Annual Report on Internal Financial Control

14th Edition

Calendar Year 2019

Department of Finance
March 1, 2020

The City of
SAN DIEGO

Executive Summary

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

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

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

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

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

This report summarizes management's approach to maintaining an internal control system that provides reasonable assurance that financial reporting objectives are met. Significant enhancements during calendar year 2019 and potential risks that were identified, either by management or through the audits performed by independent auditors and the Office of the City Auditor (City Auditor), are included. Other than what has been included in this report, management did not identify any significant deficiencies in the design or operation of internal

controls that could adversely affect the City's ability to record, process, summarize and report financial data.

Financial Reporting Achievements and Internal Control Improvements

The list below identifies the most significant financial reporting achievements and internal control improvements implemented by the Department of Finance (DoF) during the assessment period.

- Received an unmodified (clean) audit opinion on the City's 2019 Comprehensive Annual Financial Report (CAFR). No material adjustments, material weaknesses, or significant deficiencies in internal controls over financial reporting were identified through the CAFR independent audit.

- Received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA) for the fiscal year 2018 CAFR. In order to be awarded a Certificate of Achievement, the City must publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable GFOA program requirements.

- Received a Distinguished Budget Presentation Award from GFOA for the fiscal year 2019 Adopted Budget. Recipients are awarded this honor for meeting guidelines set by the National Advisory Council on State and Local Budgeting (NACSLB) and GFOA's best practices on budgeting.

- Expanded the use of a new CAFR publishing software which was introduced in 2018 to streamline preparation and enhance controls over the City's CAFR. The DoF gained process efficiencies and assurances for this important document, which is relied on by many stakeholders in various financial and investment industries.

- Assessed the design and control of currently documented significant processes to evaluate continued relevance and effectiveness. Collaborated with process owners to revise processes and related controls identified for changes during the calendar year 2019 assessment.

- Transitioned the travel and tuition reimbursements, and jury duty monitoring tests into the Governance, Risk, and Compliance (GRC) module in SAP. Manual control tests are scheduled in the system to allow testers to route issues to their supervisors for appropriate remediation and is utilized as a tracking data repository.

- Expanded Finance Academy offerings from once a year to twice a year, and expanded curriculum to include more financial topics such as fixed asset and grant management accounting. These Academies are intended to train city employees responsible for financial data to ensure proper procedures and standards are followed.

- Implemented additional risk checks in the City's SAP risk management module which is utilized to identify and mitigate risk across system user access rights, segregation of duties, and process performance.

- Created the Vendor Invoice Management (VIM) Vendor Bypass Report and implemented a daily mitigation control prior to accounts payable payment runs. The report acts as a detective control in identifying changes made to the vendor account on VIM invoices to ensure that all changes are valid.

- The citywide effort to update all Administrative Regulations (A.R.s) continued during calendar year 2019 with the completion of 1 new and 8 revised A.R.s.

- In an effort to promote operational efficiencies and customer service, the Office of the City Comptroller and Financial Management merged into the DoF in 2018. The consolidation allows for the continued reduction of certain redundancies and creates more cohesion between accounting, monitoring, and forecasting functions.

Background

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

External Financial Reports

The CAFR is the most significant financial report produced by the City for external users. It is available on the City's website and can be accessed by residents, investors, rating agencies and other interested parties. The CAFR is a comprehensive financial document that includes the balances and activity of all funds and component units of the City and related disclosures. The report typically takes five months to prepare and involves the collaboration of the DoF staff, as well as key outside department staff who provide necessary information for required disclosures. The CAFR is prepared in accordance with Generally Accepted Accounting Principles (GAAP), which are established by the Governmental Accounting Standards Board (GASB). The CAFR is audited annually by an independent auditing firm who expresses an opinion on whether or not the basic financial statements are fairly presented in all material respects in accordance with GAAP. The City received an unmodified (clean) audit opinion on the City's 2019 CAFR.

The City also produces other financial reports for external use such as the Schedule of Expenditures of Federal Awards, which summarizes all expenditures of federal awards for the fiscal year and is subject to a single audit by an external independent auditor (Single Audit). The fiscal year 2019 Single Audit is expected to be completed by March 31, 2020. The City's independent auditor also conducts an audit of the schedule of costs for the fiscal year related to the Metropolitan Wastewater System and the City's allocation of such costs to Participating Agencies (MWWD Allocation of Billing Schedule). There were no reportable findings or material weaknesses noted during the last audit periods.

Internal Financial Reports

Reports for internal use are published and presented to the City's legislative body, the City Council, and available to the public. Not only are these reports mandated as part of City Charter or the SDMC, they promote transparency and oversight of management's financial spending and plans. The City's annual budget is in many respects the most important financial report because it informs readers of the Mayor's priorities in terms of financial characteristics and serves as a key tool for financial management and compliance. Without this annual document, the City can be at risk of not funding and complying with legally mandated requirements which may result in material omissions of liabilities or penalties.

The City also publishes a long-range forecasting report known as the Five-Year Financial Outlook to establish a framework for the development of the annual budget and anticipate potential funding needs over a long-term horizon.

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

Management's Approach Using an Internal Controls Framework

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

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

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

Our assessment of internal control over financial reporting focused on an evaluation of each of these five components.

1. Control Environment

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

City Charter

The City is organized as a strong-mayor form of government where the mayor acts as the executive branch of government carrying out the operating functions of the City, while the City Council acts as the legislative body. This model of government provides checks and balances through separation of powers and is codified in the San Diego City Charter. The mayor appoints the Chief Financial Officer of the City and the City Council confirms. City Charter Section 39 gives supervision and oversight responsibility over all financial accounts of the City to the Chief Financial Officer. It requires that all financial transactions of the City be performed based upon forms prescribed by the Chief Financial Officer.

Charter Section 39 also establishes an independent audit committee to oversee the City's auditing function. The Audit Committee is composed of two members from the City Council and three members from the public who possess the appropriate technical expertise to carry out this responsibility.

Charter Section 39 also establishes independent departments to assist the City Council in establishing checks and balances over the executive branch, including the Independent Budget Analyst and City Auditor. The Independent Budget Analyst provides budgetary and policy analysis for the City Council. The City Auditor is responsible for the internal audit function of the City, with authority to investigate any material claim of financial fraud, waste, or impropriety within any City department. The City Auditor reports to the Audit Committee to prevent any conflicts of interest from reporting to the executive branch. In October 2019, City Council agreed to hold a public vote in March 2020 on amending the City Charter that will have the Council select the City Auditor from at least 3 candidates for a five-year term recommended by the Council's Audit Committee in lieu of the Mayor selecting and nominating a City Auditor for a 10-year term.

Charter Section 40 establishes the independently elected City Attorney who is elected for a four-year term for no more than two consecutive terms. The City Attorney serves as the chief legal adviser of and attorney for the Mayor, City Council, and all City departments.

The City, like most large governments and corporations, also retains an independent audit firm to independently audit its financial statements. The City's independent auditor, Macias Gini & O'Connell LLP, reviews the City's financial statements and accompanying notes and reports on any findings during their audit process. The contract for the City's independent audit firm is administered by the City Auditor and is evaluated every 5 years.

San Diego Municipal Code (SDMC)

The SDMC incorporates all ordinances passed by the City Council and approved by the Mayor. On October 11, 2004, Ordinance No. 19320 incorporated Division 41: Securities Disclosure, which establishes the Disclosures Practices Working Group (DPWG), a group of senior City officials and disclosure counsel responsible for ensuring compliance by the City with federal and state securities laws, and for promoting the highest standards of accuracy in disclosures relating to securities issued by the City or by its related entities. As required by the SDMC, the DPWG has developed the Disclosure Controls and Procedures to effectuate its responsibilities under the SDMC.

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

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

Management Policies and Practices

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

City's mayoral departments. The City's policies and procedures are communicated to employees via citywide email or by posting on the City's intranet and internet.

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

Financial Training

The City has implemented a comprehensive financial training program adopted on December 6, 2006 by Resolution R-302243. As part of citywide financial training, all levels of the organization are provided training to aid employees in submitting or reviewing financial data and reports. This includes city employees, city management, and elected officials. Under SDMC §22.4110, the City has established biennial mandatory securities law training for members of management, relevant City staff, and elected officials to ensure material information in financial documents is disclosed in accordance with state and federal security laws. In addition, elected officials are provided tailored trainings and presentations on financial topics such as budgeting principles and financial statement disclosure.

Continuing education for professional staff who have financial responsibilities is critical for delivering comprehensive and accurate financial information to the City's stakeholders. The City's Chief Financial Officer requires financial professionals to grow and maintain their professional competencies in all areas of accounting, reporting, compliance, internal controls, grant analysis, debt management, ethics, and other finance related fields. This is accomplished through training policies tailored to promote competencies in each department's respective area. The DoF training policy requires that staff engaged in accounting, financial reporting, budget, and payroll functions participate in a minimum of 40 hours of formal subject matter training per year.

The DoF staff members are also encouraged to attain professional designations such as a Certified Public Accountant (CPA) to maintain professional expertise on the latest accounting standards and practices. As of the end of calendar year 2019, the DoF has 11 staff members with the designation and they are required to enroll in continuing education courses to maintain their active status.

Other Practices and Policies

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

2. Risk Assessment

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

COSO defines "risk" as the possibility that an event will occur and adversely affect the achievement of objectives. As noted earlier, the main objective in preparing the CAFR is that the information included in the report is reliable and that it reflects the City's transactions and events for the reporting period in accordance with GAAP or other reporting requirements. The policies and procedures established for financial reporting include controls that have resulted from management's risk assessment and its efforts to mitigate such risks.

Management's Risk Assessment on CAFR

At the beginning of each CAFR preparation cycle, management communicates areas of potential risk to the City's independent auditor based on management's risk assessment and ongoing monitoring activities, including management's response to such risks through development and implementation of additional controls. Additionally, several manual processes that are vulnerable to human error have been mitigated with the implementation of new software used for the CAFR beginning in fiscal year 2018. Built-in automation for complex data, table updates and document version control are among the benefits recognized during the reporting period. As experience with the program increases, so will the opportunities for efficiencies and controls over CAFR reporting processes.

Changes in Accounting Standards

To mitigate the risk associated with changes in accounting standards, the DoF staff that have primarily CAFR preparation responsibilities are provided training throughout the year, including an annual GFOA training introducing new accounting pronouncements, and disseminate this information through cross-training within the department. Staff actively reviews all new standards to determine the applicability and requirements to properly implement in the effective reporting period. Staff also works closely with the City's independent auditors to ensure full compliance with reporting standards are met.

Each fiscal year, the DoF evaluates new accounting standards promulgated by GASB for potential financial impact. Research is assigned to the appropriate section in the department for in-depth analysis and implementation. In fiscal year 2019, the City successfully implemented GASB Standard No. 88 regarding Debt Disclosures, GASB Standard No. 89 regarding Interest during a Construction Period, and is currently researching the standards applicable for the fiscal year 2020 CAFR and beyond such as GASB Standard No. 87, Leases. This new standard for leases is expected to increase the usefulness of governments' financial

statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows or outflows of resources based on the payment provisions of the contract. The DoF has begun the process of gathering lease information from departments and developing an implementation plan. GASB Standard No. 87 is required to be implemented into the CAFR by fiscal year 2021.

Changes in Technology

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

In 2018, the City implemented a new enterprise asset management software to improve management of physical assets such as buildings, roadways, and equipment. Asset owning departments have been partnering with the DoIT and DoF to ramp up usage and training of the system to fully utilize its features. This partnership is focused on capturing asset-based information and assessing asset condition which supports asset modeling to determine useful life and future needs. Due to the integration of this new software with the City's ERP system, the DoF has been working closely with the DoIT to ensure the data integrity of financial transactions. Staff is continuously and actively working to increase IT controls, document procedures, and establish workflows to prevent erroneous charges from posting.

Several key enhancements were made to further tighten controls over financial systems data integrity. These include, but are not limited to, deriving data in budget adjustment documents to reduce human input errors and streamline the review process, consolidating the methods used to purchase assets to reduce confusion, and adding various preventative system error checks for the grants and payroll modules. Several enhancements were also made to the Human Capital Management module to automate pay-in-lieu elections for employees due to Internal Revenue Service (IRS) regulations on constructive receipt, compensation time cash outs, and leave time donations.

Advances in technology allow the City to improve current business processes, create efficiencies and reduce errors and/or risks. The Office of the City Treasurer is replacing Quadrant, their over-the-counter cashiering system, with iPayment, a centralized payment processing system. The design of iPayment has been completed, but development and testing are ongoing. In 2019, the Internal Controls Section in the DoF performed a preliminary assessment based on system specifications to gain an understanding of potential internal financial control weaknesses and did not identify any deficiencies that could impact the

financial statements. It is expected that implementation will be completed by the end of fiscal year 2020.

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

Risks associated with system changes and SAP enhancements are also mitigated with training, feedback and question & answer workshops provided to end users before and after implementation. Additionally, users can access training videos which are readily available online via SuccessFactors, the City's learning management module. These training videos in SuccessFactors are also used in conjunction with the GRC Access Request Provisioning tool to automatically verify users have completed the appropriate training prior to being provisioned the related roles. This automation was implemented in 2019. Process documentation is also developed or updated as needed.

Risks Identified through Internal Audit Function

The DoF participates in City Auditor audit entrance and exit meetings with City departments. This allows the department to be aware of and to efficiently and effectively address concerns that have an impact on accounting and financial reporting, safeguarding of City assets, and issues affecting the internal control environment. The DoF also participates in the remediation of performance and hotline audits if the City Auditor directs departments to work with the Internal Controls Section to document processes or strengthen internal controls.

In 2018, the City Auditor identified potential weaknesses in the City's payroll procedures related to paid time off for court leave – jury duty that allowed employees to receive compensation for service that was never performed. In the current calendar year, the Internal Controls Section completed and implemented a recurring monitoring test that is reviewed and completed quarterly by the Payroll Section in the DoF. The monitoring test was implemented per the City Auditor's recommendation to establish and implement review procedures to ensure that backup documentation is on file as required by the Personnel Manual, that the City has proper internal controls over paid time off for court leave – jury duty and that policies and procedures are adhered to. However, it is important to note that this issue did not have a material impact on the City's financial statements.

Stemming from a City Auditor recommendation follow-up report, Risk Management launched a new online portal for the City's Transportation Alternatives Program (TAP) in October 2019. This enhancement allows city employees to enroll online for transit passes and automates

payroll deductions, which diminishes the need for cash handling and reduces the risks involved.

3. Control Activities

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

Budgetary Control

The City adopts an annual budget authorizing the expenditure of funds based on current financial resources. Budgetary control and monitoring is a fundamental element of a government's system of internal controls.

In accordance with budgeting best practices, the City maintains a Budget Policy, CP 000-02, to guide the creation of the City's budget and outline standards for revenue generation and execution of operating and capital budget expenditures as recommended by GFOA and NACSLB.

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

Transaction Control Activities

The implementation of SAP provides the foundation for a well-designed internal control framework. SAP allows internal controls to be embedded in the system through restricted access, segregation of duties, and authorization workflows. These controls allow for review,

validation, and approval of transactions, not only mitigating the risk of fraud but also preventing transaction errors or instances of non-compliance with laws and regulations.

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

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

- Authorizations and approvals that affirm that a transaction is valid, such as the approval of a journal entry or an invoice payment;

- Verifications – comparing two or more items with each other, such as comparing goods received against a purchase order;

- Physical controls, such as comparing fixed asset inventories against control records;

- Reconciliations – comparing two data elements and taking action when differences are identified to bring the data into agreement, such as reconciling bank accounts to the general ledger;

- Supervisory controls that assess whether other transaction control activities are being performed completely, accurately and in accordance with policy; and

- Application Controls are those related to procedures to check the accuracy of the output data, including follow-up on exceptions. The Program Coordinators in the DoIT and the business process coordinators in City departments (including the DoF) validate and approve any functional changes in the SAP system. Security related changes are also reviewed by the Internal Controls Section. The DoIT's Control Change Board reviews documentation, testing, and approvals before implementing the changes in production.

Internal Controls Section

The Internal Controls Section of the DoF provides dedicated staff focused on maintaining and enhancing the City's control environment. The Internal Controls Section is involved with the implementation or monitoring of new software and reviews the system implementation for

process gaps, control weaknesses, segregation of duties, system access, data transfer to SAP, and the development of process documentation.

Control Activities Deployed through Policies and Procedures

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

The investment activities for the City Treasurer's Pooled Investment fund are governed by the City Treasurer's Investment Policy, which is based on California Government Code with additional constraints added by staff. The Investment Policy is reviewed by the Investments team, the City Treasurer, the City Treasurer's Investment Advisory Committee and then presented annually to the City Council for approval. The Investment Policy for calendar year 2020 was adopted by City Council in December 2019 and is posted on the City Treasurer's website.

The City adopted a Debt Policy in November 2007, which was last amended by the City Council in May 2019. The Policy documents the procedures and goals for the use of various debt instruments to finance City needs and the sound management of existing debt obligations.

The City adopted a Reserve Policy, CP 100-20, in October 2002, which was last amended by City Council on June 22, 2018. The Policy defines the City's reserves and sets policy targets for reserves across City operations, including General Fund, risk management and enterprise operations. These reserves help provide for strong fiscal management for future City decisions.

User fees are charged for services provided to residents and businesses in the City as a result of public need. Abiding by the standards and best practice guidelines established by GFOA and NACSLB, the City has formed a User Fees Policy, CP 100-05, to identify factors to be considered in calculating the full cost of services in order to appropriately set fees.

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

In 2016, the Human Resources department initiated citywide efforts to update existing A.R.s and Department Instructions (D.I.)'s as an additional method to strengthen the control environment. This effort continued in 2019, with the responsibility transferred to the Deputy Chief Operating Officers (DCOOs) for their respective departments for greater oversight. The A.R.s and D.I.s direct administrative policies and procedures of a continuing nature. It is important that policies as documented reflect the actual processes. The City's effort to update

all A.R.s began with the revision of A.R. 1.00-Administrative Regulation and Department Instruction Preparation Procedures, which added the involvement of the Internal Controls Section to all future revisions of A.R.s or D.I.s. The City of San Diego currently has over 100 documented A.R.s. During calendar year 2019 there were nine A.R.s that were revised or newly issued, including A.R. 95.01-Overtime Compensation and A.R. 95.21-Responding to California Public Records Act Requests.

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

The DoF continues to focus on formally documenting policies and procedures related to accounting and financial reporting. Most of these policies and procedures have been long-standing practice and are consistently applied each fiscal year. This allows the City to have a formal inventory of procedures and related controls that can be systematically monitored for effectiveness and continued relevance. The DoF has formally documented 655 processes and continuously assesses the need for further documentation. The DoF has prioritized documenting those processes that have a material impact on the preparation of the CAFR and has identified 643 processes related to the CAFR, of which 511 have been documented. The total number of processes to document changes annually as new processes are identified, new accounting standards are issued, and new software or technology is implemented. Accounting and reporting processes change with the automation of business processes to increase efficiency and as new risks are identified by management. The DoF has dedicated appropriate efforts to identify and document significant processes that may have a potential impact on City's financial reporting. In calendar year 2019, the DoF documented 79 processes and will continue efforts in the current year.

4. Information and Communication

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

Formal Communication Processes

The City has formal communication processes to ensure relevant information is communicated effectively to those responsible for preparing the CAFR. The DPWG includes individuals in key City positions within the City and external counsel that can review

disclosures, communicate known facts and other relevant information and ensure consistency throughout the City's financial disclosure documents. The DPWG has formal disclosure controls and procedures that define roles and responsibilities over the development and review of financial disclosures. These controls and procedures require that the City's Chief Financial Officer certify to the City Council that the City's financial statements included in the CAFR are fairly presented and that disclosures are true and complete. Similarly, department directors are required to also certify that contributions made by their staff are accurate and complete.

While the DPWG is responsible for ensuring that disclosures comply with federal and state securities laws, the DoF is responsible for ensuring financial statements and related disclosures are prepared in accordance with GAAP. The DoF relies on a formal distribution of work document that clearly communicates specific responsibilities for development of the CAFR, including who is responsible for preparing and reviewing the relevant sections of the CAFR. During the preparation of the 2019 CAFR, the DPWG participated in the review of the CAFR drafts. The DPWG reviewed and signed off on the disclosures included in the CAFR, including the Letter of Transmittal, Management's Discussion and Analysis, Notes to the Basic Financial Statements and the Fund Descriptions.

Pursuant to §22.4107 of the SDMC, DPWG is required to perform an annual evaluation of the City's disclosure controls and procedures. The results of DPWG's work and findings are to be presented to the City Council by January 31 of each year formally communicating any deficiencies.

During the audits of the CAFR and other financial reports, the independent audit firm requests a broad range of supporting documents. The multiple items requested are managed through a master pending list. This allows for effective communication with the independent auditor, as items are clearly assigned to relevant staff and tracked by management throughout the audit process.

The DoF created a Financial Statement Checklist to assist in the preparation and review of the fund level financial statements. This helps to communicate expectations and ensures that statements are complete and accurate. The Supervisor can then review staff work against a standard set of expectations. In addition, the DoF relies on a comprehensive accounting and disclosure checklist developed by GFOA. Each question in the checklist is assigned to a staff member within the DoF based on area of responsibility. This allows for a clear and objective way to ensure compliance with existing governmental accounting standards.

Financial Reporting Tools

The DoF continues to work with the DoIT to develop and implement new financial reporting tools for citywide use through business intelligence reporting software that allows users to perform ad-hoc queries and efficiently access financial data stored in SAP. Information is useful when it is timely, accurate, and appropriate to the user. The following reporting tools were developed and published by the DoIT and finance branch departments in calendar year 2019:

- Fund Certification Report: A citywide report that was developed as an additional method to certify funds to help remain in compliance with Charter Section 39 that states "No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the Chief Financial Officer shall certify in writing that the money required for such contract, agreement, or obligation for such year is or will be in the treasury…" and Charter Section 80 which states "sufficient funds are or will be available in the City treasury to make such expenditures…"

- CAFR Preparation Reports: Various reports were developed for the DoF staff to list fund information such as general ledger balances, CAFR classification codes, fund status, and individual responsible for the fund to assist the DoF in preparing financial statements. Creating these reports improves the ability of staff to retrieve financial data from the system by eliminating manual work to compile the data and check for errors.

- VIM Vendor Bypass Report: Used as a detective control in the disbursements process to check for cases of fraud where an employee could change the vendor to their account and receive payment. This report is run on a daily basis, prior to the accounts payable payment run, to ensure any updates to the vendor account are valid.

Many SAP related initiatives were completed by the DoIT in calendar year 2019, including 37 SAP training videos, 11 work instructions, 45 ERP eLearning courses with embedded simulations and over 10,000 SAP training instances including classroom and online courses.

Financial Training

The DoF coordinates two citywide financial training classes, a one-day class designed for newer city employees called Finance Orientation, and a multi-day class designed for seasoned employees called Finance Academy. In 2019, two Finance Orientation classes and two Finance Academy classes were offered to citywide department staff. Subject matter experts representing various departments collaborated on these accelerated learning programs to strengthen core financial competencies of key individuals through a variety of lessons. Each topic focused on the latest government practices and processes in place to strengthen internal controls and improve financial reporting for the City. Additionally, the DoF provides other annual financial training, on topics such as disbursements and budgeting, to other City departments to keep staff current on the latest procedures.

5. Monitoring Activities

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

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

Budget Monitoring

The DoF monitors fund balances, as well as revenue and expenditure projections, throughout the fiscal year. The DoF prepares monthly and periodic reports that serve as a summary of the year-to-date financial activity of the General Fund and certain other budgeted funds. These reports are presented to City Management and to the Mayor and Council. The DoF prepares an analysis of actual and projected financial activity on a quarterly basis by issuing four budget monitoring reports during the year (First Quarter, Mid-Year, Third Quarter Budget Monitoring Reports and the Year-End Performance Report). The First Quarter Budget Monitoring Report provides an update of major General Fund revenues, overtime expenditure projections, updates on selected programs and/or initiatives, updates on General Fund balance and reserve estimates, and non-General Fund Risk Management reserves. The Mid-Year Budget Monitoring Report projects revenues and expenditures through the end of the fiscal year, incorporating five months of actual revenues and expenditures. In accordance with SDMC §22.0229, the Mayor identifies any projected deficit or surplus, and recommends to the City Council mid-year budget appropriation adjustments. The Third Quarter Budget Monitoring Report is prepared incorporating nine months of actual results and includes projections through fiscal year-end. The Third Quarter Budget Monitoring Report is typically released at the same time as the City Council's first public hearing on final budget decisions for the upcoming fiscal year. This allows the City Council to have the most current budget information available for the current fiscal year prior to making decisions on the budget for the upcoming fiscal year. The Year-End Performance Report provides a detailed comparison and variance analysis of the year-end projections for General Fund revenues and expenditures found in the Third Quarter Budget Monitoring Report to the un-audited actual results to date. The four monitoring reports also include financial schedules prepared by the DoF in accordance with Charter Section 39.

Review of Independent Audits

As part of its monitoring activities, the DoF reviews the results of independent audits to identify potential areas of risk or areas for which controls need to be strengthened. Independent auditors are required by auditing standards to communicate to the appropriate governing body any material adjustments identified through the audit of the City's financial statements. For the audit of the fiscal year 2019 CAFR, there were no material adjustments identified by the independent auditors. In addition, no material weaknesses or significant deficiencies in internal control over financial reporting were identified in the *Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*, dated December 19, 2019 (see Attachment 2). The audit of the financial statements is not designed to identify all deficiencies in internal control that might be material

weaknesses or significant deficiencies. However, the audit process does require significant interaction between the audit team and management with a sustained communication effort throughout the process that allows for effective monitoring of controls over accounting and financial reporting.

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

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

During the fiscal year 2019 Comprehensive Annual Financial Report preparation process, the DoF discovered that the amounts reported in specific classifications of *Net Position* in the *Statement of Net Position* for the fiscal year 2018 CAFR were not accurately categorized. Specifically, *Restricted Net Position in Governmental Activities* was understated by $204 million and *Unrestricted Net Position in Governmental Activities* was overstated by the same amount. The *Total Net Position* was correct as reported. Once this deficiency was identified, the DoF took immediate steps to notify the City's independent audit firm, outside Disclosure Counsel and Audit Committee of the finding and corrective actions.

As was outlined in a memorandum sent from Rolando Charvel, Chief Financial Officer, to the Audit Committee, dated December 17, 2019, several enhancements to internal controls are in the process of or have been implemented. These enhancements are as follows:

1. Develop a formal materiality threshold policy for financial statement transactions. Those transactions that meet specific materiality thresholds will require additional levels of review and approval from senior staff.

2. Perform risk-based assessment over complex accounting transactions. High risk transactions will require additional levels of review and approval from senior staff.

3. A new process narrative will be developed specifically addressing Bond Refunding transactions, including sample entries, additional levels of review and approval by the Financial Operations Manager and Assistant Director responsible for the CAFR. These fund level entries will be prepared when the issuance occurs, avoiding the lag time of many months until year-end when all conversion entries are performed.

4. Create a special fund to account for Government-wide Financial Statement balances and activity. Conversion entries will be recorded in SAP with formal approval in the system of record, including proper documentation supporting the transaction. Currently, conversion entries are prepared in an excel spreadsheet.

5. Reorganization of the CAFR Team – CAFR responsibilities to be concentrated within a CAFR core team.

6. Formalization of analytical review process. All variances over specific materiality thresholds will be formally documented with appropriate supporting documentation. Review and approval will be required by senior Department of Finance staff.

7. Current training policy requires 40 hours of continuing education for accounting staff. Formal training specific to conversion entry process for relevant staff will be included in the annual training.

To ensure the City maintains adequate controls over financial reporting, the DoF will provide timely updates to the Audit Committee on the progress of implementing these enhancements.

Monitoring through GFOA Certificate Process

The City received the Certificate of Achievement for Excellence in Financial Reporting awarded by GFOA for the fiscal year 2018 CAFR. To receive this award, the City must comply with a comprehensive checklist that incorporates accounting and disclosure requirements in accordance with GAAP. Comments received from GFOA on the submittal of the CAFR also serve as a monitoring tool to ensure controls are effective. If GFOA identifies significant deficiencies in the CAFR, they disqualify it from the Certificate of Achievement for Excellence in Financial Reporting award. The review of the fiscal year 2018 CAFR resulted in three suggestions for improvements on presentation, all of which were incorporated into the fiscal year 2019 CAFR. We anticipate receiving the award for the fiscal year 2019 CAFR.

In calendar year 2019, the City was awarded two certificates for its budget document: the Distinguished Budget Presentation Award (Budget Award) for exemplary budgeting practices by GFOA for the City's Fiscal Year 2019 Adopted Budget and the California Society of Municipal Finance Officer's Operating Budget Excellence Award. The Distinguished Budget Presentation Award program was established in 1984 to assist state and local governments in preparing budget documents of the highest quality that reflect both the guidelines established by NACSLB and GFOA's best practices on budgeting, and to individually recognize governmental entities that succeed in achieving that goal. Reviews are conducted by selected members of GFOA professional staff and by outside reviewers with experience in public-sector budgeting, and feedback and comments received by the City are used to improve future year budgets.

Segregation of Duties Monitoring

The DoF continues to monitor for segregation of duties to ensure that no one individual has control over an entire process or multiple components of a process, which if abused, could cause harm to the City or result in misstatements in the financial statements. Due to the importance of maintaining controls around segregation of duties, continuous monitoring is performed. To assist users in selecting the proper roles and avoiding possible segregation of duty violations, the DoF and DoIT have begun an annual review and update of a Role Definition Guide. The Role Definition Guide identifies and defines all SAP roles, then lists the possible segregation of duty violations. The DoF works with the appropriate business process coordinators in departments to ensure the information is correct and updated. A more interactive approach was created by the DoIT with the Role Searcher Helper tool to assist users in selecting the appropriate SAP roles based on search criteria such as transaction codes within the roles or specific job functions the roles need to perform. This tool assists users in selecting the appropriate SAP roles in the City's role provisioning module of ERP called GRC.

The Internal Controls Section reviews and assesses existing and new risks that are introduced to the City's processes, along with the mitigating controls that are in place, and updates the information in GRC when deemed appropriate. This ensures the system controls are accurate, updated, and consistent with the City's actual process. In addition, the Section facilitates security role updates annually, and monitors activities performed at the transactional level either daily, monthly, or quarterly depending on the test. Automated testing is developed within GRC and the results are sent to the process owner for review and remediation where necessary.

The DoIT also continues to deploy the Business Role Management (BRM) concept to more business processes within the GRC Access Request Provisioning tool. The BRM concept is a grouping of roles based on job tasks, which helps streamline and better manage changes to roles' access. The Internal Controls Section also provides independent monitoring of privileged user activities to assess whether these accounts are sufficiently controlled and comply with the DoIT's policies and procedures. The next expected enhancement is the expansion of the BRM concept for all production systems and automation of training within the GRC Access Request Provisioning tool.

Assessment of Documented Processes and Controls

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

For calendar year 2019, process design assessments and control design assessments were delivered within GRC to the respective process owners of significant processes with financial

reporting impacts. The purpose of the assessments is to ensure documented processes are current and accurate and the predefined controls within a process are valid. The assessments identify processes that require changes to the process itself or to the related controls and the Internal Controls Section notifies process owners of the necessary revisions in a timely manner. As the nature of business processes may pertain to more than one department or personnel, it is critical that process documents are updated and re-uploaded to the City's intranet, CityNet, for all City employees to access.

Ongoing Monitoring

The DoF periodically evaluates the effectiveness of controls of transactional activities that are deemed significant by management. Monitoring of controls also includes considering whether the controls are operating as intended and that they are revised as appropriate for changes in the organization.

Several post-processing transactional monitoring activities have been established over the past few years. Examples of some are as follows:

Procurement Card Program (P-Card)

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

Travel and Tuition Reimbursements

The Internal Controls Section has reassessed and enhanced the testing of travel and tuition reimbursements by implementing testing specifications to cover conditions set forth by the respective A.R.s. Random selection of travel and tuition reimbursements encourages impartiality; however, the sampling methodology also considers testing the majority of departments at least once within the calendar year. A tracking log is created each calendar year and accompanies the monitoring test to help the Internal Controls Section achieve this objective. On a monthly basis, a manual test is scheduled in the SAP GRC module and the selection is forwarded to the Payroll Section to perform a review for accuracy, completeness,

proper authorization, validity, and cutoff. The monitoring review provides assurance that reimbursements comply and adhere to City's policies and procedures.

Jury Duty Leave

The Internal Controls Section developed a monitoring test with the objective of strengthening monitoring over paid time off for jury duty and ensuring compliance with the City's policies and procedures. On a quarterly basis, twenty-five City employees are randomly selected. The Payroll Section receives the selection and performs a review for accuracy, completeness, proper authorization, validity, and compliance with the Personnel Manual. The Internal Controls Section schedules a manual test in the SAP GRC module and monitors for timely completion of the review within the allotted time. Corrective actions by the Payroll Section are taken when findings are identified.

Accounts Payable and Disbursements

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

Purchasing & Contracting (P&C)

The Internal Controls Section assisted P&C in developing semi-automated monitoring tests in GRC with the objective of improving monitoring, compliance, and contract surveillance of citywide contracts. On a monthly and quarterly basis, the Internal Controls Section is responsible for scheduling monitoring for P&C to conduct the review, based on a formal methodology and control focus. The purpose of these monitoring reviews is to (1) ensure threshold limits are not bypassed by the splitting of purchase orders; (2) check for expired insurance policies linked to current vendors; and (3) ensure that engaged vendors are licensed to perform business within the City. SAP is utilized to pull data, and if applicable, deficiencies are flagged for review. Changes to processing of citywide contracts have been implemented with the transition of all contracts into Ariba, a SAP procurement software. This has triggered ongoing efforts between P&C, the DoIT, and the Internal Controls Section to modify and obtain proper requirements to ensure effectiveness of the respective semi-automated monitoring test affected.

Conclusion

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

Establishing effective internal controls is a continuous process. The implementation of effective internal controls reduces the exposure to error, fraud, and theft. It is management's responsibility to design, implement, and maintain internal controls and consider the areas of risk. Implementation of effective policies and procedures can prevent, detect, and correct errors and fraud before they affect the financial statements. The DoF continues to develop written policies to document and confirm existing internal financial controls and continues to work with City departments in documenting processes and new system implementations. The DoF also identifies opportunities for improvement and develops new policies and processes. Management actively assesses risk as the organization changes and as new reporting requirements are issued. As with any effective system of internal controls over financial reporting, management responds to newly identified risks by implementing or enhancing controls to mitigate such risks, including those that have been identified in this report.
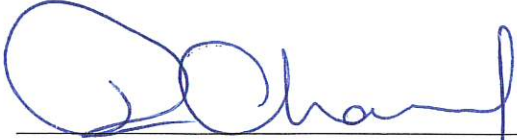
Sources

1. Gauthier, Stephen J. *Evaluating Internal Controls*. Chicago IL: Government Finance Officers Association of the United States and Canada, 2013. Print
2. Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework, Framework and Appendices, 2013*
3. Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework, Internal Control over External Financial Reporting: A compendium of Approaches and Examples, 2013*

Attachments:
1. Certification by the Chief Operating Officer, Assistant Chief Operating Officer, Chief Financial Officer, and the Director and City Comptroller, Department of Finance
2. Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

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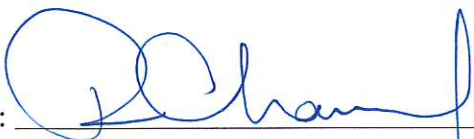Rolando Charvel, Chief Financial Officer

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Tracy McCraner, Director and City Comptroller, Department of Finance

CERTIFICATION BY MAYOR AND CHIEF FINANCIAL OFFICER

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

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

Signed: _____ Date: ___2/27/2020___
Rolando Charvel, Chief Financial Officer

Signed: _____ Date: ___2.27.2020___
Tracy McCraner, Director and City Comptroller, Department of Finance

Signed: _____ Date: ___3/2/2020___
Kris Michell, Chief Operating Officer

Signed: _____ Date: ___2/27/2020___
Jeffrey Sturak, Assistant Chief Operating Officer

mGO | Certified
Public
Accountants

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

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of San Diego, California (the City), as of and for the fiscal year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 19, 2019. Our report includes a reference to other auditors who audited the financial statements of the San Diego Housing Commission, a discretely presented component unit, as described in our report on the City's basic financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Macias Gini & O'Connell LLP

San Diego, California
December 19, 2019