Performance Audit of the City’s Financial Condition as of Fiscal Year 2020

The City of San Diego’s Financial Ratios Show Positive Financial Health When Compared To Other Benchmark Cities

Office of the City Auditor
City of San Diego

January 2022
Performance Audit of the City’s Financial Condition as of Fiscal Year 2020

Why OCA Did This Study

Financial condition refers to a government's ability to maintain existing service levels, withstand local and regional economic disruptions, and meet the demands of natural growth, decline, and change. Financial condition must be continually monitored and regularly evaluated to help ensure the City’s decisions are fully informed and financially responsible.

To objectively assess and report the City of San Diego’s financial condition, we used a well-regarded modified 10-point test that includes both short- and long-term aspects of financial well-being and relies on audited financial data published in cities’ Annual Comprehensive Financial Reports. For context, the ratios are tracked for multiple years and compared to other cities similar in population and government type. In our test, we compared San Diego with Los Angeles, CA; Phoenix, AZ; San Antonio, TX; Seattle, WA; San Jose, CA; and Austin, TX.

What OCA Found

The City of San Diego’s financial ratios show positive financial health from Fiscal Year (FY) 2011 through FY2020 compared to benchmark cities. The City’s financial condition has been top of class for the last ten years when compared to the six other cities in our test.

San Diego's 10-Point Test Score Compared to Other Cities

While the ten-year trend from FY2011 to FY2020 is positive for all of the City's financial ratios, especially in Liquidity, Solvency, and all three debt ratios, we are seeing average results in the areas of Financial Performance and Net Change in Capital Assets Value.

In addition, when we looked at each ratio over a 16 year period from FY2005 to FY2020 we noticed some negative trends for San Diego. The ratios we would like to bring to City Management's attention are:

Ratio 3 – The Financial Performance Ratio measures the rate at which City resources are growing or declining. This ratio demonstrates how well the City was able to pay expenses with revenues from that year. A negative percentage demonstrates diminished financial performance, which indicates the City is in a worse position to face future financial challenges. In FY2020, the City's ratio fell to a negative 4%. This indicates City Management should focus on both controlling annual expenses as well as monitoring annual revenues. There were financial impacts due to COVID-19 as tourism revenue, charges for services, and developer contributions and fees declined, but these losses were somewhat offset by operating grant and property tax increases.

San Diego Ratio 3 Ranking Compared to Benchmark Cities

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Ratio 4 – The Solvency Ratio is an indicator of the City’s overall capacity for repaying or otherwise satisfying all its outstanding obligations based on annual revenue. San Diego and the other benchmark cities on average have experienced similar negative trends over the course of the sixteen-year period. San Diego seems to have stabilized since FY2017 but is still in a negative trend.

Solvency Long-Term Trend (FY2005–FY2020)
(Lower is better)

Ratio 5 – The Primary Government Revenues Ratio measures the flexibility of the City’s revenues. Intergovernmental aid is revenue generated from other government entities and includes grants. San Diego’s reliance on intergovernmental aid significantly decreased in the first two years of the sixteen-year period and continued to decrease until FY2017. However, after FY2017, the City saw a trend reversal in its reliance on intergovernmental aid as more grants and other governmental funds were received, including CARES Act funds. Due to COVID-19, all cities are experiencing a similar trend.

Primary Government Revenues Long-Term Trend (FY2005-FY2020) (Lower is Better)

Ratio 10 – This ratio measures the change of the net value of capital assets. A high ratio suggests a government is keeping pace, on average, with the aging of its capital assets and replenishing them. A positive percentage change suggests the capital assets are being replenished; a negative number suggests they are being depleted. Net Change in Capital Assets Value is trending in a positive direction over the ten-year review period, but it remains one of the City’s lowest ranking metrics along with Financial Performance. One-time spikes due to the addition of large capital projects can be anticipated, but long-term under-performance in this metric can be an indication that the City is under investing in its infrastructure when compared with other cities.

San Diego Ratio 10 Ranking Compared to Benchmark Cities

City of San Diego Chief Financial Officer Remarks Related to the City’s Scores

The City Auditor’s performance audit highlights continued and sustained strength in the City’s financial condition, even after considering the effects of the COVID-19 pandemic on the City’s finances. The City’s financial indicators continue to outperform comparative cities, with San Diego being the highest overall ranked among the six cities included in this report. (Further CFO remarks on page 15 of report and the management response)

For more information, contact Andy Hanau, City Auditor at (619) 533-3165 or cityauditor@sandiego.gov.
January 14, 2022

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Transmitted herewith is an audit report on the City of San Diego's Financial Condition. This report was conducted in accordance with the City Auditor’s Fiscal Year 2022 Audit Work Plan, and the report is presented in accordance with City Charter Section 39.2. Audit Objectives, Scope, and Methodology are presented in Appendix A. Management’s comments on our audit can be found after page 69.

We would like to thank the Chief Financial Officer, the Department of Finance Director & City Comptroller, and their staff for their assistance and cooperation during this audit. All their valuable time and efforts spent on providing us information are greatly appreciated. The audit staff responsible for this audit report are Ruixin Chen, Rod Greek, Chris Kime, and Kyle Elser.

Respectfully submitted,

City Auditor

cc: Jay Goldstone, Chief Operating Officer
Matthew Vespi, Chief Financial Officer
Jeff Sturak, Deputy Chief Operating Officer
Christiana Gauger, Chief Compliance Officer
Rolando Charvel, Department of Finance Director and City Comptroller
Honorable City Attorney, Mara Elliott
Heather Ferbert, Deputy City Attorney
Jeff Kawar, Interim Independent Budget Analyst
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Background

What Is Financial Condition?

Financial condition can be broadly defined as a local government's ability to finance its services on a continuing basis. More specifically, financial condition refers to a government's ability to:

1. Maintain existing service levels;
2. Withstand economic disruptions; and
3. Meet the demands of growth, decline, and change.

A basic assessment of a local government's financial condition involves evaluating whether the local government can continue paying for what it is doing, whether there are reserves for financing emergencies, and whether there is enough financial flexibility to allow the government to adjust to change. If a government can meet these challenges, it is in sound financial condition. If not, it is probably experiencing or can anticipate financial problems.

San Diego Base Economy

The City's financial condition depends in many ways on the economic environment. According to the City's Economic Development Strategy for 2017 through 2019 (most current report), the City's economy is based on four industries:

1. Manufacturing and Innovation;
2. International Trade and Logistics;
3. Military Installations; and
4. Tourism.

These are sectors that bring money and wealth into the region. Therefore, growth or disruptions in these industries may affect the City's financial condition.

Budget

The City's Fiscal Year (FY)2022 Adopted Budget totals $4.6 billion and incorporates projections for an improved economic outlook based on the continuing trend of increases in Property and Sales taxes with decreases in both Transient Occupancy and Franchise taxes when compared to the Pre-COVID-19 era. The FY2022 Adopted Budget includes $1.7 billion for General Fund
operations, $2.1 billion for operations of the City's Enterprise Funds and all other funds, and $810 million for capital improvement projects across the City.

**General Fund Revenue Sources**

In the City's FY2022 Adopted Budget, the General Fund's largest outside revenue sources are property tax, sales tax, Transient Occupancy Tax (TOT), and franchise fees. The General Fund is supplemented by charges for services, transfers in, and other miscellaneous funds. Exhibit 1 breaks down the revenue sources that finance the City's General Fund.

**Exhibit 1:**

**Fiscal Year 2022 Adopted Budget, General Fund Revenue**

The City's FY2022 Adopted Budget reflects General Fund expenditures totaling $1.7 billion and 7,731 budgeted full-time equivalent positions. Departments within the General Fund provide core community services, such as public safety (including police and fire protection), parks and recreation, library services, and refuse collection, as well as vital support functions such as finance, legal, and human resources. These core services are primarily supported by major revenue sources,
as previously described. Exhibit 2 summarizes the FY2022 Adopted General Fund budgeted expenses by department, with those departments having a total General Fund expenditure budget of less than $20 million combined in the "Other" category.

**Exhibit 2:**

**FY2022 Adopted Budget, General Fund Expenditures by Department (in Millions)**

![Bar chart showing general fund expenditures by department for FY2022.](chart)

Note: The Other category includes: City Auditor, City Clerk, City Council, City Treasurer, Communications, Debt Management, Department of Finance, Department of Information Technology, Development Services, Economic Development, Ethics Commission, Government Affairs, Human Resources, Infrastructure/Public Works, Internal Operations, Neighborhood Services, Office of Boards & Commissions, Office of Homeland Security, Office of the Assistant COO, Office of the Chief Financial Officer, Office of the Chief Operating Officer, Office of the IBA, Office of the Mayor, Performance & Analytics, Personnel, Planning, Public Utilities, Real Estate Assets, Smart & Sustainable Communities, and Sustainability. The Citywide Program Expenditures Department budget is comprised of various programs and activities that provide benefits and services Citywide. This budget includes the funding for programs or activities that are generally not attributable to any single City department, as well as the General Fund portion of any programs that are funded both by the General Fund and non-General Funds. The Citywide Program Expenditures Department budget is administered by the Department of Finance with input from responsible departments throughout the City.

Source: Auditor generated based on FY2022 Adopted Budget.
Debt Obligations

The outstanding principal for the City's existing long-term debt obligations\(^1\) as of June 30, 2020, are as follows:

- General Fund backed Lease-Revenue Bonds and Capital Lease Obligations: $524.2 million
- Public Utilities–Water System Obligations: $1,117.2 million
- Public Utilities–Wastewater (Sewer) System Obligations: $777.1 million

Departments Involved in Managing San Diego's Financial Condition

The City's financial condition is multi-faceted and depends on the work performed by several departments, which are overseen by the Chief Financial Officer (CFO), including:

- Department of Finance—financial reporting, budgeting, fiscal consulting, disbursements, purchasing and contracting, payroll and internal controls;
- City Treasurer—receivables, banking, and investments;
- Debt Management—financing; and
- Risk Management—financial risk management, self-insurance programs.

In addition to the departments overseen by the CFO, the Office of the Independent Budget Analyst assists the City Council with budgetary inquiries and budgetary decisions. For more about these departments and their responsibilities, refer to Appendix B.

Assessing Financial Condition

Several methods, with varying degrees of complexity and comprehensiveness, exist for assessing a local government’s financial condition. We selected the modified 10-point test, as presented by Dean Mead in *Public Financial Management*, because it incorporates both short-term and long-term aspects of a city’s financial well-being, while being relatively straightforward and easy to use.\(^2\)

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\(^1\) These do not reflect debt obligations of City related entities (including the City as the Successor Agency to the Redevelopment Agency), Community Facilities Districts, or Special Assessment Districts.

\(^2\) Appendix A of this report further explains the rationale for using this method.
In order to objectively assess and report the City of San Diego's financial condition, we use a well-regarded modified 10-point test presented by Dean Mead in *Public Financial Management* (2006).

According to Mead, any financial analysis should encompass both short- and long-run financial information. This test is comprised of 10 financial ratios designed to assess performance in four areas: financial position, revenues, debt, and capital assets. Furthermore, not only should the government as a whole be considered, but governmental activities should be considered separately from the business-type activities to distinguish financial results that may be masked when information is aggregated at the government-wide level. Finally, Mead suggests to make the financial ratios of the 10-point test more meaningful by comparing to prior years and similar governments.

The test includes both short-term and long-term aspects of financial well-being and relies on audited financial data published in cities' Annual Comprehensive Financial Reports (ACFR). To give the ratios context, ratios are tracked for multiple years (FY2011–FY2020) and compared to other cities similar in population and government type (we compared with Los Angeles, CA; Phoenix, AZ; San Antonio, TX; Seattle, WA; San Jose, CA; and Austin, TX in our test).

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3 Dean Mead is a Research Manager at the Governmental Accounting Standards Board (GASB).

4 The modified 10-point test is fully explained in “A Manageable System of Economic Condition Analysis for Governments,” which is Chapter 15 of the textbook *Public Financial Management* (CRC Press, 2006).

5 The Governmental Accounting Standards Board, Statement No.98, dated October 2021, establishes the term annual comprehensive financial report and its acronym ACFR. That new term and acronym replace instances of comprehensive annual financial report and its acronym in generally accepted accounting principles for state and local governments. This Statement was developed in response to concerns raised by stakeholders that the common pronunciation of the acronym for comprehensive annual financial report sounds like a profoundly objectionable racial slur. While the statement is effective for fiscal years ending after December 15, 2021, we agree with the Board that renaming the financial report is the most direct and definitive method of communicating that the existing acronym no longer is appropriate. Therefore, we used Annual Comprehensive Financial Report with the acronym ACFR in our report when referring to annual financial reports.
As shown in Exhibit 3, the 10 ratios measure fiscal condition by three categories: Governmental Activities and Business-Type Activities, that together make up the third category, Primary Government.

**Exhibit 3:**

**Government-Wide Financial Statements**

<table>
<thead>
<tr>
<th>Governmental Activities</th>
<th>Business-Type Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Government and Support</td>
<td>Sewer Utility</td>
</tr>
<tr>
<td>Public Safety – Police</td>
<td>Water Utility</td>
</tr>
<tr>
<td>Public Safety – Fire, Life Safety, and Homeland Security</td>
<td>Airports</td>
</tr>
<tr>
<td>Parks, Recreation, Culture, and Leisure</td>
<td>Development Services</td>
</tr>
<tr>
<td>Transportation</td>
<td>Environmental Services</td>
</tr>
<tr>
<td>Sanitation and Health</td>
<td>Golf Course</td>
</tr>
<tr>
<td>Neighborhood Services</td>
<td>Recycling</td>
</tr>
<tr>
<td>Debt – Cost of Issuance and Interest on Debt Service</td>
<td>San Diego Convention Center Corporation</td>
</tr>
</tbody>
</table>

Source: City of San Diego FY2020 ACFR.

The 10-point test includes ratios for the benchmark cities pulled from Annual Comprehensive Financial Reports (ACFRs) for the 10 preceding years. Each ratio is then compared and scored with ratios computed for a peer group of similar governments (in terms of population, total revenues, geographic proximity, or other measure) from ACFRs during the same period of time. The total score can also be rated against the scores of comparable governments. The 10 ratios and their descriptions are shown in Exhibit 4.

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6 Appendix C provides more information on ACFRs and specific financial statements used in this audit.
### Exhibit 4:

#### 10-point Test Ratios and Descriptions

<table>
<thead>
<tr>
<th>Category</th>
<th>Ratio</th>
<th>Ratio Description</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2. Liquidity</td>
<td>Ability to meet short-term obligations with current assets.</td>
</tr>
<tr>
<td></td>
<td>3. Financial Performance</td>
<td>How well the City was able to pay expenses with revenues from that year.</td>
</tr>
<tr>
<td></td>
<td>4. Solvency</td>
<td>City's overall capacity to repay all of its obligations based on annual revenue.</td>
</tr>
<tr>
<td>Revenues</td>
<td>5. Primary Government Revenues</td>
<td>Flexibility of City's revenues based upon reliance on intergovernmental aid, including grants.</td>
</tr>
<tr>
<td></td>
<td>6. Governmental Activities Revenues</td>
<td>Extent to which Governmental Activities are self-financed or dependent upon taxes.</td>
</tr>
<tr>
<td>Debt</td>
<td>7. Primary Government Debt Burden</td>
<td>Long-term debt burden upon City's residents. (Maturity greater than one year.)</td>
</tr>
<tr>
<td></td>
<td>8. Government Funds Debt Coverage</td>
<td>The principle and interest that the City must pay each year on debt as a percentage of operating costs.</td>
</tr>
<tr>
<td></td>
<td>9. Enterprise Funds Debt Coverage</td>
<td>The sufficiency of resources available to repay business-type debt.</td>
</tr>
<tr>
<td>Capital Assets</td>
<td>10. Net Change in Capital Assets Value</td>
<td>Change in net value of assets for primary government. (Compares rate of investment in capital assets to depreciation of assets.)</td>
</tr>
</tbody>
</table>


In using the modified 10-point test to assess the City's financial condition, we selected six large cities for comparison based on government type and population size. We selected three U.S. cities with populations greater than San Diego (Phoenix, Los Angeles, and San Antonio), and three U.S. cities with populations...
smaller than San Diego (Seattle, San Jose, and Austin) for inclusion in the comparison group.  

We've also included information in this report on the City of San Diego's Pension, Other Post-Employment Benefits (OPEB), as well as its Contingent Liabilities and Commitments. Contingent liabilities may or may not become legal commitments of future City resources. Pension, OPEB, and Commitments identify significant future long-term liabilities for the City. Information is included in this report to ensure management and policymakers are aware of the existence and the need to actively manage these liabilities.

There was a considerable amount of uncertainty over the pandemic's effect on City revenues and expenses during FY2020. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was not passed until March 27, 2020 and the City received $248 million in April, of which $93.4 million was spent for the last quarter of FY2020. Arguably, without receipt of this federal assistance, the City's financial condition could have looked much different at the end of FY2020. While difficult to assess in totality, in the Audit Results we describe two ratios in the report that were directly or indirectly impacted—Financial Performance (Ratio 3) and Primary Government Revenues (Ratio 5). It should also be noted that the City's Short-Run Financial Position (Ratio 1) remained steady as the CARES Act provided much-needed revenue to continue essential services without using the City's Emergency Reserves.

Financial decisions can only be as sound as the information upon which they are based. Therefore, a government's financial condition must be continually monitored and regularly evaluated to help ensure the City's decisions are fully informed and financially responsible. Financial ratio analysis should raise questions that seek to explain the differences between cities and evaluate the reasons for change over time. Utilizing a peer comparison group provides some context for understanding the results of the analysis. While no two entities provide exactly the

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7 Refer to Appendix A of this report for more on the rationale for using population size as a basis of comparison.
same services, the discussion of financial ratios can lead to meaningful answers for policy-makers and stakeholders.

**Investor Caveat**  The Office of the City Auditor developed this report, and it is intended for City officials and the public. This report is the result of a performance audit and was not part of the annual audit of the City's financial statements. Expressions of opinion in this report are not intended to guide prospective investors in securities offered by the City.
Audit Results

The City of San Diego's financial ratios show positive financial health from Fiscal Year (FY)2011 through FY2020, and the City's financial condition has been top of class for the last 10 years when compared to the six other benchmark cities in our test. Overall, the City ranked 1st for the last 10 consecutive years.

While the ten-year trend from FY2011 to FY2020 is positive for all the City's financial ratios, especially in Liquidity, Solvency, and all three debt ratios, we are seeing average results in the areas of Financial Performance and Net Change in Capital Assets Value in the 10-point test. In addition, after conducting this 10-point test four times over the past several years, we now have sixteen years of financial metrics (FY2005 through FY2020), which allows us the opportunity to track the trends of these ratios over time. When we looked at each ratio over time, we also noticed some ratios experiencing negative trends for San Diego. The specific ratios that we would like to bring to City Management's attention are:

**Ratio 3** The Financial Performance ratio measures the rate at which City resources are growing or declining. This ratio demonstrates how well the City was able to pay expenses with revenues from that year. A negative percentage demonstrates diminished financial performance, which indicates the City is in a worse position to face future financial challenges. In FY2020, the City's ratio fell to a negative 4.0%. This indicates City Management should focus on both controlling annual expenses as well as monitoring annual revenues. Since FY2016, San Diego has experienced a negative trend, indicating that the City has a challenge in meeting annual governmental expenses with annual revenues received by the City. There were financial impacts due to COVID-19 as tourism revenue, charges for services, and developer contributions and fees declined, but these losses were somewhat offset by operating grant and property tax increases.

**Ratio 4** The solvency ratio is an indicator of the City's overall capacity for repaying or otherwise satisfying all its outstanding obligations based on annual revenue. San Diego and the other benchmark cities on average have experienced similar negative trends over the course of the sixteen-year period. San Diego seems to have stabilized since FY2017 but is still in a negative trend.
**Ratio 5**  
The primary government revenues ratio measures the flexibility of the City's revenues. Intergovernmental aid is revenue generated from other government entities and includes grants. San Diego's reliance on intergovernmental aid significantly decreased in the first two years of the sixteen-year period and continued to decrease until FY2017. However, after FY2017, the City saw a trend reversal in its reliance on intergovernmental aids as more grants and other governmental funds were received, including CARES Act funds. Due to COVID-19, all cities are experiencing a similar trend.

**Ratio 10**  
This ratio measures the change of the net value of capital assets. A high ratio suggests a government is keeping pace, on average, with the aging of its capital assets and replenishing them. A positive percentage change suggests the capital assets are being replenished; a negative number suggests they are being depleted. Net Change in Capital Assets Value is trending in a positive direction over the ten-year review period, but it remains one of the City's lowest ranking metrics along with Financial Performance. One-time spikes due to the addition of large capital projects can be anticipated, but long-term underperformance in this metric can be an indication that the City is under investing in its infrastructure when compared with other cities.

City Management should continue to monitor these four ratios and take corrective action if necessary.

**San Diego 10-Point Test Scores**  
San Diego's financial condition scored among the best compared to the benchmark cities, improving over the last 10 years as the scores have trended upward and stabilized at a healthy score of 12 or higher in eight of the last ten fiscal years.

However, the overall San Diego score dropped from a high of 16 to 13 from FY2017 to FY2020 due to a one-point drop in three of the ratio scores when compared to the test cities. These were: Financial Performance (ranked 5th), Primary Government Revenues (ranked 3rd), and Governmental Activities Revenues (ranked 3rd).
San Diego's individual ratio scores were calculated based upon awarding two points for each ratio that fell in the top quartile (top 25 percent) of the comparison group. One point was given for each in the second quartile, and no points were given for a ratio in the third quartile. A point was subtracted for a ratio in the lowest quartile. San Diego's ratio scores are summarized by fiscal year in Exhibit 5 below.

**Exhibit 5**

San Diego Financial Condition Ratio Scores

<table>
<thead>
<tr>
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<tr>
<td>Short-Run Financial Position</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
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<td>1</td>
<td>1</td>
<td>-1</td>
<td>1</td>
<td>8</td>
<td></td>
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<tr>
<td>Liquidity</td>
<td>1</td>
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<td>2</td>
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<td>Financial Performance</td>
<td>0</td>
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<td>0</td>
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<tr>
<td>Solvency</td>
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<td>2</td>
<td>2</td>
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<td>Primary Government Revenues</td>
<td>2</td>
<td>2</td>
<td>2</td>
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<td>Primary Government Debt Burden Per Capita</td>
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<td>Governmental Funds Debt Coverage</td>
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<td>Enterprise Funds Debt Coverage</td>
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<td>1</td>
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<td>2</td>
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<td>2</td>
<td>2</td>
<td>15</td>
</tr>
<tr>
<td>Net Change in Capital Assets</td>
<td>-1</td>
<td>-1</td>
<td>1</td>
<td>0</td>
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<td>0</td>
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<tr>
<td>Annual Totals</td>
<td>9</td>
<td>12</td>
<td>15</td>
<td>14</td>
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<td>15</td>
<td>16</td>
<td>12</td>
<td>9</td>
<td>13</td>
<td></td>
</tr>
</tbody>
</table>

Source: City Auditor generated based on based on 10-point test results.

San Diego's highest scores for the ten-year period (based on the scale of -10 being the lowest and 20 points being the highest) were related to Primary Government and Governmental Funds Debt, Solvency, and Primary Government Revenues. The lowest scores were in Short-Run Financial Position, Financial Performance, and Net Change in Capital Assets, which also led to the dip in San Diego’s score from FY2018 to FY2019.
San Diego Score Compared to Benchmark Cities

San Diego's financial condition scored the best compared to the benchmark cities as shown in Exhibits 6–8. The City has been ranked among the best from FY2012 through FY2018 and again in FY2020.

**Exhibit 6**

San Diego 10-Point Test Scores

![Graph showing San Diego's 10-point test scores from 2011 to 2020. The scores range from 9 to 16 with the highest score being 16 in 2016 and 2018. The scores are color-coded as follows: blue for 'Among the Best,' light blue for 'Better than Most,' green for 'About Average,' yellow for 'Worse than Most,' and orange for 'Among the Worst.' The source is Auditor generated based on 10-point test results.]

San Diego's FY2020 score of 13 exceeded the other cities' scores, which ranged between a high of 7 and low of 2. The highest score for any of the other cities during the ten-year period was 13 in FY2013. San Diego's score was at least four points higher than the other cities' highest score for FY2014 through FY2017 and is now six points higher than the 2nd highest scoring city. **Exhibit 7** shows San Diego's score in relation to the other tested cities' high and low scores.
Exhibit 7

San Diego’s 10-Point Test Score Compared to Other Cities

San Diego was ranked 1st or tied for 1st for all the years during the test period. Exhibit 8 displays the City’s annual rank.

Exhibit 8

San Diego’s Overall 10-Point Test Ranking Compared to Benchmark Cities

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<tr>
<td>Rank</td>
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<td>1st</td>
</tr>
</tbody>
</table>

*City of San Diego tied with two other benchmark cities.
**City of San Diego tied with one other benchmark city.

Source: Auditor generated based on 10-point test results.
Chief Financial Officer Remarks Related to the City's Scores

The City Auditor's performance audit highlights continued and sustained strength in the City's financial condition, even after considering the effects of the COVID-19 pandemic on the City's finances. The City's financial indicators continue to outperform comparative cities, with San Diego being the highest overall ranked among the six cities included in this report. The results of the audit are consistent with the City's strong credit ratings. As of June 2021, the City maintained ratings in the second highest rating category from three of the national credit rating agencies. These include "AA" ratings from Standard and Poor's and Fitch Ratings and Aa2 from Moody's Investors Service.

The COVID-19 pandemic impacted the City both operationally and financially, including significant declines in transient occupancy tax and sales tax receipts. On March 27, 2020, the federal government passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to provide emergency assistance and health care response for individuals, families, and businesses affected by the COVID-19 pandemic. The City received $248.5 million on April 22, 2020. This allowed the City to maintain General Fund reserves at existing levels without reductions to services.

It is important to note that as a result of the financial impacts of COVID-19, some of the financial ratios included in the report were affected by the decline in revenues and the Federal Relief funds received in FY2020. Some of these impacts are expected to be temporary in nature. While there continues to be some uncertainty regarding how the pandemic will continue to unfold, current projections assume that General Fund revenues will return to pre-pandemic levels in FY2023. Moreover, federal stimulus funds are not expected to continue once the pandemic subsides. For this reason, the financial trends reflected in the audit should be considered within the context of this unprecedented period.

On a more general note, while the financial ratios included in this report can be used to assess a local government's financial condition, additional information is needed to fully understand the complexity of a large municipality like the City of San Diego. Even when comparing cities of similar population, there may be significant differences between them, including different
functions performed for their residents, differences in socioeconomic, political and regulatory environments in addition to opportunities and limitations afforded by their geographic location and natural environment. There are also differences relating to revenue or debt raising ability among local agencies in California compared to localities in other states. The metrics included in this report are based on formulas that provide a high-level view of each city's financial condition. A more complete assessment can only be achieved through a careful review and understanding of each city's annual financial statements and note disclosures.
Ratio 1: Short-Run Financial Position (Financial Position)

Formula = Unreserved General Fund Balance ÷ General Fund Revenues

The Short-Run Financial Position Ratio measures the City’s ability to handle unforeseen resource needs over the short-term.

The City of San Diego had over $230 million in Unassigned (Unreserved) General Fund Balance and Emergency Reserves that equaled 13.5% of General Fund Revenues at the end of FY2020. This means that the City’s FY2020 Unreserved General Fund balance and Emergency Reserves would be sufficient to keep the City’s basic functions running for approximately 49 days. The City has averaged 51 days in reserve funds for operations from FY2012–FY2020. The Government Finance Officers Association (GFOA) recommends a minimum of 60 days; however, there is an exception for larger cities, counties, states, and other large government entities as revenues and expenditures are often more diversified and less subject to volatility.

Exhibit 1-1

Short-Run Financial Position

A high ratio suggests larger reserves for dealing with unexpected resource needs in the near-term.

Source: Auditor generated based on Short-Run Financial Position Ratio test results.
For the last seven years, San Diego's ability to meet short-term needs was below the benchmark cities' average. San Diego revised its reserve policy in 2011 with the goal to have a minimum of 8% of annual General Fund revenues held in the General Fund Reserve by FY2012. This policy change has led to improved ratios in the years following FY2011.

**Exhibit 1-2**

San Diego Ratio 1 Ranking Compared to Benchmark Cities

Source: Auditor generated based on Short-Run Financial Position Ratio test results.

San Diego ranked the 4th in eight out of the ten years. San Diego's ranking dropped to the 6th in FY2019 and rebounded to the 4th in FY2020.
**Exhibit 1-3:**

**Short-Run Financial Position Long-Term Trend (FY2005–FY2020)**

*Higher is better*

A high ratio suggests larger reserves for dealing with unexpected resource needs in the near-term.

Source: Auditor generated based on Short-Run Financial Position Ratio test results.

After San Diego revised its reserve policy in 2011, the City's Short-Run Financial Position ratio has remained stable around the 14% mark from FY2012 to FY2020. This is an improvement of almost 9% compared to the beginning of the sixteen-year period.
Ratio 2: Liquidity (Financial Position)

Formula = General Fund Cash and Investments ÷ (General Fund Liabilities – General Fund Deferred Revenues)

The Liquidity Ratio measures the City's ability to meet its short-term obligations with current assets. Although liquidity changes constantly, an annual year-end look is useful. A low ratio can be a warning that may indicate a cash flow problem and a need for short-term borrowing. Specifically, a ratio below 1.0 suggests an inability to pay current obligations. The City of San Diego's Liquidity Ratio has trended upwards in the last ten years from a low of 3.0 in FY2013 to a high of 5.4 in FY2020. This means that the City's capacity to pay current obligations is increasing.

Exhibit 2-1

Liquidity

(Higher is better)

A high ratio suggests a greater capacity for paying off short-run obligations.

Source: City Auditor generated based on Liquidity Ratio test results.

The City's Liquidity Ratio was above the average for benchmarked cities for nine of the last ten years except in FY2016 when the City was 0.5 points below the average of benchmark cities. The City's ratio was significantly above the average of benchmark cities in FY2020, suggesting a greater capacity to pay off short-run obligations compared to benchmark cities.
Exhibit 2-2

San Diego Ratio 2 Ranking Compared to Benchmark Cities

San Diego maintained consistent positions of 2nd or 3rd for eight of the ten years, with a drop to 4th in FY2013 and 5th in FY2016.

Exhibit 2-3

Liquidity Long-Term Trend (FY2005–FY2020)

A high ratio suggests a greater capacity for paying off short-run obligations.

Source: City Auditor generated based on Liquidity Ratio test results.
Over the course of the sixteen-year period, San Diego has experienced a positive upward trend reaching a new plateau above 5.0 in FY2020.
Ratio 3: Financial Performance (Financial Position)

Formula = $\frac{\text{Change in Governmental Activities Net Assets}}{\text{Total Governmental Activities Net Assets}}$

The Financial Performance Ratio measures the rate at which a city's financial resources are growing or declining. Utilizing the change in net assets for governmental activities, this ratio demonstrates how well the City was able to pay expenses with revenues from that year. A positive percentage demonstrates improved financial performance, which indicates the City is in a better position to face future financial challenges. This ratio is highly sensitive to economic factors outside the City's control, such as a decline in tourism because of a recession. Although a high ratio suggests the City is doing a better job of balancing revenues and expenses each year, a very high ratio could suggest that a city is raising too much revenue or under-spending on needed services.

The City of San Diego's Financial Performance Ratios during the ten-year period ranged from a high of 11.9% in FY2016 to a low of -4.0% in FY2020. The City's governmental revenues fell short of expenses by $157,227,000 in FY2020, and total governmental net assets decreased by 3.8% between FY2019 and FY2020 because of the revenue shortfall.

There were financial impacts due to COVID-19 as tourism revenue, charges for services, and developer contributions and fees declined from FY2019 to FY2020, but these losses were somewhat offset by operating grant and property tax increases.
San Diego had an upward trend in the first six years of the ten-year period with strong performance in FY2015 and FY2016 followed by a downward trend. There has been a lot of volatility in the ratios of the benchmarked cities with a range from a high of 245.4% to a low of -53.9% over the ten-year period.
**Exhibit 3-2**

San Diego Ratio 3 Ranking Compared to Benchmark Cities

San Diego was ranked 2nd or 3rd in FY2013 through FY2016 and was ranked last in FY2019.

**Exhibit 3-3**

Financial Performance Long-Term Trend (FY2005–FY2020)

Since FY2016, San Diego has experienced a negative trend, indicating that the City has a challenge in meeting annual governmental expenses with annual revenues generated to support governmental activities.
Ratio 4: Solvency (Financial Position)

Formula = (Primary Government Liabilities − Deferred Revenues) ÷ Annual Primary Government Revenues

The Solvency Ratio adds a long-run dimension to the analysis of the City's operating position. It is an indicator of the City's overall capacity for repaying or otherwise satisfying all its outstanding obligations based on annual revenue. A low ratio suggests that annual revenues are sufficient for satisfying the City's liabilities.

San Diego's Solvency Ratio has been relatively stable ranging from a high of 2.13 in FY2017 to a low 1.42 in FY2014. With a ratio of 2.1 in FY2020, the City's total liabilities were 110% greater than the sum of annual revenues. This includes all long-term liabilities including Pension and Other Post-Employment Benefits (OPEB - Retiree Health) for FY2020.

Despite the negative trend in the San Diego Solvency Ratio since FY2014, the ratios were consistently better than the benchmark cities' average. Benchmarked cities' ratios ranged from a high of 3.57 to a low of 1.63 during the ten-year period.
San Diego has been consistently ranked above average for the ten-year period compared to the benchmark cities, improving from the 3rd ranking in the first year to 1st in six of the last nine years. One benchmark city marginally outperformed San Diego in FY2017, FY2018, and FY2020.

Source: City Auditor generated based on Solvency Ratio test results.

San Diego Ratio 4 Ranking Compared to Benchmark Cities

Exhibit 4-3

Solvency Long-Term Trend (FY2005–FY2020)

(Lower is better)
A low ratio suggests outstanding obligations can more easily be met with annual revenues.

Source: City Auditor generated based on Solvency Ratio test results.
San Diego and the other benchmark cities' average have experienced similar negative trends over the course of the sixteen-year period. San Diego seems to have stabilized just above the 2.0 mark since FY2017 but is still in a negative trend.
Ratio 5: Primary Government Revenues (Revenues)

Formula = \( \frac{(Primary \ Government \ Operating \ Grants \ and \ Contributions + Unrestricted \ Aid)}{Total \ Primary \ Government \ Revenues} \)

The Primary Government Revenues Ratio measures the flexibility of the City's revenues. The ratio considers different sources of revenues of the primary government, including business-type activities. Intergovernmental aid is revenue generated from other government entities and includes grants. Reliance on intergovernmental aid can be risky during an economic downturn because federal and state agencies frequently withdraw or reduce payments to local governments as a cutback measure.

That said, it is important to maximize the acquisition of federal and state grants as they directly benefit the local economy, as did the Coronavirus Aid, Relief, and Economic Security (CARES) Act funding. Prudent planning should be incorporated to anticipate the impacts of economic downturns and the impact it will have to the availability of intergovernmental funding.

San Diego's primary government revenues remained low compared with peer entities over the ten-year period. However, there has been a negative trend in San Diego's Primary Government Revenues Ratio in the last six years, from a low of 1.5% in FY2015 to a high of 7.2% in FY2020. The increase in the FY2020 ratio was mainly due to an increase in funding received from the CARES Act.
Exhibit 5-1

Primary Government Revenues

(Lower is better)

A low ratio suggests a government is not heavily reliant on intergovernmental aid.

Source: City Auditor generated based on Primary Government Revenues Ratio test results.

San Diego’s 7.2% ratio in FY2020 was 1.1% below the average for comparison cities, showing that the City is not as heavily reliant on intergovernmental aid as other benchmark cities. However, San Diego’s reliance on intergovernmental aid has increased since FY2015.

Exhibit 5-2

San Diego Ratio 5 Ranking Compared to Benchmark Cities

Source: City Auditor generated based on Primary Government Revenues Ratio test results.
The City maintained a 2\textsuperscript{nd} place ranking in the first seven years of the review period, slipping to 3\textsuperscript{rd} and 4\textsuperscript{th} in the recent three years. This is an indication that San Diego is increasingly reliant on intergovernmental aid.

\textbf{Exhibit 5-3}

\textbf{Primary Government Revenues Long-Term Trend (FY2005–FY2020)}

\begin{center}
\begin{tikzpicture}
\begin{axis}[
    title = {Primary Government Revenues Long-Term Trend (FY2005–FY2020)},
    xlabel = {Year}
]
\addplot coordinates {
    (2005, 14)\addplot coordinates {
    (2006, 12)\addplot coordinates {
    (2007, 10)\addplot coordinates {
    (2008, 8)\addplot coordinates {
    (2009, 6)\addplot coordinates {
    (2010, 4)\addplot coordinates {
    (2011, 2)\addplot coordinates {
    (2012, 0)\addplot coordinates {
    (2013, 2)\addplot coordinates {
    (2014, 4)\addplot coordinates {
    (2015, 6)\addplot coordinates {
    (2016, 8)\addplot coordinates {
    (2017, 10)\addplot coordinates {
    (2018, 12)\addplot coordinates {
    (2019, 14)\addplot coordinates {
    (2020, 16)
\end{axis}
\end{tikzpicture}
\end{center}

A low ratio suggests a government is not heavily reliant on intergovernmental aid.

Source: City Auditor generated based on Primary Government Revenues Ratio test results.

San Diego's reliance on intergovernmental aid significantly decreased in the first two years of the sixteen-year period and continued to decrease until FY2017. However, after FY2017, the City saw a trend reversal in its reliance on intergovernmental aids as more grants and other governmental funds were received, including CARES Act funds.
Ratio 6: Governmental Activities Revenues (Revenues)

Formula = Net Revenue (Expense) for Governmental Activities ÷ Total Governmental Activities Expenses

The Governmental Activities Revenues Ratio measures the degree to which governmental activities are supported by taxes and other general revenues. This ratio shows the extent to which governmental activities’ functions and programs are self-financed or the degree to which they depend on financing from governmental revenues, primarily taxes. A low ratio suggests services are less reliant on general revenue financing and are more self-supporting through charges for services, grants, and contributions.

The City of San Diego has maintained a relatively constant level of taxpayer support to governmental activities, ranging between 59% and 69% during the ten-year review period. In FY2020, governmental activities generated almost $782 million in revenue through charges, fees, and grants, which fell short of expenses by almost $1.57 billion. This means 67% of expenses in FY2020 had to be funded through taxes and other general revenues. General revenues are revenues that may be used for any purpose and are not restricted to a specific use.

Exhibit 6-1

Governmental Activities Revenues

(Lower is better)

A low ratio suggests basic government services are more self-sufficient and less reliant on general tax support.

Source: City Auditor generated based on Governmental Activities Revenues Ratio test results.
San Diego’s overall trend is relatively stable in the ten-year period, although the City’s reliance on general tax support increased slightly in the last four years.

### Exhibit 6-2

**San Diego Ratio 6 Ranking Compared to Benchmark Cities**

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</thead>
<tbody>
<tr>
<td>1st</td>
<td>Other Cities’ Best</td>
<td>60.2%</td>
<td>56.6%</td>
<td>61.0%</td>
<td>60.0%</td>
<td>56.4%</td>
<td>52.4%</td>
<td>59.3%</td>
<td>56.6%</td>
<td>45.2%</td>
<td>57.5%</td>
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<tr>
<td>2nd</td>
<td>San Diego</td>
<td>63.9%</td>
<td>59.1%</td>
<td>60.5%</td>
<td>68.7%</td>
<td>65.8%</td>
<td>66.8%</td>
<td>68.7%</td>
<td>65.8%</td>
<td>66.8%</td>
<td>68.7%</td>
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<tr>
<td>3rd</td>
<td>Other Cities’ Worst</td>
<td>78.1%</td>
<td>80.1%</td>
<td>78.8%</td>
<td>77.7%</td>
<td>77.4%</td>
<td>76.6%</td>
<td>78.9%</td>
<td>78.6%</td>
<td>82.0%</td>
<td>80.5%</td>
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</table>

Source: City Auditor generated based on Governmental Activities Revenues test results.

San Diego’s ranking was better than the average of benchmark cities in seven of the ten years. While San Diego was ranked 1st in FY2013, San Diego was ranked 3rd in the two most recent years.
Exhibit 6-3

Governmental Activities Revenues Long-Term Trend (FY2005–FY2020)

(Lower is better)

A low ratio suggests basic government services are more self-sufficient and less reliant on general tax support.

Source: City Auditor generated based on Governmental Activities Revenues test results.

San Diego’s Governmental Activities Revenues Ratio has been relatively stable over the long-term, trending between 59% and 69%.
Ratio 7: Primary Government Debt Per Capita (Debt)

*Formula* = Total Outstanding Primary Government Long-Term Debt ÷ Population

The Primary Government Debt Burden Per Capita Ratio identifies long-term debt\(^8\) burden on the City's residents. A low ratio suggests there is less debt burden imposed on taxpayers and a greater capacity for additional borrowing.

In FY2020, the total outstanding debt for the City of San Diego was $2.8 billion. The City's per capita debt burden has trended downward, from $2,691 in FY2011 to $1,966 in FY2020.

Exhibit 7a-1

**Primary Government Debt Per Capita**

*Lower is better*

A low ratio suggests less burden on taxpayers and greater capacity for additional borrowing.

Source: City Auditor generated from Primary Government Debt Per Capita Ratio test results.

San Diego has maintained a level of long-term debt well below the average of benchmark cities. Since FY2012, San Diego's primary debt burden per capita ratio has been less than half of the average of benchmark cities. This suggests that the City of San Diego is in a better position than benchmark cities to repay outstanding debt and in a better position than benchmark cities for future borrowing.

---

\(^8\) Long-term debt has a maturity of more than one year after issuance.
**Exhibit 7a-2**

**San Diego Ratio 7 Ranking Compared to Benchmark Cities**

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<tbody>
<tr>
<td>1st</td>
<td>Primary Government Debt Per Capita Ratio</td>
<td>$1,800</td>
<td>$1,806</td>
<td>$2,031</td>
<td>$1,984</td>
<td>$1,974</td>
<td>$1,830</td>
<td>$1,795</td>
<td>$1,844</td>
<td>$1,811</td>
<td>$1,966</td>
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<tr>
<td>2nd</td>
<td>San Diego</td>
<td>$2,091</td>
<td>$2,082</td>
<td>$2,053</td>
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<td>4th</td>
<td>San Diego</td>
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<td>Other Cities' Best</td>
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<td>6th</td>
<td>Other Cities' Worst</td>
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Source: City Auditor generated from Primary Government Debt Per Capita Ratio test results.

San Diego's Primary Government Debt Burden Per Capita Ratio has ranked 1st since FY2014, and San Diego's debt per capita has dropped by $724 since FY2011.

**Exhibit 7a-3**

**Primary Government Debt Burden Per Capita Long-Term Trend (FY2005–FY2020)**

(Lower is better)

A low ratio suggests less burden on taxpayers and greater capacity for additional borrowing.

Source: City Auditor generated from Primary Government Debt Per Capita Ratio test results.
Since FY2009, while the average of benchmark cities has shown an increase in debt per capita, San Diego's overall trend is positive with decreasing debt per capita. Since FY2012, San Diego's primary government debt burden per capita has hovered around $1,900.
Primary Government Liabilities Per Capita

*Formula* = \( \frac{\text{Total Primary Government Long-Term Liabilities}}{\text{Population}} \)

In addition to the Primary Government Debt ratio, we calculated a ratio of all long-term liabilities, which was not part of the 10-point test. We calculated this ratio to assess whether the City's long-term liabilities were significantly different from its long-term debt. In addition to long-term debt, long-term liabilities included arbitrage liability, compensated absences, liability claims, estimated landfill closure and post closure care, net other post-employment benefits obligation, and net pension obligation. More information regarding pension and Other Post-Employment Benefits (OPEB) can be found on page 49.

In FY2020, the total long-term liabilities for the City of San Diego were almost $6.5 billion. The long-term liabilities per capita $4,536, which essentially adds $2,570 of financial obligations to the long-term debt per capita of $1,966. The City's per capita liability burden has increased due to the implementation of Governmental Accounting Standards Board (GASB) GASB 68 and GASB 75 which required the inclusion of Net Pension Liability in the financial statements beginning in FY2015 and OPEB in FY2018.

**Exhibit 7b-1**

Primary Government Liabilities per Capita

*(Lower is better)*

A low ratio suggests less future burden on taxpayers.

Source: City Auditor generated from Primary Government Liabilities Per Capita Ratio test results.
San Diego has maintained a level of long-term liabilities well below the average of benchmark cities.

**Exhibit 7b-2**

**Primary Government Liabilities Per Capita Long-Term Trend (FY2005–FY2020)**

![Graph showing the trend of primary government liabilities per capita](image)

*(Lower is better)*

*A low ratio suggests less future burden on taxpayers.*

Source: City Auditor generated from Primary Government Liabilities Per Capita Ratio test results.

San Diego's primary government long-term liabilities per capita has gradually increased while consistently remaining well below the benchmark cities' average.
Ratio 8: Government Funds Debt Coverage (Debt)

Formula = Debt Service Expenditures ÷ Noncapital Governmental Funds Expenditures

The Government Funds Debt Coverage Ratio measures debt service expenditures in relation to operating costs. These expenditures are the annual amount of principal and interest on long-term debt and the amount of interest on short-term debt that a city must pay each year. Debt service expenditures reduce spending flexibility by adding to a city's obligations and can be a major component of fixed costs.

During FY2020, San Diego's debt service expenditures amounted to $83 million or 3.9% of operating expenditures. During the ten-year review period, San Diego's government funds debt coverage ratio ranged from a high of 11.7% in FY2011 to a low of 3.9% in FY2020 and was always below the average of benchmark cities. Despite fluctuations, the ratio shows an overall positive trend.

Exhibit 8-1

Government Funds Debt Coverage

(Lower is better)

A low ratio suggests general governmental long-term debt can be more easily repaid.

Source: City Auditor generated from Government Funds Debt Coverage Ratio test results.
San Diego's FY2020 ratio was 5.7 percentage points below the average of benchmarked cities and 10.7 percentage points below the highest benchmark ratio. During the last ten years, San Diego's Governmental Funds Debt Coverage ratio was below the average of other cities, indicating greater flexibility for future spending.

**Exhibit 8-2**

**San Diego Ratio 8 Ranking Compared to Benchmark Cities**

![Graph showing San Diego's ratio ranking from 2011 to 2020](image)

Source: City Auditor generated from Government Funds Debt Coverage Ratio test results.

The City consistently remained in the top two rankings when compared to the other cities during nine out of the ten years in our review period, ranking 1st in the most recent six years.
Exhibit 8-3

Government Funds Debt Coverage Long-Term Trend (FY2005–FY2020)

(Lower is better)
A low ratio suggests general governmental long-term debt can be more easily repaid.

Source: City Auditor generated from Government Funds Debt Coverage Ratio test results.

San Diego's Government Funds Debt Coverage ratio spiked to 11.7% in FY2011 and has since experienced a positive trend as debt service has decreased to a new low of 3.9% of operating expenses in FY2020.
Ratio 9: Enterprise Funds Debt Coverage (Debt)

Formula = \((Enterprise \ Operating \ Revenue + Interest \ Expense) \div Interest \ Expense\)

The Enterprise Funds Debt Coverage Ratio indicates the sufficiency of resources available to repay business-type debt. The City uses enterprise funds to account for its sewer utility, water utility, airports, development services, environmental services, golf courses, and recycling services. These business-type activities are primarily financed through fees and charges.

The City of San Diego had maintained a relatively consistent ratio for most of the ten-year period, with a positive spike in FY2016 and FY2017. San Diego paid $76 million in interest expenses during FY2020, $9.5 million less than in FY2010.

Exhibit 9-1

Enterprise Funds Debt Coverage

(Higher is better)

A high ratio suggests greater resource availability for repaying the debts of enterprise activities as they come due.

Source: City Auditor generated from Enterprise Funds Debt Coverage Ratio test results.

San Diego’s ratio was relatively consistent with benchmark cities through FY2015 but improved significantly in the latest five-year period. This suggests that San Diego is in a better position to repay enterprise fund debt than benchmark cities. However, the variance between San Diego's ratio and the average ratio of benchmark cities has been decreasing.
San Diego fluctuated between the 1<sup>st</sup> and 5<sup>th</sup> ranking through the first half of the ten-year review period and then jumped to the 1<sup>st</sup> ranking in FY2016 and remained there through FY2019.
San Diego’s enterprise funds have been consistently generating over 15 times the amount of interest expense since FY2016. Since these revenues are pledged to meet the debt expense associated with these funds, this continues to be a positive trend.
Ratio 10: Net Change in Capital Assets' Value (Capital Assets)

Formula = \((\text{Ending Net Value of Primary Government Capital Assets} - \text{Beginning Net Value}) \div \text{Beginning Net Value}\)

This ratio measures the net change capital assets value. A high ratio suggests a government is keeping pace, on average, with the aging of its capital assets and replenishing them. A positive percentage change suggests that the capital assets are being replenished; a negative number suggests that they are being depleted.

One-time spikes due to the addition of large capital projects can be anticipated, but long-term under-performance in this metric can be an indication that the City is under-investing in its infrastructure when compared to other cities. This ratio is not intended to evaluate the capital assets’ condition—it is the replenishment of overall assets.

The City's lowest ratio was 0.2% in FY2012. FY2015 was the City's highest ratio at 4.7%, with FY2020 coming in at 3.01%, just slightly above the benchmark cities' average of 2.97%.

Exhibit 10-1

Net Change in Capital Assets' Value

(Higher is better)

A high ratio suggests a government is keeping pace, on average, with the aging of its capital assets and replenishing them.

Source: City Auditor generated based on Capital Asset's Value Ratio test results.
San Diego’s ratios were well below the average of benchmark cities in five of the ten years. In FY2020, the net change in the value of capital assets for San Diego was an increase of 3%. The FY2020 ratios for benchmark cities ranged from a high of 5.4% to a low of 0.1%.

**Exhibit 10-2**

San Diego Ratio 10 Ranking Compared to Benchmark Cities

The overall trend for San Diego is moving in a positive direction. However, the City of San Diego ranked 5th among the benchmark cities in FY2020, has never been higher than 4th, and was ranked 6th in two of the ten years, making this ratio the overall least favorable for San Diego’s 10-point test.
**Exhibit 10-3**

Net Change in Capital Assets’ Value Long-Term Trend (FY2005–FY2020)

A high ratio suggests a government is keeping pace, on average, with the aging of its capital assets and replenishing them.

Source: City Auditor generated based on Capital Asset’s Value Ratio test results.

In FY2020, San Diego’s primary government capital assets value increased by $347 million, or 3%. For comparison, to match the highest ratio of benchmark cities (5.4%), the growth of San Diego's capital assets value would have needed to be $622 million, an increase of $275 million in the net value change for capital assets.
Pension & Other Post-Employment Benefits Liabilities

Pension liabilities and Other Post-Employment Benefits (OPEB) are not covered as a unique metric in the Mead 10-point test but continue to be a focal point of governing bodies and the public. To address these concerns, the Governmental Accounting Standards Board (GASB) has issued disclosure standards related to both Defined Benefit Pension Plans (GASB 68) and Other Post-Employment Benefits (OPEB) (GASB 75). Pension and OPEB information in the City of San Diego's FY2020 Annual Comprehensive Financial Report can be found in Notes 12 and 13, as well as in the Required Supplementary Information section.

We highlight some of the more important metrics regarding Pension Disclosure in this report. The following chart highlights the City of San Diego's pension-related metrics. Descriptions of each column follow the chart.

---

9 Standards governing Pension Plan disclosures are covered under GASB 67 and 68. Standard 67 covers disclosure requirements for the pension fund entities (Plan) with fiduciary responsibility for managing the investment portfolios, while GASB 68 covers disclosure requirements for government entities (Employer) with pension plans. GASB 67 became effective for Plan fiscal years beginning after June 15, 2013, with GASB 68 becoming effective for employers one year later for fiscal years beginning after June 15, 2014.

For OPEB, the GASB Standards are 74 and 75. The effective dates for these standards are:


Since this review period covers FY2017 and FY2018, the Pension GASB has been effective since FY2015, and the OPEB standard was implemented in FY2018. For both Pension and OPEB, the Measurement Date lags the financial statement fiscal year by one year.
Pension and OPEB accounting is complex. Assumptions are used by actuaries to estimate the City’s Net Pension and OPEB Liabilities. More conservative assumptions can have a significant impact on these calculations. As such, the data in the above charts should not be used in isolation, but rather in combination to understand the health of the investment plans.

Investment Rate of Return (IRR):

- Commonly referred to as the Discount Rate. A lower percentage is considered more conservative as the investment pool is more likely to meet the set benchmark. For Pension, SDCERS has been systematically decreasing this metric since the high of 8% prior to the 2008 valuation.
  
  o To highlight the impact of this assumption:
    - For FY2020 (Measurement Date 2019), if this assumption was 1% lower, the Net Pension Liability would be $3.9 billion;
    - If it was 1% higher, it would be $1.6 billion.

<table>
<thead>
<tr>
<th>Measurement Date Fiscal Year</th>
<th>Investment Rate of Return</th>
<th>Inflation Rate</th>
<th>Net Pension Liability (NPL) (Thousands)</th>
<th>Funded Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>6.500%</td>
<td>3.050%</td>
<td>$2,658,823</td>
<td>74.5%</td>
</tr>
<tr>
<td>2018</td>
<td>6.500%</td>
<td>3.050%</td>
<td>$2,613,519</td>
<td>74.0%</td>
</tr>
<tr>
<td>2017</td>
<td>7.000%</td>
<td>3.050%</td>
<td>$2,522,056</td>
<td>73.5%</td>
</tr>
<tr>
<td>2016</td>
<td>7.000%</td>
<td>3.050%</td>
<td>$2,650,554</td>
<td>70.4%</td>
</tr>
<tr>
<td>2015</td>
<td>7.125%</td>
<td>3.175%</td>
<td>$1,713,566</td>
<td>78.8%</td>
</tr>
<tr>
<td>2014</td>
<td>7.250%</td>
<td>3.300%</td>
<td>$1,535,537</td>
<td>80.4%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Measurement Date Fiscal Year</th>
<th>Investment Rate of Return</th>
<th>Inflation Rate</th>
<th>Net OPEB Liability (Thousands)</th>
<th>Funded Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>6.450%</td>
<td>2.5% - 7.5%</td>
<td>$462,516</td>
<td>20.5%</td>
</tr>
<tr>
<td>2018</td>
<td>6.570%</td>
<td>2.5% - 8%</td>
<td>$462,264</td>
<td>19.6%</td>
</tr>
<tr>
<td>2017</td>
<td>6.730%</td>
<td>2.750%</td>
<td>$550,444</td>
<td>17.4%</td>
</tr>
</tbody>
</table>

For OPEB, the IRR is set by GASB 75 requirements based on how each government funds their OPEB liabilities.

Inflation Rate:
- A higher percentage is considered more conservative.
  Inflation impacts projected future Pension/OPEB costs of the plan.

Net Pension/OPEB Liability:
- This represents the unfunded Pension/OPEB liability (lower is better).
  - This is an outcome of the contributions plus investment returns, less the liabilities based on the actuarial assumptions.

Funded Percentage (Plan Fiduciary Net Position as a Percentage of the Total Pension/OPEB Liability):
- Higher percentage indicates a healthier plan (higher is better).
  - This is a percentage of available plan assets to the total Pension/OPEB Liability and is impacted by actuarial assumptions.

Note:

SDCERS’ Board exercises its fiduciary responsibility in the administration of the pension plan. This includes reviewing economic assumptions (investment rate, inflation rate, and cost of living increase (COLA) assumption) annually and demographic assumptions (mortality, rates of retirement, rates of disability, etc.) every five years. Changes to the assumptions may increase or decrease Pension Liabilities and as a result may change the Plan Fiduciary Net Position as a Percentage of the Total Pension Liability.
Contingent Liabilities

Contingent Liabilities\textsuperscript{10} information is being provided as there may be significant exposure to the City as a result of these future liabilities. There is no prescribed test to compare these liabilities between agencies as each city faces unique circumstances. These liabilities are not part of the Mead 10-point test.

A contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to a government that will ultimately be resolved when one or more future events occur or fail to occur. Portions of Contingent Liabilities may be accrued, and if so, are included in the 10-point test for Liquidity and Solvency.

The City of San Diego reported the following Contingent Liabilities in the FY2020 Annual Comprehensive Financial Report Note 18:

- Federal & State Grants are included because the granting agencies generally have requirements which must be adhered to. These agencies could request reimbursement for failure to comply.
  - No Estimate (Note disclosure only)

\textsuperscript{10} According to the Governmental Accounting Standards Board (GASB), there are generally three types of note disclosures in the ACFR:

- Those that describe the accounting methods, policies, and choices underlying the amounts in the financial statements;
- Those that provide additional detail about or explanations of the amounts in the financial statements; and
- Those that do not meet all the criteria to be recognized in the financial statements (for instance, because the amounts cannot be measured with sufficient reliability).

Most contingent liabilities fall into this third category of GASB required note disclosures. GASB standards make clear that the lists of specific disclosures are “neither all-inclusive nor intended to replace professional judgment” regarding what is necessary to achieve fair presentation. In other words, if a government believes that not disclosing a piece of information would cause the financial statements to be misleading, then it should disclose that information, even if it is not specifically required in the standards. Standards for reporting most contingent liabilities are contained in GASB 62 paragraphs 96–113. Pollution Remediation contingent liabilities are covered under GASB 49.
• Litigation & Regulatory disclosure requires number of claims be reported and estimates/accruals be made if determinable:
  
  - 1,083 Claims (15% decrease from FY2018)
  
  • Estimates:
    - Not accrued: $0–$195 million (Note disclosure only), ($5.3 million decrease from FY2018)
    - Accrued: $176 million ($37.4 million decrease from FY2018)

• Storm Water Pollution Remediation – The City is named as a responsible party in the cleanup and/or remediation of the areas listed below:
  
  - No Reasonable Estimate - (Note disclosure only)
    - Boat Channel at Naval Training Center
    - San Diego Bay's Laurel Hawthorne Central and East Embayment
    - San Diego Bay adjacent to Tenth Avenue Marine Terminal
    - San Diego River
    - Bacteria total maximum daily load (TMDL) (New addition since FY2018)

• COVID-19
  
  - $248,451,000 of CRF Funding through the CARES Act
    - Approximately $91,786,000 of eligible expenditures were incurred in FY2020; remainder will be applied to FY2021
Commitments

In addition to the Contingent Liabilities, the City of San Diego also discloses Contractual and Regulatory Commitments in Note 17 of the City's Annual Comprehensive Financial Report (ACFR). Contractual commitments are legally binding obligations. Regulatory commitments are not encumbered, but estimates of future costs are disclosed in the footnote. In FY2020, Commitments included the following:

Contractual (Operating & Capital) – Encumbered: $576,881,000 (11% decrease from FY2018)

- General Fund: $42,691,000
- Non-Governmental Funds: $192,573,000
- Enterprise Funds: $341,617,000

Regulatory (separate and distinct from Storm Water Pollution Remediation included in Contingent Liability Note)

- RWQCB – Municipal Storm Water Permit; Water Quality Improvement Plans (WQIP's) – Estimate.
  - FY2021–FY2035: $3,890,643,000 (24% increase from FY2018)
- California Department of Public Health Compliance Order – Estimate (unidentified portions may be encumbered as part of on-going CIP execution by Public Utilities).
  - FY2020–FY2025:
    - Water System Capital Improvements: $36,866,000 (35% decrease from FY2018)

Point Loma WWTP Modified Permit - Pure Water Program Facilities - Estimate – As a condition of receiving the permit to avoid upgrading to secondary treatment at Point Loma, the City must go forward with the Pure Water Project. Estimated costs are:

- Sewer Utility: Ph 1 - Sewer Utility; $594,000,000 (3% decrease from FY2018)
• Water Utility: Ph 1 - Water Utility; $834,000,000 (4% decrease from FY2018).
Other Pertinent Information

California State Auditor Analysis of the Fiscal Health of California Cities

The California State Auditor (State Auditor) continues to analyze financial information for California cities (423 cities in its FY2020 report) in its Local Government High Risk dashboard to identify cities that may be at risk of fiscal distress. The State Auditor assesses risk by performing various financial comparisons and calculations referred to as financial indicators. The State Auditor’s analysis relies upon information from audited financial statements prepared in accordance with generally accepted accounting principles (GAAP), as well as pension-related information from the California Public Employees’ Retirement System (CalPERS) and the State Controller.

Similar to this report, the State Auditor selects a set of 10 indicators to assess each city’s ability to pay its bills in both the short- and long-term. Specifically, the indicators measure each city’s cash position or liquidity, debt burden, financial reserves, revenue trends, and ability to pay for employee retirement benefits. The City of San Diego ranked 37th out of 423 with a ranking of 1 being the worst and 423 being the best. The ratios in which the City of San Diego under-performed compared to other California cities were General Fund Reserves (weighted 30%), and Debt Burden (weighted 15%). The two California cities included in this report, Los Angeles and San Jose were also included in the State Auditor’s report and those cities received rankings of 27th and 84th respectively. However, there are differences between the Mead 10-point test and the State Auditor’s methodology for ranking cities’ financial condition besides the weighting.

In the City’s Chief Financial Officer’s October 2019 memorandum on the subject of the State Auditor’s Financial dashboard, it was stated, “We recognize that a standard approach is necessary for the type of information provided in the State Auditor’s
dashboard. However, important factors unique to each city may not be fully captured through this tool.”

For instance, we would point out that the State Auditor’s calculation excluded the City’s Emergency Reserve of $106.1 million, (almost half of San Diego’s reserves), in its calculation of General Fund Reserves as the City includes this reserve in Restricted Net Assets unlike most other cities which generally include Emergency Reserves in Unrestricted Net Assets. According to the Government Finance Officers Association best practice advisory on Fund Balance for the General Fund, “Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.” When the Emergency Reserve is included in the calculation, the City of San Diego has adequate reserves of 13.5%, which equates to 49 days coverage (a 5.4% increase from our last report for FY2018).

We would also point out that in the State Auditor’s report, Debt Burden is calculated in relation to annual revenues whereas the Mead 10-point test metric for Debt Burden uses population resulting in a per capita burden amount. Both calculations may be appropriate depending on the purpose of the report.

It is also important to note that in the State Auditor’s report, the majority of cities (304 out of 423) in the study are significantly smaller than San Diego, with populations less than 70,000 and as little as 285.

Comparing large cities against small cities can be problematic. For instance, smaller cities generally have smaller capital projects and cash fund those projects, whereas large cities need to debt finance large projects because it makes sound fiscal sense to do so. In addition, smaller cities typically have a greater percentage of reserves when compared to their annual expenses as both are relatively low balances when compared to larger cities. For example, it would not be unusual to see small cities have in excess of six months of expenses available in unreserved balances. GFOA recommends a minimum of 60 days of unrestricted reserves; however, it also notes an exception for
larger governments due to more diverse revenue sources and less volatility in expenses.
Appendix A: Objectives, Scope, and Methodology

Objectives

In accordance with the Office of the City Auditor’s Fiscal Year (FY)2022 Audit Work Plan, we conducted a performance audit of the City of San Diego’s financial condition. Specifically, our audit objective was to examine the City’s financial well-being in four areas—financial position, revenues, debt, and capital assets—by calculating 10 ratios, analyzing trends in the City’s financial data over a ten-year period, and comparing the results to other cities of similar size and government type.

Scope & Methodology

To address our audit objective, we selected the modified 10-point test for assessing financial condition for local governments, as presented by Dean M. Mead, Research Manager at the Governmental Accounting Standards Board (GASB). This method incorporates both short-term and long-term aspects of a city’s financial well-being while being relatively simple, straightforward, and easy to use. This is because the method relies primarily on audited and reliable financial data published in the city’s Annual Comprehensive Financial Reports (ACFRs).\(^\text{11}\) This method also incorporates financial reporting changes made as a result of GASB Statement 34, which required governments to publish full accrual, government-wide information. This change made longer-run and more complete information available, which allows for the assessment of a more comprehensive concept of financial health.

The modified 10-point test is based on 10 financial ratios, which are used as indicators for several aspects of the City’s financial health. The ratios and the primary sources for the figures used to calculate them are listed in the following table.

\(^{11}\) ACFRs used for San Diego and the comparison cities were obtained from their respective websites.
<table>
<thead>
<tr>
<th>Ratio #</th>
<th>Ratio Description</th>
<th>CAFR Source(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Short-Run Financial Position: Unreserved General Fund Balance ÷ General Fund Revenues</td>
<td>Governmental Funds Balance Sheet; Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances</td>
</tr>
<tr>
<td>2</td>
<td>Liquidity: General Fund Cash and Investments ÷ (General Fund Liabilities – General Fund Deferred Revenues)</td>
<td>Governmental Funds Balance Sheet</td>
</tr>
<tr>
<td>3</td>
<td>Financial Performance: Change in Governmental Activities Net Assets ÷ Total Governmental Activities Net Assets</td>
<td>Government-Wide Statement of Activities</td>
</tr>
<tr>
<td>4</td>
<td>Solvency: (Primary Government Liabilities – Deferred Revenues) ÷ Primary Government Revenues</td>
<td>Government-Wide Statement of Net Assets and Statement of Activities</td>
</tr>
<tr>
<td>5</td>
<td>Primary Government Revenues: (Primary Government Operating Grants and Contributions + Unrestricted Aid) ÷ Total Primary Government Revenues</td>
<td>Government-Wide Statement of Activities</td>
</tr>
<tr>
<td>6</td>
<td>Governmental Activities Revenues: [Net (Expense) Revenue for Governmental Activities ÷ Total Governmental Activities Expenses] ÷ Population</td>
<td>Government-Wide Statement of Activities</td>
</tr>
<tr>
<td>7</td>
<td>Primary Government Debt Burden: Total Outstanding Debt for the Primary Government ÷ Population</td>
<td>Long-Term Liabilities Note Disclosure and Statistical Section</td>
</tr>
<tr>
<td>8</td>
<td>Government Funds Debt Coverage: Debt Service ÷ Noncapital Governmental Funds Expenditures</td>
<td>Governmental Funds Balance Sheet or Statistical Section</td>
</tr>
<tr>
<td>9</td>
<td>Enterprise Funds Debt Coverage: (Enterprise Funds Operating Revenue + Interest Expense) ÷ Interest Expense</td>
<td>Proprietary Funds Statement of Revenues, Expenses, and Changes in Fund Net Assets</td>
</tr>
</tbody>
</table>


To make the financial ratios of the 10-point test most meaningful, Mead suggested that the ratios needed the context...
provided by a comparison with prior years and with other, similar governments. Therefore, we calculated the 10 financial ratios for the City of San Diego over a period of 10 fiscal years (FY2011 through FY2020) and calculated the same ratios for six other cities over the same period of time.

To select the benchmark cities, Mead suggested three characteristics as a basis for comparison:

1. Government type;
2. Geographic region; and
3. Size (in terms of either financial activity, population, or both).

We selected benchmark cities based on government type and size. Since San Diego is the eighth largest city in the United States, selecting only benchmark cities in the same geographic region, or even within the state of California, would have made the comparison and resulting analysis less meaningful. For example, cities with a similar population size\(^\text{12}\) tend to face similar challenges and service demands, which have a direct bearing on financial condition.

We included the same comparison cities in this report as we had during the prior audit. The following table lists the cities in the comparison group along with their estimated population size as of July 1, 2020.

<table>
<thead>
<tr>
<th>City Name</th>
<th>Population Estimate (2020)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Los Angeles</td>
<td>3,970,219</td>
</tr>
<tr>
<td>Phoenix</td>
<td>1,708,127</td>
</tr>
<tr>
<td>San Antonio</td>
<td>1,567,118</td>
</tr>
<tr>
<td><strong>San Diego</strong></td>
<td><strong>1,422,420</strong></td>
</tr>
<tr>
<td>San Jose</td>
<td>1,013,626</td>
</tr>
<tr>
<td>Austin</td>
<td>995,484</td>
</tr>
<tr>
<td>Seattle</td>
<td>769,714</td>
</tr>
</tbody>
</table>

\(^{12}\) The only city in California with similar population size was San Jose, which was included in the comparison group. Also included was Los Angeles with 3,970,219 in population. San Francisco with 866,606 is closer than Seattle, however it is a City/County, and Fresno and Sacramento have just over 500,000 in population each, making them just over one-third the size of San Diego.
After calculating the 10 financial ratios for San Diego and the benchmark cities from ACFR data, we compared San Diego's results to the benchmark cities' average and plotted these on a graph. We also ranked results for all cities in each of the 10 ratios and across all 10 years. We developed our conclusions based on this comparative analysis. Finally, we calculated quartile ranges for each individual ratio based on all of the cities' ratio values. We then assigned scores to each city based on its results in comparison to the other cities. We did this for each city in every ratio across all 10 years. In accordance with the modified 10-point test, we awarded two points for each ratio that fell in the top quartile (top 25%) of the comparison group. One point was given for each in the second quartile, and no points for a ratio in the third quartile. A point was subtracted for a ratio in the lowest quartile. We used the points and the resulting cumulative score to rate San Diego's financial condition relative to the benchmark cities. This relative rating is based upon the following scoring table:

<table>
<thead>
<tr>
<th>Overall Score</th>
<th>Rating Relative to Other Cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 to 20</td>
<td>Among the Best</td>
</tr>
<tr>
<td>5 to 9</td>
<td>Better than Most</td>
</tr>
<tr>
<td>0 to 4</td>
<td>About Average</td>
</tr>
<tr>
<td>-5 to -1</td>
<td>Worse than Most</td>
</tr>
<tr>
<td>-10 to -6</td>
<td>Among the Worst</td>
</tr>
</tbody>
</table>

Source: Public Financial Management, Chapter 15.

**Disclaimers**

Analyzing financial ratios provides a broad assessment of San Diego's financial condition, but it is important to recognize strengths and limitations to this sort of analysis. The table below highlights some of the strengths and limitations of our method.
## Strengths

**Comparative data compiled under consistent accounting principles and audited under Government Auditing Standards.**

**Ratios developed independent of management and provides an independent view of the City’s finances.**

**The City’s results are contextualized by comparison to cities of similar size.**

**The City’s results are contextualized by comparison over a ten-year period.**

## Limitations

**Analysis provides a broad overview rather than detailed analysis.**

**Excludes information on level and quality of services and infrastructure as well as external factors, such as demographic and economic trends, that may affect City finances.**

**Provides historical analysis rather than projections of future condition.**

**Results are a relative comparison, but do not provide the optimal ratio value a city should strive for.**

Source: City Auditor generated.

All underlying financial information in this audit originates from the City’s ACFRs. Accordingly, we relied on the audit work performed by the City’s external financial auditors. We therefore did not audit the accuracy of source documents or the reliability of the data in computer-based systems.

Our assessment of internal controls over financial reporting was limited to a review of the Independent Auditor’s Report in the benchmark city’s Annual Comprehensive Financial Reports and the opinions expressed therein. Based on the opinions, the respective financial statements are presented fairly in all material respects.

Our review of data was not intended to give absolute assurance that all information was free from error. Rather, our intent was to provide reasonable assurance that the reported information presented a fair picture of the City’s financial health. In addition, while this report offers financial highlights, it does not thoroughly determine the reasons for negative or positive performance. More in-depth analysis would be needed to provide such explanations.

This report was independently developed by the Office of the City Auditor and is intended for the general public as a high-level report. This report is the result of a performance audit and was
not part of the annual audit of the City's financial statements. Expressions of opinion in the report are not intended to guide prospective investors in securities offered by the City, and no decision to invest in such securities should be made without referencing the City's audited ACFRs and official disclosure documents relating to a specific security.

**Compliance Statement**

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.
Appendix B: City Departments Involved in Managing Financial Condition

How Does the City Manage Its Financial Condition?

The City's financial condition is multi-faceted and depends on the work performed by the departments shown below, which are overseen by the Chief Financial Officer (CFO):

Department of Finance:
- Budgeting
- Fiscal Consulting
- Financial Reporting
- Disbursements
- Payroll
- Internal Controls
- Purchasing and Contracting

The Department of Finance provides fiscal services to the Mayor and serves as an internal fiscal consultant to other City departments. The Department of Finance prepares the proposed and annual budgets in accordance with the City Charter. During the fiscal year, it monitors the City's revenues and expenditures, oversees budget transfers and adjustments, and reviews requests for City Council and Mayoral Actions for both the operating budget and the Capital Improvements Program (CIP). In addition, the Department of Finance develops and updates the Mayor's Five-Year Financial Outlook.

The Department of Finance is also responsible for the preparation of the Annual Comprehensive Financial Report (ACFR), which includes an accounting of all City funds and its component units. The ACFR contains note disclosures that provide additional financial information and are necessary to fully understand the City's financial position. The Department of Finance performs the general accounting and financial reporting function for the City. The Department of Finance is also responsible for payment services, including payroll processing and centralized processing for all vendor payments. In addition, the Department of Finance oversees the Internal Controls Section, which is mainly responsible for implementing and monitoring internal controls over financial reporting and operations.

City Treasurer:
- Receivables
- Banking
- Investments

The Office of the City Treasurer is responsible for the receipt and custody of all City revenue, banking, tax administration, parking administration, parking meter operations, collection of delinquent accounts, and accounting for these funds. The City Treasurer is also responsible for the investment of all operating funds.
Performance Audit of the City's Financial Condition

and capital improvement funds, including the reinvestment of debt proceeds of the City and its affiliated agencies.

Debt Management:  
- **Financing**  
The Debt Management Department conducts planning, structuring, and issuance activities for all City financings to fund cash flow needs and to provide funds for capital projects, essential equipment, and vehicles. The department monitors outstanding bond issuances for refunding opportunities and performs, coordinates, and monitors certain post-issuance administrative functions.

Risk Management:  
- **Financial**  
- **Self-Insurance**  
The Risk Management Department seeks to prevent, control, and minimize the City's financial risk while providing optimum services to the City's employees and its citizens through the centralized administration of healthcare, safety, loss control, employee benefit, and other risk management programs.

Independent Budget Analyst:  
- **Budget and Policy Analysis**  
In addition to the departments overseen by the CFO, the Office of the Independent Budget Analyst (IBA) assists the City Council with budgetary inquiries and in the making of budgetary decisions. The IBA provides information, analyses, and recommendations throughout the annual budget process, as well as for all financial and policy items submitted throughout the year for City Council, Council Committee, and Housing Authority consideration. Each fiscal year, the IBA reviews and evaluates the Mayor’s Proposed Budget and Five-Year Financial Outlook, and issues reports that provide analysis and recommendations for City Council consideration.
Appendix C: Information Related to the City’s Financial Statements

Annual Comprehensive Financial Reports (ACFRs)

The financial data used to calculate the ratios in this report originate from ACFRs from the City of San Diego and the benchmark cities. ACFR is the official annual report of a state or local government. It includes introductory materials (such as a letter of transmittal and auditors’ report), financial statements, supporting notes, supplementary schedules, and statistical data. Information from the annual financial reports provides consistent, reliable data because it conforms to generally accepted accounting principles and is audited under generally accepted government auditing standards. San Diego ACFRs used in this assessment were independently audited by Macias Gini & O’Connell LLP (MGO) Certified Public Accountants, and, in their opinion, the financial statements were fairly presented in all material respects.

Basic Financial Statements

The City’s basic financial statements include three components:

1. Government-Wide Financial Statements;
2. Fund Financial Statements; and

1. Government-Wide Financial Statements

The focus of the government-wide financial statements is on reporting the operating results and financial position of the government as an economic entity. These statements are intended to report the City’s operational accountability to its readers, giving information about the probable medium- and long-term effects of past decisions on the City’s financial position.

The statement of net position presents information on all of the City’s assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the residual amount reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.
The statement of activities presents information showing changes in the City's net position during the fiscal year. All changes in net position are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. The focus is on both gross and net costs of City functions, which are supported by general revenues. This statement also distinguishes functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities and business-type activities together make up the primary government.

**Government-Wide Financial Statements**

<table>
<thead>
<tr>
<th>Governmental Activities</th>
<th>Business-Type Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Government and Support</td>
<td>Sewer Utility</td>
</tr>
<tr>
<td>Public Safety – Police</td>
<td>Water Utility</td>
</tr>
<tr>
<td>Public Safety – Fire, Life Safety, and Homeland Security</td>
<td>Airports</td>
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<tr>
<td>Parks, Recreation, Culture, and Leisure</td>
<td>Development Services</td>
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<tr>
<td>Transportation</td>
<td>Environmental Services</td>
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<tr>
<td>Sanitation and Health</td>
<td>Golf Course</td>
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<tr>
<td>Neighborhood Services</td>
<td>Recycling</td>
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<tr>
<td>Debt – Cost of Issuance and Interest on Debt Service</td>
<td>San Diego Convention Center</td>
</tr>
<tr>
<td></td>
<td>Corporation</td>
</tr>
</tbody>
</table>

Source: City of San Diego FY2020 ACFR.

**2. Fund Financial Statements**

The focus of the fund financial statements is on reporting of a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. All funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.
Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government’s near-term financing requirements.

Proprietary fund statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the Sewer and Water Utility funds, which are considered to be major funds of the City. Data for the non-major proprietary funds are combined into a single, aggregated presentation, and the internal service funds are combined into a single, aggregated presentation as well.

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City’s operations. Fiduciary funds were therefore not included in the ratio analysis.

3. Notes to the Financial Statements

The notes to the basic financial statements provide additional information that is essential for a full understanding of the data provided in the government-wide and fund financial statements.
DATE: January 12, 2022

TO: Andy Hanau, City Auditor

FROM: Mathew Vespi, Chief Financial Officer

SUBJECT: Management Response to Performance Audit of the City’s Financial Condition

The purpose of this memorandum is to provide Management’s response to the Audit Report entitled “Performance Audit of the City’s Financial Condition.” The City Auditor’s Report focuses on activity from the City’s Annual Comprehensive Financial Reports for Fiscal Years 2019 and 2020, tracking results over a ten-year period, with comparative data from cities with similar government type and population size.

The City Auditor’s performance audit highlights continued and sustained strength in the City’s financial condition, even after considering the effects of the COVID-19 pandemic on the City’s finances. The City’s financial indicators continue to outperform comparative cities, with San Diego being the highest overall ranked among the six cities included in the report. The results of the audit are consistent with the City’s strong credit ratings. As of June 2021, the City maintained ratings in the second highest rating category from three of the national credit rating agencies. These include “AA” ratings from Standard and Poor’s and Fitch Ratings and Aa2 from Moody’s Investors Service.

The COVID-19 pandemic impacted the City both operationally and financially, including significant declines in transient occupancy tax and sales tax receipts. On March 27, 2020, the federal government passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to provide emergency assistance and health care response for individuals, families, and businesses affected by the COVID-19 pandemic. The City received $248.5 million on April 22, 2020. This allowed the City to maintain General Fund reserves at existing levels without reductions to services.

It is important to note that some of the financial ratios included in the report were affected by the financial impacts of COVID-19 on the City, including the decline in revenues and the receipt of Federal Relief Funds. Some of these impacts are expected to be temporary in nature. While there continues to be some uncertainty regarding how the pandemic will continue to unfold, current projections assume that General Fund revenues will return to near pre-pandemic levels in Fiscal Year 2023. Moreover, federal stimulus funds are not expected to continue once the pandemic subsides. For this reason, the financial trends reflected in the audit should be considered within the context of this unprecedented period.

On a more general note, while the financial ratios included in this report can be used to assess a local government’s financial condition, additional information is needed to fully understand the complexity of a large municipality like the City of San Diego. Even when comparing cities of similar population, there may be significant differences between them,
including different services provided to residents, differences in socioeconomic, political, and regulatory environments in addition to opportunities and limitations afforded by their geographic location and natural environment. There are also differences relating to revenue or debt raising ability among local agencies in California compared to localities in other states. The metrics included in this report are based on formulas that provide a high-level view of each city’s financial condition. A more complete assessment can only be achieved through a careful review and understanding of each City’s annual financial statements and note disclosures.

Mathew Vespi
Chief Financial Officer

cc:   Jay Goldstone, Chief Operating Officer
      Jeff Kawar, Interim Independent Budget Analyst, Office of the IBA
      Kristina Peralta, Deputy Chief Operating Officer
      Christiana Gauger, Chief Compliance Officer
      Rolando Charvel, Department of Finance Director and City Comptroller
      Lakshmi Kommi, Director of Debt Management
      Jessica Lawrence, Director of Policy, Office of the Mayor
      Chris Kime, Principal Performance Auditor, Office of the City Auditor