: _____   Date: _February 27, 2023_
Matthew Vespi, Chief Financial Officer

Signed: _____   Date: _February 26, 2023_
Rolando Charvel, Director and City Comptroller, Department of Finance

Signed: _____   Date: _February 28, 2023_
Eric Dargan, Chief Operating Officer

Introduction

The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Internal Controls Framework is an integrated framework commonly used by organizations. This Framework is a basis for the City's internal control program and provides guidance on internal controls over financial reporting. The framework put forth by COSO is comprised of five fundamental components which, when present and functioning together, work towards the goals of reducing risk to an acceptable level and achieving objectives for reliable financial reporting. The assessment of internal control over financial reporting focused on an evaluation of each of the five components. The five components include Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring Activities.

A component of internal control supports an organization's efforts in achieving its financial reporting objectives. The component describes what is required for the organization to meet their objectives and are relevant to an entire entity or at any entity level, division, operating unit, or function of the organization. All five components must be present and functioning together to have an effective system of internal control. A principle is a fundamental concept associated with one of the five components of internal control. There are a total of seventeen principles in the Framework.

Department of Finance incorporated a management assessment template to help assess the effectiveness of the City's system of internal financial controls and ensure that it meets the following requirements: 1) Each of the five components and relative principles are present and functioning; 2) The five components are operating together in an integrated manner. The template provides a logical structure for management to analyze and document the organization's assessment of effectiveness of internal controls and assist management in developing a process for identifying and evaluating internal control deficiencies. The template is not an integral part of the internal control framework, but serves as an illustrative aide.

Three templates are included:

- **Overall Assessment**—This template summarizes management's determination of whether each of the components and relevant principles is present and functioning and components are operating together in an integrated manner.

- **Components and Principles**— This template summarizes management's determination of whether each component and relevant principles are present and functioning. The IC framework also includes points of focus to describe important characteristics of each principle. However, the framework does not require management to evaluate whether all points of focus are in place.

- **Deficiencies**—A log of all identified internal control deficiencies that can be leveraged in the evaluation of components and principles, and can enable the internal control deficiencies to be aggregated.

1. Overall Assessment of a System of Internal Control

Entity or part of organization structure subject to the assessment (entity, division, operating unit, function)		**City of San Diego**		
Objective(s) being considered for the scope of internal control being assessed		Considerations regarding management's acceptable level of risk		
Operations				
Reporting	The City's main objective of internal controls over financial reporting is to provide reasonable assurance that financial information produced for internal and external reports is reliable and transparent, reflects the City's transactions and events for the reporting period, and is in accordance with GAAP and other reporting requirements.	The acceptable level of risk is based on a general materiality threshold along with qualitative factors and professional judgement. Materiality also depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.		
Compliance				
		Present? (Y/N)	Functioning? (Y/N)	Explanation/Conclusion
Control Environment		Y	Y	The City has established a set of standards, processes, structures, policies, and practices that encompass the City's integrity and ethical values and provide the basis for the City to carry out internal controls across the organization. All principles are present and functioning, despite two internal control deficiencies identified under this component.
Risk Assessment		Y	Y	The City conducts a continuous and effective assessment of risk that allows management to determine the need for controls and monitoring activities, improvements that can be made to information and communication, and to mitigate such risks that can affect the control environment.
Control Activities		Y	Y	The City has selected and developed budgetary controls, transaction controls, general controls over technology, and control activities deployed through policies and procedures to help mitigate the risk to the achievement of the City's financial reporting objectives.
Information and Communication		Y	Y	The City has established effective communication procedures through formal communication processes, financial reporting tools, and financial trainings in order to meet accounting and disclosure requirements and to share necessary financial information internally and externally.
Monitoring Activities		Y	Y	The City has established ongoing and separate monitoring activities and communicates internal control deficiencies identified during monitoring to ensure each of the five COSO components are present and functioning.
Are all components operating together in an integrated manner? Evaluate if a combination of internal control deficiencies, when aggregated across components, represent a major deficiency*		Yes - Although there are two internal control deficiencies, they do not represent major deficiencies.		
Is the overall system of internal control effective? <Y/N>*		Yes		
Basis for conclusion		The City has established a comprehensive internal controls program and believes the internal controls over financial reporting are effective. All 5 COSO components are present and functioning.		

* If it is determined that there is a major deficiency, management must conclude that the system of internal control is not effective.

2. Components & Principles

Control Environment Component Evaluation			
Principle 1: Demonstrates Commitment to Integrity and Ethical Values	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization demonstrates a commitment to integrity and ethical values.	Y	Y	City has employee code of conduct, Equal Employment Opportunity policy, and the fraud, waste, and abuse hotline. San Diego Municipal Code (SDMC) establishes the Ethics Commission. The City's Strategic Plan has "trust" as one of the four operating principles. Performance Evaluations of work standards are conducted for classified and unclassified employees.
<u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning: - **Sets the Tone at the Top** – The board of directors and management at all levels of the entity demonstrate through their directives, actions, and behavior the importance of integrity and ethical values to support the functioning of the system of internal control. - **Establishes Standards of Conduct** – The expectations of the board of directors and senior management concerning integrity and ethical values are defined in the entity's standards of conduct and understood at all levels of the organization and by outsourced service providers and business partners. - **Evaluates Adherence to Standards of Conduct** – Processes are in place to evaluate the performance of individuals and teams against the entity's expected standards of conduct. - **Addresses Deviations in a Timely Manner** – Deviations of the entity's expected standards of conduct are identified and remedied in a timely and consistent manner.			**City of San Diego Summary of Controls to Effect Principle 1:** - **Employee Code of Conduct:** emphasizes that each employee occupies a position of public trust which demands the highest moral and ethical standard of conduct. The City has the Employee Code of Conduct Handbook to summarize the City's ethics rules, regulations, policies, and procedures and to increase awareness of ethical conduct. - **Equal Employment Opportunity Policy:** The City is committed to fair and equal treatment in the workplace, equal opportunities to succeed, and a work environment free of discrimination, harassment, and retaliation that enhances the City's integrity. - **Fraud, Waste, and Abuse Hotline**: designed for reporting suspected cases of fraud, waste, or abuse. The City Auditor investigates all complaints in a timely manner. - **Ethics Commission**: Established through SDMC. Monitors, administers, and enforces the City's governmental ethics laws, conducts investigations, advises and educates City officials, candidates, political committees, and lobbyists about governmental ethics laws, etc. - **City Strategic Plan:** One of the four operating principles in the City's Strategic Plan is trust. Committing to integrity and ethical values builds trust with the public. - **Performance Evaluations:** classified employees receive a performance plan and periodic performance evaluations of work standards and City uses progressive discipline philosophy to correct deviations. Unclassified employees complete performance evaluations that require an explanation in how they meet key managerial behavior standards and goals.

<table>
<tr><td colspan="4" align="center">Control Environment Component Evaluation</td></tr>
<tr><td>Principle 2: Exercises Oversight Responsibility</td><td>Present?
(Y/N)</td><td>Functioning?
(Y/N)</td><td>Explanation/Conclusion</td></tr>
<tr><td>The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.</td><td>Y</td><td>Y</td><td>Strong-mayor form of government with City Council as legislative body. City Charter establishes independent auditor reporting to an audit committee. Independent Budget Analyst advises City Council and Audit Committee. Budget and Government Efficiency Committee reviews a wide range of important financial topics and reports before presentation to City Council.</td></tr>
<tr><td colspan="3"><u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning:

- Establishes Oversight Responsibilities—The board of directors identifies and accepts its oversight responsibilities in relation to established requirements and expectations.

- Applies Relevant Expertise—The board of directors defines, maintains, and periodically evaluates the skills and expertise needed among its members to enable them to ask probing questions of senior management and take commensurate actions.

- Operates Independently—The board of directors has sufficient members who are independent from management and objective in evaluations and decision making.

- Provides Oversight for the System of Internal Control—The board of directors retains oversight responsibility for management's design, implementation, and conduct of internal control:
• <i>Control Environment</i>—Establishing integrity and ethical values, oversight structures, authority and responsibility, expectations of competence, and accountability to the board.
• <i>Risk Assessment</i>—Overseeing management's assessment of risks to the achievement of objectives, including the potential impact of significant changes, fraud, and management override of internal control.
• <i>Control Activities</i>—Providing oversight to senior management in the development and performance of control activities.
• <i>Information and Communication</i>—Analyzing and discussing information relating to the entity's achievement of objectives.
• <i>Monitoring Activities</i>—Assessing and overseeing the nature and scope of monitoring activities and management's evaluation and remediation of deficiencies.</td><td><u>City of San Diego Summary of Controls to Effect Principle 2</u>:

- Audit Committee Independence: City Charter Section 39 identifies the rights and authorities of the Chief Financial Officer, City Council, and Audit Committee. City Council and Audit Committee provide oversight over auditing and internal controls. Audit Committee's independence is maintained by filling positions from City Council and public members with sufficient financial reporting, accounting, and audit expertise who do not report to management.

- Independent Budget Analyst and City Auditor: release reports and advise City Council and Audit Committee members of relevant questions for management and courses of actions.

- Budget and Government Efficiency Committee: A City Council Committee that reviews a wide range of important financial topics including the Annual Budget, financial reports, fees, treasury functions, performance measures and analytics, information technology, purchasing and contracting, risk management, and pension matters. The committee ensures passage of balanced and responsible budgets that protects core City services. In 2022, the committee reviewed the updates and changes to the following policies before presentation to City Council: User Fee Policy, Reserve Policy, and Annual Review of Treasurer's Investment Policy.</td></tr>
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Control Environment Component Evaluation			
Principle 3: Establishes Structure, Authority, and Responsibility	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.	Y	Y	Authority and relationships codified in City Charter, SDMC, and A.R.s: Charter Sections 39.1, 39.2, and 39.3; SDMC §22.4101; A.R. 95.39. Chief Compliance Officer facilitates the City's response to internal and external audits. SROC provides oversight over employee safety and liability. The City reorganizes reporting lines to improve alignment of roles and responsibilities within the organization.

Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Considers All Structures of the Entity**—Management and the board of directors consider the multiple structures used (including operating units, legal entities, geographic distribution, and outsourced service providers) to support the achievement of objectives. - **Establishes Reporting Lines**—Management designs and evaluates lines of reporting for each entity structure to enable execution of authorities and responsibilities and flow of information to manage the activities of the entity. - **Defines, Assigns, and Limits Authorities and Responsibilities** —Management and the board of directors delegate authority, define responsibilities, and use appropriate processes and technology to assign responsibility and segregate duties as necessary at the various levels of the organization: • *Board of Directors* — Retains authority over significant decisions and reviews management's assignments and limitations of authorities and responsibilities • *Senior Management*—Establishes directives, guidance, and control to enable management and other personnel to understand and carry out their internal control responsibilities • *Management*—Guides and facilitates the execution of senior management directives within the entity and its subunits • *Personnel*—Understands the entity's standard of conduct, assessed risks to objectives, and the related control activities at their respective levels of the entity, the expected information and communication flow, and monitoring activities relevant to their achievement of the objectives • *Outsourced Service Providers*—Adheres to management's definition of the scope of authority and responsibility for all non-employees engaged.	**City of San Diego Summary of Controls to Effect Principle 3**: - **Independent Audit Committee**: Charter Section 39.1 establishes an independent audit committee to oversee the City's auditing function and SDMC §26.1701 outlines duties including hiring an external auditor. - **Independent Positions from City Council:** Charter Section 39.2 and 39.3 establishes independent positions to assist City Council in check and balances over the executive branch. - **Disclosures Practices Working Group**: SDMC §22.4101 establishes Disclosures Practices Working Group (DPWG) responsible for ensuring compliance with federal and state securities laws. - **Management Responsibilities over Internal Financial Controls:** A.R. 95.39 establishes management responsibilities related to establishing, maintaining, monitoring and complying with a system of Internal Financial Controls. - **Chief Compliance Officer**: facilitates the City's response to internal and external audits; and coordinates compliance with local, State, and federal regulations related to labor, wages, and health and safety. In 2022, the Compliance Department was established and added to the SDMC, via ordinance O-21402, with the Chief Compliance Officer as the administrative head of the department. - **Safety Risk Oversight Committee (SROC):** A committee established to discuss topics and provide oversight over employee safety and liability. The goal of SROC is to aid the City in actively managing risk efforts by establishing a proactive and consistent approach to identifying and mitigating risks. - **2022 Reorganization**: In 2022, the Debt Management Department was consolidated with the Department of Finance to increase coordination between debt management functions, accounting, and financial planning functions. The reorganization is codified in the SDMC and revised via ordinance, O-21565. The updated SDMC establishes the new responsibilities of the Department of Finance for debt financing, special district formation, and coordinating enrollment and payment of assessments and special taxes.

Control Environment Component Evaluation			
Principle 4: Demonstrates Commitment to Competence	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.	Y	Y	**Financial Training Program available, staff encouraged to attain professional designations (e.g. CPA), finance departments maintain training policies, Rewards and Recognition Program, goal setting, performance plans and evaluations, remote work option, and mentorship and internship programs. City Compensation Philosophy created to support attracting and retaining employees.**

<u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning: - **Establishes Policies and Practices**—Policies and practices reflect expectations of competence necessary to support the achievement of objectives. - **Evaluates Competence and Addresses Shortcomings**—The board of directors and management evaluate competence across the organization and in outsourced service providers in relation to established policies and practices, and act as necessary to address shortcomings. - **Attracts, Develops, and Retains Individuals**—The organization provides the mentoring and training needed to attract, develop, and retain sufficient and competent personnel and outsourced service providers to support the achievement of objectives. - **Plans and Prepares for Succession**—Senior management and the board of directors develop contingency plans for assignments of responsibility important for internal control.	**City of San Diego Summary of Controls to Effect Principle 4:** - **Financial Training Program:** City employees, City management, and elected officials are provided training to aid employees in submitting or reviewing financial-data and reports. SDMC §22.4110 established a biennial mandatory securities law training. - **Training Policies:** centralized finance staff must meet minimum number of annual training hours and encouraged to pursue training and designations relevant to their job per their department's training policy. - **Rewards and Recognition program and Tuition Reimbursement program:** encourages retention amongst high-quality employees and pursuit of professional expertise. - **Goal setting, performance plans and evaluations:** unclassified employees maintain goals and classified employees receive performance plan outlining objectives, responsibilities, and goals. Performance evaluations are conducted periodically by management to assess against work standards and deviations are corrected as necessary. - **Remote Work Option**: Management must maintain adequate controls to recruit and retain competent employees that will be responsible for financial reporting. In 2022, telework was finalized and implemented through A.R. 95.95 *Telework Program*. Management recognizes the benefits to employee productivity and job satisfaction by allowing a telework option. - **Expanding Recruitment Pathways**: In 2022, management expanded the City's internship and mentorship programs providing more opportunities to employees for training, development, and recognition. Furthermore, management expanded the City's internship program through State funding. Interns not only provide additional resources for departments with vacancies, but also creates a pipeline for a future workforce. - **City Compensation Philosophy:** The Compensation Philosophy aims to provide competitive, equitable and sustainable employee compensation in order to attract and retain highly qualified and high-performing employees. It serves as guidance on how the City intends to approach compensation for City employees and is intended to be updated periodically, as needed, to remain consistent with the City's strategic objectives.

Control Environment Component Evaluation			
Principle 5: Enforces Accountability	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.	**Y**	**Y**	A.R. 95.39 outlines management responsibilities for internal financial controls. Rewards and Recognition Program, goal setting, performance plans and evaluations. Management develops performance measures for departments that are posted on the City's Performance dashboard and annual budget documents.

<u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning: -**Enforces Accountability through Structures, Authorities, and Responsibilities**—Management and the board of directors establish the mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities across the organization and implement corrective action as necessary. - **Establishes Performance Measures, Incentives, and Rewards**—Management and the board of directors establish performance measures, incentives, and other rewards appropriate for responsibilities at all levels of the entity, reflecting appropriate dimensions of performance and expected standards of conduct, and considering the achievement of both short-term and longer-term objectives. - **Evaluates Performance Measures, Incentives, and Rewards for Ongoing Relevance**—Management and the board of directors align incentives and rewards with the fulfillment of internal control responsibilities in the achievement of objectives. - **Considers Excessive Pressures**—Management and the board of directors evaluate and adjust pressures associated with the achievement of objectives as they assign responsibilities, develop performance measures, and evaluate performance. - **Evaluates Performance and Rewards or Disciplines Individuals**—Management and the board of directors evaluate performance of internal control responsibilities, including adherence to standards of conduct and expected levels of competence and provide rewards or exercise disciplinary action as appropriate.	**City of San Diego Summary of Controls to Effect Principle 5:** - **A.R. 95.39 - Management Responsibilities for Internal Financial Controls:** established to provide a strong enhancement over the City's control environment. Holds management accountable for developing citywide financial policies and procedures within the Finance Branch, including citywide dissemination. Emphasizes the role of the Executive Management Team in creating an organizational culture that supports the internal control environment. - **Rewards and Recognition program and Tuition Reimbursement program:** Encourages retention amongst high-quality employees and pursuit of professional expertise. - **Goal setting, performance plans and evaluations:** unclassified employees maintain goals and classified employees receive performance plan outlining objectives, responsibilities, and goals. Performance evaluations are conducted periodically by management to assess against work standards and deviations are corrected as necessary. - **Performance Measures**: Management develops performance measures for departments that are posted on the City's Performance Dashboard and annual budget documents. Departments self-report key performance indicators (KPIs) to measure progress toward implementing their tactical plans and highlight performance results against service delivery expectations.

Risk Assessment Component Evaluation			
Principle 6: Specifies Suitable Objectives	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives	Y	Y	**Reporting Objectives:** City ensures financial statements are in compliance with accounting standards. The Annual Comprehensive Financial Report is prepared in accordance with GAAP and the City's Materiality Policy. The City's internal reports informs of the Mayor's priorities in terms of financial characteristics and provides visibility on the City's progress in managing the City's finances.
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: *External Financial Reporting Objectives* - **Complies with Applicable Accounting Standards**—Financial reporting objectives are consistent with accounting principles suitable and available for that entity. The accounting principles selected are appropriate in the circumstances. - **Considers Materiality**—Management considers materiality in financial statement presentation. - **Reflects Entity Activities**—External reporting reflects the underlying transactions and events to show qualitative characteristics and assertions. *Internal Reporting Objectives* - **Reflects Management's Choices**—Internal reporting provides management with accurate and complete information regarding management's choices and information needed in managing the entity. - **Considers the Required Level of Precision**—Management reflects the required level of precision and accuracy suitable for user needs in non-financial reporting objectives and materiality within financial reporting objectives. - **Reflects Entity Activities**—Internal reporting reflects the underlying transactions and events within a range of acceptable limits.	**City of San Diego Summary of Controls to Effect Principle 6**: - **External Financial Reporting**: Management creates the Annual Comprehensive Financial Report. The Annual Comprehensive Financial Report is the most significant external financial report and is prepared in accordance with GAAP. It includes the balances and activity of all funds and component units of the City and related disclosures. Materiality policy is followed and management risk assessment on the Annual Comprehensive Financial Report is conducted prior to the start of the report. - **Internal Financial Reporting:** Management creates the annual budget, and other informational reports for decision-making. The City's annual budget informs readers of the Mayor's priorities in terms of financial characteristics and serves as a key tool for financial management and compliance. Department budget pages include goals and objectives. Five-Year Financial Outlook, Public Utilities Department Five-Year Financial Outlook, Other Enterprise Fund Five-Year Outlooks, monthly Charter 39 Financial Performance Reports, Five-Year Capital Infrastructure Planning Outlook, State of CIP Mid-Year and Year-End reports, CIP Mid-Year and Year-End Budget Monitoring reports, City Treasurer's Monthly Investment Reports, and budget monitoring quarterly reports provide the City visibility on progress in managing the City's finances.		

Risk Assessment Component Evaluation			
Principle 7: Identifies and Analyzes Risk	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.	Y	Y	At the beginning of each Annual Comprehensive Financial Report preparation cycle, management communicates areas of potential risk to City's external auditor based on management's risk assessment and ongoing monitoring activities. City Auditor completes a citywide risk assessment to identify, measure, and prioritize the City's potential audits based on the level of risk to the City. Management performs additional risk assessment for entity transactions and events that should be represented in financial statements. Information Technology Disaster Recovery Plans identify risks and threats to the organization and the impact to the City's business operations. The City implemented Incident Response Plans and a Cybersecurity Incident Response Team (CIRT) to ensure best practices are being followed for security incidents.
Points of Focus: The following points of focus may assist management in determining whether this principal is present and functioning: - **Includes Entity, Subsidiary, Division, Operating Unit, and Functional Levels**—The organization identifies and assesses risks at the entity, subsidiary, division, operating unit, and functional levels relevant to the achievement of objectives. - **Analyzes Internal and External Factors**—Risk identification considers both internal and external factors and their impact on the achievement of objectives. - **Involves Appropriate Levels of Management**—The organization puts into place effective risk assessment mechanisms that involve appropriate levels of management. - **Estimates Significance of Risks Identified**—Identified risks are analyzed through a process that includes estimating the potential significance of the risk. - **Determines How to Respond to Risks**—Risk assessment includes considering how the risk should be managed and whether to accept, avoid, reduce, or share the risk.			**City of San Diego Summary of Controls to Effect Principle 7**: - **Annual Comprehensive Financial Report Risk Assessment**: Management performs an annual risk assessment at the beginning of each Annual Comprehensive Financial Report preparation cycle and communicates risks to the City's external auditor based on management's risk assessment and ongoing monitoring activities, including management's response to such risks through development and implementation of additional controls. - **Auditor's Citywide Risk Assessment**: City Auditor completes a citywide risk assessment to help identify, measure, and prioritize the City's potential audits based on the level of risk to the City. For the period of July 1, 2019 to June 30, 2022, the Association of Local Government Auditors completed a peer review for the City Auditor and recognized them for conducting exceptional and thorough citywide risk assessments during the review period. The City Auditor received the highest passing rate with their work in full compliance with Generally Accepted Government Auditing Standards (GAGAS). - **Entity Activities**: The City can face several non-routine events on an annual basis where management needs to make assertions regarding the recognition, measurement, presentation, and disclosure on financial statements. Management constantly evaluates events from a financial reporting objective and discloses material changes through internal and external reports. Three major events that were identified and disclosed in the latest Annual Comprehensive Financial Report are: unwinding of Proposition B, storm water regulation compliance, and Senate Bill 1383 regulation compliance. - **Information Technology Disaster Recovery Plans:** The City contracted with a vendor to perform a Business Impact Analysis/Risk Assessment (BIA/RA) and to create Disaster Recovery Plans (DRPs) to help identify risks and threats to the organization and the impact to the City's business operations. - **Cybersecurity and Incident Response Plans**: The City has a set of standards, guidelines, policies, and procedures for providing security, confidentiality, integrity, and accountability related to their information systems and/or assets. The City implemented Incident Response Plans and a Cybersecurity Incident Response Team (CIRT) to ensure best practices are being followed for security incidents. In 2022, the City implemented the cloud-based data management tool, Rubrik, for cloud-based storage and disaster recovery, employed a Security Operations Center (SOC) to ensure after hours cybersecurity monitoring, performed simulated cyber security incident table-top exercises, conducted a vulnerability assessment and deployed tools and cyber awareness training to bolster protection from ransomware and malware.

Risk Assessment Component Evaluation			
Principle 8: Assesses Fraud Risk	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization considers the potential for fraud in assessing risks to the achievement of objectives.	Y	Y	**Management participates in audit entrance and exit meetings with City departments, so department can address concerns that have an impact on accounting and financial reporting, safeguarding of City assets, and issues affecting the internal control environment.** **Management participates in the remediation of City Auditor's fraud hotline audits and assess further opportunities for fraud risk.** **The Internal Control section assesses and identifies potential risk of fraud in financial reporting during process narrative reviews.**
<u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning: - **Considers Various Types of Fraud**—The assessment of fraud considers fraudulent reporting, possible loss of assets, and corruption resulting from the various ways that fraud and misconduct can occur. - **Assesses Incentive and Pressures**—The assessment of fraud risk considers incentives and pressures. - **Assesses Opportunities**—The assessment of fraud risk considers opportunities for unauthorized acquisition, use, or disposal of assets, altering of the entity's reporting records, or committing other inappropriate acts. - **Assesses Attitudes and Rationalizations**—The assessment of fraud risk considers how management and other personnel might engage in or justify inappropriate actions.	**City of San Diego Summary of Controls to Effect Principle 8**: - **Performance audit remediation:** Management participates in audit entrance and exit meetings with City departments, so departments can address concerns that have an impact on accounting and financial reporting, safeguarding of City assets, and issues affecting the internal control environment. - **Fraud hotline remediation:** Management participates in the remediation of City Auditor's fraud hotline audits and assess further opportunities for fraud risk. - **Process narrative review**: The Internal Controls section assesses and identifies the potential risk of fraud in financial reporting during the creation and revision of process narratives.		

Risk Assessment Component Evaluation			
Principle 9: Identifies and Analyzes Significant Change	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization identifies and assesses changes that could significantly impact the system of internal control.	Y	Y	DoF staff evaluates new accounting standards promulgated by Governmental Accounting Standards Board (GASB) and new changes in technology. Management continues to assess changes in the physical and economic environment due to the COVID-19 pandemic. Management reviews the risks that come with the increase in the number of grant applications submitted and the number of awards received.
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Assesses Changes in the External Environment**—The risk identification process considers changes to the regulatory, economic, and physical environment in which the entity operates. - **Assesses Changes in the Business Model**—The organization considers the potential impacts of new business lines, dramatically altered compositions of existing business lines, acquired or divested business operations on the system of internal control, rapid growth, changing reliance on foreign geographies, and new technologies. - **Assesses Changes in Leadership**—The organization considers changes in management and respective attitudes and philosophies on the system of internal control.			City of San Diego Summary of Controls to Effect Principle 9: - **Changes in Accounting Standards:** DoF participates in an annual Government Finance Officers Association training introducing new accounting pronouncements and actively review new standards. DoF evaluates new accounting standards promulgated by GASB for potential financial impact. In fiscal year 2022, the City fully implemented GASB 87, which required a multi-year plan and dedicated staff to mitigate risks during implementation. The City also implemented GASB 92, GASB 93, GASB 97, and GASB 99 in fiscal year 2022, which did not have a material impact to the financial statements. - **Changes in Technology:** The City ensures that any changes or improvements to the ERP system are fully tested for operational needs and for the impact to financial reporting. Advances in technology allow the City to improve current business processes, create efficiencies, and reduce and/or risks. In 2022, GRC technical and application support packs were implemented. Scenarios were performed in the test environment to confirm the ERP system was working appropriately before the update was implemented in the production system. - **Changes in the External Environment:** The City assessed and identified the increased risk in the City's economic and physical environment due to the COVID-19 Pandemic. In 2022, the City continued to experience a significant increase in turnover and vacancies. See Principle #10, "Control Activities related to High Turnover/Vacancies" for the controls implemented to mitigate the risks. Staff adapted to working in a remote or hybrid environment with management facing risks such as increased risk of financial data theft, time theft, cybercrime, or fraud. See Principle #10 "Control Activities related to a Remote/Hybrid Environment " for the controls implemented to mitigate the risks. - **Grant Funding Risk:** The acceptance of grants or the increase in grant awards requires the need for oversight, monitoring, awarding, and effective communication among departments, grantee, and grantor. An ineffective grant team increases risk in delayed or inaccurate financial reporting, non-compliance with audit regulations, fines, grant funds not being used for their intended purposes, and/or return of funds to the granting agency. See Principle #10 "Grant Funding Control Activities" for the controls implemented to mitigate the risks.

Control Activities Component Evaluation			
Principle 10: Selects and Develops Control Activities	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.	**Y**	**Y**	Controls related to this include: segregation of duties, variety of transaction control activities (authorization & approvals, verifications, physical controls, reconciliations, supervisory controls, application controls). Process narrative annual assessment conducted to test the validity, accuracy, presence, and performance of processes and controls defined in process narratives. Management develops new control activities when risks are identified. Management implemented control activities in response to the influx of federal stimulus money for COVID-19 relief efforts. In 2022, management implemented control activities in response to increased turnover and vacancies, increased risk in a remote or hybrid environment, and increased risk in receiving grant fund awards.
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Integrates with Risk Assessment**—Control activities help ensure that risk responses that address and mitigate risks are carried out. - **Considers Entity-Specific Factors**—Management considers how the environment, complexity, nature, and scope of its operations, as well as the specific characteristics of its organization, affect the selection and development of control activities. - **Determines Relevant Business Processes**—Management determines which relevant business processes require control activities. - **Evaluates a Mix of Control Activity Types**—Control activities include a range and variety of controls and may include a balance of approaches to mitigate risks, considering both manual and automated controls, and preventive and detective controls. - **Considers at What Level Activities Are Applied**—Management considers control activities at various levels in the entity. - **Addresses Segregation of Duties**—Management segregates incompatible duties, and where such segregation is not practical management selects and develops alternative control activities.			**City of San Diego Summary of Controls to Effect Principle 10:** - **Various Transaction Control Activities:** embedded within multiple accounting and financial reporting processes including, authorization and approvals, verifications, physical controls, reconciliations, preventative system controls, and application controls. - **Segregation of Duties Monitoring**: The City ensures that no one individual has control over an entire process through SAP GRC module and Business Role Management (BRM). An increase in system role assignments was observed due to shift in telecommuting, but segregation of duties was still maintained through the system. DoF and Department of IT continue to perform the annual reviews of the Role Definition Guide and User Access Review to monitor for segregation of duties violations. - **Process Narrative Annual Assessment**: Annual process design and control design assessments are conducted to test the validity, accuracy, presence, and performance of processes and controls that have been identified in the process. - **Control Activities related to Pandemic Relief Funds**: The major control activities implemented related to CARES Act eligible expenses: a tracking mechanism for CARES Act spending, setting up a dedicated fund to separate expenditures and revenues from other funds, understanding the federal guidance for spending eligibility and reporting, communicating information to departments via a memorandum and instructions posted on the City's intranet, establishing roles and responsibility to manage the process and ensure compliance, creating a process to collect expenditure data with a standardized template, reviewing expenditures comply with eligibility requirements using a formal approval process, and maintaining appropriate backup documentation. - **Control Activities related to High Turnover/Vacancies**: created the City compensation philosophy, established hiring and short-term staffing procedures, Out-of-Class assignments, reclassification of jobs or special pay adjustments, expediting hiring of vacant positions, considering strategies to onboard employees faster by expanding instructor-led training efforts, job shadowing, or cross-training. In 2022, the City formalized A.R. 95.95 *Telework Program* and expanded the mentorship and internship program. - **Control Activities related to a Remote/Hybrid Environment**: Controls include maintaining department approval if teleworking is not effective for the employee, teleworkers must continue complying with all City policies and regulations including information security requirements, sharing contact information, responding to requests within a timely manner, and must continue to meet performance expectations and maintain an adequate remote worksite. - **Grant Funding Control Activities:** The City has A.R. 1.80 *Grant Application Approval and Management Procedures* and the Grants Manual available to all City staff. The Grants Review Team reviews and approves all grant applications. DoF Grant Finance Analysts and Administering Departments monitor grant operating budgets and expenditures to ensure compliance with grant agreements. DoF reviews all financial documents before submission to granting agencies and provides grant accounting and management training at the Finance Academy semi-annually and conducts training as needed.

Control Activities Component Evaluation			
Principle 11: Selects and Develops General Controls over Technology	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization selects and develops general control activities over technology to support the achievement of objectives.	**Y**	**Y**	**DoIT follows IT Frameworks to ensure the City follows IT standards and guidelines. The Chief Information Officer provides oversight of the City's ERP system. IT General Controls: maintained through cyber security tools, patching and change management, user authentication, documentation, authorizing access to applications, managing access through roles and separation of duties, and physical security of IT infrastructure. Management reviews IT changes to the ERP system for adequate preventative or detective controls. Department of IT has dedicated IT governance, portfolio management, contracts management teams, and cybersecurity incident response plans and team, to ensure the City meets its technology objectives.**
<u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning: - **Determines Dependency between the Use of Technology in Business Processes and Technology General Controls**—Management understands and determines the dependency and linkage between business processes, automated control activities, and technology general controls. - **Establishes Relevant Technology Infrastructure Control Activities**—Management selects and develops control activities over the technology infrastructure, which are designed and implemented to help ensure the completeness, accuracy, and availability of technology processing. - **Establishes Relevant Security Management Process Control Activities**—Management selects and develops control activities that are designed and implemented to restrict technology access rights to authorized users commensurate with their job responsibilities and to protect the entity's assets from external threats. - **Establishes Relevant Technology Acquisition, Development, and Maintenance Process Control Activities**—Management selects and develops control activities over the acquisition, development, and maintenance of technology and its infrastructure to achieve management's objectives.			**City of San Diego Summary of Controls to Effect Principle 11**: - **IT Framework**: Department of IT follows standards and guidelines from the following frameworks: Information Technology Information Library (ITIL), National Institute of Standards Technology (NIST), CIS Controls and guidelines, and Payment Card Industry Data Security Standards (PCI DSS). - **Chief Information Officer**: Per A.R. 95.39 *Management Responsibilities for Internal Financial Controls* , the Chief Information Officer is responsible for oversight of the software development process related to the City's ERP system and collaborates with the Chief Financial Officer to timely address significant financial system control weaknesses that could result in material financial misstatements and fraud. - **IT General Controls:** Between Department of IT, City's IT services contract vendors (Atos, Zensar, etc.), departments, and vendors, IT general controls are maintained through cyber security tools, patching and change management, user authentication, documentation, authorizing access to applications, managing access through roles and separation of duties, and physical security of IT infrastructure. - **Role Definition Guide:** Management performs an annual review to identify new ERP roles and changes, and continuously assesses possible segregation of duties violations with each user role request. - **Business Role Management:** grouping of roles based off tasks, which helps streamline and better manage changes to roles' access. - **Internal Controls Review:** Management reviews IT changes to the ERP system for adequate preventative or detective controls. - **IT Governance**: Department of IT has a dedicated governance and portfolio management team to help departments set technology and performance standards when acquiring IT applications, in order to promote efficiency & strategic alignment with the City's technology plan. They also work with departments to enforce compliance through a governance process. - **Department of IT Contract Services**: Department of IT has a dedicated contracts management team to select third-party vendors for citywide IT contracted services, such as network services and develops control activities, such as contract terms and conditions to meet minimum network availability uptimes. - **Cybersecurity Incident Response Plans and Team**: The City implemented Incident Response Plans and a Cybersecurity Incident Response Team (CIRT) to ensure best practices are being followed for security incidents.

Control Activities Component Evaluation			
Principle 12: Deploys through Policies and Procedures	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.	Y	Y	Policies such as City's Investment Policy, Debt Policy, Reserve Policy, Budget Policy and Materiality Policy. Administrative regulations, department instructions, process narratives, and work instructions are updated and reviewed by responsible departments and stakeholders. Management performs additional review for documentation in response to effects of the COVID-19 Pandemic. City Treasurer annually review their own Internal Controls Manual.
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Establishes Policies and Procedures to Support Deployment of Management's Directives**—Management establishes control activities that are built into business processes and employees' day-to-day activities through policies establishing what is expected and relevant procedures specifying actions. - **Establishes Responsibility and Accountability for Executing Policies and Procedures**—Management establishes responsibility and accountability for control activities with management (or other designated personnel) of the business unit or function in which the relevant risks reside. - **Performs in a Timely Manner**—Responsible personnel perform control activities in a timely manner as defined by the policies and procedures. - **Takes Corrective Action**—Responsible personnel investigate and act on matters identified as a result of executing control activities. - **Performs Using Competent Personnel**—Competent personnel with sufficient authority perform control activities with diligence and continuing focus. - **Reassesses Policies and Procedures**—Management periodically reviews control activities to determine their continued relevance and refreshes them when necessary.			**City of San Diego Summary of Controls to Effect Principle 12:** - **Process Documentation**: DoF has formally documented 795 processes and continuously assesses the need for further documentation. In 2022, 28 processes were documented. - **Administrative Regulations**: The IC section reviews and approves policies and procedures included in the administrative regulations to ensure internal controls exist to mitigate risks and improve efficiency. Three A.R.s were revised in 2022, including A.R. 95.95 *Telework Program* , A.R. 39.20 *Motive Equipment Replacement Policy* , and A.R. 95.21 *Responding to California Public Records Act Requests.* - **Policies**: reflect management's goals and guide decisions and actions of staff. Some financial policies include Investment Policy, Debt Policy, Reserve Policy, Budget Policy, User Fee Policy, and Materiality Policy. The City's ACFR Note 1 *Summary of Significant Accounting Policies (SOSAP)* summarizes the City's accounting policies to conform to GAAP. - **COVID-19 Pandemic Response**: Management continued to review documentation such as work instructions, standard operating procedures, and process narratives as high turnover and vacancy rates continued citywide as a result from the COVID-19 pandemic. Documentation serves as a repository of information from experienced staff with institutional knowledge and as a training tool for new or existing staff. In 2022, the City finalized and implemented telework and flexible scheduling policies in A.R. 95.95 *Telework Program.* - **Office of the City Treasurer's Internal Controls Manual:** The Office of the City Treasurer annually reviews their Investment Division's Internal Controls Manual, which outlines the specific operational procedures the Investment Division staff use in implementing the City's Investment Policy. The Investment Division Internal Controls Manual highlights the key control points implemented in their processes.

Information and Communication Component Evaluation			
Principle 13: Uses Relevant Information	Present? (Y/N)	Functioning? (Y/N)	**Explanation/Conclusion**
The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.	**Y**	**Y**	**City uses financial reporting tools to perform ad-hoc queries or run reports to efficiently access financial data stored in SAP in a timely, accurate, and appropriate manner.** **Formal Communication Process in place ensures relevant information is communicated to those responsible for preparing the Annual Comprehensive Financial Report. The DPWG communicates known facts, and other relevant information to ensure consistency throughout the City's financial disclosure documents.** **City Auditor communicates implementation statuses of audit and investigative recommendations through the Recommendation Follow-Up Dashboard and Recommendation Implementation Work Plans (RIWP).**
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Identifies Information Requirements**—A process is in place to identify the information required and expected to support the functioning of the other components of internal control and the achievement of the entity's objectives. - **Captures Internal and External Sources of Data**—Information systems capture internal and external sources of data. - **Processes Relevant Data into Information**—Information systems process and transform relevant data into information. - **Maintains Quality throughout Processing**—Information systems produce information that is timely, current, accurate, complete, accessible, protected, and verifiable and retained. Information is reviewed to assess its relevance in supporting the internal control components. - **Considers Costs and Benefits**—The nature, quantity, and precision of information communicated are commensurate with and support the achievement of objectives.			**City of San Diego Summary of Controls to Effect Principle 13:** - **Financial Reporting Tools:** Business intelligence reporting software allows users to perform ad-hoc queries or run reports to efficiently access financial data stored in SAP in a timely, accurate, and appropriate manner. In 2022, the following financial reports were created or modified. Examples: Vendor Bank Account Changes Report, FMBB Audit Report, and Open Invoice Report. - **SAP Initiatives**: In 2022, the following SAP initiatives were completed by Department of IT: 13 SAP training videos and 8,354 SAP training instances including virtual instructor led and online courses. - **Formal Communication Process:** ensure relevant information is communicated to those responsible for preparing the Annual Comprehensive Financial Report. The Disclosures Practices Working Group reviews disclosures, communicates known facts, and other relevant information to ensure consistency throughout the City's financial disclosure documents. The DPWG operates under the Disclosure Controls and Procedures (Controls). The DPWG last performed a review of its Controls in May 2021, with revisions made to the Controls to ensure that they accurately reflect current practice. DPWG will review and update the Controls in 2023, as necessary. - **City Auditor's Audit Recommendation Follow-Up Dashboard:** communicates about the implementation status of audit and investigative recommendations. City Auditor reports on the status of open recommendations semi-annually. - **Recommendation Implementation Work Plan:** City Auditor established a new Recommendation Implementation Work Plan (RIWP) process to improve transparency and provide management a tool to better facilitate the implementation of recommendations. Departments are required to complete a RIWP for new recommendations from performance audit reports.

Information and Communication Component Evaluation			
Principle 14: Communicates Internally	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.	**Y**	**Y**	**Finance Orientation & Finance Academy annual trainings to update on current processes; process documentation (A.R.s, P.N.s, and W.I.s); Internal financial statement checklist; Fraud, Waste, and Abuse Hotline** **Formal distribution of work document to clearly communicate specific responsibilities for development of the Annual Comprehensive Financial Report.** **Financial reports to committees and city council, and internal meetings with Disclosures Practices Working Group (DPWG).**
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Communicates Internal Control Information**—A process is in place to communicate required information to enable all personnel to understand and carry out their internal control responsibilities. - **Communicates with the Board of Directors**—Communication exists between management and the board of directors so that both have information needed to fulfill their roles with respect to the entity's objectives. - **Provides Separate Communication Lines**—Separate communication channels, such as whistle-blower hotlines, are in place and serve as fail-safe mechanisms to enable anonymous or confidential communication when normal channels are inoperative or ineffective. - **Selects Relevant Method of Communication**—The method of communication considers the timing, audience, and nature of the information.			**City of San Diego Summary of Controls to Effect Principle 14:** - **Financial Training:** Finance Orientation, Finance Academy, and annual trainings are held to update staff on the latest government practices, processes, and procedures. Training has continued while majority of DoF telecommutes through the use of virtual trainings offered from professional organizations like the Government Finance Officers Association, California Society of Municipal Finance Officers, and Institute of Internal Auditors. - **Internal financial statement checklist**: helps communicate expectations and ensures that statements are complete and accurate. Comprehensive accounting and disclosure checklists developed by the Government Finance Officers Association are used to ensure compliance with governmental standards. - **Formal distribution of work documents:** are used to communicate specific responsibilities for development of the Annual Comprehensive Financial Report. - **Fraud, Waste, and Abuse Hotline:** serves as a safe mechanism to enable anonymous or confidential communication. - **Internal Financial Reports:** City Auditor reports, Independent Budget Analyst reports, management policies and administrative regulations, annual budget, Five-Year Financial Outlook, Public Utilities Department Five-Year Financial Outlook, Other Enterprise Fund Five-Year Outlooks, monthly Charter 39 Financial Performance Reports, Five-Year Capital Infrastructure Planning Outlook, State of CIP Mid-Year and Year-End reports, CIP Mid-Year and Year-End Budget Monitoring Reports, City Treasurer's Monthly Investment Reports, and budget monitoring quarterly reports that provide management, City Council and Audit Committee financial information.

Information and Communication Component Evaluation			
Principle 15: Communicates Externally	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization communicates with external parties regarding matters affecting the functioning of internal control.	Y	Y	Annual report on financial internal controls; Financial policies and A.R.s posted on city website; Preliminary Official Statements issued per bond issuance; bond rating agency interviews. At the beginning of each Annual Comprehensive Financial Report preparation cycle, management communicates areas of potential financial reporting risk to City's external auditor based on management's risk assessment and ongoing monitoring activities. Citywide risk assessment to help identify, measure, and prioritize the City's potential audits based on the level of risk to the City. The DPWG includes individuals in key city positions within the city and external counsel that can communicate known facts and relevant information.
<u>Points of Focus</u>: The following points of focus may assist management in determining whether this principle is present and functioning: - **Communicates to External Parties**—Processes are in place to communicate relevant and timely information to external parties including shareholders, partners, owners, regulators, customers, and financial analysts and other external parties. - **Enables Inbound Communications**—Open communication channels allow input from customers, consumers, suppliers, external auditors, regulators, financial analysts, and others, providing management and the board of directors with relevant information. - **Communicates with the Board of Directors**—Relevant information resulting from assessments conducted by external parties is communicated to the board of directors. - **Provides Separate Communication Lines**—Separate communication channels, such as whistle-blower hotlines, are in place and serve as fail-safe mechanisms to enable anonymous or confidential communication when normal channels are inoperative or ineffective. - **Selects Relevant Method of Communication**—The method of communication considers the timing, audience, and nature of the communication and legal, regulatory, and fiduciary requirements and expectations.			**City of San Diego Summary of Controls to Effect Principle 15:** - **Annual Report on Financial Internal Controls**: The Internal Controls Section releases an annual report to summarize management's approach in maintaining the City's internal controls system provides reasonable assurance that financial reporting objectives are met. - **Policies and Procedures:** Financial policies and A.R.s posted on the City's website to communicate information to external parties. - **City Auditor Risk Assessment and Audit Reports**: City Auditor completes a citywide risk assessment to help identify, measure, and prioritize the City's potential audits based on the level of risk to the City. - **Annual Comprehensive Financial Report Risk Assessment:** At the beginning of each Comprehensive Annual Financial Report preparation cycle, management communicates areas of potential risk to City's external auditor based on management's risk assessment and ongoing monitoring activities. - **External Reports**: such as the Annual Comprehensive Financial Report, financial policies, and administrative regulations are shared on the City's website to be accessed by residents, investors, rating agencies, and other interested parties. - **The Disclosures Practices Working Group (DPWG)**: includes individuals in key City positions within the City and external counsel that can review disclosures, communicate known facts, and relevant information and ensure consistency throughout the city's financial disclosure documents. The DPWG operates under Disclosure Controls and Procedures (Controls). - **Bond rating agency interviews and Offering Statements:** The City prepares a Preliminary Official Statement (POS) that contains all material information to help investors determine whether to purchase securities offered by the City. The DPWG reviews the statement before City Council approval of a public debt issuance and its related disclosure document. The City also conducts presentations with ratings agencies prior to marketing new securities. The DPWG is required to review all materials that the City presents to bond rating agencies and investors. - **Fraud, Waste, and Abuse Hotline:** serves as a safe mechanism to enable anonymous or confidential communication. - **Communication with external parties regarding assessments:** The City's external auditor, Macias, Gini & O'Connell LLP, reviews the City's financial statements and accompanying notes and reports on any findings during the audit process. City financial information is communicated to external auditor through a master pending list.

Monitoring Activities Component Evaluation			
Principle 16: Conducts Ongoing and Separate Evaluations	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning	**Y**	**Y**	**Ongoing Monitoring for transactions related to: p-card, travel & tuition, jury duty, invoices, procurement, electronic banking changes, and aging good receipts.** **Annual review of process narratives and IT security roles.**

<u>**Points of Focus**</u>: The following points of focus may assist management in determining whether this principle is present and functioning: - **Considers a Mix of Ongoing and Separate Evaluations**—Management includes a balance of ongoing and separate evaluations. - **Considers Rate of Change**—Management considers the rate of change in business and business processes when selecting and developing ongoing and separate evaluations. - **Establishes Baseline Understanding**—The design and current state of an internal control system are used to establish a baseline for ongoing and separate evaluations. - **Uses Knowledgeable Personnel**—Evaluators performing ongoing and separate evaluations have sufficient knowledge to understand what is being evaluated. - **Integrates with Business Processes**—Ongoing evaluations are built into the business processes and adjust to changing conditions. - **Adjusts Scope and Frequency**—Management varies the scope and frequency of separate evaluations depending on risk. - **Objectively Evaluates**—Separate evaluations are performed periodically to provide objective feedback.	**City of San Diego Summary of Controls to Effect Principle 16:** - **Segregation of Duties Monitoring**: The City ensures that no one individual has control over an entire process through SAP GRC module and Business Role Management (BRM). - **Assessment of Documented Processes and Controls:** Periodic evaluation for process design to test for validity, accuracy, and performance of the process as documented and control design assessments to test presence and performance of controls that have been identified within the process. The Internal Controls Section uses a designed risk-based approach to prioritize and select process documentations for the periodic assessments. The Internal Control Section also sends notifications to process owners to update documentation on a regular basis. As a result of the assessments and process owner-initiated changes, 41 process narratives received major revisions and 104 had minor updates in 2022. - **Ongoing Monitoring:** Management conducts monitoring of the following transactions to ensure compliance with objectives: procurement card, travel and tuition, jury duty leave requests, invoices, journal entries, purchase order splitting, vendor business licenses, and electronic banking changes.

Monitoring Activities Component Evaluation			
Principle 17: Evaluates and Communicates Deficiencies	**Present? (Y/N)**	**Functioning? (Y/N)**	**Explanation/Conclusion**
The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.	**Y**	**Y**	**City management reviews and monitors audits performed by City Auditor and works with departments to strengthen controls.** **DoF reviews the independent audit conducted by external auditors to identify areas where internal controls can be strengthened.** **DoF conducts an internal review of the preparation and completion of the Annual Comprehensive Financial Report to identify entries that occurred after the draft was submitted to external auditor.**
Points of Focus: The following points of focus may assist management in determining whether this principle is present and functioning: - **Assesses Results**—Management and the board of directors, as appropriate, assess results of ongoing and separate evaluations. - **Communicates Deficiencies**—Deficiencies are communicated to parties responsible for taking corrective action and to senior management and the board of directors, as appropriate. - **Monitors Corrective Actions**—Management tracks whether deficiencies are remediated on a timely basis.			**City of San Diego Summary of Controls to Effect Principle 17:** - **City Auditor Performance Audit Reports:** City management reviews and monitors audits performed by City Auditor and works with departments to strengthen controls. - **Independent Audit Review:** Management reviews the results of independent audit from MGO to identify potential areas of risks or areas for which controls need to be strengthened. Chief Compliance Officer and City Auditor monitors corrective actions have been completed through follow-up reports and status meetings. DoF also works closely with departments to modify processes, establish new controls, or strengthen existing controls as it relates to financial reporting. - **Annual Comprehensive Financial Report Review:** DoF conducts an internal review of the preparation and completion of the Annual Comprehensive Financial Report to identify entries that occurred after the draft was submitted to external auditor.

3. Summary of Deficiencies

Summary of Deficiencies						
ID #	Source of the internal control		Internal Control Deficiency Description	Is internal control deficiency a major deficiency? (Y/N)	Owner	Remediation Plan
	Component	Principle				
Performance Audit of the City's Strategic Human Capital Management	Control Environment	#4	Widespread uncompetitive compensation poses a growing shorthand long term risk to the City's ability to maintain and attract a high-quality workforce for providing public services, and has likely contributed to several negative effects on the City workforce and public services.	N	Several Departments	City agreed to auditor recommendations in their HCM report including creating a Total Compensation Strategy--which the City has developed; City uses special salary adjustments process to maintain competitive hiring; financial training program offered to entry level and experienced finance staff citywide; increase in documentation to preserve institutional knowledge. In 2022, Human Resources developed and presented the Total Compensation Philosophy to City Council. The philosophy states in part that "*The City's total compensation for its employees endeavors to pay at least the market median for comparably situated public employees. The City's goal is to move toward the market median for all classifications that are currently under the market median.*" The City is expecting to conduct a compensation study with a consultant which will be reviewed to determine how far the City is from the classification level between the market median and the specific classifications within the City. In 2022, the City continued to provide general salary increases, special salary adjustments for several job classifications, and the employee defined benefit pension plan was restored, all to improve employee recruitment and retention.
Performance Audit of the City's Strategic Human Capital Management II: Employee Performance Management	Control Environment	#4, 5	Employee performance can have an impact on an organization's environment and capability in providing high-quality public services. The City could improve its ability to effectively identify or address poor performance or misconduct issues and show employee appreciation and recognition to help engage employees and drive them to continue commendable performance. Otherwise, it could affect the City from providing high-quality public services for its customers and have an impact on other employee's performance and the city environment.	N	Human Resources & Personnel Departments	To mitigate some of these effects and help the City strengthen its capability to have an engaged workforce, management agreed to these key recommendations: report Employee Performance Review completion rates in the City's annual workforce report, review and monitor the Rewards and Recognition Program, strategically monitor aggregate discipline trends, and expand disciplinary processes and discipline-related training for supervising employees. In calendar year 2022, Human Resources published the first annual Workforce Report providing critical workforce data and analysis to City staff with actionable items based on data gathered from the HR Performance dashboards and City Employee Sentiment surveys. Human Resources also continued to improve the City's employee experience by modernizing HR services, improving and increasing access to professional development opportunities, and streamlining rewards and recognition processes. Human Resources improved monitoring on the Rewards & Recognition program by conducting a survey of employees on the use of the Rewards & Recognition Program to identify overall program improvements. Once improvements are identified, HR will update A.R. 95.91 *Employee Rewards and Recognition Program.*

COSO Internal Control — Integrated Framework Principles

Operations · Reporting · Compliance

Entity Level · Division · Operating Unit · Function

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring Activities

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Control Environment

1. The organization demonstrates a commitment to integrity and ethical values.

2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.

3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.

4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.

5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

Risk Assessment

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.

7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.

8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.

9. The organization identifies and assesses changes that could significantly affect the system of internal control.

Control Activities

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

11. The organization selects and develops general control activities over technology to support the achievement of objectives.

12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

Information & Communication

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

Monitoring Activities

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

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**Independent Auditor's Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

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To the Honorable Mayor and Members of the City Council
City of San Diego, California

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of San Diego, California (City), as of and for the fiscal year ended June 30, 2022, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 28, 2022. Our report includes a reference to other auditors who audited the financial statements of the San Diego Housing Commission, a discretely presented component unit, as described in our report on the City's basic financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. Our report also includes emphasis of matters paragraphs indicating the City implemented Governmental Accounting Standards Board (GASB) Statement No. 87, *Leases*, and the effect of the known liability related to the unwinding of Proposition B as of June 30, 2022. Our opinion is not affected by these matters.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Macias Gini & O'Connell LLP

San Diego, California
December 28, 2022